# Policy Brief
# Simulated impacts on growth and financing of social protection in the Lao People's Democratic Republic

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## Economic Challenges

Before the COVID-19 pandemic, the Lao People's Democratic Republic had achieved high economic growth rates since it transitioned to a market economy. Economic growth averaged about 7–8 per cent from 2003 to 2019.

However, this economic growth might not be sustainable in the long run. Firstly, the Lao economy is highly dependent on the resource sector; this could have a negative long-term impact in the form of what is called "Dutch disease"[1] (Corden 1984; Corden and Neary 1982). Secondly, the Lao People's Democratic Republic still has a high poverty rate, and income gaps have increased.

The recent economic growth has not effectively reduced the poverty rate and inequality. Thirdly, human capital is poor, with the country's Human Development Index being low overall and lagging behind other countries in the Association of Southeast Asian Nations (ASEAN). Fourthly, the Lao People's Democratic Republic faces problems around poor nutrition, and school enrollment is relatively low.

Despite increased consumption and reduced poverty, malnutrition remains a serious problem, especially in pregnant women and young children. Improving nutrition among pregnant women and small children is one of the Lao People's Democratic Republic's most critical tasks.

In addition, it appears that the COVID-19 pandemic will have a severe impact on long-term economic development. The pandemic has not only had a direct impact on the Lao economy, but it has also an impact on long-run economic growth through declines in labor productivity and total productivity. A recent empirical study showed that the accumulated effects of COVID-19 on gross domestic product (GDP) growth would be -25.36 per cent over a period of 28 years – or about -0.91 per cent annually (Kyophilavong, forthcoming).

In addition, the COVID-19 pandemic also saw a decline in industry output, household income, household expenditure, and welfare – all of which will have a long-term impact on growth.

[1]The Dutch disease refers to the booming of natural resources (oil, gas, mineral, etc.) that causes a decline in other sectors (manufacturing or agriculture), leading to a decrease in economic growth.

# Reasons for investing in social protection

Human capital is the engine of economic growth, and it is therefore generally believed that enhancing peoples' ability to receive, decode and understand information is essential (Schultz 1961; Becker 1962). The human capital accumulated through education facilitates technological progress through improvements to existing technologies or the development of new technologies (Romer 1990).

Therefore, from an economic growth theory perspective, it is clear that health and education investments play an important note in long-run economic growth in developed and developing countries.

The highest investment return comes from investment in education (17 per cent return annually on average). Across all levels of education, investment in pregnant women and early childhood development is the most important, and they have an 18 per cent return on investment annually (Heckman 2008; 2011).

Maternal and child nutrition are crucial challenges in both individual and national development. The benefits of good maternal and child nutrition include reduction of morbidity and mortality in childhood; improvement of cognitive, motor and socio-economic development; improvement of school performance and learning capacity; improved adult status; and improved work capacity and productivity (The Lancet 2013). As a result, good maternal and child nutrition will benefit individual and economic development.

Therefore, it is crucial to provide social protection aimed at pregnant woman and early childhood development.

# Predicted impact of social protection

Empirical studies from a computable general equilibrium (CGE) model and micro-simulation conducted under the United Nations Joint Programme “Leaving no one behind: Establishing the basis for social protection floors in Lao PDR” show that social protection will increase accumulated real GDP by 33.79 per cent over 28 years, or by 1.21 per cent annually (Kyophilavong, forthcoming). The study also showed that social protection would increase industrial outputs, reduce the trade deficit, and increase household income and welfare.

In addition, the simulations showed that social protection would reduce poverty and inequality. Poverty would be reduced by 0.62 per cent and inequality would be reduced by 0.23 per cent in just the first and second years of providing social protection benefits to pregnant women and newborn children.

Social protection not only increases expenditure among benefit recipients, which has multiple effects on production and growth, but it has a significant impact on increasing skilled labor and productivity among skilled and unskilled workers.

In the absence of adequate social protection and due to the long-term effects of COVID-19, the Lao People’s Democratic Republic will experience low economic growth (Kyophilavong, forthcoming). But if the Government does adequately invest in social protection, the country will recover from the pandemic and experience high levels of economic growth.

Thus, social protection is ultimately crucial for the long-term development of the Lao People’s Democratic Republic.

# Financing sources for social protection programmes

The literature shows that natural resources-rich countries frequently neglect to invest in education (Gylfason 2001). As a result, their economic growth becomes slow and stagnant (Sachs and Warner 1995; Leite and Weidmann 1999).

The Lao People's Democratic Republic is ranked as a resource-rich country that exports mineral and electricity to other countries. The revenues from the resources sector dominate the largest share of the government budget.

The main challenge of managing these natural resources revenues is to use the revenues more effectively and productively for long-term development. But many natural resource-rich countries fail to invest their revenue toward those areas that are essential for ensuring this long-term development, such as education, healthcare and infrastructure.

Most resource-rich countries have established a fund for development and emergency uses. This purpose of this fund is to reduce the extent of fiscal procyclicality and macroeconomic volatility (Tsani 2013; Truman 2008). In addition, the fund also mitigates the negative impact of Dutch disease (Usui 1996). By saving appropriate revenues from natural resources in an established fund, a country could prevent real exchange rate appreciation (as well as the decline in competitiveness that would be the result of such appreciation).

At present, there is no such development fund in the Lao People's Democratic Republic. All revenues derived from the resources sector have been expended on increasing government salaries and building infrastructure, primarily basic infrastructure such as roads and bridges.

Therefore, the Government must establish a "Human Development Fund" to provide funding for social protection benefits for pregnant women and early childhood development. The sources of this fund must come from revenues derived from taxes and royalties from the resources sector. For instance, 20–30 per cent of revenues from all natural resources (mining, hydropower, forestry, etc.) could be mandatorily invested in the "Human Development Fund".

This fund should be located in the Government Office and should have a board chaired by the Prime Minister. Board members should include the ministers from the Ministry of Education and Sport, Ministry of Labour and Social Welfare, and Ministry of Finance.