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Policy Guidance

Capitalizing Social Protection in Lao PDR

October 2020

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	Introduction	1
	Policy Guidance	2 to 3
	Capitalizing Social Protection in Lao PDR	4 to 5
	NSPF Capitalization Issues	6
	Case Review	7 to 11

The UN Capital Development Fund makes public and private finance work for the poor in the world's 47 least developed countries (LDCs).

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UNCDF's financing models work through three channels: (1) inclusive digital economies, which connects individuals, households, and small businesses with financial eco-systems that catalyse participation in the local economy, and provide tools to climb out of poverty and manage financial lives; (2) local development finance, which capacitates localities through fiscal decentralisation, innovative municipal finance, and structured project finance to drive local economic expansion and sustainable development; and (3) investment finance, which provides catalytic non financial structuring, de-risking, and capital deployment to drive SDG impact and domestic resource mobilisation

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Introduction

This report is part of a 2-part report on the capitalisation of the National Social Protection Fund (NSPF) of Lao PDR. In this report, we address: (i) Current state and complexity of social protection in Lao; (2) Problems facing NSPF capitalisation; and (3) A brief case study of social protection funds in Thailand.

We picked Thailand as the country has gone through many reiterations of social protection funds and successfully adopted the universal healthcare fund (UHC), which we deem as an important milestone. Thailand is also culturally similar to Lao PDR and we believe it is an easier path for Lao PDR to consider following the Thailand's model. We did consider Vietnam as Laos' peer but we believe Vietnam's market is evolving and still lacks transparency, especially on the debt market. There is also no credible credit rating agency in Vietnam.

Our review of Laos' social protection situation, a case study in Thailand, and Lao bond trend and capital market exposure leads us to propose solutions in the Key Findings section below, which we will examine further in details in our next report which we will focus on: (1) A range of funding solutions for Laos' NPSF; (2) Major criteria for selecting an ideal funding solution; and (3) Our recommendation on how to capitalise NPSF.

Policy Guidance

The study suggests key considerations for policy makers in terms of the National Social Security Fund (NSSF)

Policy Consideration 1 - Consolidation

Our study on the current social protection schemes in Lao PDR leads us to believe Lao PDR will need to consolidate its national protection under one scheme under NSPF in order for the fund to be easily managed and funded. One fund will enable Lao PDR to allocate government budget more easily and the fund could be managed from one office, which will also save the country a budget to build up expertise in many offices.

Policy Consideration 2 - Creating a New Pathway

We do not believe Lao PDR has a luxury to run various funds (similar to Thailand) at the same time when the Lao government is trying to avert the default next year. We are of the opinion that Lao PDR also should not wait to fund its NPSF as its population is ageing.

Policy Consideration 3 - Debt Financing

Laos' debt situation, as pointed out in our study of the Lao bond trend and capital market exposure, tells us the country does not have any room to borrow this or next year, especially in an international market. Even in a domestic market, local borrowing only crowds out investments which are very crucial for economic recovery at the time of COVID-19 pandemic. We said in the last report the path the Lao government should follow in order to issue international debt again.

Policy Consideration 4 - Blending Finance for NSPF

That said, we believe the best way to fund NSPF is through blended finance (i.e. grants or official development assistance (ODA)), public sector budget through expense reallocation and expense cuts, and contributions from employees and employers with the latter being kept at the minimum for those earning at the low to middle income brackets in order to boost domestic spending as much as possible. It is paramount that the government provide finance from the public sector budget that can be complimented with ODA and employer / employee contributions in order that SP becomes a annual budget item with international classification through specified accounting codes. Today, SP (apart from the civil service) is not budgeted for by government. The blended finance option in the medium to long term will also require that debt financing instruments (bonds) are utilised.

Policy Consideration 5 - A Professionalized Fund

The example of Thailand's Government Pension Fund provides a concrete example of a professionalized fund that Lao PDR should create in the context of the NSPF a professionalised fund. It is recommended that the NSPF is similarly organised and carries a comparable mandate and independent operational jurisdiction allowing the fund to invest in a broad range of different global and domestic asset classes. It is suggested that the Fund be established to invest but also to allow for the use of fund managers to ensure that sustainability of the NSPF.

Policy Consideration 6 - Regaining Fiscal Space

We believe Lao PDR should also seek to restructure its debt through a multilateral development organisation (such as International Monetary Fund, Asian Development Bank, Asian Infrastructure Investment Bank, and/or the new International Development Finance Corporation) as well as bilateral loan maturity extension. Once debt service obligations are reduced to c.USD750m from C.USD1bn for the next 3-5 years, we believe the Lao government will have more room to maneuverer its budget to fund NSPF. We will examine these potential solutions above in more details in the next report.

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Introduction
Policy Guidance
Capitalizing SP
Capitalization Issues
Case Review

Capitalising Social Protection in Lao PDR

Lao Ministry of Labour and Social Welfare (MoLSW) operates two social security systems, each for public and private sector employees under the Civil Servant System (CVS) and the Social Security Organisation (SSO), respectively. Lao Ministry of Public Health runs the Community-based Health Insurance (CBHI) and Health Equity Funds (HEF). CVS is a contributory social security system with contributions of 8% and 8.5% from employees' salaries and employers' payrolls, respectively. SSO applies to all employers with 10 or more employees with contributions of 5% and 4.5% from employees' salaries and employers' payrolls, respectively.

CBHI, under technical assistance by the World Health Organisation (WHO) and grants from United Nations Humanitarian Security Fund (UNHSF), targets population in the informal sector with voluntary membership and family coverage. Last but not least, HEF was designed with the World Bank, Asian Development Bank, and WHO to cover the poor's health care by purchasing CBHI cards for poor families. To the extent of our study, all social protection funds in Lao are funded by the government's budget, members, and grants from donors.

2017 Labour force survey shows that only 14.4% of the population was covered by a social protection scheme. Of the country's 4.8m working age population, only 15.8% was covered. The Lao government aims to provide a national projection floor (i.e. social security and healthcare) for all citizens in all stages of life by 2030. That is, the government plans to merge all the social protection systems into NSPF under National Social Protection Strategy (NSPS) which envisions universal access to social protection services through a continually capitalised fund which should be designed to ensure timely payments. NSPS aims to provide the following:

- Citizens with health services;
- Employees and self-employed entrepreneur a formal sector with social protection schemes covered by social security;
- Unprotected workers in an informal sector with access a higher level of social security protection and;
- The most vulnerable citizens with social welfare such as cash grants.

For NSPF to work, we believe a self-funded portfolio of investment will be needed to provide predictable cash inflow to pay claims. The portfolio can be funded by budget, grants, debt, and contributions by the population. In addition, the administrative function of NSPF needs to make sure the information and benefit distribution systems are properly designed to handle the disbursements and claims. The Lao government needs to ensure its budget accounts for NPSF in terms of 2 percent of GDP and 2 of government expenditure.

In addition, stakeholders need to monitor the implementation and provide inputs/predictions such as targeted employees and self-employed entrepreneurs or disabled persons to be covered under NSPF. UNCDF is helping the Lao MoLSW and Ministry of Finance (MOF) to develop a business plan, including an entity location, use of funds, management of NSPF, revenue structure, fund mandate, fund size, financial modelling, jurisdiction of NSPF and so on.

Lao PDR has relationships with many multilateral organisations on setting up social protection funds. NSPF is simply a new brand of all the 4 existing plans (CVS, SSO, CMBI, and HEF), in our view. As such, we believe the Lao government should try to utilise technical assistance and grants (as well as official development assistance) from organisations such as UNHSF. The need to fully utilise grants stems from Laos' limitation to borrow and allocate additional government budget to establish NSPF. Here are the funding limitations at the Lao government:

First, the current state of Lao economy in light of the COVID-19 (as pointed out in our Capital Market Exposure report, dated 9-Sep) does not allow for additional debt without lowering debt service obligations in the next 3-5 years. Moody's downgrade of Lao issuer credit rating on 14-Aug closed a window for Lao PDR to issue any international bonds to refinance in its debt maturity. Its continued fiscal and current account deficits will force the government to repay debt through foreign exchange reserves as well as foreign direct investments. The 1-Sep announcement of China Southern Power Grid (CSG)'s equity injection is good news, in our view, but the lack of details on the amount, timeline, and conditions will prevent Lao from issuing debt to fund NSPF in the near term.

Second, the 2018 GDP per capita of USD2,542 (vs. Thailand's USD7,274 and Vietnam's USD2,557) will make Laos' NSPF unable to rely too much on member contributions. Third, as reported in the 9-Sep report, the Lao government revenue is on a decline. Budget allocation may need to be prioritised toward helping Lao citizens survive through COVID-19 first rather than funding NSPF. In addition, the chronic fiscal deficit will require the government to cut spending and that could include staff cuts, in our view. Last but not least, Laos' population is raging against Lao's inability to internally fund NSPF (EXHIBIT 1). That said, the possible funding amount for NSPF is difficult to predict, in our judgment, until Lao economy stabilises.

Introduction
Policy Guidance
Capitalizing SP
Capitalization Issues
Case Review

NSPF Capitalisation Issues

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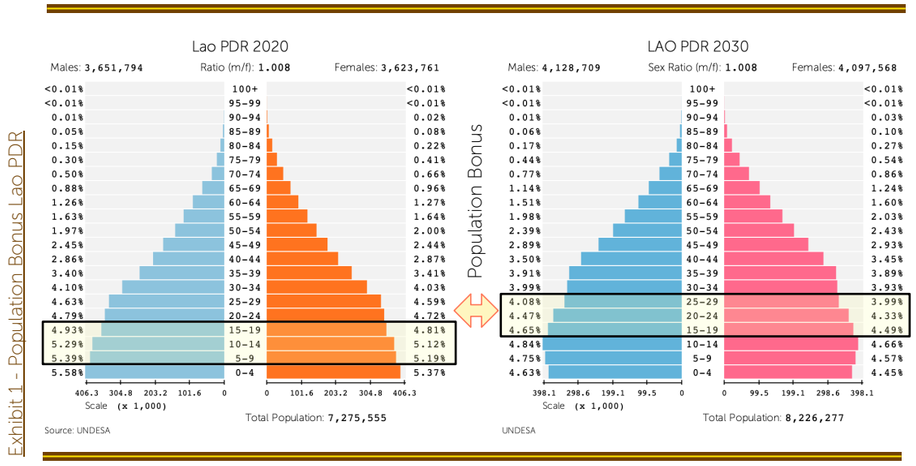

Exhibit 1 - Population Bonus Lao PDR

Case Review - Social Protection in Thailand

Social protection schemes in Thailand primarily includes Government Pension Fund (GPF), Social Security Fund (SSF), and the National Pension Fund (NPF). A heath care plan is UHC which is also known as the "THB30-cure-all" scheme. The capitalisation of Thailand's social protection fund is a combination of member contributions as well as budget allocation. There is no leverage on any social protection schemes in Thailand.

Government Pension Fund - Thai Civil Service

GPF is for government employees to contribute 3%-15% of salaries with a mandatory contribution of 3% and voluntary contribution from 1% to 12%. The government tops up 3% on the mandatory portion and another 2% beyond the mandatory portion The fund, at c. USD32bn in size, invests into 18 different asset classes that for the purpose of this document have been arranged under five headings (EXHIBIT 2). The main bulk of investments c.80% are fund to be in local and overseas bonds and increased its holding of foreign equities from 5.1% in March to 9.5% in August. The fund also invests in illiquid assets such as real estate and private equity funds of c.10% at the time of this report.

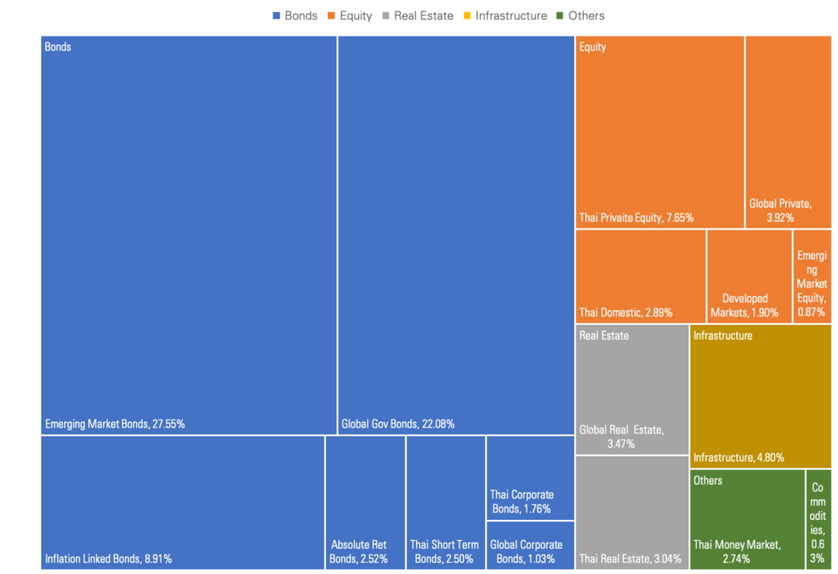

Exhibit 2 - Thailand GPF Asset Classes investments

The GPF's investment policy is governed by legislation and ministry bylaws and carries a complex fund management structure. Notably, the GFS uses an external fund manager for investment purposes. The key investment policy areas for the fund are

- Diversify the portfolio to minimise risks and maximise returns;
- Review and evaluate the asset allocation every 3 years or when major incidents/turning points occur;
- Set clear investment targets, benchmarks and methodologies along with effective monitoring and evaluation and compliance programs;
- Appoint fund management companies specialised in managing specific investments in different asset classes;
- Allocate funds to internal and external fund managers as per the Committee's policies;
- Define clear and transparent investment management procedures with clearly defined roles and responsibilities of relevant divisions which work together in a system of checks and balances. Ensure that the Fund's operations strictly comply with the laws and investment regulations.

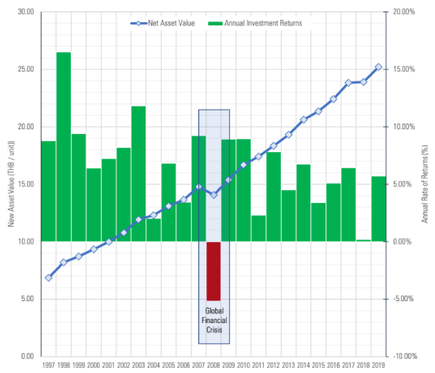

Exhibit 3 - GPF Performance Data

We understand GPF faces a challenge to boost returns as a result of a declining bond yield on the COVID-19 situation. GPF's 2019 return was 5.7% versus the averaged 4.3% during the previous 5 years (EXHIBIT 3). GPF's management aims at 4% return between 2019 and 2021 and seek to increase its maximum overseas investment to 40% from the current 30% in order to boost risk-adjusted returns.

Social Security Fund - Private Sector

Introduction
Policy Guidance
Capitalizing SP
Capitalization Issues
Case Review

The roots of Thailands Social Security Fund (SSF) can be traced back through the introduction of various pieces of labour legislation during the 1950s that was updated in the 1990's. Presently Thailands social security system is legalised through; the 1990 Social Security Act (amended 1994 and 1999 and the 1994 Workmen's Compensation. The first insurance scheme - the compulsory workmen's Compensation Scheme was implemented in 1974 .

The SSF sets an objective to guarantee benefits for injured persons and providing relief, especially for distressed persons and families. The SSF provides for a basic and standard social protection package covering; (i) Sickness, (ii) Maternity, (iii) Child Allowance;, (iv) Death, (v) Pensions and (vi) Unemployment Benefit. The SSF is funded through three distinct flows; Employer (5 percent), Employee (5 percent and the public sector budget 2.75 percent (EXHIBIT 4).

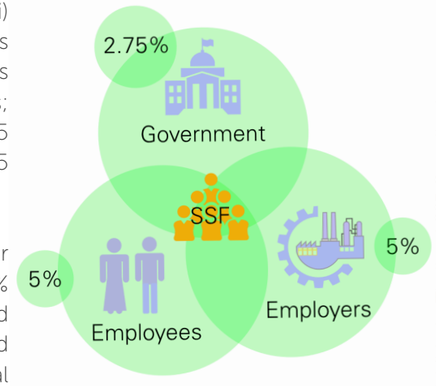

Exhibit 4 - Thailand SSF Contributions

SSF, at US$65 bn in size, is for all other formal employees with contribution of 5% each from both employers and employees. A supplement of 2.75% is paid by the government, bringing total contribution to 12.75% for each formal employee. We note the contribution has been temporarily reduced to 2% for both employees and employers, respectively, in September in light of a COVID-19 crisis.

Thailand is in progress to require companies with at least 100 employees to set up NPF. Under the draft law, employers and employees will be required to each contribute 3% of an employee's salary for the first 3 years before increasing to 5% during 4th to the 6th years, 7% between the 7th and the 9th years, and 10% from the 10th year on. We understand the seed capital for the fund was set at THB60bn. In essence, NPF and SSF will be mandatory for all formal employees at companies with at least 100 employees.

The Workmen's Compensation Fund (WCF)

The Workmen's Compensation Fund (WCF) solely provides employees with; (i) a guaranteed compensation from employers in case of accident and or disease from work, (ii) to provide rehabilitation so that workers who suffer from disability can recover to earn a living and (iii) promotes health and safety in the workplace from the perspectives of employer and employee responsibilities. In accord to the prevailing legislation, The Workmen Compensation Act passed in June 1994 and which came into force on July 1, 1994. the employers finance the WCF which is an occupational injury fund. The WCF does not payout extensive levels of compensation but provides for basic support, however disability payments are maximised upto 15 years.

	Notes	THB
Medical Services		
Nominal	basic	45,000
Max upon condition	Injury and responsibility	300,000
Cash Benefits		
Temporary Disability	60% of salary	1 year
Partial Disability	60% of salary	10 years
Permanent Disability	60% of salary	15 Years
Death	60% of salary	8 Years + FG
Funeral Grant	National min wage x 100	22,100
Rehabilitation Charges		
Medical and Rehabilitation		20,000 max
Operational Charges		20,000 max

Universal Health Care (UHC)

UHC was designed to cover every citizen. The government injects capital every year into public hospitals and asked each hospital to provide care to every visiting patient. The care under UHC is basic and patients who asked for premium treatments are suggested to seek care under their own budgets.

We understand the plan is far from perfect and some public hospitals have reportedly refused to provide treatments for complicated diseases that can be expensive to treat. Although some policymakers wish to ask citizens to help pay for the expensive cost, the reform is slow as UHC can be political and easily picked up to criticise the government. In our view, the success of UHC in Thailand stems from (1) multiple government commitment to make it happen and (2) Thailand's abundant healthcare resources, especially the requirement for new doctors to serve in rural areas for a few years.

Health Expenditure in Thailand

Healthcare expenditure for Thailand is illustrated below (EXHIBIT 5) which is desegregated by source i.e; public sector, household and private. Generally there has been a constant increase in value terms especially in the context of the public sector budget. As a value - public health expenditure has increased 8 fold from 56.8 million THB (1994 to 472.6 million (2017). In terms of expenditure as a percentage of GDP (LCU) in 1994, public health expenditure equated to 1.54 percent increasing to 3.05 percent in 2017.

As highlighted the public health expenditure as a percentage of GDP illustrates a volatile and unpredictable characteristics of public sector policy making, since it mat be considered that predictable heath care expenditures need to be established so to assure long-term investments and public service delivery

The expenditure as a percentage of GDP provides a useful measure for public policymaking in Lao PDR. Thailand has been providing over 2 percent of GDP towards public financed health care since 2002 reaching to over 3 percent in 2016, equating to 472.5 million THB.

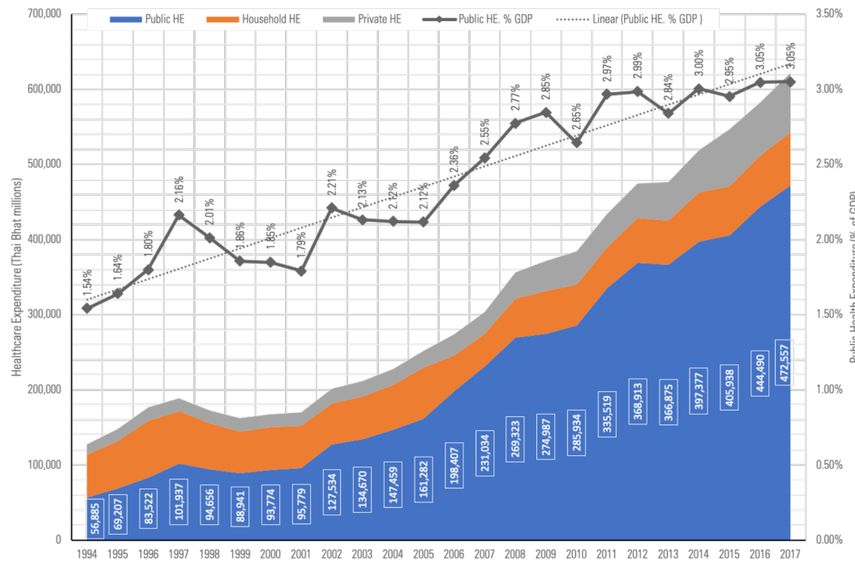

Exhibit 5 - Thailands Expenditure on Healtcare

Introduction
Policy Guidance
Capitalizing SP
Capitalization Issues
Case Review

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Policy Guidance Note

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