

This Action with a EUR 5 M contribution from the EU and AUD 10 M co-financing from Australia, builds on the strong foundations laid by the successful ongoing EU-funded PFM reform programme implemented by the World Bank. It will continue supporting PFM reforms. In this new phase, the Action will reinforce our policy dialogue on PFM, in partnership with Australia (through a WB PFM Umbrella Trust Fund), and it will place emphasis on reinforcing line Ministries' PFM, piloting gender and green budgeting, improving the governance of State enterprises, and strengthening the National Assembly's financial oversight role. The action thus remains closely interlinked with our budget support and planning/ budgeting technical assistance in education, and with the new EU-funded governance project, as all these operations are mutually reinforcing.

2 RATIONALE

2.1 Context

Laos' **rapid economic growth** over the last three decades (annual average of over 7%) propelled the country from a low-income to a lower middle-income status, and it is expected to **graduate from LDC status in 2026**. Laos' GDP per capita of USD 2,570 in 2019 (according to the WB) is more than ten times the figure in 1990, and the poverty rate more than halved between 1993 and 2019, falling from 46% to 18%. The strong growth potential, rich natural resources, the establishment of several Special Economic Zones, and recent massive infrastructure investments to improve its trade links with the ASEAN, China and beyond, opens **important opportunities for private investment and job creation**. Improving the business environment and continued investment in infrastructure and logistics will be key for unleashing this high potential, while ensuring environment, social and governance (ESG) responsible business approaches, bearing in mind the do-not harm principles and leaving no one behind. EU trade with Laos is very modest in comparison to our trade with neighbouring ASEAN countries (EU Member States together represent the 4th largest trading partner to Laos). According to the International Trade Centre (ITC), and considering **European partners' interest to increase trade and investment with Laos**, there is significant potential for inclusive growth.

Rapidly rising debt and the COVID-19 pandemic are creating important **macroeconomic and fiscal challenges**, which require more efficient public finance management. Although Lao PDR managed to avoid the spread of the COVID-19 pandemic in 2020, its economy was severely impacted (estimated GDP growth of only 0.5% in 2020 and 2% in 2021). The surge in cases in mid-2021 (up to about 35,000 in October 2021) and the strict lockdown measures are having a direct impact on Lao PDR's socio-economic development.

The Government has embarked on the **9th National Socio-Economic Development Plan (NSED) 2021-2025**, which has fully embraced the Agenda 2030, and seeks to foster **sustainable, green and inclusive growth**. The overall objective of the 9th NSED is *"to focus on the socio-economic development based on the country full potentials in order to strongly graduate from the Least Development Countries (LDC) with quality, well-balanced and green growth and to achieve the sustainable development goals in 2030"* focusing on six main pillars including Sustainable and Diverse Economy, Human Asset Development, Livelihood Improvement, Environment Protection; Climate resilience and Governance. In a context of reduced revenues and rapidly-rising debt, PFM reforms have become very high on the agenda of the new Lao Government and National Assembly. The new Prime Minister has expressed very strong commitments to macroeconomic and fiscal consolidation, and to improve the efficiency and transparency of public administration, including fighting corruption.

The Government acknowledged the role of social protection in reducing poverty, inequality, and vulnerabilities and in promoting socio-economic development and social cohesion. In 2018 Lao PDR participated in constructive dialogue with treaty bodies on the basis of its initial report on the International Covenant on Civil and Political Rights, the combined third to the sixth Child Rights Convention reports, and the combined eighth and ninth reports on the Convention on the Elimination of all Forms of Discrimination against Women.

The **new PFM action plan (2021-2025)** expected to be approved in February 2022 outlines priority activities aimed at addressing the weaknesses identified in the 2019 Public Expenditure and Financial Accountability Assessment (PEFA) Report. These activities include (i) improving fiscal policy, (ii) developing and revising legislations, (iii) improving revenue management reform; (iv) improving expenditure management reform; (v)