

Making Access Possible

2021



Laos PDR

Financial Inclusion Refresh

Making Access Possible

Making Access Possible (MAP) is a multi-country initiative to support financial inclusion through a process of evidence-based analysis feeding into a financial inclusion roadmap jointly implemented by a

range of local stakeholders. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. In each country, MAP brings together a broad range of

stakeholders from within government, the private sector and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country.

This report was jointly prepared by a consortium consisting of Beed Management Private Limited (Nepal) and Drs. Timo H. Hogenhout, with Beed Management as Consortium Lead and Mr Sudip Bhaju as Team Leader, and has been carefully reviewed by UNCDF.

The stakeholder interviews and data collection that informed the report were enabled by the Steering Committee for the MAP Diagnostic Refresh as appointed by the Governor of the Bank of Lao PDR (BoL): Mr. Phanthaboun SAYAPHET (Deputy Director of BoL's Financial Institution Supervision Department) as Head of the Steering Committee; Ms. Salika CHANTHALAVONG (Deputy Director of the Lao Statistics Bureau's Statistic and Economics Department), as Deputy Head; and Ms Chansaleum KONGKEO (Head of Division at Lao Statistic Bureau's Statistic and Economics Department) and Mr. Kikeo BOUALAPHET (Technical officer of BoL's Financial Institution Supervision's Department) as members.


Statistics and financial-sector data have been obtained from official Government sources, where available: the Lao Statistics Bureau of the Ministry of Planning and Investment; the Commercial Bank Supervision Department, Financial Institution Supervision Department and Payment System Department of BoL; the Insurance Supervision Division of the State-owned Enterprise Management and Insurance Department of the Ministry of Finance; and the Lao Social Security Organization.

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The cover symbol and artwork

Through the MAP programme, we hope to effect real change at country level and see the impact of financial inclusion on broader national growth and development. The cover graphic features a Frangipani (Dok Champa), the national flower of Laos. The plant has fragrant pale pink or white flowers. Each flower is an example of the successful growth in a unique environment.





Working together to support implementation of Agenda 2030

Countries are seeking new ways to address complex and interconnected challenges. Fulfilling the promise of the UN Sustainable Development Goals (SDGs) requires multisectoral approaches that bring together expertise from a range of perspectives. By harnessing our comparative advantage and working within the context of our respective mandates, we can collectively make significant progress towards realising the vision of the SDGs.

Financial inclusion is increasingly positioned as an enabler of broader development goals, in support of the SDGs. More and more countries are including an inclusive financial sector as a key objective in their national development plans, and this tendency is further underpinned by the G20 leadership of financial inclusion, which highlights the ongoing relevance of the SDGs and nationally led financial inclusion efforts. Furthermore, financial markets play a vital role in creating a sustainable future.

Access to finance for individuals, small and medium enterprises (SMEs) and governments is important to a number of the SDGs, helping to facilitate secure payments, including for basic services and trade; smooth cash flows; offer financial protection; and improve allocation of capital while also enabling investments in many areas.

This MAP refresh, in supporting country efforts, increases the focus on inclusive growth (especially through SMEs and agriculture), access to basic services (energy, health and education), and improving household resilience, as well as gender equality. Increased reliance on technological innovation and digital financial services will help to improve the scale and efficiency of financial inclusion interventions.

This refresh was undertaken by the United Nations Capital Development Fund (UNCDF) to jointly address the United Nations Development Programme's (UNDP's) Signature Solution 1, which seeks to work with countries to keep people out of poverty, relating directly to SDG 1: eradicate all forms of poverty, wherever it exists.

The core focus of Signature Solution 1 is helping people get out of – and stay out of – poverty; and hence the analysis and interventions identified help eradicate poverty, such as by creating decent jobs and livelihoods, providing social safety nets, and ensuring access to services such as water, energy, healthcare, credit and financing support for investment in productive assets.

Partnering for a common purpose

By combining inspiration, ideas, knowledge and resources with our partners, we become more than the sum of our parts.

We are committed to empowering investors—public and private alike—with the clarity, insights and tools they need to optimise the positive impact of their investments, closing the gap between high-level principles and financial performance to make a positive contribution to society.

Note on the use of household data

In 2015, a FinScope Laos Consumer Survey was concluded as part of the first MAP diagnostic (also 2015). A summary report and presentation of FinScope is available as a separate deliverable, and the FinScope dataset is available for future research at <https://uncdfmapdata.org>. For the 2021 refresh, UNCDF is conducting a Financial Inclusion Mobile Tracker Survey, to provide an update of the main financial inclusion indicators provided in the 2015 diagnostic and survey. The Tracker Survey will be completed in 2022, and analysis meant to feed into the refresh report will be provided to stakeholders separately once the survey results becomes available in 2022.

Our technical response

Improve household welfare by improving their access to financial services so the access is broad, convenient and deep, meeting the needs for livelihoods development; assist households and enterprises to increase economic efficiency and support growth by improving financial inclusion.

This vision was established by the Lao PDR Financial Inclusion Roadmap 2018-2025 (FIRM), which was endorsed by the Governor of BoL in August 2019 and was publicly launched in January 2021. Over the period 2014 to 2018, UNCDF supported BoL in developing this policy document on financial inclusion. Following the completion of the 2014/15 MAP exercise, the seven priority intervention areas highlighted in the Making Access Possible (MAP) diagnostic report for the Lao PDR were condensed to five, in a process closely coordinated by BoL and UNCDF. Those five policy priorities, as well as the 55 activities necessary to realize them, were subsequently embedded in the FIRM.

The 2015-MAP diagnostic report for Lao PDR considered the country context, demand and supply for financial services, and the regulation of these services. The report highlighted the need for interventions in accordance with those opportunities that best meet the national objectives for growth and improved livelihoods. Such interventions were then documented in the form of a roadmap, which provided the structure for defining, prioritising, coordinating, measuring and tracking the interventions. The report identified practical recommendations for overcoming barriers to greater financial inclusion, including (i) Improving the availability and sustainability of credit; (ii) Consumer protection and empowerment; (iii) Strengthening village funds; (iv) Payment ecosystem development; and (v) Extending the outreach of banks and other financial service providers (financial outreach).

This study focuses on key market changes that have occurred since FIRM's priorities and initiatives were formulated, from the perspective of achieving positive socio-economic impact and progress toward the Sustainable Development Goals (SDGs). The report is written on the assumption that the reader is familiar with both the 2015-MAP diagnostic and FIRM.

Laos PDR at a glance

Sources: Lao Statistics Bureau, Bank of Lao PDR, World Bank, UNDP

GDP
US\$18.9
billion

2019



GDP per capita
USD 2,654

LAK 23.06 million

2019

Ave. GDP growth

4.8%

2015-2019

GDP
PPP current international

USD 58.6
billion

2019



GDP per capita
PPP current international

USD 8,173

2019



GDP-per-capita ranks 8th out of 10 ASEAN countries, 63% higher than Cambodia's and almost double the value of Myanmar's GDP per capita

Contribution to GDP

Agriculture

15.2%

2019

Contribution to GDP

Services

42.3%

2019



The Lao PDR is a Least Developed Country. The government aims to graduate out of the category of LDC's by 2026.

Contribution to GDP

Industry

31.4%

2019

Remittances
as proportion of GDP

1.6%

2019

GNI current

USD 17.7
billion

2019

GNI current
per capita

USD 2,560

LAK 22.25 million

2019

Laos PDR at a glance

Sources: Lao Statistics Bureau, Bank of Lao PDR, World Bank, UNDP

Total population

7,123,000



2019

The Lao PDR has a very young population

42%

below the age of 20

2019

69%

below the age of 35

Inflation

3.3%

2019

Human Development Index

0.613

137 out of 189 countries

2019

Life expectancy

67.9 years



2019

Gini-coefficient

38.8

2018

Inequality adjusted HDI

0.461

East Asia and Pacific: 0.621

2019

Poverty headcount

18.3%

2018

Gender Development Index

0.927

World: 0.943

2019

Gender Inequality Index

0.459

113th out of 162 countries

2018

Employment

91%

Employed

2017

95%

Villages are covered by the mobile cellular network

2019

92%

Population using a mobile phone

2019

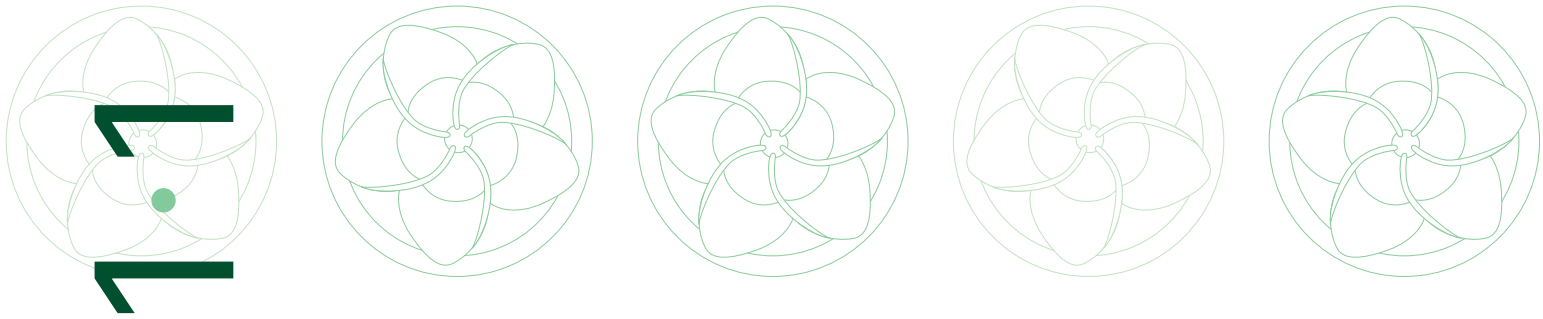
50%

Population using the internet

2019



The changing environment



Economy, Population and Growth

Rapid economic growth levelling off in recent years. Since the adoption of the “*New Economic Mechanism*” as standing economic policy in the late 1980s, Lao PDR has made remarkable economic progress: annual GDP growth over the 30-year period between 1989-2018 averaged 7.1%, even when including the years of the Asian Financial Crisis of 1997-99, while GDP-per-capita growth averaged 5.1% over the same period.¹ This is impressive, as the country had to build its economy from the ground up in 1975, after many years of the Second-Indochina War and relentless USA bombardments. Over the last five years, GDP growth has levelled-off from 5.7% (2015) to 3.1% (2019) and on average 4.8% for the half decade. Nevertheless, the impressive growth over the last three decades resulted in Laos achieving lower middle-income status with a GNI of USD 2,560 per capita (2019), despite its remaining status as an LDC, from which it aims to graduate from in 2026. Within the group of ten ASEAN countries, its GDP-per-capita of USD 2,630 ranks eighth, comparable to Vietnam, but 57% higher than Cambodia and almost double that of Myanmar, the other two remaining LDC’s in ASEAN.

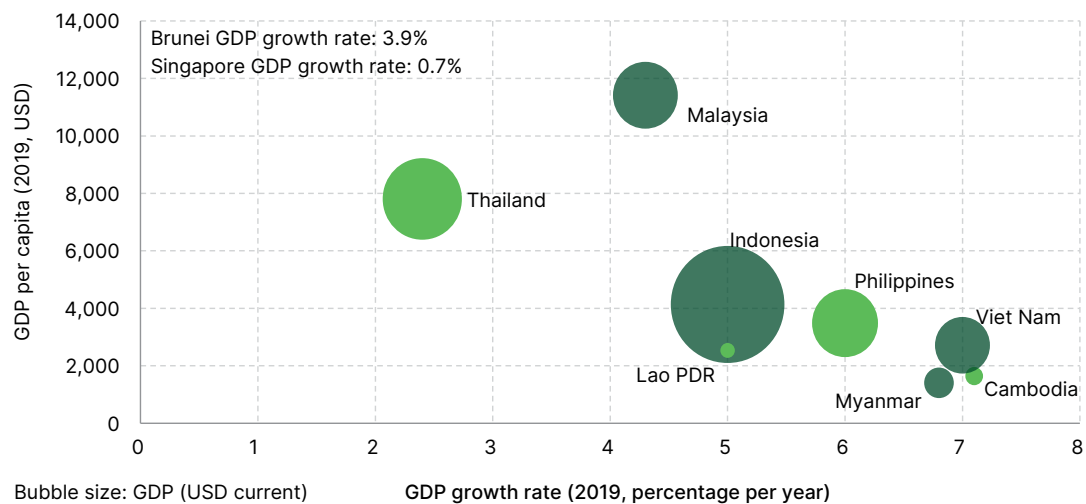
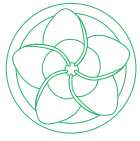


Figure 1: GDP Growth Rate and GDP per Capita Income for ASEAN Countries

Source: World Bank Country Data, 2019

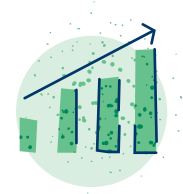


Future growth prospects, and impact of COVID-19. The pandemic had a massive impact on the country's growth, but Laos managed to maintain a growth rate of an estimated 0.4% in 2020, although this is the lowest level in three decades. Being a landlocked country, Laos' weak physical infrastructure and high transport-related costs and constraints, constitute a main impediment to making more effective use of its strategic location between populous economic powers China, Thailand, and Vietnam, and to exports generally. However, completion of a new railway from Vientiane to South China (for late 2021) and a new highway extending partly from Vientiane (completed late 2020) will be the first two main improvements of this infrastructure. In addition, increasing exports of electricity (expected to triple by 2030), as well as expected increase in private investment, gives rise to optimism on long-term prospects for GDP growth.

Middle income status and impressive poverty reduction achieved. As a result of sustained economic growth, Lao PDR has made impressive progress in terms of poverty reduction, with a reduction of poverty-head count from 51% (1997) to 10% (2018), a decline of 0.4% for every percent of GDP growth.² Impressive improvement has also been achieved in life expectancy to 67.9 (2019) from 53.4 (1990), and human development, with an HDI of 0.613 (2019) up 51% from 0.405 in 1990.

Young, ethnically-diverse, low-density population, with low labour-force participation. Laos has a low population density, with 7.1 million people living in 1.3 million households across an area roughly the size of the United Kingdom (population 68 million). The population is both ethnically diverse, with the dominant Lao-Tai group making up 62% of the population and really young - 69% of people are below the age of 35 and 42% not older than 19. Of the population of working age (15 years and older), only 41% are part of the labour force, of which 91% are employed. A large portion of the working-age population (59%) is not in the labour market, of which 87% are engaged with own-use production work in the family because of family requests and obligations, or fully voluntarily.

Rising FDI dominated by China, focusing on infrastructural investment. Over the last five years, the dominance of China as investor in and builder of large infrastructural projects and provider of sovereign debt has become most prominent and changed the landscape of the economic centre Vientiane and much of the North of the country in sometimes spectacular fashion. China has become the main provider of FDI and debt financing and China also became the largest trading partner recently. Laos is rich in resources that China requires for growth and to sustain its large population. In 2021, railway infrastructure will connect Vientiane directly with the South of China, home to hundreds of millions of Chinese people within a few hours by train, and in the future expectedly by car. Chinese investment focuses on hydropower and infrastructure, including not only railways and roads but also huge residential-building complexes, hospitals, malls and entertainment venues, which are being built at a rapid pace by Chinese companies in Vientiane Capital and in Special Economic Zones.



As a result of sustained economic growth, Lao PDR has made impressive progress in terms of poverty reduction, with a reduction of poverty-head count from 51% to 10%

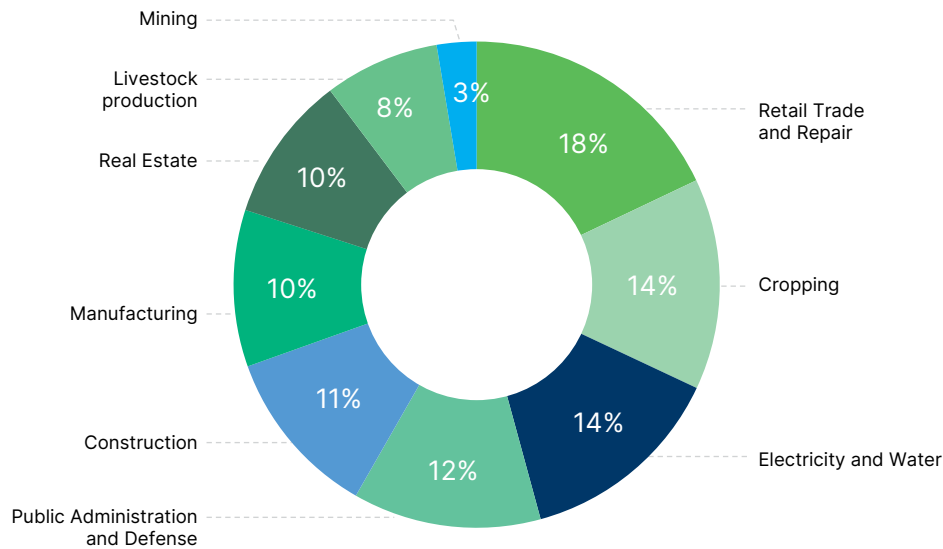
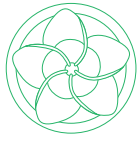


Figure 2: Breakdown of GDP by Sector, 2019

Source: Statistical Yearbook, 2019

Increased financial-sector outreach. Over the period 2014 to 2020, the Lao PDR's banking sector continued to grow both in terms of the number of banks, branches, service units and ATMs as well as in terms of portfolio size. In particular banking-sector deposits continued to increase strongly, notably in foreign currencies, but credit growth slowed down following years of rapid expansion. The number of non-bank financial institutions (NBFIs) and their overall portfolios' size, particularly in the leasing sector, have developed rapidly but from a low base and are catching up to banks in terms of outreach. Pawn shops continue to play a minor role. Expansion of formal payment-services is similarly high, coming from a low base, following the introduction of *licensed non-bank payment service providers* (NBPSPs) and *agent networks*, based on the new Law on Payment Systems.

High degree of economic diversification. Over the 31-year period of 1989-2019 the economic structure of Laos has changed significantly. Agriculture's contribution to GDP has declined from 47.5% to 15.2%, while services (42.3%) and industrial-production (31.4%) became the main sources of GDP and GDP growth (as of 2019). However, the economy has reached a high level of diversification, with no single sub-sector standing out as main contributor to GDP as seen from contributions from the five largest sub sectors: Agriculture (15%); Wholesale and Retail (13%); Taxes and import duties (11%); Electricity (10%); Public administration and defence (9%); Construction (8%); Manufacturing (8%); Other Services (7%); Real estate (6%); Mining and quarrying (6%); Finance and insurance (3%); Accommodation and food (3%); and Education (2%).³ However, there are large differences between some of these sectors' contribution to GDP and that to employment and income-generation for the broader populace (See Section 2).

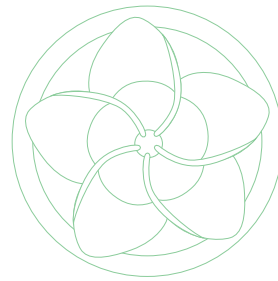
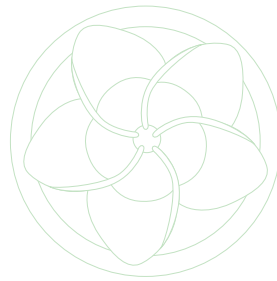
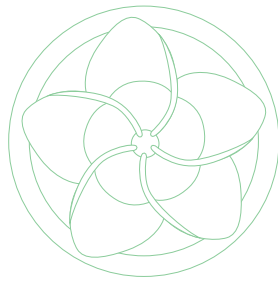
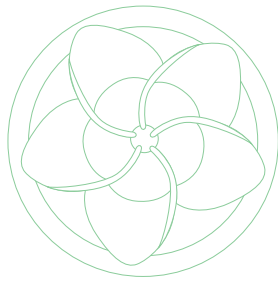
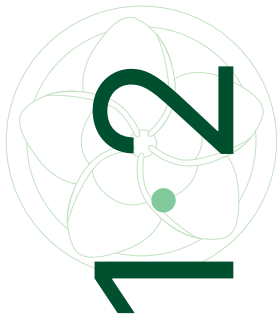


Public finance increasingly reliant on foreign sovereign-debt finance. Laos' public finance suffers from structural challenges, leading to a continued and growing, sometimes urgent needs to borrow. On the income side, public finance suffers from a weak tax base and ditto tax-measurement and collection practices, combined with the low profitability and high level of informality of economic production. Moreover, many of the large-scale investments in hydropower, mining and Special Economic Zones were provided with significant tax-deductions, and 80% of the profit tax base has been estimated to be exempt.⁴ On the expenditures side, Laos has large and growing debt-service obligations on sovereign debt in foreign currency related to investments in infrastructure and energy production, financed mainly by China, Chinese banks and companies, but also to local, Lao-owned construction companies.⁵ In the Lao PDR there is dependence on international finance than on domestic public resources, in proportional terms, with Official Development Assistance (ODA) playing a significant role in financing development. Laos is a net receiver of ODA at 3.7% of GNI (2019), up from 3.4% in 2015.

Volatile exchange rate but improving current-account deficit. Consumer-price inflation has generally been moderate to low, and declining, at 1.8% over the last five years to 2019. The official exchange rate to USD however, has moved quite considerably: Following an appreciation of 36% over 2005-2013, the official exchange rates has since lost 10% of its value by 2019 and has continued to depreciate since.⁶ BoL determines the official foreign currency exchange rate on a daily basis and seeks to maintain the LAK/USD exchange rate fluctuation to a maximum of 5% per year.⁷ In the meantime, as a consequence of structural challenges to Laos' public-finance situation, its trade balance and its foreign currency reserves, a parallel market for LAK has developed. Currently, a USD buys around LAK 9,500 LAK officially in the banking sector and LAK 11,400 on the parallel market. Over the last decade, Laos has had a negative current-account balance, as it relies on imports for capital and consumer goods, including fuel, mainly from neighbouring Thailand.⁸ Since 2015 the current-account deficit has improved from 15.8% to 5.2% of GDP (2019) but IMF has projected continued current account deficits of around 12% of GDP for the short to mid-term.⁹



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Policy and Regulatory Framework

At present in Laos, there is no single dedicated agency with the specific, dedicated mandate to oversee financial-inclusion policy development, management and implementation. The FIRM identified the issue as a gap and recommended establishment of a formally-mandated Steering Committee to ensure effective oversight, coordination and implementation of activities to enhance financial inclusion embedded in the FIRM.

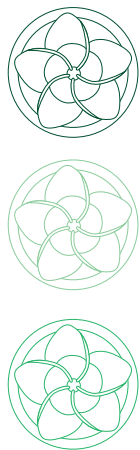
It further recommended establishment of Technical Working Groups, in order to identify and discuss financial-inclusion technical issues and propose solutions; and active engagement with the Government Office to solicit formal endorsement of the FIRM to ensure ample political support.

The natural locus of a FIRM Steering Committee and supporting Financial Inclusion Office would be BoL as main financial-sector authority. Financial inclusion is concerned with building well-regulated financial ecosystems and BoL oversees those institutions that are most capable of enhancing financial inclusion: commercial banks, leasing companies, MFIs, payment-service providers (PSPs) and agent networks. The Steering Committee and supporting office should best be mandated to go above and beyond any supplier-based segmentation and specifically include commercial banks, leasing companies and PSPs. There are two main reasons for this: First, commercial banks, PSPs and (perhaps to a lesser extent) leasing companies have most potential to drive financial inclusion and inclusive socio-economic development. Second, until recently, apparent supplier-based regulatory segmentation of financial-service provision has restricted unleashing of that potential.¹⁰

The FIRM and the MAP Refresh study have the potential to inform and support the Government's key long-term strategies on achieving economic growth and inclusion. In Laos, socio-economic development is guided by five-year National Socio-Economic Development Plans (NSEDP), which are concluded simultaneously with the appointment of new political leadership for the same period. The NSEDP reflects the highest political-level policy priorities and normally contains policy priorities on financial inclusion, as is the case with the



Financial inclusion is concerned with building well-regulated financial ecosystems and BoL oversees those institutions that are most capable of enhancing financial inclusion.



current draft of the 9th NSEDP (2021-2025). To ensure the Roadmap's relevance it should reflect these priorities and support their realization.¹¹ Towards the future, ensuring that financial-inclusion policy priorities and measures identified in MAP exercises and in FIRM will be embedded in the processes that lead to elaboration and amendments of the NSEDP would improve the effectiveness of their implementation. Currently, there are already significant consistency between priorities set by the NSEDP and priorities identified in the FIRM (see Table 1). Moreover, in 2016 the Government formally endorsed BoL's *Strategy for Development of a Monetary-Financial Institution System (2016-2025)*, further setting the framework for FIRM's direction and priorities. As the latter strategy doesn't provide ample details on issues of financial inclusion for 2021-2025, this MAP Refresh and FIRM can be considered to complement it.

Table 1: Financial-inclusion policy overview

POLICY AND STRATEGY DOCUMENTS
<p>Draft 9th National Socio-Economic Development Plan: NSEDP 2021-25.</p> <p>Highest-level socio-economic policy document for 2021-25, guiding the Government's priorities and activities, to be approved by the National Assembly. NSEDP prioritizes the following outcomes, or topics, and activities, which should guide the financial inclusion roadmap's priorities towards the future.</p> <ol style="list-style-type: none"> 1. Enhance access to savings and credit products for people and businesses, including rural areas. 2. Enhanced access to finance for micro, small and medium enterprises (MSMEs), through: <ul style="list-style-type: none"> • Mobilization of low-cost funding. • Support to diversified financial mechanisms. • Support to MSMEs' capacity to access finance. • Reduce reliance on informal-finance sourcing. • Support credit-information management systems. 3. Enhance the payment system, mobile and digital financial services: <ul style="list-style-type: none"> • Modernize the financial and monetary systems infrastructure to support advancement of the digital economy. • Apply modern information and communication technology (ICT) to improve financial services to be convenient, swift, secure, and transparent. • Support the electronic payment system to be more comprehensive, secure and effective. 4. Improve formal-financial sector corporate governance and capacity: <ul style="list-style-type: none"> • Improve management and staff capacity of banks and NBFIs in line with international standards, to ensure their stability and ability to fund economic production. 5. Enhance financial-consumer protection: <ul style="list-style-type: none"> • Support financial-consumer management agencies to be more comprehensive, secure and effective.
<p>Strategy for the Development of Monetary-Financial Institution System of Lao PDR (2016-2025) and Vision towards 2030.</p> <p>Long-term financial-sector vision and strategy approach elaborated by BoL and formally endorsed as Government policy in a Government Decree (GoL, 316, 19/08/2016).</p>
<p>Financial Inclusion Roadmap 2018-2025 (FIRM)</p> <p>Vision and strategy focused on financial inclusion issued by BoL, not yet approved by Government.</p>

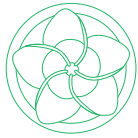


Table 2: Overview of new regulations¹²

LAWS	
Insurance (2019)	Regulations on establishment, management and operations of private insurance companies
Commercial Banks (2018)	Regulations on establishment, management and operations of commercial banks
Payment System (2017)	Comprehensive dedicated regulations on the over-all payment system.
GOVERNMENT DECREES	
Financial Consumer Protection (2020)	Regulations for banks and NBFIs on protection of financial services consumers.
Credit Information (2019)	Regulation on production and use of credit-information services.
DECISIONS	
Credit Guarantee Company (2020)	Regulations on establishment, management and operations of credit-insurance companies
Lao Payment and Settlement System (2020)	Detailed implementation guidelines on settlement and clearing.
Payment Service Provision (2020)	Regulation of prudential and non-prudential standards for payment services by FSPs in LAK and forex.
Lao QR Code Standard for Payment (2020)	Detailed implementation guidelines and standards on use of QR-codes in retail payment system.
Systematically Important Payment Systems (2019)	Regulation for standards and systems applied to wholesale-payment infrastructure.
Standards of Financial Service Access (2019)	Decision on certification and measurement of access to finance provision by FSPs and village funds in (small) villages and rural areas.
Retail Payment System (2019)	Regulation for standards and systems applied in retail-payment services infrastructure and provision.
Credit Provision in foreign currency by banks (2018)	Regulation on provision of credit by banks in foreign currencies
Access to credit Information (2018)	Regulation on access to credit-information by banks and NBFIs.
Establishment of Commercial Banks and Banks' Branches (2016)	Regulations for the establishment of fully-licensed banks and branches.
INSTRUCTION	
Implementation of the Decree on Microfinance Institutions (2016)	Specification and concretization of regulations governing the establishment, management and operations of MFIs.

Source: Official Lao Gazette of the Ministry of Justice

Since 2015, the financial-sector regulatory framework has undergone extensive expansion and in instances led to disruptions for financial-service providers.

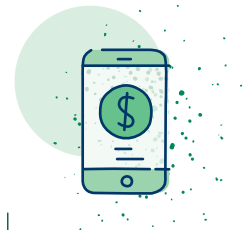
Since 2015, the regulatory framework related to financial inclusion has changed considerably. According to overviews provided by responsible departments in BoL, over 60 regulations for banks, NBFIs and PSPs have either been newly issued or adapted, covering a broad range of issues. Of those, many have not yet



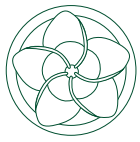
been published officially in the Ministry of Justice's Gazette as required by Law as a condition for their legal validity, although they are being applied.¹³ Among regulations changed in line with recommendations made in FIRM are those that set a cap on the interest-rate spread for banks; on the development on the payment ecosystem; on credit information; and on participation of Micro Finance Institutions (MFIs) in the depositor protection fund. Another most important regulation that has a basis in FIRM's *priorities* is the *Decree on Financial Consumer Protection*.¹⁴ The Decree provides a legal framework foundation for comprehensive protection of all financial sector consumers. Significantly, it includes key stipulations on attention for the repayment capacity of borrowers, transparency in financial product information and establishment of complaint mechanisms by FSPs, all of which had been recommended in FIRM. Table 2 provides an overview of new regulations issued since 2015 that were published in the Official Gazette.

Regulatory changes have strengthened the Payments System. The overview of new regulations in table 2 reflects progress made in establishing an enabling environment for the payments ecosystem in line with FIRM recommendations, which has led to increased professionalization and digitization of the payments system. In 2018, a dedicated Payment Systems Department (PSD) has been established in BoL to oversee and supervise implementation of the Payment Systems Law (2017). Since then, the PSD has issued six new regulations on various aspects of the payments system and DFS in 2019–20 alone, technically-assisted by dedicated experts from World Bank. The regulations outline definitions, principles, standards and prudential and non-prudential safeguards on both wholesale and retail payment-system infrastructure and service provision. The regulations will enable retail-market expansion involving dedicated subsidiaries of mobile-network operators (MNOs) and banks and a range of retail-payment modalities, including e-money, use of QR-codes, facial-recognition and digital payments. On the wholesale front, regulations have enabled increased outreach of real time gross settlement (RTGS) and an automated-clearing house (ACH) and automated-teller machine (ATM)-sharing pool. As a positive result, digital retail payments have expanded rapidly in number and scope, yet are accompanied by a need for continued strengthening of the design and application of prudential and consumer-protection standards.

Interference in savings markets decreasing the value proposition of formal-sector savings for the Lao populace. In the banking sector, banks' ability to price for costs and risks have been improved by lifting the cap on the spread between interest rates on deposits and loans (2019). The cap on interest rates on deposits however, was withdrawn with a carefully phrased instruction not to raise rates too much, still disallowing the use of pricing as a tool to compete in the market for deposits. Continued interference in the savings markets is also causing LAK-funding shortages for FSPs. As a result, formal-sector savings are less attractive for the large majority of the Lao population for whom savings are the primary sought after financial service.



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Internal systems and corporate governance have seen significant progress.

The new Law on Commercial Banks has established mandates for the establishment of appropriate systems for corporate governance, risk management, internal auditing and maintaining adequate capital and liquidity. Minimum registered capital has been increased to LAK 500 billion (USD 53.19 million) from LAK 300 billion (USD 31.91 million) for fully licensed commercial banks and to LAK 300 billion (USD 31.91 million) for foreign commercial bank branches.

Credit interest-rate cap for MFIs introduced. In an apparent attempt to reduce interest rates charged by licensed MFIs, an interest-rate cap for loans issued by MFIs has been set at currently 3.27% nominally per month, combined with the instruction to calculate interest on declining balances for loan amounts over LAK 5 million (USD 532).

Law on Consumer Protection likely to foster greater consumer protection.

A big step forward has been the issuance of a Decree on Financial Consumer Protection (2020), which provides both a necessary and potentially powerful foundation towards raising industry standards on client protection.

New regulation on credit information has enhanced its scope and coverage.

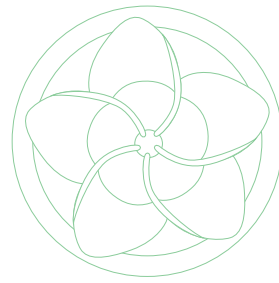
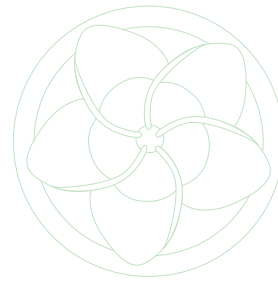
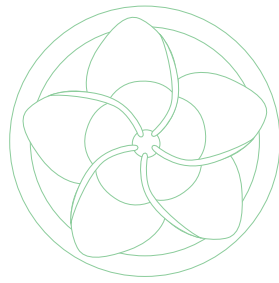
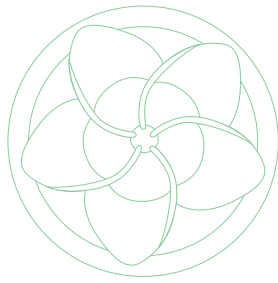
The Decree and regulation on credit information aims to solidify standards and requirements for, and participation of providers and users of such credit information, and of the information itself, in light of the privatization of the Lao Credit Information Company (LCIC). Beyond regulation, issues for the expansion of credit information data are related to ID-documentation and are of a technical nature, relating to IT and MIS constraints on the side of both the LCIC and FSPs.

New Insurance supervision mechanism in place for effective supervision.

In the insurance sector, in 2016 a more-dedicated supervisory agency has been established in the form of the Insurance Supervision Division of the State-owned Enterprise Management and Insurance Department (DSI) of the Ministry of Finance.¹⁵

New capital standards for the insurance companies in place. The newly-issued *Insurance Law (2019)* has raised required capital standards with 100% to USD 2 million for each dedicated life and non-life insurance company, and USD 4 million for combined licenses (life and non-life), soon to be raised to USD 3 million and USD 6 million respectively. The law provides a mere framework regulation and subsequent issuance of detailed regulations by DSI is required for further clarification and implementation.

An interest-rate cap for loans issued by MFIs has been set at currently 3.27% nominally per month.



Links between financial inclusion, the real economy and human development

There are several links between financial inclusion and the real economy and human development identified both in UNCDF MAP's research and verified by stakeholders.

Financial services, like most services, are not used for their own sake but because people have an underlying need (an economic need) that gives rise to a financial need – and financial services help them meet this need. In their daily lives, for instance, people need to purchase goods and services, or they might need to take care of family by sending relatives money; and people also need to make sure there is enough money over the course of their income cycles to do this. People plan for unexpected expenses but they also plan for the future: for particular events, to acquire durable goods or big assets, and for their old age. These are all real economic needs. They have nothing to do with financial services, yet they give rise to financial needs: a need to transfer value (geographically), manage liquidity, manage risks, and plan for the achievement of goals (transfer value over time). It is these financial needs that financial services aim to satisfy. Financial needs arise from underlying economic needs – needs that, because they are non-financial, can be termed real economic needs. Without a functional economic need, people would have no need for financial services.

Therefore, how exactly, and to what extent (formal) financial services can contribute to the achievement of economic and financial goals will depend on whether the services match the underlying demand and the individual's/household's/small business's activities in their community, in the real economy and in the wider society. The MAP cross country data clearly demonstrates that vulnerable and excluded consumers 'make a plan' to access required resources, even though this is not easy and they access resources less than their less-vulnerable peers. Often, they pay more and get less; sometimes they pay less and get less. They use what they can – different financial services, formal and informal – to access what they need. Ultimately, consumers are in control of their finances (even if they sometimes need to resort to less-than-optimal financial



Financial services, like most services, are not used for their own sake but because people have an underlying need (an economic need) that gives rise to a financial need.



mechanisms to meet their needs). Either way, consumers already spend money on the crucial resources of education, healthcare and basic services (e.g. energy) in the pursuit of opportunities relating to employment and income earning. While people's money thus greases the wheels of the national and global financing systems, in developing markets consumers are far removed from the financing system because they are more likely to be operating on the margins and in the informal sector. Thus, their contribution or ability to contribute is often not recognized.

At a household or individual level, this expenditure is also not enough to expand infrastructure. Households, in general, are not able to build a new school or clinic – and poor households even less so. However, as MAP data shows, on aggregate this expenditure adds up to substantial amounts. Although currently most of this expenditure is informal (i.e. people relying on informal financial services to meet these needs and the spending occurring in informal markets), such expenditure, if formally mobilized, can be leveraged as a mechanism for growth.

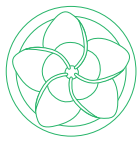
Citizen-centric financing. Increasing populations' access to resources obviously requires governments, providers, investors and donors to make additional investment in service infrastructure such as education, healthcare and basic services (including energy). But evaluating viable and sustainable business cases for leveraging existing household spend can help governments fund investment using local financial systems. Citizens increasingly want control over their financing, though; their decisions will therefore influence and impact both the local and national financing agendas. To drive economic growth, the financial sector needs to contribute to building the physical and human capital available in the economy and/or support innovation in the methods of production (technology), which in turn could contribute to future growth in productive opportunities.

A well-functioning system that can enable inclusive growth partly requires financial service providers to understand how to meet consumers' real economic needs. And where the financially excluded do not immediately present viable business cases, identifying them enables government to determine and define better public-sector provision of services, based on need. Yet, the fact that there are large sections of a society without access to retirement savings, healthcare or education, for instance, is detrimental to that society – because the resulting ill effects are communal. In countries where a significant proportion of the population lack the means to access what MAP has come to term 'the four crucial needs' (basic services and infrastructure, education, healthcare, and entrepreneurship opportunities), economic growth is hampered partly because the inability to meet those needs has undermining consequences that are also communal and societal.

As an enabler of real economic activity, and by including those in the informal economy, financial inclusion can play a role to unlock domestic finance flows that are currently being reticulated in the informal sector, by utilizing the finance



To drive economic growth, the financial sector needs to contribute to building the physical and human capital available in the economy and/or support innovation in the methods of production.



flows at a household level that are already spent on needs like education, healthcare etc. and directing them through more formal channels, allowing for the aggregation of these flows, and potential to leverage it for investment requirements. A renewed focus on a longer term strategy to increase financial inclusion could therefore assist to unlock additional sources of domestic financing, or grow the pool of domestic finance available. More actively linking financial inclusion and its potential to actively engage the low-income segment of the market into the formal economy can support further growing domestic financing. Increasingly, financial inclusion is demonstrating the “triple impact factor” in the context of sustainable finance.

- A lack of financial inclusion is a sustainability risk. Adequately addressing inclusion of the low-income market can strengthen financial stability and promote more resilient economies, through an active inclusive growth agenda
- Financial inclusion initiatives achieve a range of primary and secondary positive social impacts - often mutually reinforcing in themselves and resulting in environmental benefits
- Financial inclusion changes the dynamics of finance in a national context and could change the way that sustainable finance is practiced in the future by empowering new sets of stakeholders and actors in financing

The Lao PDR’s Development Finance Assessment (DFA, 2017) acknowledges that delivering on the Government of Lao PDR’s ambitious national development goals will require both the necessary scale and mix of financing—public, private, domestic and international. Despite significant increases in all sources of financial resources since 2000 (in real terms), the DFA highlights constraints to all current sources of financing to achieve the SDGs, despite the need for increased resources to fund investment in this regard. This includes a constraining fiscal space, projected declines in FDI, constrained domestic equity and private finance environment and changes in the modality of ODA. The composition of financing in Lao PDR is also different from other ASEAN countries, relying less on domestic public resources, and more on international public finance.

There are however opportunities to increase the availability and sources of finance to fund development objectives, but this refresh highlights the role that financial inclusion can play in mobilising resources to increase domestic sources of financing, by linking financial inclusion to household level economic needs that can support the achievement of development goals and the SDGs. This could also contribute to lessen the reliance on international public finance. Financial inclusion, through supporting growth in the real economy, could over the longer term also contribute to increasing domestic public finance (through taxation).


The following section provides the insights into the role of financial inclusion, into broader human development and highlight the linkages between financial inclusion and inclusive growth in Lao PDR. This understanding can be leveraged to enhance domestic financing in Lao PDR to achieve better social outcomes in each of these areas.



A renewed focus on a longer term strategy to increase financial inclusion could therefore assist to unlock additional sources of domestic financing, or grow the pool of domestic finance available.

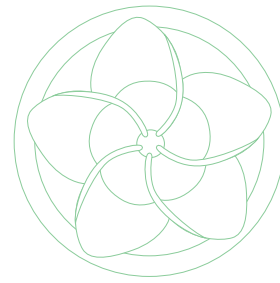
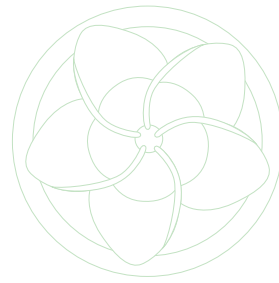
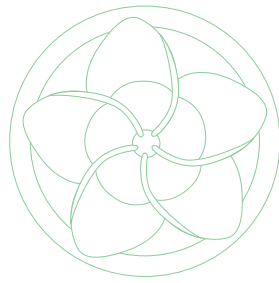
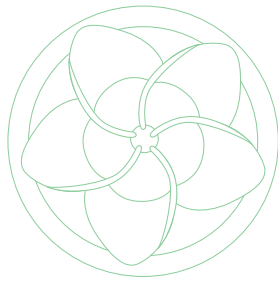
PART 1 NOTES

- 1 WB, n.d.
- 2 (a) Ibid: at USD 1,90 a day (2011 PPP); at USD 3,20 a day reduction from 37% to 11%. (b) WB, 2017.
- 3 LSB, 2019.
- 4 IMF estimates that up to 80% of the profit-tax base could be exempt.
- 5 Official stats put 42% of public debt or public-guaranteed debt as provided bilaterally by China as per 2018.
- 6 WB, n.d.
- 7 IMF, 2019.
- 8 Imports from Thailand compete directly with production at home and are preferred, due to a combination of lower prices and perceived higher quality.
- 9 WB, n.d.
- 10 In Laos, some consider *financial inclusion* as something that can or should only be achieved by microfinance institutions and semi-formal providers. As illustration, the annual meeting of microfinance practitioners is labelled the "*Annual Financial Inclusion Forum.*"
- 11 Typically, development partners' country programs, such as those of ADB, IFC etc, follow the periodicity of NSEDPs and are elaborated to support the policy priorities embedded in a particular NSEDP.
- 12 New regulations published in the Ministry of Justice's Official Gazette, classified by type of legal source in ascending order of legal hierarchy. E.g., laws take legal precedence over decrees, and so on.
- 13 Article 80 of the Law on Making Legislation requires any regulations to be published at the official Gazette of the Ministry of Justice to have legal validity, but for those issued at district or village level.
- 14 A comprehensive overview of FIRM accomplishments is provided in section 3 of this report.
- 15 Earlier, insurance regulation and supervision were the responsibility of the MoF's Fiscal Policy Department.



2

Financial
inclusion
and its links
to social and
economic
questions



Introduction

Lao PDR is in a strong position to rekindle growth after the pandemic, as recipient of FDI from foreign sources, as well as the planned infrastructure investments and energy export expansion. However, as discussed in this section, there is much that can still be done to translate this growth into broader prosperity for the majority of the population.

The Government do however have an opportunity to leverage its pandemic recovery efforts to address underlying issues that were present historically, which can support growth recovery, but more importantly, also engineer a more inclusive growth environment. For instance, to draw more people, and especially the youth into the labour force would require job creation on a large scale. Further investment in infrastructure could support this if combined with investment in education, social protection, and access to essential services like energy, further supporting future growth that would benefit a broader segment of the population.

However, given Lao PDR's current fiscal constraints and reliance on ODA, the financing agenda need to identify local streams of capital that could be leveraged for development objectives. Households already spend money that can contribute to investment in physical infrastructure, setting up or expanding businesses in key sectors of the economy and human and social development contributing to job creation. If formally intermediated, financial inclusion can therefore support the achievement of broader growth objectives in Laos. However, this require formal financial inclusion that aggregates and mobilizes money flows, and ultimately increases the availability of domestic capital as a source of investment. Thereby, financial inclusion has the potential to contribute funding the development objectives of Government, as well as contributing to SDG achievement at the household level, and inclusive economic development in the process.

Based on international frameworks for inclusive growth, UNCDF has identified nine areas which government can influence to make growth and economies more inclusive. Of these, one is financial inclusion in itself, and an additional six can be supported through financial inclusion. These additional six areas include education and skills development, basic services provision and infrastructure for



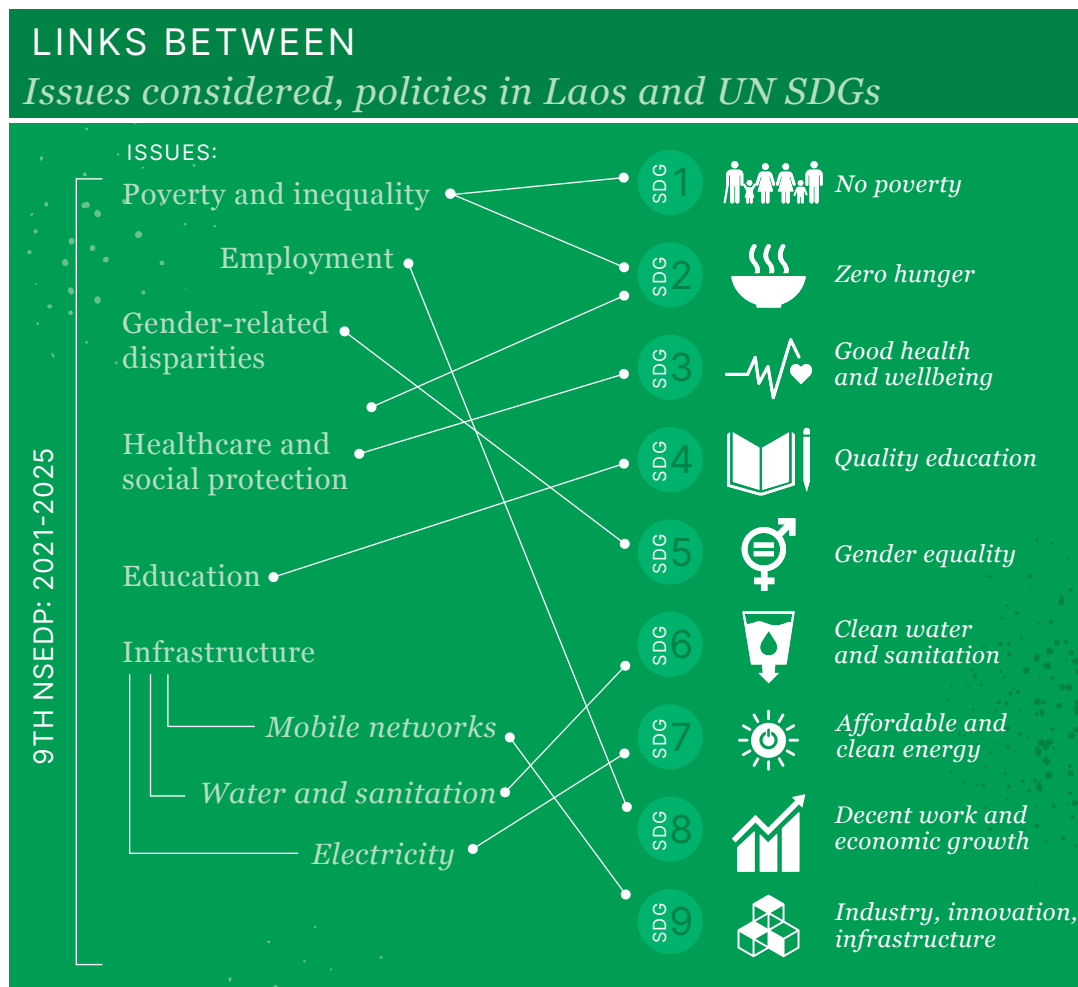
To draw more people into the labour force would require job creation on a large scale. Further investment in infrastructure could support this if combined with investment in education, social protection, and access to essential services like energy.



basic service delivery, health and human development, asset building and entrepreneurship, fiscal transfers and social protection, and unemployment and inequality. UNCDF further found that households already prioritise these areas in their own household spending, albeit the majority of this spending happens informally. Four in particular stand out most in household spending: education, basic services, healthcare and entrepreneurship. In order to understand how financial inclusion can support inclusive growth objectives, it is therefore necessary to understand key social issues in Lao PDR relating to these areas, while locating them within government's objectives as well.

Financial inclusion, as a poverty reduction mechanism, is relevant as a tool to address inequalities and support the vulnerable segments of the population. Thus, to create a stronger linkage between financial inclusion as an enabler of inclusive growth, the MAP refresh takes a deeper look at the main social and economic issues and opportunities in the Lao PDR and their relation to financial inclusion.

The issues reviewed in this section were identified and selected based on (i) their impact on individual human development, (ii) their impact on sustainable growth in society and (iii) their relationship to government policies, especially the 9th NSEDP.





9TH NSEDP: 2021-2025 **SUSTAINABLE DEVELOPMENT GOAL**

- Reduce the number of poor households to less than 5%
- Lift 204,360 household out of poverty
- Reduce the number of poor villages to 421 villages



No poverty



Zero Hunger



Employment

- Reduce unemployment to 15%
- Increasing the workforce to 2.57 million
- Developing skills of up to 25,000 workers
- Recruitment for 486,759 workers, incl. 310,384 unemployed



Decent work and economic growth



Gender

- Reduce Gender Inequality Index to 0.430
- Increase Gender Equality Index to 0.984
- Increase Gender Development Index to 0.675
- Reduce lifetime gender-based domestic violence to 12%



Gender equality



Social protection

- Expand NSSF coverage of new business to 1,275
- Increase registration of new insurance members to 157,500 people
- Increase registration of all types of insurance benefits to 479,633



No poverty



Zero Hunger



Healthcare

- Reduce stunting rate among children under five to 26%
- Reduce under-five mortality rate to 30/1,000 live births
- Increase Universal Health Care to 96% of the total population
- Increase life expectancy to over 73 years of age



Good health and wellbeing



Education

- Enrolment rate for primary education year 1 to reach 98%
- Enrolment rate for secondary education year 4 more than 74%
- Literacy rate among 15-24-year-olds to reach 91%
- Mobilize 12,500 graduates from universities in the field of natural sciences, technology, engineering, and mathematics



Quality education



Infrastructure | Mobile networks | Electricity

- Increase access to roads in all seasons to 90% of villages/households
- Increase transport of passenger and cargo by all modes of transport by 7% per annum
- Enhance Logistics Performance Index (World Bank ranking)
- Expansion high speed fiber-optic network to all districts
- Expansion of mobile base stations, of which 100% of 3G, 90% of 4G and 50% of 5G of nationwide coverage
- Increase households with access to electricity to 98% of total
- Finalise expansion electricity-grid coverage



Industry, innovation, infrastructure



Affordable and clean energy



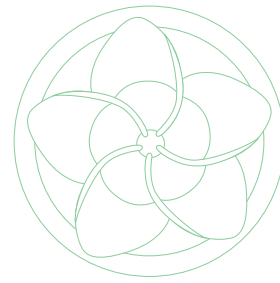
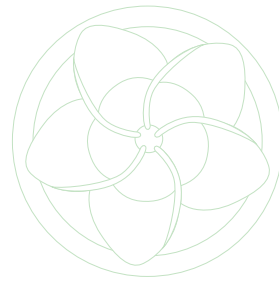
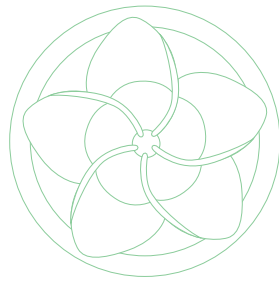
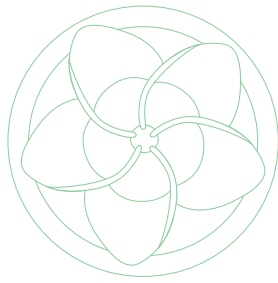
Water and sanitation

- Increase safe water utilization rate to reach 95%
- Increase household toilet utilization rate to reach 85%



Clean water and sanitation





Poverty and inequality

Poverty has reduced, but selected groups lag behind due to their socio-economic backgrounds. As a result of strong economic growth over the past two decades, the poverty headcount reduced from 51% (1997) to 10% (2018). Still, poverty remains relatively high among minority ethnic groups and poorly educated households. In 2019, a poverty rate of 34.6% was observed among people living in households headed by people without a formal education - ten times higher than the households headed by people who have completed secondary education. Similarly, poverty is concentrated in rural areas, with specific ethnic dimensions. It is the highest among the Mon-Khmer (42.3%) and Hmonglu-Mien (39.8%) ethnic groups.¹ A recent study using consumption data from a 2019 LSB survey found that the poverty rate is 7% in the urban population and 23.8% in rural areas, with half of all poor living in just five (out of 18) provinces, and one-in-five in Savannakhet province alone. As most of the geography is rural and home to roughly two-thirds of the population, most of the poor live in rural areas.

Inequality is rising despite the decreasing urban-rural inequality gap. The estimated Gini index has increased from 30.5 in 1992/93 to 38.8 in 2018/19 at the national level,² due to the increasing concentration of consumption at the top end of the distribution.³ The rural poverty rate dropped by 7.6% points to 23.8% between 2013 and 2019,⁴ and poverty has fallen faster in rural areas (compared to urban) owing to the improvement in farm incomes and remittance inflow. The vast majority of rural, farming households and significant number of the urban population are not officially considered poor; however, they are highly vulnerable to socio-economic setbacks, medical emergencies of income providers and, natural disasters (weather induced, pests, animal disease in case of rural households) and resettlement.⁵ For instance, about 80% of the population still lives close to the poverty line (under USD 2.50 per day) with a 10% likelihood of falling back into poverty under normal circumstances. Thus, a shock of the magnitude of the COVID-19 pandemic is likely to exacerbate this vulnerability.⁶

Food insecurity remains a serious issue. The prolonged drought conditions and severe floods in various parts of the country severely affected the 2019 main (wet) season paddy crop, which is the primary food staple. It was estimated that from the beginning of March 2020, 67,800 members from the vulnerable communities would be food insecure due to their pre-existing conditions and these disasters. Food insecurity (as measured by the food consumption score) was said to be the most acute among the poor households and those dependent on upland rice cultivation.⁷



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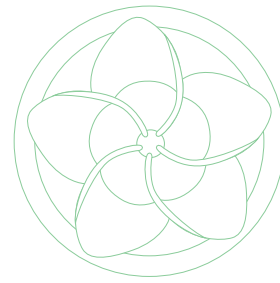
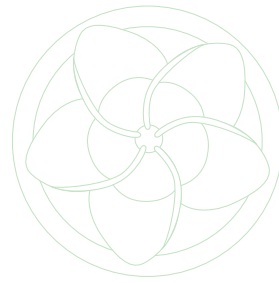
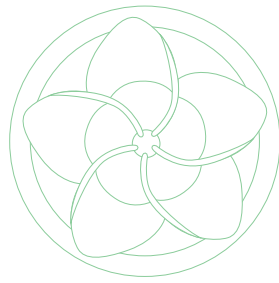
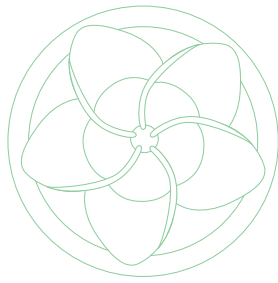
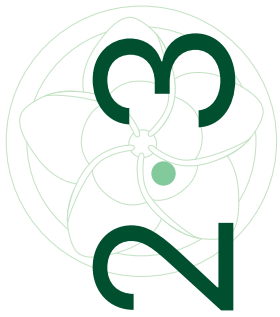
COVID-19 will expectedly have a severe long-term impact on the poor. The pandemic is expected to partially reverse the poverty reduction from 2013 to 2019 with a slowdown in the non-agricultural sectors, combined with a decline in remittance flows. In households with severely affected livelihood, COVID-19 is expected to have intergenerational transmission of poverty in two ways - first, reduction in spending on education and health as a coping strategy; second, selling of household assets. These coping strategies are not easily reversible and reduce the ability to cope with stress and further intensify vulnerability.⁸ Poverty rates are expected to rise rapidly among the urban poor in the short term and intensely among the rural poor in the medium term; given the high rates of migration to urban areas and reliance on urban remittances, the loss of jobs in urban areas is expected to translate to deprivations among dependents living in rural areas. Particularly, families with children and larger households are at the highest risk of loss of livelihood and thus, poverty and deprivation. Similarly, single parent households in urban areas are likely to suffer the most, as are most households in urban areas – due to their higher reliance on high-risk sectors.⁹

Poverty eradication is a main priority of the Government. Government has embedded the objective of poverty eradication and related measures in its legal system in the form of a dedicated Government Decree (348/GoL, 16/11/2017). It ensures strong political support and consistency in measurement and approach based on relevant local circumstances. It applies a holistic, multidimensional approach to poverty, based on the core notion that there is a range of basic conditions and services that one should have access to in order to not be poor. Both the draft 9th NSEDP (2021-2025) and the *Decree on the Criteria for Poverty Graduation and Development* (No. 348/GoL, 16/11/2017) prioritize inclusive growth and development, and the reduction of poverty. The Government aims to gradually lessen dependence on ODA and instead ensure that economic growth will enhance well-being of the Lao population by creating food security and extension of social security and public services.

Financial sector development has a significant impact on poverty alleviation and is inextricably linked to economic growth. This can include better ability to smooth consumption, increased access to opportunities, increased human capital development, and improved health. A more inclusive financial sector has both indirect and direct effects on poverty reduction, including links between financial sector development and more equitable growth, as well as the effect of expanding access to financing, particularly for the poor and in rural areas.



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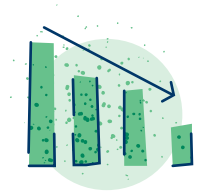
Employment

Careful analysis of the potential workforce indicates significant underemployment.¹⁰ In Laos, reflecting the fact that the population is so young, just two in three people, or 68% of the population, is of working age (i.e. 15 years and older) and make up the *potential workforce*. When assessing the employment status of this *potential workforce*, only 41% are part of the *actual workforce*, i.e. they are either *active in or available on the labour market*. Furthermore, of the 59% of the potential workforce that aren't in the labour market, 87% (or 51% of all people of working age) aren't available for economic production because they are engaged with own-use production work in the family because of family requests and obligations, or fully voluntarily and can be considered *underemployed*.¹¹ In addition, of those in the actual workforce, 9% (or 4% of all people of working age) are considered *unemployed*.

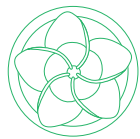
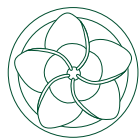
Low utilization of the potential labour force and high levels of dependency.

The combined groups of under and unemployed make up 55% of the potential workforce, making for substantial leakage of potentially productive capacity.¹² The combined groups of the young, those outside the actual workforce and the unemployed, together making up a group of dependents, represent a large portion of the population (75%), which means that just 25% of the population are actually providing an income for themselves and their family members.¹³

Employment is much determined by family dynamics. The combined groups of paid and unpaid family members together comprise 3,177,000 people, or two-out-of-three (66%) of the people of working age.¹⁴ This reflects the family-based nature of Lao enterprises, which we will explore in more depth in section 5: Family-based enterprises maximize revenue with existing resources rather than profit, as profit maximisation would require firing family members. Management is based on family hierarchy and for younger members there is a strong family-, culturally- and socially-based obligation to support or be available.



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**Table 3: Workforce and employment**

	CATEGORY (2019)	NUMBER (X 1,000)	% OF POTENTIAL WORKFORCE	# CATEGORY	% CATEGORY
1.	PEOPLE WORKING AGE (15+)	4,838	100%		
1.1	Outside workforce	2,864	59%		
1.2	Inside workforce	1,974	41%		
1.1	OUTSIDE WORKFORCE			2,864	100%
1.1.1	Own-use production in family	2,492	51%		87%
1.1.2	Old age, disability, students	372	8%		13%
1.2	INSIDE WORKFORCE			1,974	100%
1.2.1	Unemployed	186	4%		9.4%
1.2.2	Employed	1,788	37%		90.6%
1.2.2	EMPLOYED			1,788	100%
	Agriculture	640	13%		35.8%
	Trade and repair	383	8%		21.4%
	Public administration and defence	182	4%		10.2%
	Manufacturing	163	3%		9.1%
	Education	98	2%		5.5%
	Construction	97	2%		5.4%
	Rest	232	5%		13%
1.2.2	TYPE OF EMPLOYMENT			1,788	100%
	Salaried	579	12%		32.4%
	Employer	20	0.4%		1.1%
	Own-account worker	504	10%		28.2%
	Contributing family member	685	14%		38.3%

Source: Yearbook 2019 and Workforce Survey 2017

Employment is dominantly provided by the agriculture sector and small trade, followed by the public sector. In terms of sectors providing employment, 36% work in agriculture; 21% in trade and repair, mostly at very small, retail level, *informal micro and small enterprises (iMSEs)*, which we elaborate more on in section 5: 10% are employed in public administration and defence or, phrased differently, are civil servants; 9% in manufacturing; 5.5% in education and 5.4% in construction.

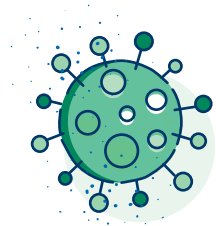
Employment abroad is topped only by agriculture and matches employment created by all enterprises inside Laos. Before the start of the pandemic, the total number of Lao nationals that had found employment abroad as labour migrants has been estimated at around 500,000.¹⁵ As we will see in more detail in section 4 below, this is at the same level as all employment created by all Lao enterprises combined, which stood at 490,000 and is as large as 28% of all people measured to be employed by the Workforce Survey.¹⁶



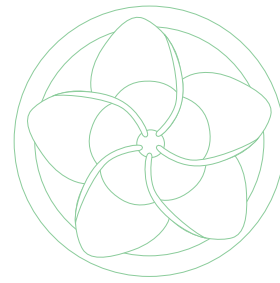
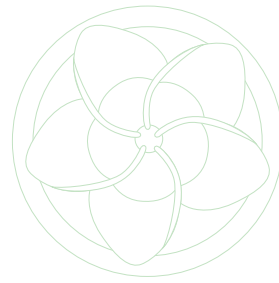
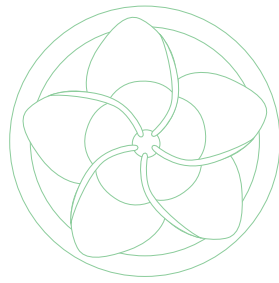
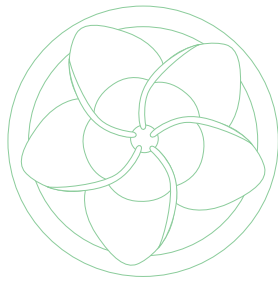
Weaknesses in human capital poses a critical obstacle to inclusive growth, competitiveness, and economic diversification. In a recent Global Competitiveness Report survey, employers cited an inadequately educated workforce as the top constraint to doing business in the Lao PDR. Other surveys - the World Bank-supported 2011/12, Skills Toward Employment and Productivity (STEP) survey and 2012 Enterprise Survey - produced similar results. Employers face shortages of foundational soft skills and vocational-specific hard skills.¹⁷

The COVID-19 outbreak has added pressure to the job market. The lingering effects of the lockdown and pandemic have resulted in unemployment and income losses. By July 2020, nearly 13% of workers employed before the pandemic had lost their jobs, raising the unemployment rate to over 25%. The pandemic forced more than half of overseas Lao workers to return home, and at the same time, some domestic employers cut jobs after their businesses ran into financial difficulties.¹⁸ Approximately 36% of returnees indicated that they would stay until the pandemic ends. More than 33% planned not to work outside the Lao PDR again and 25% were unsure. The pandemic may have a long-term impact on the migration pattern in the Lao PDR as many returnees who plan on staying back are planning on upskilling for better opportunities in the country, especially through vocational training.¹⁹

Financial inclusion contributes significantly to the reduction of unemployment in developing nations by giving income-generating options through access to credit or improved risk mitigation mechanisms.



The lingering effects of the lockdown and pandemic have resulted in unemployment and income losses.



Gender Related Disparities

Women's economic participation is high yet gender inequality remains.

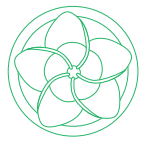
Laos ranked 126th out of 159 countries on the Gender Inequality Index (GII), a composite index based on scores for reproductive health, political empowerment and labour market participation. The Global Gender Gap Index (GGGI), which benchmarks national gender gaps on economic, political, education, and health-based criteria, ranks Laos a high 43rd out of 153 countries. In both indices however, Laos scored very high for women's economic participation and opportunity; the GGGI ranked Laos third out of 153 countries on this sub-index, much higher than ranks for educational attainment (110), health and survival (98) and political empowerment (98). In East Asia and Pacific, Laos ranks third behind only New Zealand and the Philippines, but higher than Australia and all other Southeast Asian countries, including Singapore and Thailand²⁰. The findings of the GGGI and the divergence between the score on economic participation and opportunity, on one hand, and scores on access to (political) power, education and health (care), on the other, can both be seen reflected and further unpacked by some additional, detailed statistics.

Women's high levels of economic participation is skewed towards micro and small enterprises. In the Lao PDR, household-based, micro and small enterprises (MSEs) make up 99% of all enterprises and are the dominant organizational structure of economic production:²¹ Two-thirds of staff of MSEs are female, and in 64% of MSEs Women manage day-to-day affairs, while in 53% of MSEs, women are end-responsible for overall management. At the same time, however, the majority of the owners of MSEs are men (56%). Looking at larger, more formalized and structured companies, there is lower female participation. In formalized companies, with over five staff, overall women's ownership stands at 36%; 46% for small, 8% for medium-sized and 9% for large companies. The proportion of female participation in management are 38% overall; 53% for small, 12% for medium-sized and 6% for large companies.²² Women are similarly underrepresented in power structures at the household level, where men are often considered the head of the family. In government, few women are seen in leadership roles - 2.6% of Village Heads, 6% of District Governors, 13% of Head of the Household and 27% of National Assembly members.²³

Female employees often have lower pay than male counterparts. Gender differences in pay are found to be statistically significant. Even when their characteristics, such as education, work experience, ethnicity, and marital status



Laos ranked 126th out of 159 countries on the Gender Inequality Index, a composite index based on scores for reproductive health, political empowerment and labour market participation.



are identical, the average hourly wage rate of male workers is 11.2% higher than that of female workers. In sectors, such as agriculture and fishery, where 1.1 million of the 1.5 million female workforce is engaged, women's contributions to production, often unpaid, remain invisible and undervalued owing to the lack of sex disaggregated data across economic sectors.

Disproportionate impact of the pandemic on women's jobs. Women spend significantly more time in care work compared to men, which is further exacerbated by the COVID-19 pandemic. With the confinement of dependent family members at home with the lockdown, women are more likely to absorb the additional burden of caring for children, and either discontinue work or bear a double load of income generation activities as well as caregiving.²⁴ The economic implications of this crisis are skewed towards jobs and sectors with overwhelming presence of women.

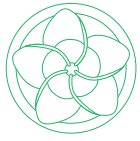
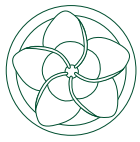
Fewer girls are educated than boys in Lao PDR. Gender parity has been achieved for both primary (89.9% boys – 89.4% girls) and secondary (59.4% boys - 61.5% girls) school enrolment.²⁵ Nevertheless, the drop-out rate for girls in upper-secondary levels are higher and girls' school completion rates are therefore lower, and the same goes for levels of literacy. Gender disparities are strongest in rural, poor and ethnic-minority communities where women are most vulnerable and too often unable to attend or complete school due to the engagement in unpaid work, financial constraints, physical access, insufficient school infrastructure and language barriers. Families with financial struggles may not afford to send girls to school or prioritize boys in case of limited resource as per the trend before the pandemic. This leads to girls marrying and conceiving at young age, and higher levels of girls aged 15-19 working (40%) than boys (28%) to support their families based on sociocultural expectations.²⁶ The pandemic is likely to exacerbate this practice with more girls being expected to support family finances.

The institutional and legal environment embeds and supports equal rights for women. Politically, women's socio-economic position is enhanced by a powerful mass-organization, the Lao Women's Union, which counts 25% of the population as its members and has its foundation in the Constitution. Gender discrimination is explicitly prohibited in the Constitution and is further legally supported in the form of a law dedicated to ending all forms of discrimination against all women and girls.²⁷ Such legal support is relevant and appropriate, as 16% of men between the age of 15 and 49 still believe it is justified for a man to beat his wife for various reasons.²⁸ Specific to inclusive-economic growth and social empowerment, women have both equal rights and equal ease with starting a business, and have equal rights to own property.²⁹

Women have lower financial literacy than men. Women generally score lower than men and the reasons for this are still debated. However, it is found that women are more willing than men to admit that they do not know an answer. Higher levels of education of the person as well as their parents are positively correlated with financial literacy.³⁰

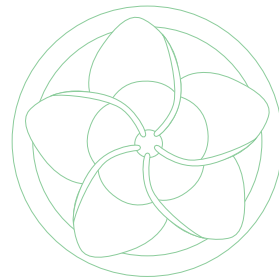
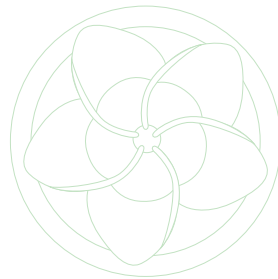
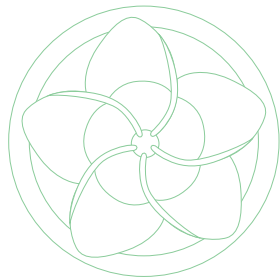
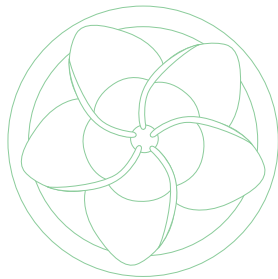


Women spend significantly more time in care work compared to men, which is further exacerbated by the COVID-19 pandemic.



More women are migrating for economic opportunities. Many young men and women are migrating for wages and remittances in Lao. The number of women working in the capital of Lao PDR has increased. Mainly, young rural women are employed in textile factories, which has influenced women's roles and status as industrial workers both inside and outside the workplace.³¹ Women constitute 59.2% of internal migrants (Lao Statistics Bureau 2016). The garment sector is dominated by female workers. Financial difficulties are the primary reason for their migration, specifically the inability to harvest and sell sufficient rice, and failure to provide for the education of the migrant or her sibling(s).³²

The largest and most persistent gender disparities exist among ethnic minorities in rural uplands. Due to the fact that these gaps may be linked to a variety of interrelated, observable causes, the government and development partners can take potentially useful policy interventions. The most effective strategy would be a combination of initiatives aimed at reducing fertility and increasing girls' completion of secondary education in rural upland communities. Financial constraints mixed with a lack of accessible secondary education facilities, as well as cultural considerations, are significant obstacles. Even though women are more likely to use informal financial services, formal financial solutions that address educational barriers for women in these areas can be beneficial.



Healthcare

There are remarkable achievements in improved health outcomes but Lao PDR is still lagging behind in the region. The life expectancy in Laos was 68 years in 2019 from 53 years in 1990. Other key statistics showcase similar progress – the under-five mortality rate declined to 46 (2019) from 153 (1990) per 1,000 live births, and maternal mortality rate reached 151 (2019) from 594 (1995) per 100,000 live births. Although this is an improvement in the context of Lao PDR, the mortality rate is still the highest among all the ASEAN countries.³³ Furthermore, malnutrition is still a severe problem, as it is responsible for almost 45% of deaths of children under five. This means that poverty, which is intrinsically intertwined with food security and nutrition, significantly impacts on health outcomes in Laos.

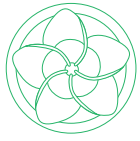
There is disparity in access to health care services. According to the 2017 data for key social indicators, health services is yet to reach equally to people from all backgrounds. The disparity is mainly based on the socio-economic status and urban/rural areas. For instance, overall 64% of deliveries were attended by a skilled birth attendant, but this is much higher in urban areas (90%) compared to deliveries in rural areas without a road, where only 34% had a skilled birth attendant. Similarly, the under-five mortality rate was 53 deaths per 1,000 live births in rural areas and 24 in urban areas, and similar discrepancies exist for other key health metrics.

There is an impact on women's access to health services due to the existing gender-based inequalities. Women face particular gender-based constraints in accessing health care owing to mobility limitations and heavy domestic duties. In traditional settings, women still depend on their husbands and families to access health care services – in terms of information and finances. Similarly, the girls are often married off early. The rate of early marriage and childbearing for girls is the highest among the ASEAN countries - one in four girls aged 15 – 19 are married, and within that age group, one in 10 girls have begun childbearing. As a result, it affects their health and well-being. Adolescent girls' health, nutrition, and education level have to be urgently improved in order to reduce early pregnancy, the maternal mortality rate, and child stunting.

The Government has been following a strategic plan to address these challenges. The GoL developed a Health Sector Reform Strategy (HSRS), 2013 – 2025 to deliver essential and high-quality health services and responding to growing and changing demands. The focus is to achieve Universal Health Coverage for all by



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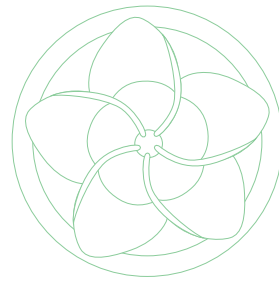
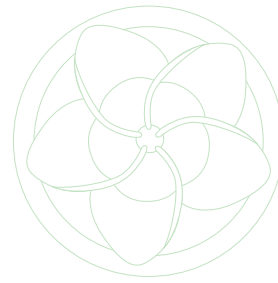
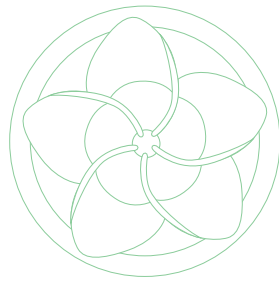
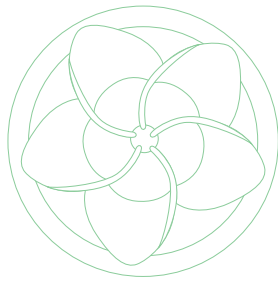
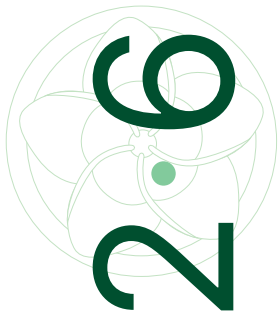
2025. To do so, the strategic directions articulated by the MoH include: 1) the introduction of modern medical technology; 2) the revision of existing licensing and accreditation rules and procedures for health care providers and facilities; 3) the creation of an investor-friendly environment in the health sector, opening the door to an expansion of private sector provision; 4) the implementation of the social health protection policy (i.e., the National Health Insurance scheme); and 5) a move toward hospital autonomy.

As a result of effective Government decision making, the National Health Insurance (NHI) system offers Universal Health Care that currently covers 94% of the population. In 2016, the GoL integrated different health insurance schemes into one NHI system aiming to expand its national coverage.³⁴ The NHI system is largely taxpayer funded and offers all Lao citizens treatment at public health facilities in 17 provinces for very small out-of-pocket payments. The NHI Law was passed in 2018 and in July 2019, Ministry pooled funds and risks, and health-insurance elements of social-security schemes, which is now provided by the NHI. To access care under NHI, patients pay a low co-payment at facility level ranging from 5,000 LAK (USD 0.53) to 30,000 LAK (USD 3.19) depending on their treatment needs. The NHI scheme predominantly relies on tax-based financing, which is combined with contributions from workers in formal employment. This ensures that those without the means to contribute are not excluded from accessing treatment. This has led to significantly improved access to health care for previously uninsured sections of society, including the many in informal employment.

Financial inclusion can assist households to cope with unexpected medical expenses, including reducing out-of-pocket expenses, which can still be significant for low-income households.



The NHI system is largely taxpayer funded and offers all Lao citizens treatment at public health facilities in 17 provinces for very small out-of-pocket payments.



Social Protection

Few people have access to social protection, limited to employees in the formal sector. In 2020, only 15% of the population were insured by the NSSF, although this increased by 19% from 2015. Around 29% of those insured in 2020 were primary insured, with the rest being family members³⁵. The low coverage is the combined result of low-levels of compliance by enterprises with the legal obligation to register with the Lao Social Security Organization and high-levels of informal employment, i.e. people working without a formal-labour contract in accordance with the law: Only 1.9% of the total enterprise population have registered, and as a result, less than 2% of all enterprises have socially insured their employees. In addition, only around 17% of employment is estimated to be formal. There is an urgent need to expand participation beyond the current number for NSSF to be more effective in the long run.

Limited coverage of social protection programs leading to inability to respond to the pandemic shocks. In the current context, it is believed that the coverage of social protection programs is limited and lacks the sufficient capacity to respond to pandemic shocks. Those covered by social protection programs are mostly limited to social insurance provided by the private sector or civil services, while few programs provide limited health insurance to the poor. It benefits the formal working population primarily through contributory schemes, although there is limited social assistance benefits to the vulnerable population, but this largely excludes the informal sector. The social protection system is highly fragmented as there is a huge gap in the current social protection coverage for rural population, informal sector workers, and working age populations, as well as older persons and young children. This limited infrastructure is seen to be one of the weakest links in delivering effective, efficient, and timely responses to the COVID-19 crisis.³⁶

Social protection schemes cover a wide range of areas and is spread in different laws and regulations. In terms of social security, protection offered by the National Social Security Fund (NSSF) covers eight types of risks and benefits: sickness benefits, childbirth grant, employment injury and occupational disease benefits, non-work-related disability benefits, pensions, death grants, benefits for insured family member and unemployment benefits. As a part of social welfare, there is free educational support for children through the administration of block grants to eliminate school collection fees for all students, provision of scholarships to children in secondary education from poor families, National



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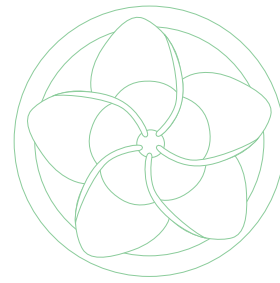
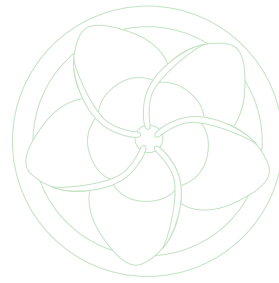
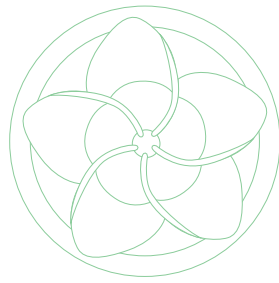
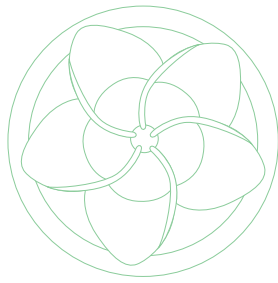
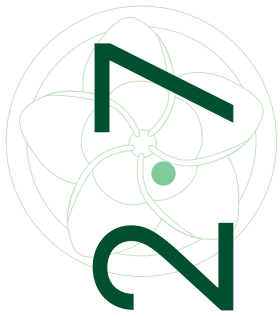
Schools Meals Program for primary and secondary schools in poor districts, provision of a stipend to poor students in secondary education and provision of technical and vocation education and training scholarships to students from poor and disadvantaged families. There is also improved livelihoods and essential services provision in terms of assistance to children with special protection, persons with disabilities and the elderly.



Gaps remain, including fragmented policy environment. With the implementation of the social protection policies, there has been immense improvement in health, nutrition and education indicators, however, the system still has gaps in serving uniformly across various groups and maintaining financial sustainability.³⁷ The overall policy and regulatory environment on social protection is spread out in various laws and regulations, including the Constitution; the Law on Healthcare; National Health Insurance Strategy; Social Security Law; and the Labour Law to name a few.



Social protection programs create additional needs for financial services among the poor, which must be met in order for such programs to have a greater impact. Financial inclusion, in turn, can support more effective distribution of social protection, including increased governance.



Education

Lao PDR has achieved the Millennium Development Goal (MDG) target but needs to achieve significant improvement in the education indicators. With a net enrolment in primary education of 98.7% (2017), the country has met the MDG target of universal access to primary education with gender parity.³⁸

However, there are many factors that need attention to ensure equal access, and particularly access to quality education. The attendance in Early Childhood Education (ECE), and lower and upper secondary levels is still found to be low, particularly due to unequal access between geographies and socioeconomic groups, while quality of education could also improve.³⁹

In terms of access to education, across all levels, Lao PDR has strong socioeconomic and regional inequalities proven by the percentage of children and young people who are out of school. Factors such as socioeconomic status, mother's education, ethnic background, rural-urban placement and provinces play a significant role in influencing their attendance in school from the ECE to the upper secondary level. Children with highly educated mothers have greater tendency to stay in school to attend upper secondary education. Similarly, language is also a determining factor. The Lao-Tai ethno-linguistic group (62% of the population) (See section 1.1) has a higher attendance rate compared to other ethnic groups, at almost 50%. Children from this group are at an advantage at school, especially at primary level, as Lao is the school language. Students' attendance from wealthier families is seven times higher in upper secondary level than those from poor families. The impact of these variable increases significantly between primary and lower secondary education to upper secondary education, making the disparity between the more and less privileged students even wider.⁴⁰

The quality of education remains a challenge. There is high repetition rates in early primary grades, low literacy levels, low transition rates to the next education level, and high dropout rates at all levels. According to a 2017 student learning assessment, only one in three Grade 3 students met literacy standards for promotion to Grade 4, and one in five students met the standards for mathematics. Similarly, students at the end of lower secondary (Grade 9) do not master literacy and numeracy skills according to a 2019 assessment. There is a vast difference in learning across districts, schools and among students from different socio-economic and ethnic groups. Moreover, few students reach the upper secondary level. For every 100 students that start Grade 1, only 83 reach



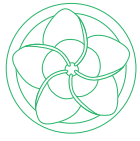
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Grade 5, 51 reach Grade 9/Mathayom 4, and 33 reach Grade 12/Mathayom 7.⁴¹ Most students do not finish their education beyond the primary level.



Additionally, students from low socioeconomic and non-Lao-Tai ethnic groups featured prominently in this data, indicate that child labor and early marriage are factors that need to be addressed for those of secondary school age.⁴²

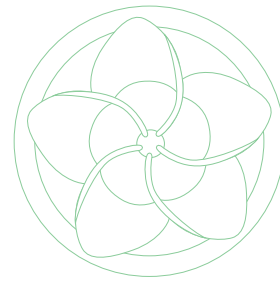
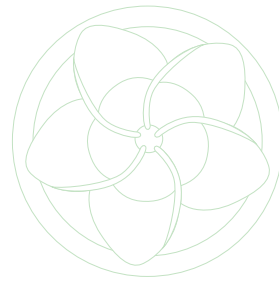
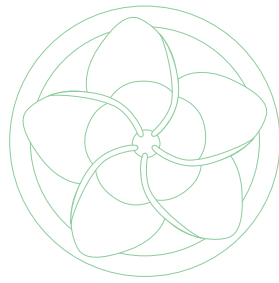
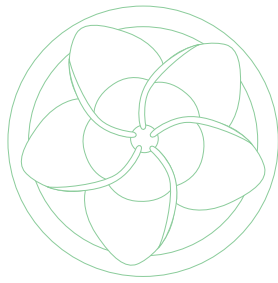
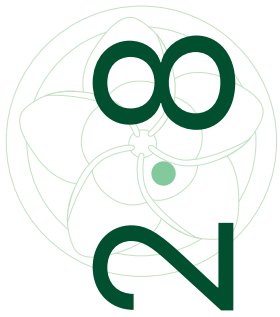


This implies that improving education would require more than just additional investment, as it is primarily driven by social factors.

Budget allocation to education remains lower than the commitment of the Government. The lack of investment in the supply side, to provide required infrastructure, facilities and teachers, is seen to be a major factor in the inability to reach the students in the rural and remote areas.⁴³ Article 60 of the Education Law (2015) states that 18% of the national budget should go to education, while the Education Sector and Sports Development Plan (ESDP 2016-2020) uses a 17% annual target. However, despite these commitments, the actual allocation to education has remained low and gradually decreased from 15.8% in 2015/2016 to 13.7% in 2019 and 13.1% in 2020. In comparison to ASEAN countries, Lao PDR spends less on education, only 2.6% of GDP, much below the median global public education expenditure of 4.7% of GDP and that of countries like Vietnam and Malaysia⁴⁴. Proper commitment of budgetary funds or additional budget can help tackle issues regarding access in rural areas, where there is minimal investment on education infrastructure.

The pandemic has had a disproportionate impact on students from poorer backgrounds. The closure of schools with little notice has impacted the ability of educators to support students, resulting in students from poorer backgrounds struggling to continue their education.⁴⁵ This has exacerbated the urban/rural divide in education, which was already significant prior to the pandemic, with only 28.5% of children from rural backgrounds attending secondary school, compared to 64% of children from urban backgrounds.⁴⁶

Financial inclusion can help households deal with the cost of education, through appropriately targeted savings, credit and educational insurance products.



Infrastructure

Lao PDR has made significant progress to expand infrastructure for provision of basic services but there are issues that need to be addressed to increase access and improve quality of services.

Water and sanitation

Lao PDR has made impressive achievement in water supply and sanitation access but the gap between access of the urban and rural population remains persistent.

Between 1995 and 2015, access to improved water supply and sanitation increased from 40% to 76% and from 21% to 74% respectively. However, urban areas and higher income groups have benefitted disproportionately from this progress. Almost two-thirds of the urban population have access to piped water on the premises against only 6% in the rural areas. The difference is more acute for access to improved sanitation; 23% of the poorest quintile has access to improved sanitation against 99% of households in richest quintile. 72% in the poorest quintile continue to defecate in the open. Institutional water supply and sanitation coverage remains low with 48% of primary schools, and a quarter of health facilities lacking access to safe drinking water and sanitation facilities.⁴⁷

The Government has prioritized the issue of water supply, sanitation and hygiene. It is considered as one of the four national priority sectors. The National Strategy for Rural Water Supply, Sanitation and Hygiene for Lao PDR 2019-2030 is closely aligned with the SDGs; it seeks new investments towards attaining 65% achievement in safely managed services and 35% achievement in basic service by 2030. The strategy identifies the following key challenges: (i) extending services and improving water quality, (ii) adequate and reliable financing for rural water supply, sanitation and hygiene, (iii) raising district level capacity in human resources and capacity to develop and maintain water, sanitation and hygiene (WASH) services⁴⁸ in remote and poor communities, and (iv) service delivery modalities that would help increase the speed of delivery while maintaining implementation quality and local ownership.⁴⁹

Lack of financing has been an ongoing challenge in providing as well as accessing services. Whether a household has access to formal or informal water and sanitation services, they often require money to access these services at the household level. Similar to any other regular expense, people use financial services (payments, savings and credit) to help them meet and facilitate such



Between 1995 and 2015, access to improved water supply and sanitation increased from 40% to 76% and from 21% to 74% respectively.



expenses. As a large proportion of this expenditure can be in the informal sector, and through using informal financial services (like cash payments, saving at home, or informal credit), these expenditure flows largely remain unreticulated. In other words, they cannot be aggregated and mobilised for capital investments by the formal financial sector, and invested back into the formal economy. This is a missed opportunity, particularly for investments into service provision of the very services the money is spent on in the first place. Improving access to financial services that can help people manage their expenses on basic services like water and sanitation, therefore not only help households to better meet their expenses, but can also have knock on effects for the economy and country to expand infrastructure for service delivery, thereby helping nations meet their national development goals, as well as their SDG goals.

Electricity

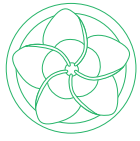
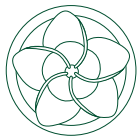
Access to electricity has significantly improved. Lao PDR has made significant progress in providing electricity to its citizens, having implemented its National Electrification Program. Between 2000 and October 2017, the rate of electrification increased from 36% to 94%, and in turn led the country to surpass its previous target of 90% electrification by 2020 ahead of schedule.⁵⁰

The rapid expansion of access to electricity is a result of many factors. Laos' aim is to be the battery of SE Asia by way of production and export of (mainly) hydropower-generated electricity to Thailand and Vietnam. Export value of electricity has been growing steadily and currently there are 68 hydropower dams in operation with more planned and under construction. The revenues from hydropower exports were critical in funding the first years of the national electrification program. Moreover, a number of additional factors played a significant role in further expansion. This includes proactive government policies and financial assistance; high performance of EDL (Electricite du Laos; a state-owned enterprise) in leading, planning, and implementing the program in a cost-efficient manner; state subsidies and below-cost retail rates for poorer segments; implementation of a financing mechanism (Power to the Poor Program) to assist the poorest rural households; and utilization of off-grid solutions for households in remote areas when cost effective.⁵¹ As a result, electricity has also become a huge revenue earner for the country, especially through exports to neighbouring countries and ASEAN states such as Thailand, Vietnam, Cambodia, Malaysia, Myanmar and Singapore. The export is expected to increase to about 20,000 MW between 2020 and 2030.⁵²

However, access to electricity still varies by region and the consumers complain about the high cost of electricity. Around 67,000 households remain without electricity and depend on traditional biomass for lighting and cooking, especially in the northern provinces, electrification rates are significantly below the national average, such as Phongsaly (58.4% in 2017) and Houaphan (73.2% in 2017). Biomass fuels are also used in small-scale industrial production in rural areas, such as alcohol production and tobacco processing.⁵³ Similarly, the citizens complain about the soaring prices of electricity, making it more difficult



Electricity has also become a huge revenue earner for the country, especially through exports to neighbouring countries and ASEAN states such as Thailand, Vietnam, Cambodia, Malaysia, Myanmar and Singapore.



for the low income families.⁵⁴ Similar experiences were demonstrated in other MAP countries where the citizens extensively relied on firewood and other energy sources for daily activities despite access to electricity, due to the high cost of particularly cooking with electricity. Therefore, it is essential to make electricity more affordable for some segments of consumers, as it could conserve environmental resources and contribute to the SDGs.

Access to electricity is significant for poverty reduction and improvement of livelihoods. Energy access improves the lives of people as it increases access to services and opportunities, such as financial inclusion – which in turn also supports access to electricity. Financial inclusion provides access to finance to invest in basic energy needs (such as a solar power system) and the ability to pay for electricity using payment systems. Energy inclusion, on the other hand, leads to an overall improvement of people's welfare. Access to energy enables the charging and use of devices to facilitate financial transactions (such as mobile phones or POS devices), allows generation of income to realise financial needs, and enable people to take advantage of more opportunities and services in the economy, including shifting to clean energy sources. As such, the feedback loop between financial inclusion and access to energy sources is one of the ways in which energy access increases welfare in a country.

The government has plans for energy generation diversification. The GoL recognizes the need to diversify energy generation. As a result, it has started exploring the potential of other energy resources beyond hydropower, mainly non-hydro renewables, aiming to increase the share of non-hydro renewable energies to 30% of total consumption by 2025. Studies show that the country has the potential to develop solar power. Currently, solar power production only accounts for a small share of Lao PDR's electricity output. Solar power is primarily used in small home systems, mainly in rural areas, installed by development organizations and private companies. More than 18,657 households across 430 villages have consumed electricity from these solar power systems. In order to facilitate the growth of solar power, the government has listed solar power as an important component for developing off-grid electrification, and a medium to create sustainable new incomes and reduce poverty.⁵⁵

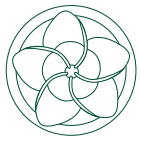
Mobile Network Infrastructure

Strong mobile penetration and telecommunications infrastructure is critical for enabling digital services in the country⁵⁶ as this has implications for development of businesses, in terms of market access, access to information and systems (including payment systems), as well as individual financial services.

In Lao PDR, mobile phone usage is widespread but the ICT infrastructure and uptake is still low. Mobile network stations expanded to 7,805 stations which covers 95% of all villages, and 92% of Lao households have (at least one member with) access to a mobile phone. There has also been a steady rise in the number of internet subscribers (3 million users in 2018)⁵⁷ and mobile connections (increased by +7.7% between January 2020 and January 2021).⁵⁸ The mobile



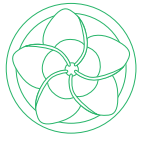
Energy access improves the lives of people as it increases access to services and opportunities, such as financial inclusion – which in turn also supports access to electricity.



phone subscription rate is around 87%, mobile broadband internet is around 35% and fixed broadband is around 3%. However, all three these indicators are lower than that of most neighbouring economies. Fixed broadband speed is also significantly lower than neighbouring countries at around 8.7 Mbps, compared with 10.9 Mbps in Cambodia and 24.2 Mbps in Vietnam. Penetration for 4G/LTE services is very low compared to the rest of the region, and is offered by only one mobile operator.⁵⁹



There is limited competition among the few telecom enterprises of Lao. The country has few large telecom companies which are wholly or partially state-owned enterprises (SOEs) and they dominate the domestic market. The local competition index for Lao PDR is poor as it ranks 129 out of 137 during 2017-2018, which affects the internet service charges.⁶⁰



The relatively high cost of services is impacting the access to digital services. The International Telecommunications Union (2017) data shows that mobile broadband prices in Lao PDR are just below the average for Asia-Pacific (4.2% of GNI per capita for 1 GB, compared to 5.4% for Asia-Pacific), but that fixed broadband prices are notably higher than in neighbouring economies (16.5% of GNI per capita for Lao PDR, compared to 14.5% of GNI per capita for Asia-Pacific). For broadband pricing, a recent survey of 196 countries ranked Lao PDR as the 192nd most expensive at USD 231.76 per month.⁶¹

Affordability and quality of services need urgent attention. In order to drive the uptake of digital services and promote widespread digital development, it is crucial to improve affordability and quality of service across urban and rural areas. Increasing access to high quality, low cost, broadband services will support the upcoming phase of digital development in Lao PDR and also make it globally more competitive.⁶²

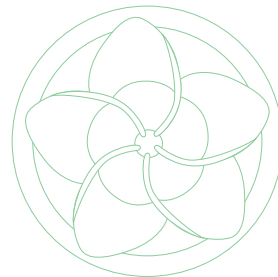
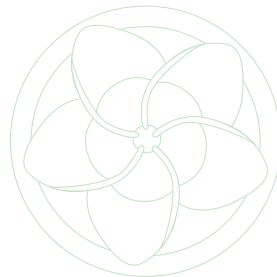
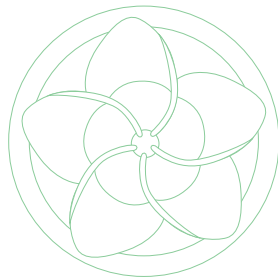
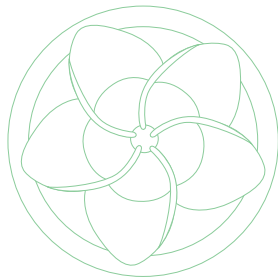
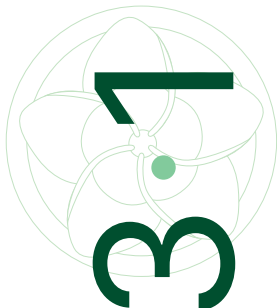
PART 2 NOTES

- 1 UNICEF, 2021.
- 2 UNCTAD, 2021.
- 3 LSB and WB, 2020.
- 4 WB, 2020b.
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- 6 WB, 2015.
- 7 FAO, 2020.
- 8 UNICEF, 2021b.
- 9 Ibid.
- 10 LSB and ILO, 2017 and LSB, 2017.
- 11 The remaining 13% aren't available because of old age, full-time studying or disability.
- 12 The unemployed (186,000) plus those involved in own-use family production (2,492,000).
- 13 People from 0-14 (2,285) plus those outside the workforce (2,864) plus the unemployed (186,000).
- 14 Contributing family members (685,000) plus those involved in own-use production in family (2,492,000).
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National financial inclusion strategy achievements

This section provides a detailed overview of realization of activities, referenced against the outcomes of MAP (2015) and the FIRM (2018-2025). In a subsequent section on supply-side findings, we review and, where deemed relevant, re-establish priorities and recommend activities against regulatory and market developments, based on progressive insights, with the intention of informing strategic changes required.



Achievements resulting from Financial Inclusion Road Map 2018-2025

The FIRM outlined its vision for enhancement of financial inclusion, which was to “Improve household welfare by improving their access to financial services so the access is broad, convenient and deep, meeting the needs for livelihoods development; assist households and enterprises to increase economic efficiency and support growth by improving financial inclusion.”

The FIRM proposed to realize this vision by:

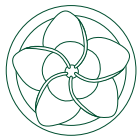
- Increasing general access to financial services among adult population from 75% to 85% by end of 2025
- Increasing access to formal financial services among adult populations from 47% to 65% by end of 2025;
- Increasing access to more than one financial product among adult population from 29% to 60% by end of 2025;
- Increasing access to financial services among adult women from 76% to 85% by end of 2025.

The FIRM targeted to achieve these outcomes by:

- enhancing formal financial sector infrastructure, encouraging competition, modernising regulation and reducing risks;
- extending financial services to low income households and least served groups; and
- facilitating well targeted credit to productive enterprises and farmers and for investment in assets.

The FIRM concluded by proposing five priorities to support these vision and outcomes, phrased as follows:

- Improving the availability and sustainability of credit;
- Consumer protection and empowerment;
- Strengthening village funds;
- Payment ecosystem development; and
- Extending the outreach of banks and other financial service providers (financial outreach).

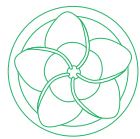
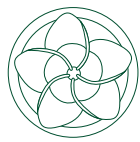


In terms of progress on implementation, table 4 and 5 reflects considerable success in several priority areas (including payments), most pronounced of which the strong enhancement of the regulatory environment and infrastructure of the payment ecosystem, where impressive progress has been achieved, including in terms of market development. This, despite the fact that the FIRM has been issued only relatively recently and that no governing structure to oversee its management and implementation has been set up. As will be discussed in section 4, the improvement of the enabling environment of the payment ecosystem has resulted in positive impact on the number and range of types of financial-service suppliers, distribution channels and payment-services offered and used.

As elaborated on below, the overall picture showing progress in other priority areas is more varied, with several planned activities being completed and others a work-in-progress. This is related to the nature of many of the activities, which had been planned for the medium or long term and couldn't realistically have been completed by now. Activities also include sub-activities or tasks. Table 4 summarizes progress in line with the overview given in table 5, and distinguishes activities that are a work-in-progress or have partially been completed. Cases in which there is insufficient information to make a clear assessment has also been noted. Of the 53 activities outlined in the FIRM, 10 activities have clearly been completed. Of the remainder, just over half of activities i.e. 22 activities have seen some level of progress, while 19 activities have not seen any progress so far (or have unclear progress). Some activities from the FIRM are also identified by this 2021 Refresh for continued implementation has as key priorities, based on their continued relevance (see section 6).

In addition to an overview of activities, Table 5 details the status of realization per planned activity as follows: if an activity has been achieved (1), has been partially achieved or is in progress (2), has not been achieved (3) or if the status is not clear (N).

PROGRESS PRIORITY:	TOTAL ACTIVITIES:	FULLY ACHIEVED:	PARTIAL/ IN PROGRESS:	NOT ACHIEVED/ UNCLEAR:
Improve availability and sustainability of credit	11	3	3	3
Consumer empowerment and protection	11	X	7	4
Strengthen village funds for sustainability and relevance to the rural population	9	1	3	5
Improve the payments ecosystem through improved payment infrastructure	17	6	6	5
Extend the outreach of banks and financial service providers	5	X	3	2

**Table 5: Detailed overview of FIRM Realization**

FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION		
1. IMPROVE AVAILABILITY AND SUSTAINABILITY OF CREDIT		
Regulatory	• Review impact of caps on interest rates on lending by FSPs	1
	• Require FSPs to consider the ability of borrowers to service debt on the basis of income rather than simply considering collateral	2
	• Introduce rules on product information disclosure and restrict using flat-rate credit	2
	• Improve effectiveness of credit information collection and sharing, by extending compulsory participation in and sharing information with the credit-information registry and requiring lenders to ascertain the credit record of borrowers before making new loans	2
	• Pay more attention to ability of borrowers to service debt on basis of cash flow	N
Financial institutions	• Develop new credit products especially those not dependent in collateralized lending	3
	• Develop insurance products to support credit (e.g. credit life and high-risk credit)	1
	• Develop MSME-credit through lines of wholesale credit, guarantee funds	1
Subsidized credit	• Develop refinancing linkages between FSPs (e.g. banks to NDT MFIs)	3
	• Review provision of subsidized credit by Government, with a view to reform that will help to reduce fiscal costs and improve credit discipline and impact effectiveness	3
	• Set to learn from international best practice	3
2. CONSUMER EMPOWERMENT AND PROTECTION		
Financial literacy	• Ensure that all formal FSPs report publicly, consistently and timely in accordance with legal requirements and that all relevant financial-sector statistics are regularly published	2
	• Encourage FSPs to develop financial literacy amongst their customers	2
	• Aim to integrate learning on financial literacy into the education system	3
Consumer protection	• Require dormant bank accounts to be transferred to BoL	3
	• Establish compulsory procedures in FSPs to deal with customer complaints	2
	• Extend depositor protection beyond banks to MFIs	2
Regulatory	• Ensure that all existing laws, regulations and guidelines and directives relating to the financial sector are publicly and readily available	2
	• Ensure that AML/CTF regulation is more effectively implemented	2
	• Introduce tiered KYC-regulations	2
	• Faster finalization of draft laws and regulations	N
	• Ensure consistency in regulatory requirements across different but similar types of institutions and consistency in interpretation of laws and regulations	N
3. STRENGTHEN VILLAGE FUNDS FOR SUSTAINABILITY AND RELEVANCE TO THE RURAL POPULATION		
Regulatory	• BoL should take regulatory and supervisory responsibility for the VF sector	2
	• BoL should establish a set of regulations, covering operating procedures, accounting and reporting requirements, cash and risk management, provisioning etc. applicable to all VFs, perhaps graduated and related to size	N
	• Delegate supervisory responsibility for smaller VFs (the majority) to regional support organizations	N
	• Develop regulations for VF-support organizations and supervise them	N



FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION


Developmental	• Mobilise broad-based political support for the objective of stabilising the VF sector and undertaking reforms, committing resources to ensure sustainability and fulfilment of potential	3
	• Utilize experience of GIZ-AFP project to roll out effective support and supervision mechanisms for VFs nationwide	2
	• Promote establishment of regional VF support organisations; or conversion of existing entities to more effective and properly structured support organisations	2
	• Establish third-tier organization for training and auditing	1
	• Consider Nayoby Bank as provider of wholesale credit to successful VFs	N

4. IMPROVE THE PAYMENTS ECOSYSTEM THROUGH MOBILE MONEY, DIGITAL-FINANCIAL SERVICES, AND IMPROVED PAYMENT INFRASTRUCTURE

Regulatory	• Finalise draft-MM regulations to provide more certainty in the regulatory environment for MM-service providers	2
	• Finalise a comprehensive legal, regulatory and reporting framework for payments, encompassing both core high-value clearing and settlement systems, as well as retail-payment service providers	2
Payment infrastructure	• Ensure that high-level settlement infrastructure (RTGS) is effective and functional, and require banks to participate	1
	• Establish clearing mechanisms for interbank payments instruments (cheques, EFTs) with appropriate data-communication channels)	1
	• Consider national switch linking banks, points-of-sale (POS) terminals, mobile companies etc, enabling payments functionality across channels.	1
	• Participate in regional (ASEAN) cross-border payments and settlement system	N
Mobile money	• Support mobile-money systems, get pilots up and running	1
	• Refine business models on the basis of pilot experience and move from pilot to nationwide rollout as quickly as possible	2
	• Ensure that agent networks function effectively, providing adequate liquidity for cash-out demands and mobile-money agents have convenient facilities for rebalancing cash and e-value.	2
	• Ensure that agent network penetrate areas beyond the current reach of banks	1
	• Encourage other banks and MNOs to consider MM products	1
	• Support cross-border mobile money (especially Thailand-Laos)	N
	• Introduce products linking mobile money to bank accounts	2
	• Facilitate cross-border mobile money	N
Developmental	• Consider the case for offering grants/subsidies to agents in more remote areas in early stages of mobile money development	N
	• Establish payment service providers association for discussion of issues of concern to industry	3
	• Promote interoperability between different mobile-money platforms and between non-bank mobile money providers and banks	2

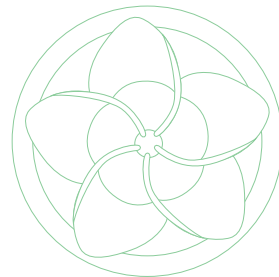
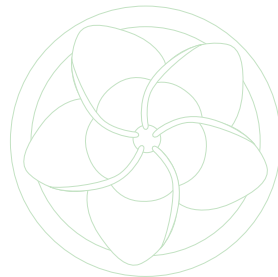
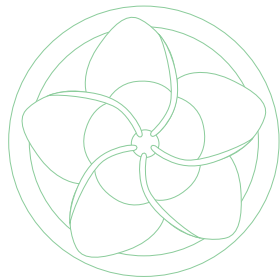
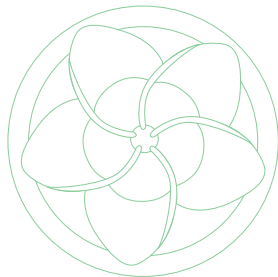
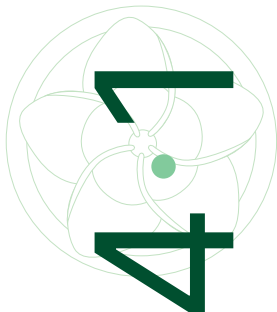
5. EXTEND THE OUTREACH OF BANKS AND OTHER FINANCIAL SERVICE PROVIDERS

Regulatory	• Remove regulatory barriers to the establishment of new branches by banks, MFIs and leasing companies, such as additional capital requirements	3
Products	• More innovation in product design, moving beyond traditional products, to those more suitable for low-income households	2
Physical outreach	• Financial institutions need to be more innovative in extending distribution networks through branches and non-branch channels	2
	• Investigate the potential for branchless banking using independent (third-party) agents, such as retail stores, who would provide banking services on behalf of banks.	2
	• Consider strategic alliances between banks and MFIs for better outreach	3



● 4

Supply-side analysis and findings



Formal financial-sector outreach

Increased financial-sector intermediation. Credit growth slowed down following years of rapid expansion, while banking-sector deposits continued to increase strongly, notably in foreign currencies. Compared to 2015, deposits are now more dollarized.

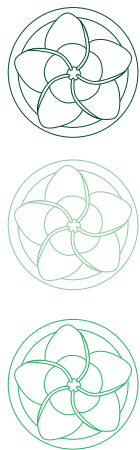
When portfolios denominated in LAK are further examined, a different picture emerges: credit in LAK continued to grow relatively rapidly, while the LAK-denominated loan-to-deposit ratio has remained high at 83%. Non-bank financial institutions (NBFIs), particularly the leasing sector, have developed rapidly from a low base and are catching up to banks in terms of outreach. Pawn shops continue to play a minor role. Expansion of formal payment-services is similarly high, coming from a low base, as further illustrated below in the section on the market for payments.

Table 4: Overview changes since MAP: Financial intermediation

NUMBER IN BILLIONS LAK	2014	2020	GROWTH%
COMMERCIAL BANKING SECTOR			
Credit portfolio value	51,292	78,238	53%
Deposit portfolio value	45,996	102,521	123%
credit portfolio / deposit portfolio	88%	76%	
LAK denominated-credit portfolio	20,597	38,226	86%
LAK denominated-deposit portfolio	23,040	45,803	99%
NBFIS			
All NBFIs credit	377	5,405	1333%
Of which: leasing sector	131	3,987	2943%
Of which: MFI sector	243	1,412	481%
Of which: pawn shops	3	6	100%

Source: Bank of Lao PDR's Annual Economic Report and supervisory departments.

Changes seem to reflect impact of regulations. While credit growth has slowed as a result of a variety of factors, including slower economic growth, increased perceived risks in the economy, lower public spending, and current levels of non-performing loans (NPL), the impact of regulations seems to be reflected in the data: The cap on interest rates on deposits had the greatest influence on the pricing of LAK-denominated deposits, particularly in light of the LAK's ongoing devaluation, resulting in the relative decrease of LAK-denominated deposits. The cap on the interest rate differential between credit and



deposit portfolios has contributed to the banking sector's credit rationing and slower total credit growth. The appropriate intervention of prohibiting foreign currency lending to firms earning income in LAK has slowed the growth of forex-denominated credit. In addition, in comparison to the MFI sector, the leasing sector has grown rapidly due to large-scale foreign direct investment (FDI) induced by the ability to own up to 100% of leasing companies, whereas foreign ownership of MFIs has remained limited to 30% of capital and has not resulted in FDI in any MFI.

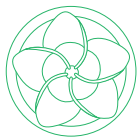
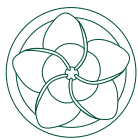
Relatively large and growing number of commercial banks. For a small market, Laos has a relatively large and growing number of commercial banks. A significant proportion are subsidiaries of foreign banks with limited operations in Laos, focused on servicing domestic-country customers from Thailand, the Republic of Korea, China, and Vietnam. Overall, commercial banks continue to show low returns and high capitalization, the latter but for some state-owned banks, while there are indications that NPL levels in some banks could be significantly high.¹

Table 5: Banking Sector Network

BANK TYPE	2014	2020
Commercial Banks	37	44
Branches	80	115
Service Units	358	538
ATMs	862	1,336
Policy Bank	1	1
Branches	10	10
Service Units	65	70

Source: Bank of Lao PDR Annual Economic Report and Policy Bank interview.

Strong growth of NBFIs, led by leasing companies. The NBFIs sector's outreach has grown strongly since 2015 but from a low base. As a result of its much stronger growth, credit-market outreach of the leasing sector has taken over that of the overall MFI-sector, or all deposit-taking MFIs (DTMFIs), non-deposit-taking MFIs (NDTMFIs) and savings and credit unions (SCUs) combined.² What is more, the leasing sector's growth has been realized with a significantly lower number of physical outlets but similar numbers of staff and credit officers overall. So far, NBFIs have not engaged agent networks to expand their network.

**Table 6: NBFIs balance sheet and portfolios and distribution networks 2020**

PORTFOLIO INFORMATION (2020)	DTMFI	SCU	NDMFI	LEASING CO.	PAWN SHOP	TOTAL
Credit portfolio (billion LAK)	1,089	119	204	3,987	6	5,405
Number of borrowers	64,574	10,755	22,447	101,118	1,394	200,288
Deposit portfolio (billion LAK)	1,216	126	93	-	-	1,435
Total # of depositors	205,934	33,878	33,812	-	-	273,624
Number of Institutions	21	27	81	29	30	188
Branches	16	-	12	11	-	39
Services Units	34	10	19	11	2	76

Source: Bank of Lao PDR Financial Institution Supervision Department

FDI and consumer demand driving leasing sector growth, but LAK denominated lending causing issues. FDI and urban demand for consumer goods, such as vehicles and smart phones, have propelled the leasing sector's rapid growth. In addition, powerful foreign financial-services groups invested in the leasing sector, due to strong growth in consumer finance and low minimum capital requirements of LAK 0.5 billion. The groups expanded by applying institutional capability and proven market approaches in Laos as a foundation for their success, enabled by their financial strength. However, as leased items are purchased in foreign currency, the depreciating LAK has caused challenges for leasing companies, which' credit portfolio has to be denominated in LAK.

Table 7: Leasing-sector networks and outreach growth 2014-2020

LEASING SECTOR	COMPANIES	CREDIT PORTFOLIO (M. LAK)	# LOANS	AVERAGE LOAN SIZE (M. LAK)
2014	16	130,796	7,567	17.3
2020	29	3,987,000	112,035	35.6

Source: Bank of Lao PDR Financial Institution Supervision department

Significant growth in the licensed and registered MFI sector. The MFI sector has grown significantly in terms of number of MFIs, number of depositors and borrowers, and total credit portfolio value. The larger average loan sizes for all types of MFIs reflect the regulatory allowance to issue loans up to LAK 50 million, up from LAK 10 million earlier. Slow expansion of NDTMFI's portfolios reflects the limit on borrowing beyond 30% of their loan portfolio, largely reducing NDTMFIs to lending based on paid-up capital. From a prudential regulatory perspective, there is no need for such regulation as no risk is posed either to assets of the public nor to the financial system overall. Rather, the NDTMFI has been purposely designed to offer a low threshold to professional investors in the form of low-capital requirements and allow leveraging by attracting liability funding from professional parties.



MFI sector highly concentrated. The MFI sector is highly concentrated, with three MFIs accounting for about 50% of the total loan portfolio and number of borrowers. They also account for over 60% of the total depositors. Lending to salaried people based on salary-guarantees and automatic monthly transfer of instalments by HR departments of the relevant Government agency dominate as market approach by these largest MFIs and several others, followed by lending to traders on commercial centres or markets in urban setting in nation, provincial and district capitals.

Table 8: MFI-sector networks and outreach

ALL MFIS	TOTAL	CREDIT PORT (M. LAK)	# LOANS	AVG (M. LAK)	# DEPOSITORS
2014	67	243,348	41,537	5.9	159,126
2020	129	1,412,000	84,263	16.8	273,624

Source: Bank of Lao PDR

Non-bank payment-service providers and agents

Expansion of payment landscape. The landscape of formal FSPs has also been extended by *licensed non-bank payment service providers* (NBPSPs) and *agent networks*, based on the Law on Payment Systems, and a series of follow-up regulations and individual approvals issued and overseen by a Payment Systems Department (PSD) that has recently been established in BoL. So far nine NBPSPs have been licensed to offer various types of mobile and electronic-payments services and mobile-money, next to 39 banks, and several banks and NBPSPs have received individual conditional approvals to operate through agent networks.³

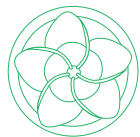
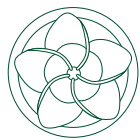


Table 9: PSD licensing of services

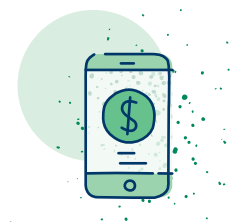
TYPE OF SERVICE	BANKS	NBSPS	TOTAL	REMARK	
Card payment	19	-	19		
Electronic money (e-wallet)	6	4	10		
Electronic-money transfer	39	3	42		
Electronic acceptance of payment	Acquiring (QR Code)	22	4	26	E.g.: WeChat Pay, Alipay, UnionPay, EDC/POS
	Bill payment	17	3	20	e.g. Utilities, road tax
Agent networks		1 (BCEL)	2	3	M Money: 319 agents
					BCEL: 881 agents
					U Money: 8,519 agents

Source: Bank of Lao PDR Payment Systems Department

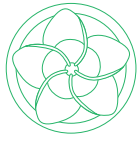
Banks still dominate payment landscape. The largest bank of the country by assets, state-owned BCEL, is thought to be the dominant actor when it comes to electronic payments through its BCEL-One mobile-payment platform. BCEL-One applies facial-recognition and an e-wallet called *OneCash*, which enables payments through social media. BCEL also operates BCOME, an agent-distribution network that enables a range of money-transfer, payment and cash-in and out services.

NBSPs mostly selling air time top ups, but have better outreach. Most prominent among the NBSPs is Start Fintech,⁴ which was licensed in August 2019 to operate as *U-Money* providing e-money, bill-payment and money-transfer services and works through 8,519 agents nationwide (2020), mainly top-up cards selling agents and *customer-service units* of Star Telecom, its mother company. In the slightly-over-two-year period since its inception, *U-Money* in particular has achieved significant outreach in terms of the numbers of people that have downloaded its mobile-money app and have made at least one transaction. Overall, by the second half of 2020, unofficial data reported 1.9 million app-downloads and digital-wallet openings for all e-money providers combined with almost 480,000 people making at least one transaction every 90 days; of those, *U-Money* were said to have made up some 25%.

Other payment service providers also taking off. In the meantime, the second largest MNO, Lao Telecom, has established its dedicated subsidiary under the name M-Money in 2019, which received its license in July 2020 to offer e-money, bill payment and money-transfer services and works through 318 agents nationwide (2020), which consist of branches or customer-service units of Lao Telecom, its mother company, as well as outlets of some banks including Agriculture Promotion Bank and Joint Development Bank. M-Money reported 50,000 consumers and 10,000 merchants to have downloaded its app and monthly total transaction value of about LAK 3 billion to LAK 4 billion in over 60,000 transactions.



Overall, by the second half of 2020, unofficial data reported 1.9 million app-downloads and digital-wallet openings for all e-money providers combined with almost 480,000 people making at least one transaction every 90 days; of those, U-Money were said to have made up some 25%.



LAP Net and its role. Towards the future, participation of NBSPs in LAP Net and generally LAP Net’s approach to providing a public service to allow and enable interoperability between banks and NBSPs will be important in extending outreach of effective payment services to the Lao population.

Agents. Until now, no specific regulation governing agent involvement has been developed, and approvals have been granted on an individual basis with constraints and cautions attached, in order to balance the need to stimulate outreach expeditions while also learning from experience. FSPs are made totally liable for the acts of their agents as part of conditionalities connected to approvals, and they must establish a Dispute Resolution Procedure and an associated Hotline to report problems, both of which must be staffed by at least two full-time persons. The development of guidelines for agent networks is presently underway.



Until now, no specific regulation governing agent involvement has been developed, and approvals have been granted on an individual basis with constraints and cautions attached.

Village Funds

Village funds (VFs) are ubiquitous as a result of donor support and government promotion. As seen in MAP (2015), in over 25 years semi-formal village-based funds (VFs) have been set up in roughly half of all villages, most financially sponsored by donors and promoted by Government at various levels.⁵ VFs are based on bylaws, employ basic, lowly reliable, paper-based administration, can’t meet basic reporting standards and operate outside the regulatory and supervisory scope of BoL.⁶ Currently, most VFs have been funded from member contributions as village-savings and loan funds (VSLFs).

Table 10: Data on VFs - GIZ-AFP and Lao Women’s Union

	# VILLAGE	# MEMBERS	FUNDS MANAGED
GIZ-AFP	831	192,230	LAK 436 billion
LWU/Other	2,826	342,498	LAK 287 billion
Total	3,657	534,728	LAK 723 billion

Source: GIZ-AFP Project Management and Lao Women’s Union Development Department

FIRM prioritized support to VFs on the presumption that the GIZ-AFP project had shown VFs can be successful and sustainable. The FIRM established that generally VFs are *unsustainable* and that members are at risk of losing their life’s savings. Despite this conclusion it proposed strengthening VFs in order to enhance their sustainability and relevance to the rural population, on the presumption that GIZ’s AFP project, which FIRM stated comprised 10% of all VFs, had shown that VFs can be successful and sustainable, with appropriate support and supervision through regional apex organisations.⁷

GIZ-AFP’s project’s VF system is neither financially nor operationally sustainable. It has since become apparent that, like other VFs, the GIZ-AFP’s project’s VF system is neither financially nor operationally sustainable and suffers from fundamental, endemic and pervasive problems.⁸ Among other elements, the analysis of sustainability hadn’t considered the many million’s



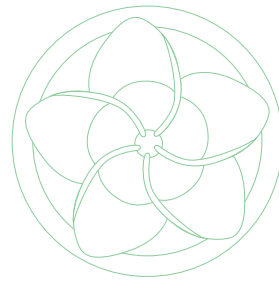
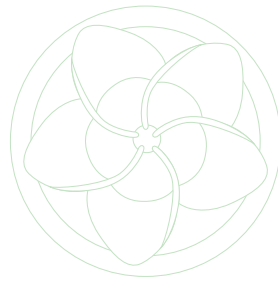
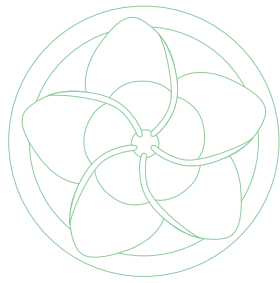
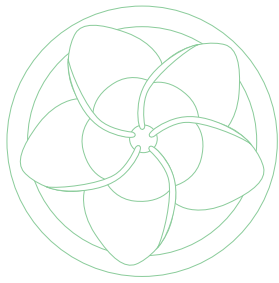
worth of funding of setting up and monitoring the project-based VF system and reliance on project-hired international and national experts. In the meantime, it has become apparent that the AFP-VF system, as other VFs in Laos,⁹ suffers from endemic, pervasive operational and financial problems, which will continue to lead to high risks for their continuity and members' savings and can't be considered to meet "do-no-harm" donor guidelines.¹⁰ Design of structure, management and operations is based on bylaws, lacks crucial elements of *good governance* and isn't properly embedded in the legal and financial-sector regulatory framework. The VFs aren't managed on a professional basis and prone to elite capture and outright fraud. The rewards system strongly incentivises loan issuance without adequate consideration of return on the activity funded, repayment capacity nor portfolio quality.

VFs don't intermediate financial resources effectively to support economic growth. Rural households primary need in terms of financial services is for liquid savings stored safely. As economic opportunities in rural areas are scarce, most VFs have savings that aren't intermediated beyond village level, where the loan portfolio suffers from idiosyncratic risks, on top of risks mentioned in the previous paragraph. If made in the banking sector, savings would be intermediated to places, in sizes and durations and to borrowers where they would more effectively produce socio-economic return to society and savers alike.

Proper supervision isn't feasible and a questionable use of scarce resources. Most VFs can't produce basic, reliable data on their performance nor meet basic regulatory reporting requirements that would allow for their supervision. As VFs are based on *bylaws* that have been agreed upon *voluntarily* by villagers with the involvement of village authorities, the legal and political scope for their supervision is not clear. In practice effective regulation and supervision of VFs has shown to be less than realistic. As village funds are ubiquitous and spread out all over the country, the practical and logistical implications of an attempt at supervision would be prohibitive and be at the expense of supervision of licensed institutions, resulting in a doubtful trade-off. Furthermore, if the financial-sector authority would take on the responsibility for VFs, the failing of some VFs that would likely occur could undermine BoL's authority.

Continued support to village funds undermines both sustainable, regulated sector building and credit culture. The investment made into the VF system are *sunk costs* and don't warrant consideration in a long-term strategic approach. Continued favouring and sponsoring of VFs doesn't support enabling healthy ecosystems of well-regulated professional FSPs and negatively impacts credit culture.

There is a need for an emergency plan for GIZ-AFP VSLFs. The GIZ-AFP VF systems have been registered and licensed by BoL, even while not fitting requirements and objectives of applied regulations. In effect, there is a joint fiduciary responsibility for GIZ and BoL for the savings made by rural villagers and a joint stake in carefully guarding the VFs' future. As GIZ's exit is set for May 2022 without a properly founded and elaborated exit strategy, there is an urgent and immediate need for a plan to ensure the safety of the savings of GIZ-AFP VF members, requiring external grant funding to ensure continued intense monitoring. For the middle and longer term, there is an urgent need for the elaboration of a plan of transformation of existing GIZ-AFP VFs, requiring full transparency towards VF-members on the status and possible scenarios and choices for the future of their VFs, including voluntary managed dissolution. Such a plan should investigate options for smooth transition of VF-members to set up or become clients of formal FSPs.



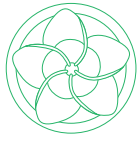
The formal financial sector and its regulatory environment

Increasing supervisory demands despite increasingly solid and comprehensive regulatory foundation and supervisory processes. Increasingly solid and comprehensive regulatory foundation and supervisory processes have been built over time. The positive results are evident with strongly increased numbers of regulated FSPs and outreach in terms of distribution networks and uptake in all product markets. Yet the same strong growth of the number of formal FSP and their outreach pose increased supervisory demands on the sector authorities. Laos' formal financial sector and its services have grown at such a rapid pace, the demands on the regulator have grown significantly, both in its fiduciary role as the authority responsible for ensuring a level playing field and a healthy sector, and in its role as protector of consumer interests. The large number of over 60 new regulations relevant to banks and NBFIs that have been enacted since 2015 could be interpreted as reflecting both this demand and the rule-based method used to meet it.

In this new market environment, a more risk-based approach to regulation and supervision could be most effective. With a larger number of FSPs and growing outreach, the risks posed by FSPs and their operations, the costs associated with oversight, and the need to enhance financial inclusion should best be carefully considered and balanced. Internationally, regulators have gradually adopted a risk-based method as recommended by the Bank of International Settlements. Compared to a rule-based approach, the risk-based approach views risk management as a more collaborative effort and responsibility shared by regulator and sector, and is considered a more effective and efficient method of supervision. In BoL, the PSD appears to apply such approach, where, in the absence of detailed regulations and in close collaboration with applicants, individual licenses are granted with conditions limiting risk in order to test novel approaches, products, distribution channels, and modes of operation. The PSD and FSPs alike can benefit from the implications for prudential oversight and consumer protection.



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FSP eager to strengthen constructive communication with regulators. In Laos across the board FSPs are eager to engage in regular, timely, open communication lines and feedback loops with the financial sector authorities to ensure effective risk management and reduce undue negative regulatory impact for regulator and financial sector. Qualitative interviews with financial-sector professionals revealed that FSPs are keen to engage in such constructive discussion and cooperation, believing that it has the potential to improve results for the regulator, FSPs, and the economy as a whole.

Despite strong formal-sector growth, semi and informal finance remain prevalent. Informal and semi-formal financial-service provision have remained prevalent and, in the case of semi-formal provision actively promoted.¹¹ Semi and informal financial services are common in developing financial sectors and normally over time gradually replaced by well-regulated, professional FSPs. While regulated markets emerge and develop, some semi-formal providers are able to professionalize and become part of a more permanent financial sector infrastructure while most simply dissolve. Regulators and providers in the financial services sector typically grow together over time, as does the regulatory and supervisory framework, which is updated over time to ensure that regulation remains relevant and effective as markets evolve and their essential characteristics change. Continued favouring and subsidization of semi-formal VFs is considered counterproductive in the current market climate, with an increasingly effective regulatory and supervisory framework in place and a wide range and big number of competitive, professional FSPs having entered the market.

The Lao National Chamber of Commerce and Industry plays an increasingly important role in private and financial sector development. The private-sector operated Lao National Chamber of Commerce and Industry (LNCCI) organizes the leading platform for advocacy and private-public sector dialogue named the Lao Business Forum (LBF). The LBF's finance-sector working group (FSWG) is the key conduit for high-level financial-sector advocacy and has contributed to key regulatory improvements and raised high-level awareness for others. It recommended lifting the cap on the spread between interest rates on deposits and credit, which happened in 2019. Other issues brought to the table include easing of collateral standards and fees; registration requirements for credit documentation and security agreements; and improvement of the services of the Lao Credit Information Company (LCIC). The LNCCI further organizes technical assistance for MSMEs on administration and loan application in its SME Service Centres, enables partnerships between FSPs and MSE borrowers and is setting up an angle-investor network.

The LBF has enhanced effectiveness of industry associations in fostering financial inclusion. LBF's approach involves ensuring comprehensive and detailed technical analysis of issues by external professional experts, supported by data collected by the Lao Banks Association (LBA), Lao Microfinance Association (LMFA) and FSPs. Issues brought forward are accompanied by public, concrete



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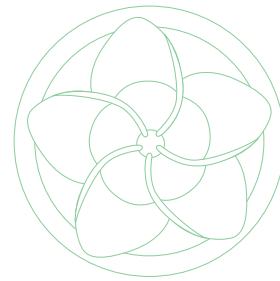
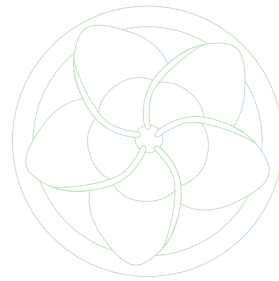
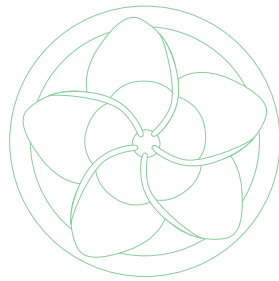
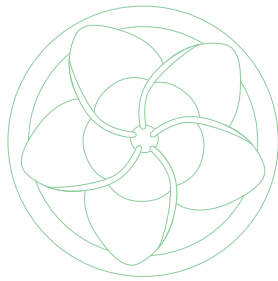
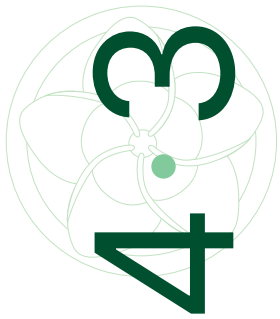


and detailed proposals for modification of existing policies and regulations, proactively managed by LNCCI. The LBF has the potential to enhance the effectiveness of LBA and LMFA as sector advocacy platforms.



Industry associations so far have played a moderate role in advocacy. So far, direct advocacy efforts of LBA and LMFA has been moderate in scope and effectiveness despite periodical meetings with the regulator, as politically sensitive issues are foregone. This seems to be at least partially driven by a level of ambiguity as to the role as representative of their members versus that of the regulator. Driven by external-donor funding, the LMFA has started to provide services to development agencies, away from their member-MFIs, on initiatives that are considered at odds with building inclusive financial systems. The Insurance Association mainly drives on voluntary input from insurance companies' management, with one staff for secretarial and admin functions, while the leasing sector has halted establishment of an industry association because of procedural challenges. Since December 2019, an embryonic association for SCUs have also been established (LASCU), with the support of ACCU and DGRV Germany.





Savings

Savings most relevant and demanded type of financial services, particularly informal savings. Both in terms of the functionalities offered and in terms of uptake, savings are the most relevant and demanded type of financial services in the population: whereas only 20% of adults borrowed, 77% of adults had savings (2014). Of people with savings, Finscope measured that only 34.6% saved in a formal FSP, 19% in a semi-formal village savings-and-loan funds (VSLFs)¹², while remaining mechanisms used were informal and in-kind. Of those making savings in the formal-financial sector, 33% did so in a bank, 1% in MFIs, 0.4% in an SCU and 0.2% in the Postal Savings Institute.

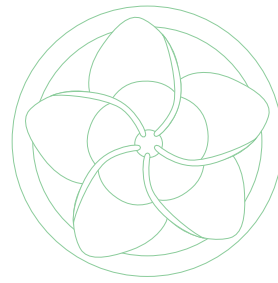
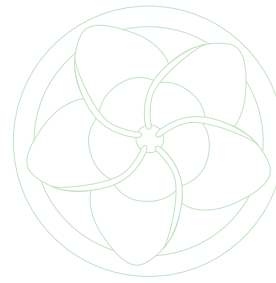
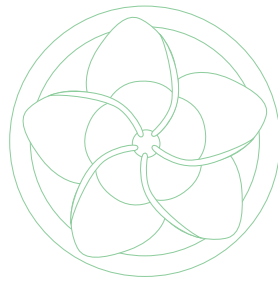
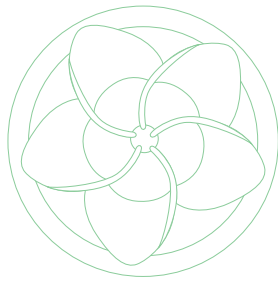
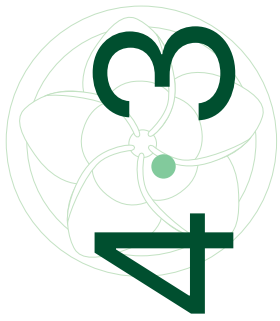
Formal and semi-formal savings growing, skewed by one MFI. Both formal and semi-formal sector outreach in savings markets have grown in absolute sense (see Section 4.1).¹³ However, this is in part driven by one MFI, which runs a targeted school and children's savings program accounting for 25% of all savers in DTMFIs. The average value of MFI savings is LAK 5.2 million per depositor, although a minority of depositors account for most of the depositor value. For instance, 93.4% of DTMFI depositors account for just 12% of DTMFI deposits. For this group, the average deposits is a mere LAK 794,000 (USD 80), suggesting these are made by the low-income households that constitute the target for financial inclusion efforts.

Savings in VSLFs are made at significant risk and low levels of accessibility. Average savings made in GIZ VSLFs are almost double that of DTMFI's liquid savers at LAK 1,427,000 (USD 140) while the VSLFs have achieved massive outreach, higher even than that of formal MFIs, because of donor support to the semi-formal sector. However, savings in VSLFs are exposed to idiosyncratic risks, low-quality loan portfolios, low levels of accessibility and liquidity, and are not covered by any form of deposit protection.

Potential to leverage remittances for savings. Remittances by labour migrants are often a first entry for rural folk to pro-actively seek information about and engage with the formal financial sector, because of the need to send money home to their families and dependents. These payment modalities provide an entry point which if properly followed up on, can lead to opening of savings accounts and generally to a previously unbanked person to start engaging with the formal sector. Labour migrants are therefore a prospective target market segment for savings, and pre-departure information and support by banks has the potential to positively influence uptake by the labour migrant and their families.



Of those making savings in the formal-financial sector, 33% did so in a bank, 1% in MFIs, 0.4% in an SCU and 0.2% in the Postal Savings Institute.



Payment services

Banks are continuing to extend the use of digital means of financial-service distribution and payment via apps and other applications, with the majority of their reach thus far concentrated in urban economic areas and among the technologically sophisticated. In particular BCEL has been successful through use of its BCEL One mobile-banking app but many others are following swiftly. Banks are likely to aim greater extension of their digital money and mobile-financial services as a way to establish client-track records, minimize information asymmetry, lower distribution costs, and obtain finance in the future. Because Laos is primarily a cash-based culture with limited financial management capabilities, the expansion of DFSs and MFSs is likely to be a long-term project.

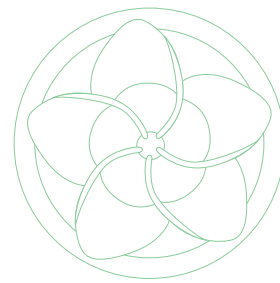
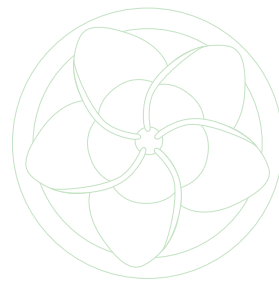
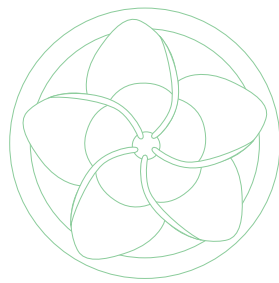
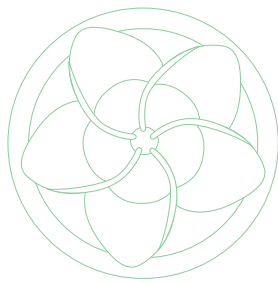
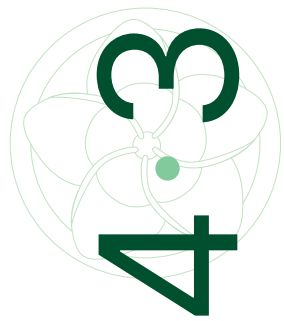
Uptake of digital services increasing and driven by urban centres. Electronic payments and e-money have thus far been welcomed by the urban, well-educated, and relatively tech-savvy population of downtown Vientiane Capital. Successful use cases include the ability to pay road taxes via the largest state-owned bank, BCEL; payments for food delivery and taxi services; and QR-code payments in coffee shops and restaurants.

Recently, the government and private sector have begun piloting large-scale payroll and social security payments through digital channels. It will be interesting to watch how this affects the use of mobile money and payments. In the future, the true test will be to observe an expansion of outreach outside Vientiane's downtown capital, as MNO branch and agent networks are more mobilized and use-case tested. The NBPSPs will face competition from numerous commercial banks, whose mobile apps offer many of the features offered by the NBPSPs.

Easy availability of cash in cash-out mechanism remains important for uptake for some time to come. Due to the fact that Laos is a cash-based society in which the general population is more comfortable and habituated to conduct numerous daily transactions in cash for living expenses, easy access to cash-in and cash-out stations will be critical to boosting adoption following the rollout of agent networks and establishing trust and acceptance among the target audience of people living outside downtown Vientiane Capital who are less literate and tech savvy.



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Credit

MAP (2015) indicated little positive impact of credit, high levels of indebtedness and low financial-management capacity.¹⁴ In 2015, 43% of people that had borrowed didn't consider their lives to be improved as a result. Further indicative of the negative impact of credit, 80% of Lao adults hadn't borrowed, mainly because of fear for being in debt (53%) or not being able to repay (24%). Income-to-debt-service and asset-to-debt ratios of low-income farmers (25% of adults) and low-income entrepreneurs (9% of adults), together making up one-in-three Lao adults, indicated high-levels of *over-indebtedness*.¹⁵ These numbers should be further appreciated against a background of a population of which 78% of adults found it difficult to very-difficult to keep up with financial commitments and of which 50% identify the lack of income as main reason for not engaging in planning of their financial situation. The latter result hints at low levels of financial capability, further evidenced by a high 68% of Lao adults feeling they need more information about managing money.

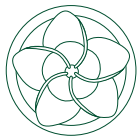
Income levels for many households and enterprises don't allow for effective, responsible use of productive or consumer credit. As seen in more detail in section 5 below, household and enterprises income levels are generally low. In the past, debt finance has too often been issued beyond levels warranted by repayment capacity, production and income risks, and financial-management capacity, leading to over-indebtedness and high NPL levels.

Need for better assessment of repayment capacity and productive credit use.

There is an overarching need for the regulated financial sector to focus on accessing borrowers' repayment capacity and more effectively support economic growth by allocating resources to economic ventures that produce highest return for society. Such over-crediting was made possible by low attention to repayment capacity assessment and responsible lending. Instead, lending has been characterized by practices of relationship, collateral and (salary)-guarantee-based loan allocation, and top-down, indiscriminate targeting of geographical areas or sub-sectors of the economy with loans on concessional conditions. Low attention to repayment capacity by the formal sector resulted in the fact that profitability of an enterprise and the likelihood to get a loan are not related and that for successful enterprises, lack of access to finance continues to be a main constraint, only topped by the lack of available well-capacitated staff.¹⁶ To ensure FSPs can most effectively support economic growth and employment generation, the formal-financial sector should gear towards cash-flow and income-based loan allocation decision making.



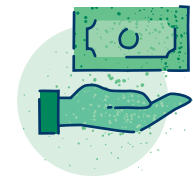
Further indicative of the negative impact of credit, 80% of Lao adults hadn't borrowed, mainly because of fear for being in debt (53%) or not being able to repay (24%).



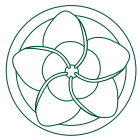
Missing middle can be served by banks and leasing companies. The bulk of enterprises in Laos have low-levels of assets and paid-up capital. For instance, for 92.5% of enterprises, paid-up capital is below LAK 100 million and for 73.1%, it is below one million. In addition, for 91.7% of enterprises total asset value is between LAK 10 million and LAK 500 million, and for 76% it is less than LAK 100 million.¹⁷ This suggests a range for MSME-loan sizes of between LAK 5 million and LAK 500 million, using basic rule-of-thumb cut-off values for debt-to-equity ratios in MSME-lending. However, the bulk of suggested loan sizes would be below LAK 200 million and even LAK 100 million. As MFIs are allowed to issue loans in sizes up to LAK 50 million but actual averages are around LAK 20 million, MFIs can only partially service the MSE segment. At the same time, most banks' minimum loan sizes start at LAK 100 to 200 million, right above the level demanded by the bulk of MSMEs. The proverbial missing-middle in SME lending in Laos is therefore roughly determined by loan sizes of between LAK 50 and LAK 200 million and can only be filled in by banks and leasing companies with a strategic, dedicated focus on servicing this market segment.

Few FSPs have the strategic focus and institutional expertise to successfully service the small enterprises that dominate economic production, income generation and employment. Successful lending to small enterprises demands specific management and technical expertise. Building related institutional capacity is difficult, takes time and requires a dedicated strategic focus. Information asymmetry challenges are higher and loan size smaller, resulting in higher costs and risks compared to loans for larger, formal enterprises.¹⁸ Over time, the regulatory environment in particular for banks has been uncertain with regard to the allowance for market-dynamics to determine pricing of risks and costs, and generally with regard to the allowance to implement a dedicated strategy to service smaller loan-size market segments. MFIs and leasing companies so far have primarily focused on salary-guarantee based lending. As a result, credit delivery to economically-active households and the bulk of (small) enterprises has seen little effective market-based provision.

Successful small-enterprise lenders deal with information-asymmetry challenges as they present themselves. The Information asymmetry between lender and borrower constitutes a main challenge that requires careful, labour intense scrutiny of loan applicants. As income and expenditure data and financial statements are lacking, and transactions are made in cash, the burden is on credit officers to carefully reconstruct an income statement of prospective borrowers and verify his socio-economic situation. FSPs that are effective have the core capacity to assess the repayment capacity of loan applicants as-is, without requiring financial statements or extensive application procedures and transaction documentation on the borrower's part; they are aware of their borrowers' socio-economic lives and willingness to repay; and they develop the necessary capacity within their organizations. They don't rely on a working credit bureau or credit guarantee organization but build a strong first line of defence against delinquency within their own organization.



MFIs and leasing companies so far have primarily focused on salary-guarantee based lending. As a result, credit delivery to economically-active households and the bulk of (small) enterprises has seen little effective market-based provision.



Some banking-sector regulations and their abrupt introduction have constrained credit delivery to MSMEs. In 2015, the interest cap regulation was imposed abruptly, limiting banks' ability to lend to successful and growing MSMEs and encourage inclusive economic growth. The (enforcement of) legislation limiting lending in foreign currency to businesses that earn revenue in that currency was particularly appropriate and timely, given the LAK's dropping value. However, the unannounced nature of the measure led to banks incurring losses on forex-denominated long-term liability funding acquired to invest in credit portfolio growth. The interest-rate cap on deposits was withdrawn with a caution not to hike rates excessively or the cap would be reinstalled. In effect, banks are unable to use pricing as a tool, resulting in a current shortage of LAK-denominated deposits for FSPs focused on MSME lending, exacerbated by low interbank intermediation and challenges foreign lenders face when targeting to provide LAK-denominated debt. As a result, FSPs focused on MSMEs lending are faced with the need to ration credit and reduce loan portfolio and network growth targets.¹⁹

Towards the long-term future, FSPs seek to use electronic-payment track-record building as a means to reduce information asymmetry. The strong growth of the digital-payments ecosystem and expected retail-level digital payments in the longer-term future, enables FSPs to establish track records as a basis for information-asymmetry risk reduction and, as a result, enhance the quality and lower the cost of loan-allocation decision making, thus stimulating MSME lending.

The Lao Credit Information Company functions as online credit registry that consistently increases outreach. The LCIC is a BoL-owned separate legal entity that operates the online credit registry for formal FSPs, which used to be operated as a department of BoL's BSD. Supported by IFC, over time the registry has enhanced its infrastructure and outreach. With 19.8% of the adult population currently covered, it outperforms the SE Asian region's Ease of Doing Business 2020 average of 16.6% and is not far below the OECD's average of 24.4%. Of the total of 884,034 adults covered, 29,645 are businesses, which implies that 22% of all businesses in Laos have a credit record. The registry currently cooperates with 41 banks, 15 leasing firms, 52 NDTMFIs, 9 SCUs, and 9 DTMFIs, covers loans of all sizes and updates data monthly.

The Government, finance and business sectors have made urgent demands for enhanced quality of credit-information services but the LCIC struggles with basic capacity and data quality issues. LCIC's staff used to work in the IT Department in BoL and lack background in building a credit-information company. The capacity of LCIC's existing database and software systems are limited. Current online credit-registry services offered by the LCIC are appreciated by formal FSPs, but data are uploaded manually and not cross-checked, posing quality issues. Notable external challenges for the LCIC include the multiple and often paper-based ID and registration systems applied in Laos, resulting, for example, in different spelling of names and addresses for the same individual or firm, not recognized by FSP and LCIC systems. To enhance scope and quality of LCIC's services, the LCIC require capacity-development support yet, despite offerings from development partners, haven't been able to agree on such support.



FSPs focused on MSMEs lending are faced with the need to ration credit and reduce loan portfolio and network growth targets.



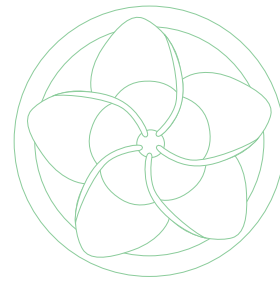
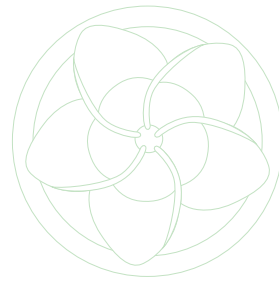
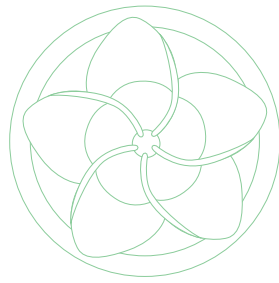
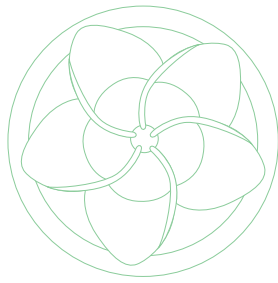
Subsidized lending remains a dominant strategy in MSME, rural and agricultural finance.

The FIRM contains recommendations for review of the provision of subsidized credit and for learning from international experience, planned to be followed-up on in the short term. However, subsidized lending has remained a main conduit for MSME, rural and agricultural lending, implemented by MSME wholesale-lending platforms, such as the Small and Medium Enterprise Promotion Fund (SMEPF) and the USD 300 million concessional financing from the Chinese Development Bank managed by BoL. Subsidized lending was noted in the NSEDP as a means of promoting agriculture and will continue to be employed in donor-funded village credit programs, state-owned agricultural promotion and policy banks, and a variety of commercial banks and MFIs that have borrowed from the platforms listed.

Phasing out subsidized lending would require strong political support and fundamental assessment of impact. For subsidized lending to be truly phased out and be replaced by a healthy, market-based financial system, there should be political support to such an approach that could benefit from experiences with subsidized-lending approaches elsewhere. Secondly, as subsidized-lending has been institutionalized over time and impacts food-production, incomes and social-support systems, responsible phase out requires a gradual, balanced approach that replaces subsidies channelled through the financial sector with alternative, more effective ways of subsidization. This requires an assessment, which should focus on the desired economic and social outcomes as a starting point, and include an assessment of direct and indirect, short and long-term costs and benefits of the current approach if compared to alternatives, from a perspective of real economy outcomes. More effective and efficient economic production often hinges on a range of real economy and regulatory aspects that require restructuring before finance can be employed effectively.

Current MSME-wholesale lending approaches are focused on larger enterprises and don't support wholesale-lending market development. The FIRM prioritized MSME-wholesale lending as a way to enhance access to MSME-credit services. Indeed, access to LAK-denominated liability funding is a constraint for banks and leasing companies, and to a lesser extent MFIs.²⁰ Apart from the project-based *Lao Access to Finance Fund* housed at BoL however, conditions applied by wholesale-lending platforms only allow borrowing banks and MFIs margins of between 1.5% to 3%, which aren't sufficient to cover operational costs, and require much-below-market interest rates to be charged to MSME borrowers. As a result, the wholesale and retail loan-allocation processes have become blurred by non-market-development-based considerations and criteria, and have attracted FSPs that don't have a dedicated MSME-lending corporate strategy and focus on larger enterprises, not the MSEs that are most excluded.

Shortage of LAK-denominated funding for banks and leasing companies. Currently, in particular banks and leasing companies with a strategic focus on the *MSE market segment* have to reduce projections of growth of their outlet network and credit portfolio because of structural constraints to LAK-denominated liability funding. Within the overall shortage, the shortage of longer-tenure funding is most pronounced. In order to deal with the situation, it is recommended to enable an environment that allows MSME-lending banks and leasing companies to access LAK-denominated funding in the form of deposits (only for banks and DTMFIs), borrowings in the interbank market or in the form of corporate bonds, based on the notion of market dynamics determining pricing.



Insurance

Risk mitigation is an important motive in socio-economic household management in Laos, yet there is little awareness around it, with minimal uptake of formal insurance products due to lack of cultural appetite or concrete demand. However, as a positive result of bold Government decision making, strong progress has been made in the uptake of formal public-health insurance while coverage of the social-security system has been growing steadily if slowly.

Public Insurance Sector

National Health Insurance System covers most of the population. Since 2016, the Government has made a series of bold, coherent decisions to restructure the public health-insurance system, which combined, resulted in a spectacular increase in coverage to 94% of the population, up from 29.8% in 2014. A first key decision was to consolidate all existing public-health insurance systems in one system, the National Health Insurance system (NIH). As part of the restructuring and consolidation, health-care insurance that used to be provided as part of the larger social-security package offered through the National Social Security Fund (NSSF) to civil servants and the formally employed, is now provided via the NIH. Secondly, the mandate and authority to manage the NIH has been allocated to a dedicated and specialized National Health Insurance Bureau (NHIB). The Government also decided to fund the NHI from the national budget and offer universal-health coverage for all Lao citizens. For the Lao population, the new NHI means that they can get in and out-patient treatment at public-health facilities nationwide for very small fees, while the poor and vulnerable, such as pregnant women and children under the age of five, are exempted even from making these fees. Currently, levels of awareness around the extension of coverage among the population and uptake are following the high level of coverage (Also see section 2.4)

National Social Security Fund coverage is low. A different picture emerges when looking closely at outreach of the social-security package for formal employees in the public and private sectors, and voluntarily insured among the self-employed: NSSF outreach has been growing steadily but slowly. According to numbers provided by the Lao Social Security Organization (LSSO) for 2020,



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a total number of 1,068,873 people were insured by the NSSF, or 15% of the population, up 19% from 2015. Of this, 314,753 were primary insured and the remainder are family members. Virtually all public-sector employees were insured and as a group make up 57% of individuals covered by the NSSF. Private-sector employees and the voluntarily insured who are covered by the NSSF, together make up only 8.4% of the total number of private-sector employees identified in the Workforce Survey. The low coverage is the combined result of low-levels of compliance by enterprises with the legal obligation to register with the Lao Social Security Organization and high-levels of informal employment, i.e. people working without a formal-labour contract in accordance with the law: Only 1.9% of the total enterprise population have registered and only around 17% of employment is estimated to be formal.

Private Insurance Sector

Rapid increase in number of insurance providers. After a long period of private-insurance supply being dominated by a single provider, over the last decade the number of private-insurance companies has grown exponentially to a total of 22 licensed providers currently. Since opening of the private insurance market in 1990, for many years the local subsidiary of international insurance conglomerate Alliance, Allianz General Laos (AGL), was the single provider and until a decade ago there were just six insurance companies. Since, the number of private-insurance providers has grown strongly: Currently Laos has 22 private-insurance companies of which 18 operate in the non-life insurance market, 10 in the life-insurance market and six in both markets.

Supply is still strongly concentrated and the sector comprises a majority of companies with minute market shares. Currently, AGL is still the largest insurance company with a 44% market share by premium, followed by Lao-Viet Insurance Company with an 18% market share. The two companies dominate the non-life insurance market even more, with a combined market share of 67%. Most other insurance companies are very small, and have high-cost structures and low risk-absorptive capacity.

The private-insurance sector's total market size is small. The total economic value of the private-insurance market is small but serviced by a dense supply side that is highly competitive and undermines margins for many providers to levels that could well prove unsustainable. In 2019, total annual premium value or market size for 2019 was LAK 685 billion (USD 70 million) of which 8% produced in the market for life insurance and 92% in that for non-life insurance. The actual market size is even smaller than suggested by these numbers, as individual risks of over USD 200,000 have to be reinsured in the international re-insurance markets, as a consequence of which 64% of total premium value, or LAK 437 billion (USD 45 million) flows out of the country.

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Private-insurance market-size grows only marginally. Over the period between 2014-2019, insurance penetration (insurance premium as a percentage of GDP), has increased marginally from 0.37% to 0.42%, while insurance density (average premium per capita per year) grew from LAK 70,000 (USD 7.4) to just over LAK 98,000 (USD 10.4) over the same period.²¹

Strong competition threatens margins and small insurers' financial strength. As a result of the fact that there are (too) many companies operating in a very small market, there is strong price competition to gain market share to an extent that threatens sustainability of operations and ability to actually be able to cover an insured risk in case of its occurrence, for some companies. The tedious financial position can for example be seen reflected in the fact that the loss ratio (percentage of premium paid out on claims) has grown from 23% to 95% between 2015 and 2019.

Levels of compliance and risk awareness in most small insurance companies are (too) low. With the exception of some foreign-owned companies, compliance and risk awareness in the sector are low. Life insurance is offered with the use of appropriate actuary tables and too often risks insured for a value of over USD 200,000 aren't re-insured, in order to forego the payment of related re-insurance premiums. Actual assessment of the financial position of the insurance sector is hampered by the lack of availability of audited financial statements, despite an obligation to produce those, but reserves of some small companies are considered to be too low.

Raising of mandatory capital will lead to supply-side consolidation. There is an expectation of market consolidation as a consequence of raised minimum capital combined with the requirement to embed each life and non-life insurance license in a separate legal entity with dedicated governance, management and operational structures, causing significant additional overhead on the many small private-insurance companies.

Uptake is dominated by individual property and casualty risk insurance, mainly third-party liability insurance. The private-insurance market is dominated by insurance of risk related to property and casualty, and mainly consists of compulsory third-party-liability (TPL) insurance. The market for life insurance so far is a relatively small and underdeveloped market. The corporate private-insurance market is almost fully re-insured internationally. Of the total remaining retail-market premium of LAK 248 billion (USD 25 million), 70% relate to individuals and households, and 30% to MSMEs. The Lak 174 billion (USD 18 million) total premium value related to insured individuals and households are paid on only about 180,000 policies.

Lacking compliance and enforcement of compulsory TPL-insurance undermines market expansion. Even though main TPL constitutes the bulk of policies in the retail segment, about 30% of owners of cars and 90% of owners of motorbikes don't have compulsory TPL-insurance. Enforcement of regulations on compulsory TPL-insurance is structurally lacking and the main impediment for increased uptake. In case of incidents, the absence of TPL-insurance leads to serious



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complications and loss of resources for insurers when dealing with claims and reimbursement. The situation is further complicated as the judiciary in cases overrides insurance-contract conditions and exemptions, undermining the value of sticking to a TPL-insurance contract.



The private-insurance sector and regulator haven't been able to achieve standardization of TPL-insurance coverage, premium and commissions. In developed and developing private-insurance markets, in order to maximize uptake and socio-economic benefits, and minimum handling costs of TPL-insurance, coverage, conditions, premiums and commissions related to TPL-insurance are standardized. Such standardization supports social awareness around (the benefits) and acceptance of insurance as a risk-mitigation measure, as a basis for private insurance-market expansion. In Laos, despite several efforts, the sector can't seem to come together and the regulator so far hasn't been able to take the lead on the issue.



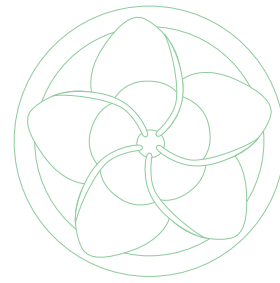
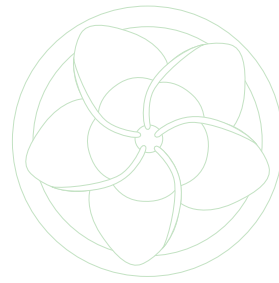
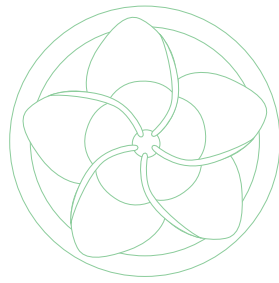
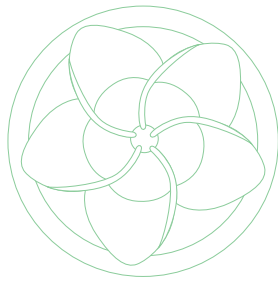
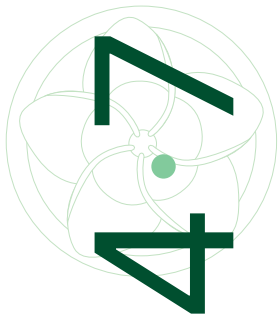
Some banks and MFIs operate as agents. Private-insurance companies have engaged in cooperation with banks and MFIs as agents, offering life-insurance coverage to borrowers with premiums collected or discounted by the MFI. Such initiatives are relatively new in the market but offer an interesting opportunity to further expand on towards the future.

Lack of micro insurance feasibility assessments. So far, Laos has had no serious assessment of the feasibility aspect of introducing micro-insurance products, for example personal-accident insurance. One main reason has been the combined facts that the formal-MFI sector so far has remained relatively small and underdeveloped, while many formal-MFI customers are covered by the NSSF, being civil servants which covers them under such risks.

Little interest from insurers for credit insurance or guarantee. The recent attention in Laos for credit insurance or guarantee as a product and the creation of a regulatory foundation for the establishment of licensed credit-insurance or guarantee companies by BoL so far has raised little interest in the private-insurance sector. Initial assessment of the issue preliminarily indicates that private-insurance companies consider that such second-line of defence against losses caused by loan default are only of interest when a decent first line of defence has been established in the form of a well-functioning formal banking and NBF sectors.



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Financial Consumer Protection

There is an urgent need to prioritize awareness and institutionalization of financial-sector consumer protection standards. Numbers on over-indebtedness and support to VFs reflect that financial-consumer protection (FCP) has not been a prominent consideration in the financial-inclusion stakeholder community. In 2020, realizing the importance of the topic, the Government has adequately stepped in and issued the *Decree on the Financial Consumer Protection*.²² The most recent LBF Finance-sector Working Group meeting discussed the importance of the issue, and its importance was also broadly echoed during interviews with financial sector practitioners for this report.

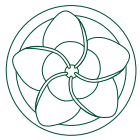
Existing levels of awareness on consumer protection in the formal-financial sector are low. Formal sector awareness of FCP has been low in banking, leasing, MFI and pawn-shops sectors. Just one of 44 banks and eight of 129 MFIs have publicly endorsed the SMART Campaigns Client Protection Principles (CPPs).^{23, 24} At meso-level, no FCP initiatives are known from the LBA. The LMFA has an adequate Code of Conduct that its members are required to subscribe to, but compliance has not been checked or enforced. Among MFIs that have publicly endorsed the CPPs and LMFA, core aspects like a complaint mechanism (for example) have yet to be put into practice.

The Government has set a firm legal foundation for financial-consumer protection. The Law on Consumer Protection gives the responsibility for FCP to BoL.²⁵ The Laws on BoL and on Commercial Banks, and the Decrees on MFIs and the Depositor Protection Fund provided further basic and scattered FCP measures on depositor protection, transparency of financial information, loan-product design and pricing, and dispute resolution. The issuance of the Decree on FCP since set up a comprehensive, systematic foundation for FCP and has extended its scope.

A concerted, fundamental effort by the regulator, industry organizations and FSPs is required to achieve the objective of well-protected financial consumers. A strong and systematic legal foundation is in place but requires a range of policy, strategic and practical measures to achieve the objective of well-protected financial-services consumers set by the Government. The role of BoL as regulator in firmly setting FCP industry standards is crucial. Still, practical implications of the Decree on FCP's standards and CPPs are far-reaching and will



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take time to understand and incorporate within both industry organizations and FSPs. There is a need for development partner support in the form of technical expertise and assistance to the regulator, industry organizations and FSPs.



The newly issued Decree on FCP is further the most appropriate conduit for realization of core priorities that have been set in the FIRM, including those on extension of the deposit protection system; lending based on income and debt-service capacity and prevention of over-indebtedness; transparency in pricing and product conditions; and setting up procedures for customer complaints.



The effort should start with awareness raising and prioritization of compliance FCP standards. Implementation of the Decree of FCP should start with taking stock of awareness and institutionalization of FCP measures in FSPs and followed up by an awareness raising campaign. BoL should take a firm, public stand on FSPs' compliance with FCP principles and set up a dedicated unit to oversee progress, receive complaints by the public sector, and regularly report to the Board of Governors. Industry organisations should prioritize the issue and ensure they themselves are fully compliant, and either embed expertise in its organization or hire external expertise to enable sector capacity building. Development partners and industry organizations could join to organize workshops with expert speakers and panel discussions to enable elaboration of a sector-based plan for compliance, with concrete steps and timelines for FSPs to follow, and feedback to the FCP Unit in BoL.

Urgent need for financial education. A recent study reviewed the main determinants of financial literacy. The average score of financial literacy in Lao PDR was 12.5 out of 21, lower than the 30-country average score of 13.3 and some other developing Asian economies such as Thailand (12.8) and Indonesia (13.4). About 66% of Lao PDR respondents self-assessed that they have the same level as other adults. The financial literacy scores of men were slightly higher than those of women. Similarly, men have higher financial knowledge scores than women.²⁶ In the study, the main determinants for financial literacy were found to be overall educational level, income, age, and occupational status. Urban residents, more educated and higher-income respondents tend to have higher financial literacy scores while female respondents have slightly lower financial literacy scores than male counterparts. Both financial literacy and general education levels are found to be positively and significantly related to savings behaviour and financial inclusion, and these results hold even when correcting for possible endogeneity of financial literacy.²⁷



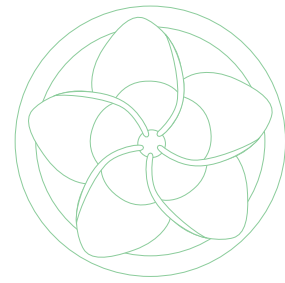
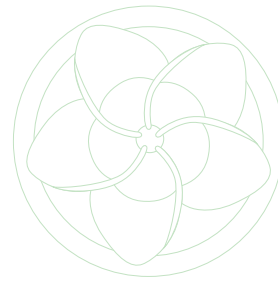
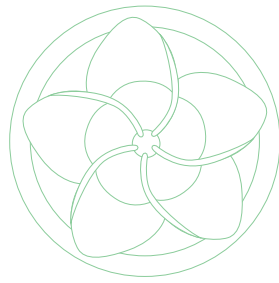
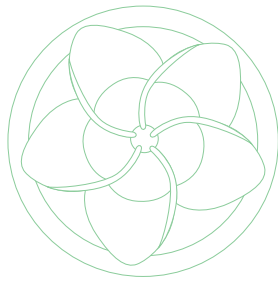
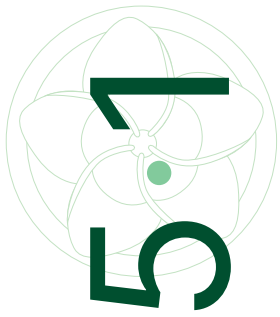
The average score of financial literacy in Lao PDR was 12.5 out of 21, lower than the 30-country average score of 13.3 and some other developing Asian economies.

PART 4 NOTES

- 1 IMF, 2019.
- 2 The MFI sector consists of deposit (DTMFIs) and non-deposit-taking (NDTMFIs) shareholder-owned MFIs, and member-owned savings and credit unions (SCUs).
- 3 BOL, 2017.
- 4 Start Fintech, which has offered its services under the name U-Money since December 2018 as the wholly-owned, dedicated subsidiary of the largest mobile-network operator (MNOs), Star Telecom, which operates under the name Unitel
- 5 VFs have a legal foundation in Government policy documents, regulations and both de-jure and de-facto decisions and activities of Government agencies and mass organizations at various levels.
- 6 This, despite the fact that the PM Decree on MFIs prohibits VF operations without a license from BoL.
- 7 BoL set up seven Network Support Organizations in six target provinces, which acts as apex bodies to the GIZ-AFP VFs in particular, and provide training, financial literacy and funds management.
- 8 GIZ, 2014.
- 9 The responsible LWU managers estimated that over 90% of VFs under their wings suffer from fundamental and endemic problems and are at risk of collapse. International experts estimate that 50% of LWU initiated VFs have already subsided, some of which have since reestablished themselves from scratch.
- 10 Interviews held for the purpose of this report.
- 11 Finscope (2014) measured that less than 50% of borrowings are from formal sources and less than 40% of savings services. It further found that even MSMEs rely on informal sources of credit over banks, both for more (16%) and for less profitable MSMEs (23%). The more profitable the MSME, the more it would seek to source credit with banks; of the more profitable MSMEs, 9% would seek bank financing compared to only 4% for less profitable ones.
- 12 Village funds can be distinguished depending on funding source: those funded by member contributions are described as VSLFs; those funded by external donor or Government funding as village-credit funds (VCFs).
- 13 Relative shares couldn't be assessed due to incomplete datasets on VFs and banking sector depositors.
- 14 UNCDF, 2015
- 15 For low-income farmers debt was measured on average 38 times larger than income and more than two times as large as total savings; for low income self-employed (non-farming) ratios are 36 and 1.7 respectively.
- 16 WB, 2014.
- 17 LSB, 2020.
- 18 For detailed enterprise characteristics, see section 5.2 below.
- 19 The Economic Census shows that 97% of enterprises generate income in LAK and thus require LAK-denominated loans.
- 20 That situation would be different if NDTMFIs would be allowed to leverage capital and can change towards the future now MFIs have been instructed not to set deposit-interest rates at too high levels.
- 21 Ministry of Finance, 2020.
- 22 BOL, 2020.
- 23 EMI, XMI, FC, Doukhoun, Saynhai Samphanh, WFDF, and SCUs Huamchai Phatthana and Luang Phrabang.
- 24 ACLEDA Bank Lao's owner, ACLEDA Bank Cambodia Plc., is one of only 120 FSPs globally to be CPP Certified.
- 25 BOL, 2020b.
- 26 Morgan and Trinh, 2019.
- 27 Ibid.

• 5

Economic
sectors that
can drive
growth and
employment



Introduction

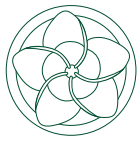
The number of people of working age and the labour force are estimated to increase by 25% over the next 20 years and, if the Covid-19 measures remain in place, will further increase by the 100,000s of labour migrants that have returned home. The importance of job creation and education for the Lao economy will therefore only grow, and have been given top political importance.

To get there, the country needs to reignite economic growth to regain lost jobs and further grow the demand for labour, while increasing government revenue. In turn, this could empower government and households to alleviate most of the social issues highlighted in this refresh. Financial inclusion can play a key role in supporting the real economy, thereby contributing to growth, by intermediating the significant savings that are stored in-kind and in village funds, through the banking sector, towards those enterprises that show profitability and have repayment capacity. However, such support should be targeted to sectors or through channels that could amplify employment creation and growth, while supporting sources of revenue (like exports), thereby increasing the efficiency of financial inclusion's impact on poverty reduction. This assessment of Laos' socio-economy aims to provide context for determining how enhanced financial inclusion could most effectively support achievement of the government's political priority of inclusive economic growth and the creation of income-generating opportunities for the broader populace.

The main source of GDP has transformed from agriculture to services and production. Following the government's adoption of the "New Economic Mechanism" as an economic policy in the 1980s, the Lao PDR's natural economy has been changed into an economy driven by services and production sectors. In 30 years, agriculture's relative contribution to GDP has fallen from 48% to 15% (2019) as GDP growth averaged 7%. Despite its now-relatively low contribution to GDP, agriculture continues to be the primary source of income and employment for the majority of the population. Following three decades of strong GDP growth, the newly elected government has placed a greater emphasis on inclusive growth, income generation, and employment for the larger population.



The country needs to reignite economic growth to regain lost jobs and further grow the demand for labour, while increasing government revenue.



Farming remains the primary source of income for the vast majority of Lao households but provides low levels of income. Due to low-income levels, these farming households are excluded from the benefits of the country's rapidly changing socio-economic system, and as a result, they are vulnerable and at risk of falling further into poverty.



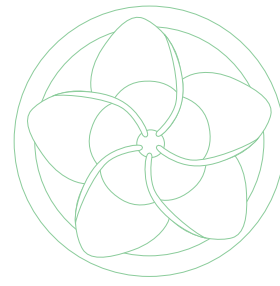
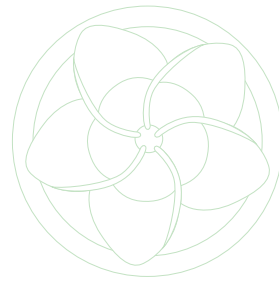
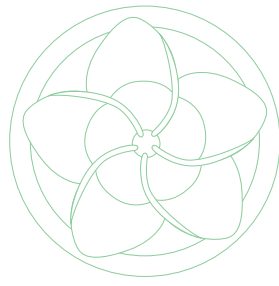
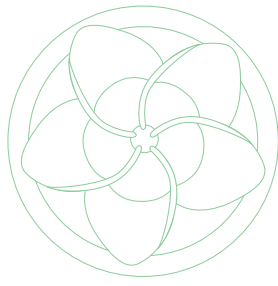
Policy focus on economic development through trade and manufacturing. The Lao PDR's economic-policy approach, best summarized as a state managed market-based economy, has been embedded in the Constitution as standing policy.¹ The applicable articles describe a level-playing field for all enterprises and protection of property rights and investments, foreign and Lao-owned alike. A core, long-term and overarching policy objective embedded in the Constitution, is to transform the existing "*natural*" economy dominated by subsistence agriculture into a "*trading and manufacturing economy*". On this objective, remarkable progress can be observed: over the 31-year period of 1989–2018 agriculture's contribution to GDP has declined from 47.5% to 15.2%. Currently, services (42.3%) and industrial-production (31.4%) are the main sources of GDP and GDP growth.



Small-scale economic activities in retail trade and labour migration are main livelihood strategies. The main household strategies for increasing and stabilizing income are engaging in economic activities in trade in an MSEs; labour migration to the greater Vientiane area; labour migration abroad (primarily to Thailand); and seeking employment as a salaried worker in manufacturing. Income strategies are determined at the household level, rather than on an individual basis, and are influenced by broader factors such as family relationships, culture, and socioeconomic status.

The need to raise and, even more so, stabilize income is a deeply felt and ingrained motive for Lao households related to high levels of socio-economic insecurity. The deep-seated desire to secure and stabilize income over the course of a lifetime can also be seen in the high value placed on securing a position as a civil servant, which is the number-one aspiration in terms of a future career for the vast majority of the young population and their parents, as well as the large number of "volunteers" working for the government on annually-renewable short-term contracts. Because the government is actively pursuing a policy to limit the number of federal officials over time, winning such a position will remain hard for everyone but a select few.

Education is highly valued long-term strategy but only available to those who can afford it. Main strategies to enhance and secure income towards the longer-term future include investment in education of offspring for those who have the means, often combined with active family planning; and creating enough off-spring to secure income for those who don't have the means to support education, often coinciding with being bound to remote agricultural land and belonging to ethnic minorities.



Agriculture

Majority of population involved in agriculture. The majority of the Lao population (64%) still lives in rural areas and works in agriculture, mostly cropping and paddy rice production in the monsoon season. Farming is the principal source of income and livelihood for 52% of people, and an important source of income for 78% of individuals (almost four out of five).² Agriculture continues to be important in terms of livelihood generation and employment, as evidenced by the fact that agriculture accounts for 61% of all hours worked in Laos each year.³ The Workforce Survey (2017) similarly found agriculture to be the main source of employment, taking up 36% of the workforce.⁴

Many people working in agriculture support their families with little or no pay.

The disparity in percentages between the two polls mentioned in the previous paragraph reveals more about the nature and productivity of activities: According to the categories used in the workforce survey, the majority of people of working age (59%) are unemployed because they are not accessible for economic production. Rather than being unemployed, 87% of those surveyed were considered outside the workforce as they were working in the family's own-use production activities, the majority of whom were from farming households⁵.

Agricultural production characterised by structural low productivity. Over the decade ending 2017, the value of agricultural production had grown only as a result of increased acreage and working hours, with productivity stagnant.⁶ However, 50% of agricultural production consists of monsoon-season paddy-rice production, which is largely at subsistence levels. Only 4% of wetland paddy fields are used for production in the dry season, while irrigation and fertilization could enable productive use in that period. Agriculture is the main source of income for poor households who rely on rice production throughout the monsoon season⁷.

Agricultural production and employment provide low levels of income and make farming households economically vulnerable. The incomes of both high and low-income farmers are lower than the average income of low and high-income economic groups from other sectors. Farmers, furthermore, have the highest risk of sliding into poverty of any socioeconomic category.⁸ When revenue levels are compared to debt-service requirements and debt-to-asset ratios, data found by MAP (2015) strongly suggest that one out of every two farmers in Laos is over indebted.



The majority of the Lao population (64%) still lives in rural areas and works in agriculture, mostly cropping and paddy rice production in the monsoon season.

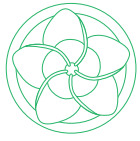


Farmers lack organization and combination of forces. Farming is done on a small scale, by families, on small plots of land, and in typically difficult physical terrains, such as steep hill and mountain slopes. Because only a few farmers engage in commercial farming, most other farmers do not benefit from economies of scale, labour differentiation, or a stronger bargaining position in value chains. Investments in flood prevention, irrigation, storage, transportation, and trade are not made, nor are they worth making, due to the small scale of operations.

Farmers face various challenges in regulations and practices, impact from natural disasters and from economic development projects. Farmers are often restricted from determining prices and freely selling their produce due to regulations on price controls and on licensing of trade, and of informal practices to the same effect. Unfavourable weather, in the form of flooding, drought, or cold spells, as well as crop pests and livestock illnesses, affect farmers in Laos on a regular basis, and few risk-mitigation strategies are employed or invested in. Farmers need to compete with imports from Thailand, which are more economically produced and funded, resulting in lower prices, and whose quality is frequently seen as superior by Lao customers. Farmers are becoming increasingly land insecure as a result of a mix of factors including the lack of strong, so-called Golden Land Titles in rural areas and investor concessions to hold and utilize properties that agricultural families have been using for generations. Even when there is a regulatory provision for compensation, it is sometimes not paid or is insufficient to compensate for lost livelihood opportunities.⁹

There are yet few successful agricultural cooperatives. There are still few examples of farmers effectively forming cooperatives and joining forces to gain size, labour organization, and market power. The initiative is taken by INGOs related to Lao people residing abroad, in the few occasions where it is successful. They provide access to markets and resources while also exporting processes and capability to Laos and building a strong entity with their family and friends back home in Laos. The international Lao-family link ensures mutual confidence in the venture, the “skin-in-the-game” and long-term horizon that regular development assistance often lacks yet is a fundamental ingredient of the success. Other successful examples are in and around Vientiane involving biological farmers markets and networks, which are actively supported by Government.

There are some prospective commercial agricultural sub-sectors and opportunities. Some of agriculture’s fastest-growing and most economically attractive sub-sectors include animal husbandry and commercial agricultural production of cassava, coffee, maize, bananas, rubber and fresh vegetables. Much of the output in these subsectors is commercial, meaning it has a higher productivity and is primarily exported to China and to a lesser extent Vietnam. Laos has the potential to become an agricultural exporter, with big and increasingly affluent populations in neighbouring countries, increasing demand for healthy food and protein, and in the case of Vietnam, a dearth of arable land for its production.



The government actively targets agricultural exports as policies and export value is growing strongly but from a low base. The government has pursued the opportunity firmly, resulting in significant increases in export revenue; from USD 600 million in 2018, to USD 943 million in 2020, a 57% rise in just three years. Of the export value in 2020, 24% were from bananas (top export), while in 2019, livestock, rubber and bananas were the top three.¹⁰ Other main export earners from agriculture are cassava, coffee beans, maize, rice, watermelons, grapefruit and tamarind. Export of coffee was valued at USD 120 million (2018) but has significant local market as well, both in a growing trend.

Export quota and procedures pose a challenge for Lao exports and often favour Chinese-owned companies exporting from Laos or importing from China. Export quotas and imposed standards for procedures and hygiene are obstacles for Lao farmers, who are hampered by cumbersome regulations imposed by receiving countries, whose regulations are easier navigated by foreign companies and nationals. In export-oriented production, such as bananas, large land-holding farmers are increasingly simply leasing their land to foreign (Chinese) investors, who finance and operate the farms in Laos using hired labour and organize export using their familiarity with Chinese rules and practices, and too often not adhere to local rules on environmental protection. Farmers with insufficient land holdings are unable to participate and are frequently forced to work as low-wage laborers on these foreign-managed plantations. Large multinational corporations' buyers and agents in Thailand and China utilize their market and financial power to impose contractual agreements on Lao farmers, some of which shift production and price risks to the farmers.

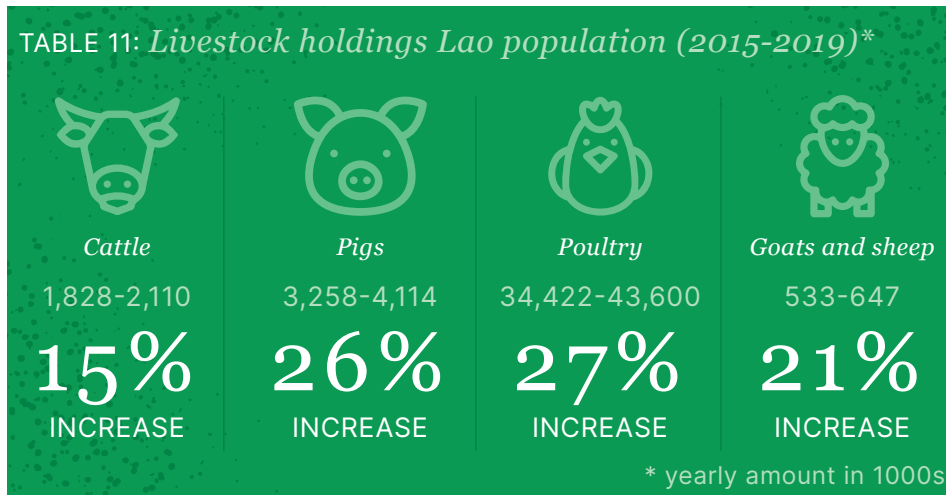
Commercial-livestock production is a prospective commercial-agricultural sector. There has been an increase in the number of livestock herds, with 89% of farmers owning some type of livestock, owing to increased demand for animal protein from an increasingly affluent Lao urban population as well as its Vietnamese and Chinese neighbours. Smallholders own 95% of livestock, which has traditionally been used to accumulate assets or wealth to be sold off in hard times. However, as a result of large-scale development projects, contract farming for foreign-owned companies in Laos, and rising prices, livestock has increasingly contributed to farmers' income and livestock production has been increasingly applied as an income-generating strategy. Over the recent decade, some FDI has been invested in huge cattle ranches that produce animals for export. Because of a combination of proximity to border-crossing corridors with proactive traders from Vietnam and China, large-scale livestock sector development projects, and a lack of alternative livelihood strategies due to the mountainous terrains and lack of arable lands, livestock production is particularly promising for the Northern part of Laos, where poverty is relatively high and ethnic minorities are numerous. Cultural adaptation to the most effective livestock-production systems, including prevention of disease and enhanced feeding methodologies are key factors of improved productivity.



Export quotas and imposed standards for procedures and hygiene are obstacles for Lao farmers, who are hampered by cumbersome regulations imposed by receiving countries.

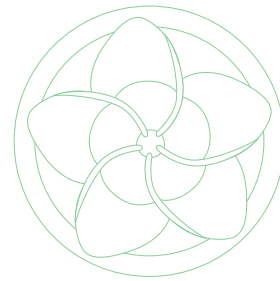
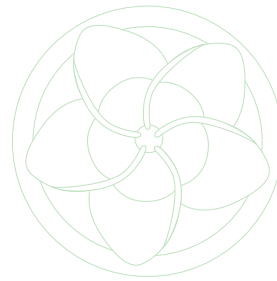
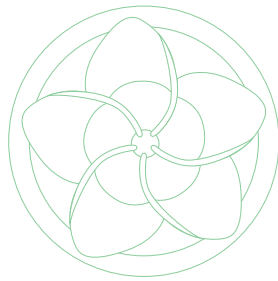
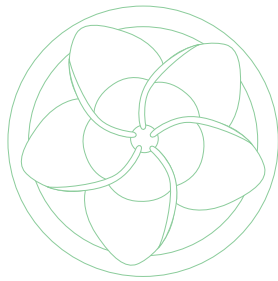
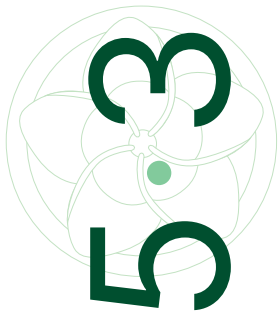


TABLE 11: *Livestock holdings Lao population (2015-2019)**



Source: Lao Statistics Bureau Yearbooks

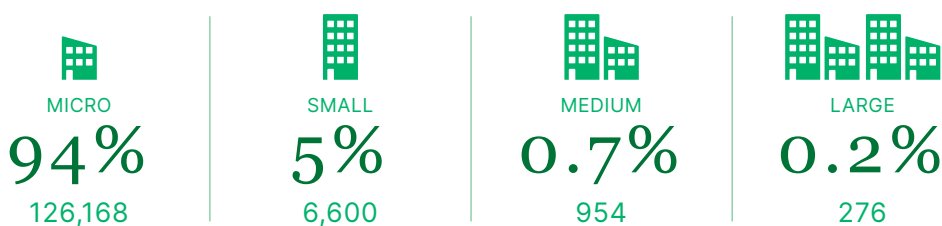
Agriculture credit can be most effectively supplied in effective agricultural value chains. Selected economic actors, such as traders and agri-processing companies, and connected primary producers in well-functioning production and distribution chains that produce substantial economic value, offer opportunities for effective credit delivery. Examples can be found in agricultural production destined for export to China as well as certain geographical areas with good conditions for effective agricultural production, such as for example Xieng Khouang Province in case of livestock production and Paksong District in the case of production of coffee, fruit and other products.



MSMEs

Almost all enterprises in Lao PDR are either micro or small enterprises. Beyond agriculture, economic production is dominantly organized in the form of *micro and small enterprises (MSEs)*: Of all 133,997 enterprises surveyed in the latest economic census (2019), 94% classify as a *micro enterprise* and 99% of enterprises are either *micro or small*, having invested little in capital goods or productive assets.¹¹ In terms of the human resource base, *MSEs* dominate as well as 91% of enterprises employ just five people at most; while just 225 enterprises have over 100 staff and a total of 517 enterprises employ over 50 staff. However, together they employ 490,373 people.

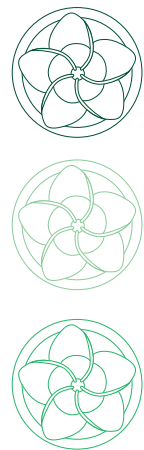
TABLE 12: *Enterprise distribution 2019*



Source: Economic Census, Lao Statistics Bureau

MSEs provide a significantly higher and more stable source of income compared to agriculture and play a core role in providing income and employment to the broad population. Even when production takes place at very-small scale, enterprises in industry and services sectors provide income levels that on average are over twice that of farmers, and are more frequent and reliable. MAP (2015) measured that within the segment of self-employed, average income is LAK 0.76 million per month for low-income self-employed people and LAK 6.8 million per month for high-income self-employed people (USD 80 and USD 700).¹² MSEs play a very important role in job creation and income generation, and can be considered the backbone of the Lao economy.

MSEs dominantly operate in providing retail trade and repair services, and other services. Overall, 64% of enterprises are in trade, 21% in (other) services and just 16% in production. Looking deeper at the three sub-sectors of inclusive-economic activity, we find that simple trade and repair, mainly retail, make up 61% of all enterprises and contribute 47% to employment; followed by manufacturing with respectively 15% of enterprises contributing 23% to employment; and hospitality, incl. restaurants, with 11% of enterprises respectively contributing 12% to employment.¹³ Together, these three sub-sectors, out of a total of 21 sub-sector contribute 82% of employment with each of the 18 other sub-sectors' contribution small.



Percentage enterprise distribution 2019



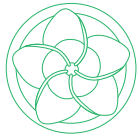
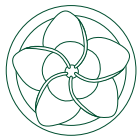
Table 13: Enterprise segmentation by sectors, number of staff and employment.

SUB-SECTORS	NUMBER OF ENTERPRISES	EMPLOYMENT	% OF EMPLOYMENT
Trade and repair	85,432	228,367	47%
Manufacturing	18,856	110,257	23%
Hospitality and rest.	14,459	60,074	12%
Other	15,250	91,695	18%
Total	133,997	490,373	100%

Source: Economic Census, Lao Statistics Bureau

Enterprises in Laos are dominantly family-based based and managed according to family hierarchy and seniority. Apart from being small, Lao enterprises are characterized by the fact that they are organized as a family enterprise and that management is dominantly based on family hierarchy. There are several key implications of this, including structural, inherent inefficiencies. They tend to stay close to home, literally, and make strategic and management decisions based on seniority, not management skills or technical expertise, which, along with capacity-building, are lowly regarded and not invested in.¹⁴

The family-based orientation brings inherent inefficiencies resulting in low productivity. These are also the enterprises where the 51% of people of working age who are outside the workforce (because they are engaged in own-use production work in the family) are employed. Family-based enterprises focus on maximizing revenue based on the number and capacities of all family or household members and the existing asset base, rather than profit maximization. Long-term capacity building and organizational structural development are underestimated, and management tends to focus on day-to-day, ad-hoc decision making based on short-term time horizons.¹⁵ Low-capacity and rewarded young family members are mostly responsible for production. This condition results to low productivity and revenue when combined with low levels of investment in productive assets and capacity. The abilities and expertise of the owners and managers, their age and practical education, and the usage of contemporary equipment have all been recognized as the most important success criteria in studies of determinants of success of Lao MSMEs.¹⁶



Enterprises are dominantly characterized by absence of dedicated governance, management and organizational structures.¹⁷ In general, businesses lack a formal organization and governance structure dedicated to the management and finance of commercial activities distinct from family concerns, and they are conducted in the name of the owner (98% of the time), rather than as a separate legal company. The majority of businesses are owned by Lao nationals (95%) and do not use any IT systems, including computers (93%). In terms of education, 62% of managers have completed secondary school, 19% have added either vocational or academic education, and 19% have just completed basic education.

Enterprise are dominantly urban-based, operate from a single location and for the local market.¹⁸ Overall, 95% of businesses have only one location and produce for the local Lao market, which accounts for 97% of revenue. They are primarily urban-based, with 60% officially based in urban areas, over one-third in the bigger Vientiane area, and 55% in the combined areas of the larger Vientiane, Savannakhet, and Champassack provinces, with only 45% operating in the remaining 14 provinces. The vast majority of businesses are young, with 75% having started operations between 2010 and 2019.

The large majority of enterprises aren't properly registered or licensed and operate in an informal economy. Only 30% of businesses are registered with the Ministry of Industry and Commerce (MoIC), and just 22% have a license of approval from the regulatory body that oversees their industry. The majority of businesses (82%) pay tax but do not have a full tax number (87%) and pay a lump-sum tax at the district level based on negotiation of the tax liability, rather than on measurement of income based on financial statements.¹⁹ In effect, the dominant organizational structure of economic production is the informal micro or small enterprise (*iMSE*) that operates in grey economy, which' production is not captured in official statistics on GDP. As a result, a credible estimate of the true value of economic production remains elusive, and the official GDP figure is significantly understated. Academic research suggests that Laos is one of two ASEAN countries with the largest shadow, grey, or informal sectors, accounting for 50% of the formal economy, up from 30% a decade earlier, as the value of the grey economy grew faster than that of the formal economy.²⁰

Enterprises lack administrative systems, transact in cash, can't provide financial statements and don't have enough insight into profitability.²¹ Almost all businesses (96%) don't apply any kind of accounting or administration system and in effect have little insight in profitability, nor are they able to prepare even a basic financial report. Business transactions are blended with household transactions and dominantly cash-based. Despite considerable differences related to the size of the business, 32% of medium-sized and 11% of large businesses lack even a basic administrative system.



Overall, 95% of businesses have only one location and produce for the local Lao market, which accounts for 97% of revenue.

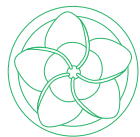
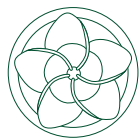


Table 14: Enterprise segmentation by size, legality and administrative organization

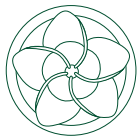
ENTERPRISES WITH:	MICRO	SMALL	MEDIUM	LARGE	OVERALL
Number	126,168	6,600	954	276	133,997
business registry	27%	77%	94%	100%	30%
business license	20%	45%	73%	85%	22%
tax number	11%	42%	84%	96%	13%
administration system	2%	21%	68%	89%	4%
basic administration system	2%	18%	55%	61%	3%
No administration system, at all	98%	79%	32%	11%	96%

Source: Economic Census, Lao Statistics Bureau

Main reason for informality is the regulatory uncertainty and combination of indirect and direct, sometimes hidden costs resulting from regulations and dealing with authorities; the Red Tape.²² Annual registration and license renewals are required or a business must cease operations; rules and authorities' mandates are frequently unclear and applied arbitrarily, depending on broader relationships with government officials; and negotiations can drag on and drain scarce resources, both in terms of lost production time and costs for a professional negotiator. Informal payments are a common occurrence. Companies have little motivation to construct adequate, formal structures and administration, preferring to forego the benefits of economies of size and scope, market power, and reduced sensitivity to external shocks and income volatility rather than pay the opportunity costs of formalization.

Informal practices by larger, formal companies are a challenge for policy makers and the economy. Despite its ubiquity, informality of MSEs doesn't constitute a substantial concern in terms of offering unfair competition as they provide highly localized services in areas unserved by larger companies.^{23 24} In fact, formal enterprises in Laos are faced with less (40%) competition from unregistered or informal enterprises than both the average in East Asia and Pacific (50%) and the average in lower-middle income countries (55%).²⁵ Official statistics show that larger, registered enterprises do apply informal practices when it comes to hiring staff, social insurance and taxation, and have more leverage to negotiate with authorities as reflected in the large 80% of the corporate tax base being exempt.²⁶

The ubiquitous iMSEs are underrepresented in economic and financial-inclusion policy design. Despite their dominance in economic production, income generation and employment, *iMSEs* are lowly represented and considered in industry platforms, enterprise surveys and discussions on economic-development policies, both from the side of development partners, policy makers and regulators.



One-third of larger, registered enterprises show some size and revenue growth.²⁷

Recent analysis of the dataset of formally-registered enterprises with at least five staff, a subset of 9% of the overall enterprise population skewed towards larger, better organized, enterprises, measured that *two-thirds* of the subset employ less than 20 staff and realize low revenue growth. This implies that one-third of registered enterprises does operate at some scale and with levels of profitability that would possibly enable effective financial-sector borrowings. The analysis further found that just 6% of the group of small, fast-growing enterprises show consistent growth and become medium-size. The most successful group, characterized by a larger size (⇒ 20 staff, 40 on average) and fast revenue growth (⇒ 20%), comprises no more than 1% of formal enterprises, most of which are located mainly in Vientiane Capital.

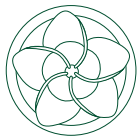
Table 15: Successful enterprise characteristics

CHARACTERISTICS	SIZE (AVG STAFF)	REVENUE GROWTH	SECTOR	PERCENTAGE FORMAL ENTERPRISES
Small "successful" necessity entrepreneurs	8	0% > 10% <	Services, manufacturing	14%
Small, very fast growth	8	> 20%	Retail and services (>90%)	9%
Small, fast growth	11	>10% < 20%	No sectoral predisposition	6%
Medium size, moderate growth	32	>0% < 20%	Outside retail	2%
Medium size, high growth	40	>20%	No sectoral predisposition	1%

Source: *Closing The Gap Mekong: Country report the Lao PDR, Entrepreneurial Ecosystem Assessment** (April 2019), commissioned on behalf of the Dutch Good Growth Fund.

The larger and more successful the enterprise, the more important the challenge is to identify, hire, train and keep an adequately-educated and capacitated workforce. A large 58% of the most successful and 23% of slower growing medium-sized enterprise mention human resource capacity as they key constraint. In production and manufacturing, electricity becomes an issue and more so for medium-sized (29%) than smaller enterprises.

Access to credit is the second-most important constraint for successful enterprises. Most prospective companies also experience access to finance as their largest challenge (24%). More in-depth assessment of what exactly this challenge is characterized by, highlighted the observation that higher-levels of profitability do not predict easier access to credit.²⁸ This is further indicative of a finding that was broadly confirmed during interviews with financial-sector practitioners: the formal financial-services sector is not adequately capable of fulfilling its core role in the economy, of assessing the repayment capacity and prospects of applicants and allocate resources to those productive opportunities that the economy would benefit from most.



Low productivity limits companies' competitive position in foreign markets.

The industry is extremely inward-oriented, with only 2.9% of the firms exporting directly. These enterprises find it hard to compete because of a combination of: low productivity compared to enterprises in foreign markets; the challenge to produce the levels of quality demanded in foreign markets or by foreign governments; a general lack information about, understanding of and access to foreign markets.²⁹ Since Laos is an LDC, Lao-based manufacturing companies have duty and quota-free access to the market of the EU for almost all products based on the single-transformation production criterion for imported material, which has been a driver behind the success of some of the main garment producers. However, this advantage would disappear in 2026 if the plan to graduate from LDC status will be achieved.

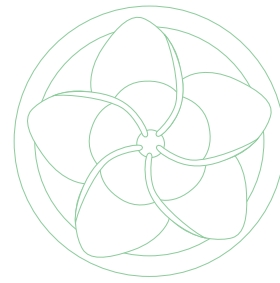
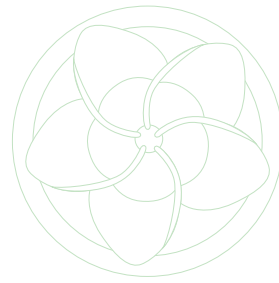
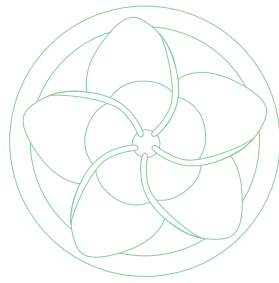
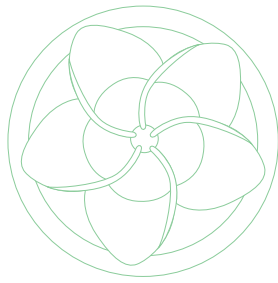
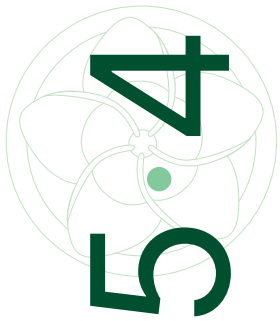
Business environment less than conducive. Laos is ranked at 154 of 190 states on the World Bank Group's 2020 Ease of Doing Business Index. This highlights the complexity of the business environment in Laos, with high costs of doing business and need for a more transparent, dynamic, and streamlined business environment. Since the majority of firms operate informally, they avoid rules and regulations. Additionally, high direct and indirect costs involved in regulatory compliance and infrastructural challenges like transportation and electricity make it difficult to do business in Laos.

Low enterprise productivity reinforced. Currently, the large majority of survivalist and low productivity enterprises are kept afloat by employing (too many) lowly productive family members. As a result of availability of low-paid family members, capital investment that would enhance productivity are less necessary or attractive, and often not made. Secondly, as the young family member remains working in the family enterprise whether there is (enough or interesting) work or not, they don't have to compete in the workplace and develop capacities. Thirdly, highly-educated or capacitated family members that have, for example studied overseas, are more often than not absorbed in family business, regardless of the issue whether their capacity for producing added value is highest there.

Those who are employed are so dominantly on informal basis, even in formal companies, and at low wages. The combined groups of those working for an informal enterprise, and those working informally for formal companies or for economically-active households together account for 83% of all employment. These informal employees are not covered by social security nor protected by the legal system. Despite the informal nature of their hiring, 84% work on a de-facto permanent basis and a third of employees receive regular salary payments. Average annual income generated through the various sorts of employment is LAK 28.8 million (USD 3,350) or LAK 2.4 million (USD 280) per month.



Laos is ranked at 154 of 190 states on the World Bank Group's 2020 Ease of Doing Business Index. This highlights the complexity of the business environment in Laos.



Migration and Remittance

Labour migration and remittances are significant source of income for the population and the country as a whole. Both in terms of numbers and importance to the Lao economy, national income, and recipient families, the importance of migration and remittances is highly significant. Laos' GDP, GNI, employment, and poverty reduction have all benefited from migration, as migrants have invested in Laos, sent money home, and provided access to global capital markets and value chains. For many low-income and often rural households, labour migration has been applied successfully as strategy to reduce dependency and raise and stabilize income through remittances. In numbers: 23% of all Lao adults receive monetary remittances³⁰ and for 44% of those who do, remittances are the main source of income, and often a more stable source.³¹

The number of labour migrants is very large and matches the total number of staff of the enterprise population of Laos. According to data from UNDESA, there are 1.3 million Lao natives (individuals of Lao origin) living abroad, almost 20% of the total population:³² One million in Asia, 0.25 million in North America (mainly the USA), 55,000 in Europe (mainly France), and 12,000 in Oceania (mainly Australia). Thailand hosts 935,000 of Asia's one million migrants. Recent data by the International Organization on migration using official sources put the number of international labour migrants at 500,000, a number that excludes informal migrants and in itself is as large as all staff of all enterprises operating inside Laos combined.

Individual households and Laos as a whole may benefit from well-regulated and organized international labor migration in the short and long term. Laos could continue to benefit from well-organized and regulated international labor migration, as already pursued by the Government in MoUs with Thailand, Japan, and South Korea. First, the large number of unemployed young family members would ease household budget pressures. If properly organized, this could support Laos's long-term economic growth by increasing and stabilizing national income and decreasing poverty. Increased focus on investment in productivity enhancement of agricultural production back home; import of skill and capital goods; and access to value or production chains in Thailand.

Labour migration inside Laos have driven by rural females, often from minority groups.³³ Of internal migrants within Laos, many are women from poor upland rural households of non-Lao-Tai ethnicity that seek employment in Vientiane's manufacturing (garments), hospitality, restaurants, and entertainment industries.

20%

There are 1.3 million Lao natives living abroad, almost 20% of the total population.



Of all 206,000 internal migrants (2015), the majority migrates to seek employment, of which 60% are female. In Laos, 17% of people are internal lifetime migrants, as are 40% of all Vientiane residents. Jobs are often low-paying and formal social protection is limited. Despite the risks, the choice is rational and often benefits both sides, but is primarily driven by poverty: it reduces dependency on scarce resources within the family, allows escape from marriage, giving birth at a young age, a lifetime of hard physical work and poverty, as well as the responsibility of caring for both parents and young children at the same time. Migrants live in and support each other in groups, enjoy some level of freedom, and can grow in independence and status by becoming more world smart and taking care of siblings and parents by sending money. The amounts sent are based on what migrants can afford, but the target is 20% of income. Internal migration remittances are primarily used to supplement agricultural income and educate siblings.

International labour migration is dominantly to Thailand but increasingly includes South Korea and Japan.³⁴ Labour migration to Thailand is a main conduit for large numbers of Lao nationals from Vientiane and rural areas from the Southern part of the country. If including estimates for informal migrants, the total number of Lao nationals working in Thailand could well be above 400,000 and up to 500,000: Next to 290,000 registered migrants, 30% were estimated to be “*in the process of being registered inside Thailand*” and another 34% fully informal. On top of that, the number of labor migrants to Japan and South Korea are estimated at 50,000 for each country. These groups’ total annual remittances could be worth as much as USD 600 million and constitute a main household-income raising and stabilisation strategy. Wages in Thailand are higher and living expenses lower, while migrants gain independence, confidence and interpersonal skills that they value highly.

Labour migration to Thailand significantly informal and seasonal in nature. As seen in the previous paragraph, much labor migration to Thailand is informal. Informal migration is a rational choice; costs involved in running documents and getting licenses as part of formal migration are over two-months-worth of average salary and need to be paid upfront. Many aren’t able to make the upfront payments and have to borrow, further raising costs. Informal migration requires lower upfront investment but does bring significant costs down the line, lacking legal protection, having to work more hours and days, and having to pay informal fees. Much of migration is seasonal and people return back home for rice planting or harvesting, and for New Year. For such seasonal migrants, formal migration is less interesting from a cost-benefit analysis point of view.

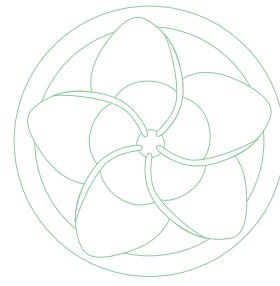
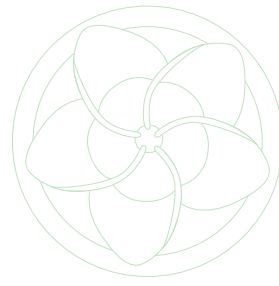
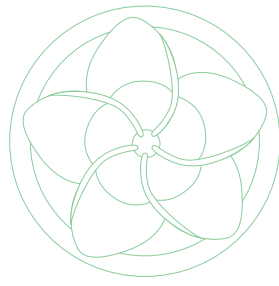
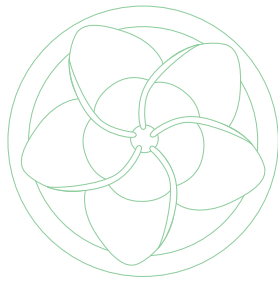
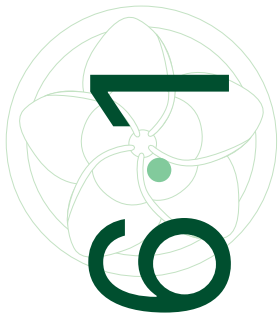
Pre-departure education improves migrants’ preparedness, access to public and private services, and remittance effectiveness. Families back home can benefit from pre-departure preparation and education. Home-based village and family networks now extend in both countries, influencing migrants’ awareness of regulations, procedures, and implications. In the past, migrants’ awareness was low, and they rarely planned or prepared. Avoiding formal migration procedures, which are more than twice as expensive as informal migration, used to be common practice. As example, financial inclusion interventions can include pre-departure training on formal monetary transfer mechanisms, assistance in opening savings and transaction accounts, technical assistance in managing incoming money flows effectively, and credit landing assistance. The use of formal remittances leads to improved financial literacy and the use of formal financial services, such as productive loans, for fully documented migrants.

PART 5 NOTES

- 1 Constitute Project, 2021.
- 2 UNDCF, 2015.
- 3 ADB, 2018.
- 4 LSB, 2017.
- 5 In similar fashion, the Economic Census excludes family-based subsistence farming as economic activity.
- 6 WB, 2017.
- 7 ADB, 2018.
- 8 UNCDF, 2015.
- 9 ADB, 2018.
- 10 Xinhuanet, 2021
- 11 LSB, 2020.
- 12 FinScope MAP 2014-15.
- 13 Data from Economic Census (2019). Workforce survey set trade and repair at 21% contribution to employment, explained (at least partially) from exclusion of agricultural production in the Economic Census.
- 14 Ngaochay and Walsh, 2011.
- 15 Ibid.
- 16 Vixathep, S., 2017.
- 17 Ngaochay and Walsh, 2011.
- 18 Ibid.
- 19 More on this in the section on informality.
- 20 Vo and Ly, 2014
- 21 LSB, 2020.
- 22 Lao National Chamber of Commerce and Industry, 2018 and WB, 2019.
- 23 WB, 2017.
- 24 WB, 2019.
- 25 WB, 2018.
- 26 IMF, 2019.
- 27 Roosmalen and Phodsavang, 2019.
- 28 WB, 2014.
- 29 GIZ, 2014.
- 30 UNICEF, 2015.
- 31 IOM and Asian Research Center for Migration, 2016.
- 32 UNDESA, 2019.
- 33 UNESCO, 2018.
- 34 IOM, 2020.
- 1 Exchange-Rates.org, n.a.



Conclusions and recommendations



Conclusion and recommendations

Given Laos' spectacular economic growth since the 1990s, significant increases in social metrics has been achieved, for instance improvements in the HDI, and Laos has achieved lower middle-income status as a result. However, the country remains an LDC, and growth has slowed in recent years, more so with the impact of the pandemic. Laos has a structural trade deficit and is heavily reliant on imports.

The young population shows significant underemployment, providing low-productivity labor as input to their family's economic activities, mainly organized in micro and small businesses with low capital investment and assets, the majority of which are informal due to a restrictive and burdensome regulatory environment. Despite legal requirements for employers, employment in bigger, official firms is overwhelmingly informal, with over 80% of people working without labor contracts or social-security coverage. Few businesses apply appropriate administrative systems and prepare financial statements, and in effect lack adequate insights into profitability. Most businesses transact in cash and combine personal and business income and expenses. They do not use professional and merit-based management methods, undervalue capacity development, and focus on maximization of revenue with existing family members and assets, rather than profit maximization, as a result of their family-focused orientation.

Agriculture, informal micro and small enterprises in retail commerce and services, and labor migration to Thailand, and increasingly to Japan and the Republic of Korea, provide the majority of employment and income creation options for the Lao population. Unlike agriculture, where income levels are low and around half of farming households live on subsistence levels, iMSEs and labor migration provide higher and more dependable income for related households, and working in manufacturing does so for a far smaller fraction.

Due to a combination of endemic and environmental factors, Lao firms are often low in productivity, in part due to the complexities of Laos' business climate, which includes high transaction costs and a lack of a transparent, dynamic, and



Despite legal requirements for employers, employment in bigger, official firms is overwhelmingly informal, with over 80% of people working without labor contracts or social-security coverage.



streamlined corporate environment. The majority of the businesses operate informally, evading the –often prohibitive– indirect and direct costs caused by red tape. Additionally, Laos’ economic environment is complicated by ambiguous tax rates and infrastructure difficulties such as transportation and power. Very few enterprises export directly, reflecting a predominantly inward-looking economy.

Laos aims to graduate from its LDC status in 2026, and long-term optimism about economic growth is founded in natural resources industries and improvement of infrastructure. The new government has placed a greater emphasis on inclusive economic growth, job creation, and income generating for the general public, rather than on GDP growth as a metric of success. Financial inclusion can play a key role in supporting the Government with these core objectives of their socio-economic policies, by leveraging household spending to help government fund its development objectives, and by aggregating and mobilizing capital contributing to financial sector development and investment. Financial inclusion also supports real economic activity and growth, which can support job creation and unlock broader economic growth. Thereby, financial inclusion contributes to SDG achievement at the household level, and inclusive economic development in the process.

With financial inclusion increasingly emphasizing the role of national financial systems as enablers for or lubricants of the real economy, policymakers need to take a long-term view with regard to developing inclusive markets that can lead to growth. The links between finance, economic growth and poverty are complex. Developing domestic financial markets requires an uncommonly sound grasp of consumers’ real economic needs at ground level. By better serving the needs of low-income sectors, countries can leverage a broader portion of the population in developing their domestic financial markets, while also unlocking new opportunities for financial service provision and real economic activity. Financial services can thus, in helping different segments meet their real economic needs, facilitate greater real economic activity, at the same time reducing opportunity gaps between low-income segments and the rest of the population.

It is therefore of critical importance to understand how financial services provision and access has changed, and what can be done to further enhance this, in contribution to inclusive growth. To ensure financial inclusion support development priorities, focus should be on enabling the well-regulated financial sector to invest and expand brick and mortar, as well as agent and digital footprints, and focus on and adapt to the real economic needs of dominant socio-economic segments of society in terms of income generation and employment, i.e. entrepreneurship, gender equality, healthcare, social protection, education etc.

To trigger financial sector expansion, investment in commercial banks, leasing companies and MFIs would be stimulated by a stable, conducive regulatory environment, and open constructive communication and cooperation between public and private sectors. In terms of financial-service markets, this requires rural savings to be intermediated nationally through the banking sector, credit to be issued based on repayment capacity and international remittances to be applied as an entry point for banks to engage the formal financially excluded



The links between finance, economic growth and poverty are complex. Developing domestic financial markets requires an uncommonly sound grasp of consumers’ real economic needs at ground level.



(rural) households. Generally, it also requires careful protection of the socio-economically vulnerable groups consisting of agricultural households, iMSEs and labour migrants, and setting strong industry standards on financial consumer protection. Towards the long-term future and slowly over time, digital and mobile-based payments can support financial and economic inclusion, but cash will expectedly continue to play a key role in financial intermediations for a long time to come.

Policy, institutional and regulatory framework level

The FIRM 2018-2025 has been the first policy document published in Laos specifically focused on financial inclusion. Building on that foundation, this MAP Refresh suggests to further elaborate a comprehensive long-term vision for financial inclusion to guide policies and interventions and an institutional framework for its realization and monitoring.

A recommended vision or definition is that financial inclusion is achieved when all individuals and businesses have access to and are able to effectively use a broad range of financial services that are responsibly and efficiently provided at a reasonable cost by sustainable institutions operating in a well-regulated market-based environment.

Development of such a vision could be supported and internationally referenced by the Government signing the Maya Declaration on providing formal-financial services to the financially excluded which is something the People's Bank of China, China's Banking Regulatory Commission, the National Bank of Cambodia, Bank Indonesia, the Bangko Sentral ng Pilipinas, and Bank Negara Malaysia have already done.

If the Government targets to further the vision of financial inclusion as suggested, it is recommended for the Bank of Lao PDR to join the Alliance to Financial Inclusion for support and international reference just like ASEAN financial sector regulators National Bank of Cambodia, Bank Indonesia, Bangkok Sentral ng Pilipinas, Bank Negara Malaysia, and Bank of Thailand; and Chinese financial sector regulators People's Bank of China and China's Banking Regulatory Commission have all already done.

Establishment of a permanent Financial Inclusion Office or Secretariat within BoL.

To support effective institutionalization of specialized expertise, establishment of a permanent Financial Inclusion Office or Secretariat *within BoL* with a strong, cross-supply-side cutting and dedicated mandate to advance financial inclusion and monitor progress would be effective. The Office should report directly to the Board of Governors of BoL and closely coordinate with internal and external stakeholders in public and private sectors, and with industry platforms.



Government endorsement of the FIRM and high-level Steering Committee. To ensure ample political support, the FIRM could be endorsed as Government Policy by Decree and a high-level Steering Committee for its implementation appointed. The Steering Committee could be assisted by the Financial Inclusion Office or Secretariat in the Bank of Lao PDR. Regular measurement of progress would support identification of effective policy measures. Such endorsement of the FIRM could well be effective in triggering donor programming on technical and financial support, as it has in other countries.



Need for more open, constructive dialogue between financial-sector authority and private sector. Over time, the financial sector's regulatory basis and supervisory mechanisms in Laos have become increasingly robust and lead to a significantly increased number of regulated FSPs and expanded outreach in terms of distribution networks and penetration across all product segments. There is however a need for more open, constructive dialogue between the financial-sector authority and banks and NBFIs, with a view of FSPs as partners that share the goal of a healthy and effective financial sector, as part of a risk-based approach to regulation. Timely communication and positive feedback loops on market trends, regulatory priorities and socio-economic development goals would be mutually beneficial, set up a more stable and predictable enabling environment for FSPs, would prevent or mitigate undue regulatory impact and thus be conducive for FSPs' trust and further investment in expansion of networks and services. Such could well be *organized in technical-working groups to function under the overseeing Steering Committee and assisted by the Financial Inclusion Office or Secretariat*. This approach would lower the need and demand for formal public-private sector dialogue in the Lao Business Forum, by identifying issues and jointly finding solutions *before negative effects occur*.

Publication and translation of acts, rules and regulations. Financial-sector authorities should ensure that all issued acts, rules and regulations are formally published in the Lao Gazette of the Ministry of Justice, in line with article 80 of the Law on Legislation, and where possible ensure availability of English-language translations, for which donors should provide funding.



Savings

Savings constitute the most demanded financial service and should be safe and liquid, given their importance in terms of providing a buffer and socioeconomic safety net for vulnerable low-income households. This imply requirements for providers, which should be financially healthy and operationally strong and for the regulator, which should limit deposit taking to licensed, well-regulated institutions that meet strict prudential criteria. Support for the Deposit Protection Fund, should be promoted, as it provides further scrutiny and awareness in FSPs. Savings in VSLFs are at serious prudential risk and illiquid and, if placed in the banking sector, would me more effectively allocated to support economic growth. The general trustworthiness and image of the regulated financial sector will encourage growing monetization of savings away from storage in kind, allowing intermediation of scarce resources to fuel economic growth. The continuing and improved stability of the national currency is a significant factor for this.



Payments

The payments ecosystem has made significant advancements in terms of both quality and reach. A foundation, in the form of a payment infrastructure and a regulatory and supervisory environment, has been established, and market players have been entering and breaking through previously existent distribution barriers with digital solutions and agent networks. The main challenge now is to strike a balance between promoting and enabling continuing market expansion on the one hand, and guaranteeing adequate prudential and consumer protection measures on the other. So far, the newly established PSD has handled this challenge and the rapidly increasing demand for supervisory engagement admirably well, especially given that it was only established three years ago (2018) and operates with just 22 employees, the majority (15) of whom are new and have no background, expertise, or experience working on the payment system.

Market participants are aggressively seeking to expand their services, and core elements of their business model are not yet covered by explicit regulations, but rather given conditional and caveated approvals with subsequent monitoring; fiduciary and consumer-protection responsibilities are growing, necessitating more detailed regulations and enhanced institutionalized capacity. The PSD has developed and adopted a comprehensive Strategic Plan for Payment System Development for 2021-2025, and has prioritized the elaboration of regulations and standards for both 2021 and 2022, while regularly regulating PSPs and payment systems under its jurisdiction. There is a critical need for PSD support to ensure ongoing positive progress.

Labor migration is a big socioeconomic issue for Lao (rural) households because it is their primary source of income and poverty alleviation. Because of the necessity to send money home to their family and dependents, labor migrants are a prospective target market category for banks, as remittances are often a first entry point for rural folk to seek knowledge about and participate with the formal financial sector. If correctly followed up on by FSPs, the opportunity can lead to the opening of savings accounts and of participation of previously unbanked persons in the formal sector.



Finally, the development of e-government and the digital economy are significant policy priorities of the government, which are deeply incorporated in the NSEDP and are inextricably tied to digital-financial outreach. The UNCDF has developed a tool to assist governments in assessing their ability to achieve a digitally inclusive economy, including DFS, identify constraints, set priorities, and measure progress, or in short, to manage the transformation – the so-called Inclusive Digital Economy Scorecard, which we recommend the Lao PDR apply.



Credit

The banking sector has witnessed just a modest increase in loan growth, although credit in local currency and from MFIs and NBFIs has seen a significant increase. Regulatory interest rate caps have an important impact on the expansion of credit in the economy. Despite regulatory hurdles, the leasing business had tremendous growth, which was primarily driven by FDI in the sector and consumer demand. In the credit market, one of the issues is a lack of awareness of responsible lending among the various types of FSPs and among those working at the macro, meso, and retail levels of the financial sector. The existing product offerings, which are based on subsidized loans, must be phased out and replaced by a robust, market-based financial sector. This is only possible if such an approach is supported at the highest political levels. When it comes to getting credit to homes and businesses in an effective and responsible manner, quality of credit should take precedence over quantity. Creditor information services have improved as a result of the functioning of the LCIC, but they must be further strengthened in order to function more efficiently.



Insurance

In recent years, formal public health insurance coverage has increased strongly, while social security coverage has increased gradually. The main gap is in the capacity of the regulator, both in terms of expertise, support infrastructure and systems, and numbers of staff. All main issues plaguing the public insurance sector, such as the lack of detailed regulations, of actual supervision and enforcement of standards, of sector coordination, of publication of sector data and information, lead to lack of trust in the private insurance sector, undermining its growth and development.

The private-insurance sector is in its infancy, with growth mostly driven by non-life insurance of risks associated with property and casualty, mainly compulsory third-party liability (TPL) insurance. In recent years, the insurance sector has witnessed a proliferation of providers emerge from a monopoly condition. With the exception of a few foreign-owned enterprises, the sector has a low level of compliance and risk awareness. Regulation and supervision of the private insurance market requires further improvement and technical assistance to the newly established private-insurance sector regulator, the Insurance Supervision Division of the Department of State-owned Enterprises and Insurance at the Ministry of Finance, is the main way forward towards establishment of a firm foundation for private-insurance sector development.



Financial Consumer Protection and Empowerment

There is an overarching need to raise industry standards to minimum levels determined by the Decree on Financial Consumer Protection and the SMART Campaigns Client Protection Principles at all regulatory, industry, and retail levels, and across the board in all types of FSPs. Apart from high levels of over-indebtedness and financial distress, and low levels of financial management capacity among the population, the need became apparent from the number of financial sector practitioners who referred to the issue as urgent during interviews conducted for this survey, and from the amount of attention paid to the subject during the most recent meetings of the LBF's FSWG. The Government recognized the issue's importance and recently published the Decree on Financial Consumer Protection, which establishes a legislative framework for connected actions and makes prioritizing such operations highly important.

Recommendations

Based on the findings of this diagnostic, the following recommendations can be made across financial product markets and areas:

Institutional environment

1. Redefine and set vision for financial inclusion as a condition where all individuals and businesses have access to and are able to effectively use a broad range of financial services that are responsibly and efficiently provided at a reasonable cost by sustainable institutions operating in a well-regulated market-based environment.
2. Government and Bank of Lao PDR are recommended to sign the Maya Declaration and become member of the Alliance for Financial Inclusion.
3. Government and Bank of Lao PDR are recommended to formally endorse FIRM, set-up a Financial Inclusion Office in BoL that reports directly to the Board of Governors and Government, a Steering Committee to oversee FIRM management and implementation, and technical-working groups to discuss technical issues and propose solutions.
4. Bank of Lao PDR should publish all regulations on Lao Gazette of Ministry of Justice and should publish regular, detailed, reliable sector information.
5. Bank of Lao PDR and Lao Statistics Bureau are recommended to hold five-yearly nationally representative quantitative demand side studies into uptake and usage of financial services and related motives.

Consumer Protection

1. Establish a permanent Financial Consumer Protection Office in BoL with the mandate to design, recommend, instruct, and monitor the implementation of financial consumer protection measures for banks, NBFIs, and PSPs, in order to support the implementation of the Government Decree on Financial Consumer Protection and the SMART campaign's Client Protection Principles. The Financial Consumer Protection Office should report directly to the Board of Governors and coordinate with internal and external stakeholders, including relevant departments within BoL, the MoF (on insurance), bank and MFI associations, and the LBF's FSWG.



2. Assess the degrees of awareness of CPPs and implementation. Through self-assessment questionnaire, the financial authorities, in collaboration with sector associations, should assess the degrees of awareness of CPPs among boards of directors and senior management, as well as the levels of institutionalization of CPPs within FSPs. A phased and risk-based regulatory approach should be devised in close cooperation and communication with the FSPs and their industry organizations based on the outcomes and subsequent verification of self-assessment findings during on-site and off-site monitoring.
3. Issue and enforce clear instructions based on Decree. Following that, supervisory departments for banks and NBFIs could issue comprehensive instructions for licensed institutions under their regulatory responsibility on the principles they should follow, as outlined in the Financial Consumer Protection Decree and CPPs.
4. Regular dialogue and interaction within the sector. BoL and sector associations, supported by development partners, are recommended to organize regular, periodical workshops on client protection organized and administered by the Consumer Protection Office or Secretariat, in order to promote awareness, constructive dialogue, and the development of solutions to the problem. Resulting documents and publications should be made available to all relevant internal and external stakeholders from the public and private sectors, as well as the development-partner community.
5. Strengthen DPF and widen the coverage. The technical and financial assistance offered by World Bank should strengthen the quality and reach of the DPF and should including technical assistance from the International Association of Deposit Insurers (IADI) and assistance in raising knowledge about coverage. DPF should become a member of the IADI, just like similar institutions from ASEAN countries Cambodia, Thailand, Indonesia, Brunei, Malaysia, Philippines and Vietnam.

Payments-ecosystem development

1. Development partners should provide ongoing, in-house, specialist-technical assistance and training, combined with budgetary and IT-infrastructure support to the PSD, targeted at realization of the objectives and activities of the *Strategic Plan for Payment Systems Development for 2021-2025*.
2. PSD to continue elaboration of regulations for PSPs as follows, in line with the strategic plan:
 - Guidelines on:
 - Electronic Money;
 - Electronic Fund Transfer;
 - Acquiring payments;
 - Payment Facilitating;
 - Bill Payment;
 - Agents (of PSPs).
 - Decisions on:
 - External Audit for Payment System Operators and Non-Bank Payment Service Providers;
 - Cross-Border Payment Services;
 - Bank Identification Numbers (BIN);
 - Business Rules and Message Specification.



3. PSD to enable MNOs' dedicated subsidiaries to interact safely with banks, financial-sector regulators and PSD should adopt legislation on trust accounts.
4. PSD to provide a real-time monitoring and reporting system for PSOs and PSPs, as well as relevant guidelines.
5. PSD to enable open and low-cost access to LAP Net's services for all licensed professional retail-PSPs, including NBPSPs, for which there is currently no clear regulatory requirement.
6. PSPs should begin holding regular meetings and, in the future, form a PSPs Association, and the PSD should lead or encourage such meetings.
7. PSPs and the government could encourage public-awareness and education campaigns on the use of digital and mobile financial services, focusing on micro and small businesses and the rural people, on national television and social media, and development partners should support such initiatives.
8. The PSD should provide for tiered KYC procedures, allowing for simple, low-value transactions.
9. Development partners should provide support to PSD to pursue Inclusive Digital Economy Scorecard to Laos.
10. Government (Ministry of Labour and Social Welfare), banks, NBPSPs, and development partners working on labor migration (International Organization for Migration, International Labour Organization) and financial-sector development (World Bank, UNCDF) should collaborate to:
 - Conduct comprehensive and detailed studies on remittance flows associated with Lao labor migration to primary destinations- Thailand, Japan, and the Republic of Korea, including methods of remittance, frequency, amounts used, motives, the impact of pre-departure preparation on modes of remittances, and the impact on receiving households, among other things.
 - As part of larger formal-migration preparation, prepare payment and savings-account focused financial-services preparation training. Pre-departure information and support may have a favorable impact on the labor migrants and their families' uptake.
 - Look into and implement low-effort, easy-to-access, low-cost cross-border formal remittance options.
11. UNCDF to offer application of Inclusive Digital Economy Scorecard, to the Lao PDR to Government.



Village funds

1. Rural finance provision by formal FSPs: The government should carefully assess impact and opportunity costs involved in favouring VSLF and broader village funds as the primary conduit for the provision of rural financial services in the long run. Instead, we recommend to consider a vision of rural finance provision by formal FSPs and enable the regulated sector actors to realize that potential. Donors should carefully assess if their efforts don't do any harm and if they should subsidize village funds.

Savings and credit regulated FSPs

1. The banking and DTMFI sectors should be allowed to thrive and encouraged to reach out by providing enabling conditions, such as allowance for market-based pricing, ease of opening branches and service units, and use of agent networks (in particular if such agents offer cash-in and out options).
2. Banks and DTMFIs should use low-threshold products for provincial and rural clients, and to welcome them through campaigns, office environment, and employee attitudes.
3. Banks and DTMFIs could engage in proactive savings initiatives, such as school-savings programs and the development of specific savings products tailored for certain and key life goals, such as going to college, marriage, retirement etc.
4. FISD should encourage DTMFIs to become members of the Deposit Protection Fund.
5. LMFA should support DTMFIs with application and approval processes involved in becoming a member of the DPF by liaising with the DPF and organizing workshops on the same.
6. Banks and DTMFIs to become members of the DPF.

MFIs

1. Government recommended to allow FDI in licensed shareholder-based MFIs along the lines of the authorization for commercial banks and leasing firms, which would allow up to 100% ownership. Prospective investors should be carefully screened for their levels of knowledge and experience in establishing Greenfield microfinance operations in Southeast Asia, as well as their vision and track record on social performance and client protection.
2. Bank of Lao PDR should stop prudential regulation of NDTMFIs and withdraw the notice that limits NDTMFIs to attract debt financing up to only 30% of their loan portfolio, but instead monitor and proactively supervise market behaviour.
3. FISD should clarify the recently issued Decision on interest rates for DTMFI and NDTMFIs (No. 319/BoL, 20/05/2020) to MFIs and MFA alike, on its actual and expected implications for deposit and credit interest rates in the short and long run. MFIs and the MFA should closely monitor and have interactions about the Decision's impact on MFIs' ability to attract liability funding, scale up operations, and reach credit growth targets, as well as their financial performance.



Credit markets

1. BoL is recommended to engage in constructive dialogue with the banking and NBFIs sectors to address the scarcity of LAK-denominated liability funding and to improve access to such funding. This can be done through:
 - Allowing market dynamics to determine pricing of deposits;
 - Stimulating interbank-market dynamics, where is required with support from development partners (e.g. IFC, IMF)
 - Investigating feasibility aspects of and supporting LAK-denominated corporate bond issuance.
2. Market-based MSME lending approach. The SME Promotion Fund and BoL should rethink their approach to MSME wholesale lending in order to adopt one that applies market-based wholesale lending conditions and does not interfere with the strategic marketing and pricing approach of FSPs.
3. Commercial banks and NBFIs should be incentivised to build institutional capacity to make loan-allocation decisions based on repayment capacity and willingness of borrowers, reducing information asymmetry between them and MSEs applicants.
4. The Government is recommended to carefully explore a long-term plan to phase out subsidized loans through the banking system and replace it with more effective subsidies, as well as social security and cash-delivery programs to protect the poorest and meet social goals. Aside from food security, agricultural subsidies should only be used strategically, based on thorough, well-researched and structured sub-sector-based restructuring plans that result in more efficient production and higher output.
5. LCIC to concentrate on institutional capacity building and work closely with IFC and other development partners for technical and financial support. BoL could act as an equity partner to urge the LCIC to engage in structural cooperation with IFC and other development partners.
6. The LNNCI SME Service Centres are recommended to continue and expand offering courses in administration and loan application preparation but at full-cost covering or commercial basis, i.e. not subsidized basis, following careful selection of the commitment of the owners of enrolling SMEs.

Insurance-sector development

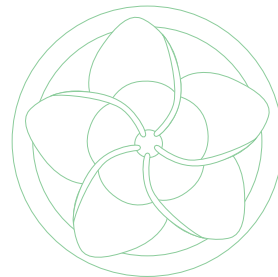
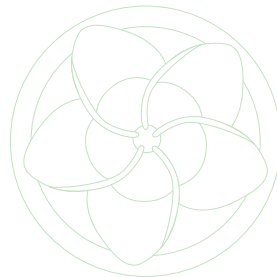
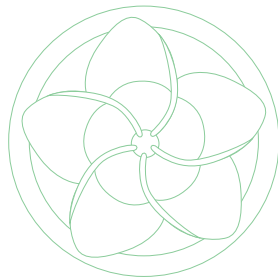
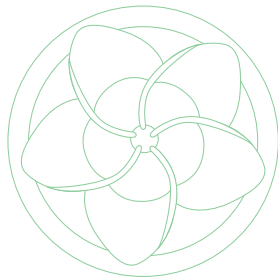
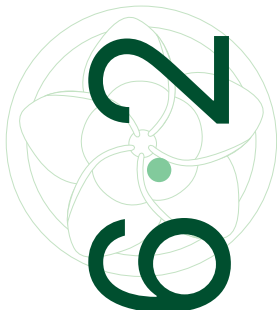
1. Government-led efforts to increase public awareness of Universal Health Coverage through print and electronic media, as well as collaboration with development partners to implement roadshows and campaigns.
2. Capacity building of NHIC. It is recommended to bring together development partners to create, finance, and implement ongoing institutional capacity building programs for the NHIC.
3. Development partners should conduct an up-to-date, comprehensive, and detailed assessment of the Insurance Supervision Division's institutional capacity-building requirements and create a capacity-building program.



4. Government should adopt a firmer political and legal stance on compliance with existing legislation on obligatory social insurance through the NSSF and on employment contracts by larger businesses (e.g., those with more than 20 employees).
5. Collaborate with the LNCCI to ensure that all members comply with mandatory social insurance requirements administered by the NSSF and with official, written labor contracts.
6. Government to ensure that the Insurance Supervision Division is truly institutionalized including hiring additional staff, providing a career path for existing staff and preventing rotation, establishing the necessary technical infrastructure, and establishing a strong regulatory and supervisory mandate and independence.

The proposals made above are intended to establish a required foundation for the Insurance Supervision Division. The primary issue that must be addressed initially in order to provide the groundwork for a successful private insurance market is the establishment of a capable regulator and supervisor. Without this basis, the following proposals cannot be implemented successfully:

1. The Insurance Supervision Division should continue to update and detail the regulatory structure in accordance with the new Insurance Law
 - continue to gather and publish data and information about the insurance industry;
 - conduct comprehensive and detailed on-site and off-site supervision of the private sector using a risk-based approach, and enforce regulations and standards more strictly where the financial health of individual private insurance companies, the sector's good name, and trust are at stake;
 - work closely with the traffic police and the Ministry of Transport to assist in the enforcement of motorists' mandatory TPL insurance requirements.
2. Professional and worldwide private insurance companies to collaborate pro-actively in developing a blueprint for standardizing TPL-insurance coverage, premiums, and commissions, and to seek authorization and enforcement by the Insurance Supervision Division.
3. Private insurance businesses should strengthen their ties with banks and microfinance institutions in order to cross-sell complementary insurance products such as life and home insurance to borrowers in the formal financial sector.



Implementation and evaluation

As seen from the previous chapters and paragraph, based on the finding of the MAP Refresh, we proposed to add and modify some recommendations. In addition, in order to offer a logical sequence of recommendations, we propose to reorganise as follows:

FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

2021 PRIORITY AREA 1: INSTITUTIONAL ENVIRONMENT AND INFRASTRUCTURE

2021 Recommendations

Policy

- Sign the Maya Declaration
- Clearly define and delineate financial inclusion and redefine the Vision of FIRM to include well-regulated and responsible provision only.
- Formally endorse FIRM following redefining vision.
- Ensure process for embeddedness of FIRM objectives in NSEDP

2021 Recommendations

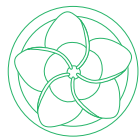
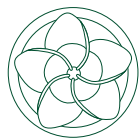
Institutional

- Join the Alliance for Financial Inclusion
- Establish a permanent, dedicated and mandated *Financial Inclusion Office* in BoL that reports directly to the Board of Governors.
- Establish a formally mandated Steering Committee to oversee implementation of FIRM, supported by the Financial Inclusion Office.
- Establish regular technical-working group meetings including relevant stakeholders from public, private and development sectors on issue suggested by the financial-services industry.
- Regularly publish detailed and relevant financial-sector statistics.
- Hold five-year comprehensive and detailed quantitative demand-side surveys into uptake and motives

2021 Recommendations

Regulatory

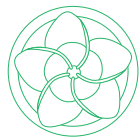
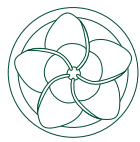
- Publish all valid financial-sector regulations on the Official Lao Gazette of the Ministry of Justice
- Enforce obligations for formal FSPs to publish audited annual reports.
- Engage in risk-based supervision and timely, cooperative communication with FSPs on regulatory targets and means to achieve those.



FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

2021 PRIORITY AREA 2: IMPROVE EFFECTIVENESS AND SUSTAINABILITY OF RETAIL-CREDIT MARKETS AND MARKETS FOR WHOLESALE-LIABILITY FUNDING.
Adapted from 2018 Priority area 1: Improve availability and sustainability of credit

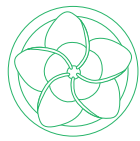
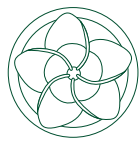
<p>Regulatory</p>	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Review impact of caps on interest rates on lending and liability funding by shareholder-based MFIs • Allow 100% FDI in shareholder-based MFIs • Withdraw prudential supervision of NDT MFIs. • Allow market dynamics determine liability-funding pricing of FSPs. • Stimulate interbank lending and facilitate corporate bond issuance by banks and NBFIs. • Do a case-study into success-factors of successful MSE-lending in Laos and publish results.
<p>Financial institutions</p>	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> • Develop new credit products especially those not dependent in collateralized lending • Develop refinancing linkages between FSPs (e.g. banks to NDT MFIs) • 2021 edits and additions • Hire expertise to design and institutionalize strategic-market approach, credit policies and credit-department and staff capacity targeted at assessing repayment-capacity assessment of MSEs and economically active-households.
<p>MSME wholesale lending platforms at BoL and SMEPF</p>	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Apply market-based wholesale-lending conditions that don't interfere in FSPs strategic marketing approach and pricing; • Support term lending; • Focus on MSME-loan size segment of up to LAK 500 million; • Support banks' lending to non-registered enterprises and economically-active households; • Make eligibility depended on a dedicated strategic approach to MSME lending, as evident from business plans and commitment by the Board of Directors and senior management.
<p>Credit Information</p>	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • LCIC should focus on institutional capacity building and welcome support from IFC and other development partners. • BoL should urge the LCIC to engage in structural cooperation with IFC and other development partners.
<p>Subsidized credit</p>	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Request expert studies into costs and benefits of subsidized credit, compare with alternative ways of achieving socially desirable outcomes using more direct, effective ways to subsidize, and feasibility aspects and strategic trajectories of phasing out subsidized credit, applying lessons learned internationally and in Laos. • Based on outcomes of the studies, develop a plan to replace subsidization through credit and formal FSPs by direct subsidies to agricultural producers, MSMEs and social beneficiaries that are directly linked to more effective production or social outcomes. <p>Adapted from 2018 recommendations:</p> <ul style="list-style-type: none"> • Review provision of subsidized credit by Government, with a view to reform that will help to reduce fiscal costs and improve credit discipline and impact effectiveness • Set to learn from international best practice



FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

2021 PRIORITY AREA 3: CONSUMER PROTECTION AND EMPOWERMENT
Adapted from 2018 Priority area 2. Consumer empowerment and protection

Regulatory, supervisory	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> • Introduce tiered KYC-regulations • Ensure consistency in regulatory requirements across different but similar types of institutions and consistency in interpretation of laws and regulations <p>2021 edits and additions</p> <ul style="list-style-type: none"> • Establish dedicated and mandated Financial Consumer Protection Office at the Board of Governors of Bank of Lao PDR • Take stock of awareness and institutionalization of CPPs in banks, NBFIs and PSPs. • Elaborate strategic regulatory approach to raising industry CPP standards in close cooperation with industry associations and development partners: <ul style="list-style-type: none"> - Prevention of over-indebtedness: lending decisions are based on borrowers' repayment or debt-service capacity. - Transparency on pricing and other conditions. - Mechanism for complaint resolution. - Fair and respectful treatment of clients. - Appropriate design of products and distribution. - Responsible financial-product conditions. - Privacy of client data. • Issue instructions to FSPs on compulsory institutionalization of CPPs. • Monitor FSPs market behaviour and compliance and sanction non-compliance.
Industry associations	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Ensure full compliance with CPPs, develop and implement a plan to that effect. • Develop Action Plan to: 1. take stock of current levels of awareness and compliance with CPPs within their sectors; 2. provide awareness raising material and information, and organize interactive workshops with experts on the issue; 3. offer technical assistance, either in-house or by hiring external technical experts. • Make compliance mandatory for members, and monitor and sanction market behaviour accordingly. • Regularly publish reports on compliance and progress on CPPs.
Development partners	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Support raising industry standards based on Government Decree on Financial Consumer Protection and CPPs
FSP	<p>2021 edits and additions</p> <ul style="list-style-type: none"> • Comply with Government Decree on Financial Consumer Protection. • Institutionalize the Client Protection Principles
Financial literacy	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> • Encourage FSPs to develop financial literacy amongst their customers • Aim to integrate learning on financial literacy into the education system



FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

2021 PRIORITY AREA 4: ELABORATE AND IMPLEMENT A RESPONSIBLE PHASE-OUT PLAN FOR THE GIZ-AFP VF SYSTEM.
Adapted from 2018 Priority Area 3. Strengthen village funds for sustainability and relevance to the rural population

Policy, regulatory

2021 edits and additions

- For Government: cease favouring of village funds.
- For BoL: continue existing deregulation of village funds.
- Elaborate a plan for responsible transition of the GIZ-AFP VF-NSO systems that have been licensed and/or registered by the FISD and actively seek donor support for elaboration and implementation of such plan.

Developmental

2021 edits and additions

- GIZ and German bilateral-development cooperation should reconsider their decision to withdraw any funding and technical assistance after May 2022 to the combined village-fund and NSO system they have set up over 12 years and instead design and support an adequate phase-out strategy.
- Mobilise broad-based monetary and technical support for the objective of supporting a prudent, responsible phase-out or strategic solution for the GIZ-AFP VF-NSO systems that have been under FISD supervisory responsibility.
- Cease subsidization of setting up village funds generally.
- Elaborate a comprehensive and detailed study to documents risks, impact and opportunity costs involved in favouring and subsidizing village funds.

2021 PRIORITY AREA 5: IMPROVE THE PAYMENTS ECOSYSTEM THROUGH MOBILE MONEY, DIGITAL-FINANCIAL SERVICES, AND IMPROVED PAYMENT INFRASTRUCTURE

Payment infrastructure

2018 Recommendations outstanding or relevant

- Participate in regional (ASEAN) cross-border payments and settlement system

2021 additions

- Enable participation of NBPSPs in LAP Net.
- PSD to recommend PSPs to set-up a PSPs Association and have regular meetings to provide relevant feedback.
- PSPs should start having regular meetings and set up a PSPs Association.

Mobile money

2018 Recommendations outstanding or relevant

- Refine business models on the basis of pilot experience and move from pilot to nationwide rollout as quickly as possible
- Ensure that agent networks function effectively, providing adequate liquidity for cash-out demands and mobile-money agents have convenient facilities for rebalancing cash and e-value.
- Ensure that agent network penetrate areas beyond the current reach of banks
- Encourage other banks and MNOs to consider MM products
- Support cross-border mobile money (especially Thailand-Laos)
- Introduce products linking mobile money to bank accounts

Developmental

2018 Recommendations outstanding or relevant

- Facilitate cross-border mobile money
- Establish payment service providers association for discussion of issues of concern to industry
- Promote interoperability between different mobile-money platforms and between non-bank mobile money providers and banks.

2021 edits and additions

- Provide ongoing, in-house, specialist-technical assistance and training, combined with budgetary and IT-infrastructure support to the PSD, targeted at realization of the objectives and activities of the Strategic Plan for Payment Systems Development for 2021-2025.
- Support public-awareness and education campaigns on the use of digital and mobile financial services using national TV and social media, focused on micro and small enterprises and on the rural population.
- Apply the Inclusive Digital Economy Scorecard to Laos. (new) development, policy
- Study remittances flows linked to Lao labour migration to Thailand, Japan and ROK and low-effort, easily-accessible, low-cost, cross-border formal remittance modalities; based on outcomes, prepare payment and savings-account focused financial-services preparation training as part of broader formal-migration preparation, and design related payment modalities.



FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

2021 PRIORITY AREA 6: EXTEND THE OUTREACH OF BANKS AND OTHER FINANCIAL SERVICE PROVIDERS

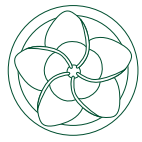
Regulatory	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> Remove regulatory barriers to the establishment of new branches by banks, MFIs and leasing companies, such as additional capital requirements
Products	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> More innovation in product design, moving beyond traditional products, to those more suitable for low-income households
Physical outreach	<p>2018 Recommendations outstanding or relevant</p> <ul style="list-style-type: none"> Financial institutions need to be more innovative in extending distribution networks through branches and non-branch channels Investigate the potential for branchless banking using independent (third-party) agents, such as retail stores, who would provide banking services on behalf of banks. Consider strategic alliances between banks and MFIs for better outreach

2021 PRIORITY AREA 7: ENABLE PRUDENT AND ACCESSIBLE SAVINGS SERVICES

Deposit Protection Fund	<ul style="list-style-type: none"> Lao Deposit Protection Fund (DPF) could become member of the International Association of Deposit Insurers (IADI). Development partners should technically and financially support improved quality and outreach of the Deposit Protection Fund (DPF), including procuring technical support from IADI, and support to increased awareness around coverage for the broader population. FISD should encourage DTMFIs to become members of the Deposit Protection Fund. LMFA should support DTMFIs with application and approval processes involved in becoming member of the DPF.
FSPs	<ul style="list-style-type: none"> Banks and DTMFIs should become members of the DPF. Banks and DTMFIs could engage in proactive savings campaigns and create savings products coined for specific and important life's targets, such as for education. Banks and DTMFIs should apply low-thresholds for provincial and rural clients and welcome them through in public relations campaigns, office design and staff attitude, including low level of required minimum balance, easy opening and withdrawal procedures, issuance of passbooks and low costs savings products.

2021 PRIORITY AREA 8: STRENGTHEN THE FOUNDATION FOR ENHANCED SOLIDITY AND OUTREACH OF INSURANCE-SERVICES SECTORS.

Public insurance sectors	<ul style="list-style-type: none"> Use national TV and social media to raise awareness for Universal Health Coverage Development partners should support the Government in raising awareness on Universal Health Coverage. Development partners should design, fund and implement continued institutional-capacity building programs for the National Health Insurance Bureau. The Government should support compliance of larger companies with existing regulations on compulsory social insurance through the NSSF and on employment contracts. The Government could cooperate with the Lao National Chamber of Commerce and Industry to support compliance of all LNCCI members with compulsory regulations on social insurance through the NSSF and formal, written labour contracts.
Private-insurance sector regulatory and supervisory foundation	<ul style="list-style-type: none"> Development partners should do an up-to-date, comprehensive and detailed assessment of required institutional capacity-building needs of the DSI's Insurance Supervision Division. Development partners should design and provide a comprehensive, intense, in-house, long-term and insurance-specific technical assistance program to DSI's Insurance Supervision Division based on outcomes of the assessment. The Government should ensure true institution building of the Insurance Supervision Division, including hiring additional staff, providing a career path for and prevention of rotation of existing staff, building the required technical infrastructure, and providing a strong regulatory and supervisory mandate and independence.



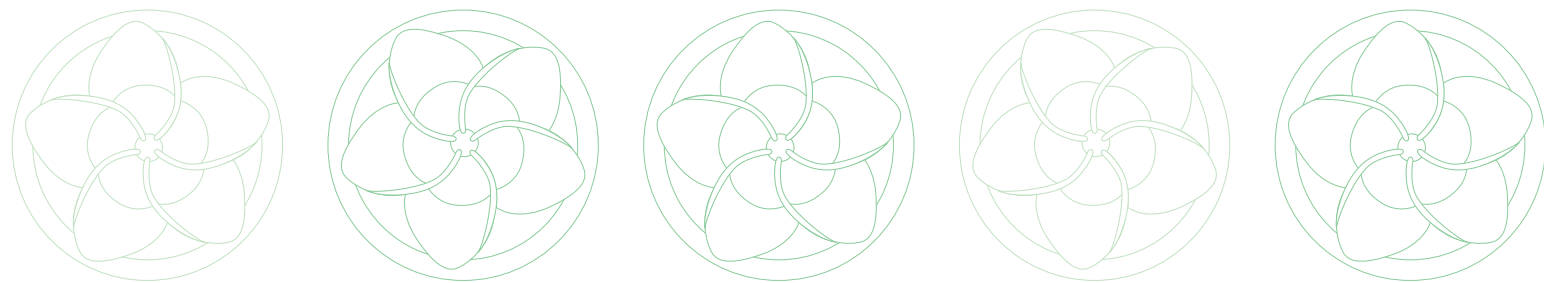
FIRM (2018-2025) PRIORITY AREAS OF INTERVENTION

Private-sector insurance development

- Continue updating and detailing the regulatory framework based on the new Law on Insurance.
- Engage in comprehensive and detailed on-site and off-site supervision of private-sector supervision applying a risk-based approach, and apply stricter enforcement of regulations and standards.
- Cooperate with the traffic-police and Ministry of Transport to support enforcement of compulsory TPL-insurance requirements for motorists.

Private-insurance companies

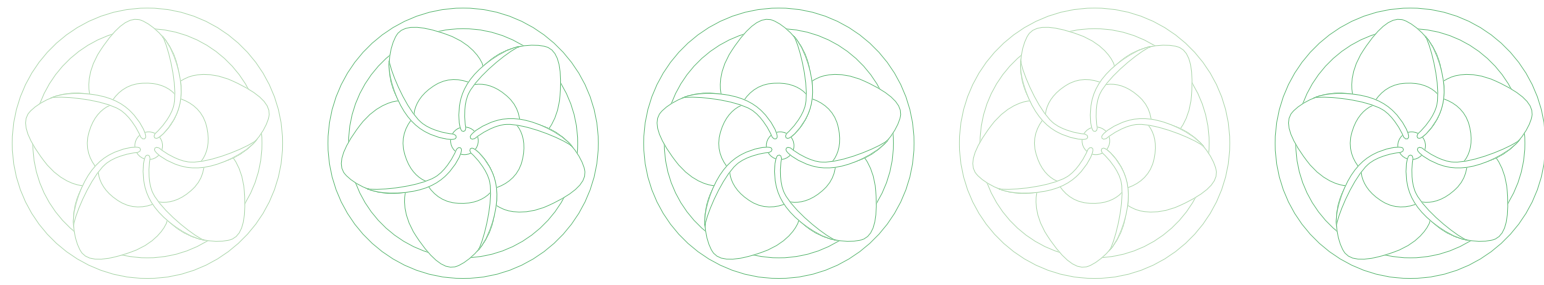
- Pro-actively cooperate in design of standardization of TPL-insurance coverage, premium and commissions, and request legalization and enforcement thereof by the Insurance Supervision Division.
- Continue linkages with banks and MFIs on cross-selling of insurance products that are complementary, such as life and house insurance to FSP borrowers.



Acronyms and abbreviations

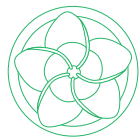
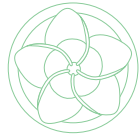
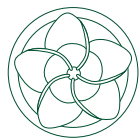
ACH	Automated Clearing House	LMFA	Lao Microfinance Association
ASEAN	Association of Southeast Asian Nations	LNCCI	Lao National Chamber of Commerce and Industry
ATM	Automated Teller Machine	LSB	Lao Statistics Bureau
BoL	Bank of Lao PDR	MAP	Making Access to Financial Services Possible
CCH	Cheque Clearing House	MDG	Millennium Development Goal
CPI	Consumer Price Index	MFIs	Micro Finance Institutions
DSI	Department of State-owned Enterprise and Insurance Department	MNOs	Mobile-network Operators
DTMFI	Deposit-Taking Microfinance Institution	MOH	Ministry of Health
ECE	Early Childhood Education	MoIC	Ministry of Industry and Commerce
FDI	Foreign Direct Investment	MSEs	Micro and Small enterprises
FIRM	Financial Inclusion Roadmap 2018-2025	MSME	Micro, Small and Medium Enterprises
FSPs	Formal Financial-Service Providers	NBFI	Non-Bank Financial Institutions
FSWG	Finance-Sector Working Group (of the Lao Business Forum)	NBPSP	Non-Bank Payment Service Providers
GBV	Gender Based Violence	NDTMFI	Non-Deposit-Taking Microfinance Institution
GDP	Gross Domestic Product	NHI	National Health Insurance
GDI	Gender Development Index	NHIF	National Health Insurance Fund
GGGI	Global Gender Gap Index	NPL	Non-Performing Loans
GII	Gender Inequality Index	NSEDP	National Socio-Economic Development Plan
GNI	Gross National Income	NSSF	National Social Security Fund
HDI	Human Development Index	ODA	Official Development Assistance
HSRS	Health Sector Reform Strategy	POS	Point-of-Sale
IADI	International Association of Deposit Insurers	PSD	Payment Systems Department
ICT	Information and Communication Technology	PSP	Payment-Service Providers
IMF	International Monetary Fund	RTGS	Real Time Gross Settlement
iMSEs	informal Micro and Small Enterprises	SCU	Savings and Credit Unions
LAK	Lao Kip (the national currency of the Lao PDR)	SDGs	Sustainable Development Goals
Lao PDR	Lao People's Democratic Republic	SOE	State-owned Enterprises
LAP Net	Lao National Payment Network	STEP	Skills Toward Employment and Productivity
LBA	Lao Banks Association	UNCDF	United Nations Capital Development Fund
LBF	Lao Business Forum	USD	United States Dollar
LCIC	Lao Credit Information Company	VF	Village Funds
LDC	Least Developed Countries	VSLFs	Village Savings and Loan Funds
		WASH	Water, sanitation, and hygiene

Throughout this report, the Lao PDR and Laos are used to describe the Lao People's Democratic Republic, while Lao is used as an adjective and adverb, or to describe nationality, language, and ethnicity. The national currency of the Lao PDR is the Kip (LAK). Throughout the report, the exchange rate used to convert a value in LAK to a value in USD is 9,400 LAK for 1 USD, which is the three-month average exchange rate over the period March-May 2021.1



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