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Opportunities for U.S. Development Cooperation in Laos

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Introduction

Laos is Southeast Asia's only landlocked country, nestled between China, Vietnam, Thailand, Cambodia, and Myanmar (Burma). Over the past 30 years, it has experienced one of the highest economic expansions in the Southeast Asia region. Prior to the Covid-19 pandemic, its economy grew an impressive **7.3** percent per year, on average, between 1993 and 2019. Due to sustained growth, the country was able to slash its **poverty** rate from 46 percent in 1993 to 18 percent in 2019; by 2011, the **World Bank upgraded** Laos from low-income to lower-middle-income status.

Although Laos, officially the Lao People's Democratic Republic (Lao PDR), is a communist state, in the past two decades, successive governments have sought to open the economy to foreign trade and investment. In 2013, it became a member of the World Trade Organization (WTO) and in 2015 it joined the Association of Southeast Asian Nations (ASEAN) Economic Community. Laos has also encouraged greater foreign direct investment (FDI) from Vietnam, Thailand, and China—its **largest** trade partner and investor—in hydropower, mining, and agriculture.

Yet the United States has not **historically** had strong economic or diplomatic ties with Laos. In fact, the U.S.-Lao relationship is overshadowed by the legacy of the Vietnam War. The Ho Chi Minh Trail (1959–75), much of which ran through Laos, provided supplies to North Vietnamese fighters and was a heavy target of U.S. bombing. An estimated 2 million tons of munitions were dropped on Laos during the war, making it the most bombed country per capita in the world. An estimated **80 million** of these cluster munitions remain as unexploded ordnance (UXO), covering one-third of the territory. These weapons explode from time to time, wounding and killing hundreds of Lao each year. The legacy of the war has fostered a level of mistrust toward the United States that perseveres in U.S.-Lao relations.

However, in the past five years, the relationship between both countries has improved. As a continued effort to repair the legacy of war, in 2016 the Obama administration announced a three-year, **\$90 million** package for UXO removal. In that same year, President Barack Obama became the **first U.S. president** to ever visit the country, culminating in the **U.S.-Lao PDR Comprehensive Partnership**. The agreement marked a new era of bilateral relations, aiming to address mutual areas of interest and pivot overall U.S. engagement toward Southeast Asia. Areas of collaboration within the U.S.-Lao PDR Comprehensive Partnership include economic relations, U.S. assistance, war legacies and UXO clearance, environment, health, education, and governance. The two countries also established a **Trade and Investment Framework Agreement**. Moreover, U.S.-Lao ties have since grown closer with the 2020 establishment of the **Mekong-U.S. Partnership**, which funds development programming in Laos and its neighbors. Today, the United States is the **fifth-largest** destination for Lao exports, and the **U.S. Agency for International Development (USAID)** maintains several projects in the country.

The government of Laos recently launched its ninth National Economic and Social Development Plan (2021–25), aiming to better integrate its economy into the global marketplace, improve the overall wellbeing of its population, and target environmental, governance, and connectivity challenges (see Figure 1). In crafting its development policy, the country aims to graduate from the United Nations’ Least Developed Country (LDC) status by 2026 and strengthen its resilience to economic and environmental shocks. **Graduating** from LDC status would mean the **loss** of some preferential market access, but it could also bring economic gains and increased access to credit and investment. More importantly, it is a development milestone that signals to the outside world that the country has achieved a certain measure of success. The current government is eager to work toward this goal.

Although the country has made significant strides in reducing poverty, Laos also remains one of the poorest countries in the region. As in many developing countries, Covid-19 has had far-reaching effects on Laos’s economy and society, threatening to derail its socioeconomic progress. Even before Covid-19, the country faced numerous economic **challenges**: falling foreign-currency reserves, a ballooning external public debt, and a current-account deficit. The **Covid-19** pandemic has led to an increase in poverty and food insecurity. Economic growth contracted **0.4 percent in 2020**, while unemployment rose to **25 percent**, up from 16 percent at the end of 2018. **Sectors** such as travel, tourism and hospitality, and transportation have struggled to bounce back because of the emergence of the Delta variant, which has prompted multiple lockdowns. At the same time, Covid-19 has exposed many weaknesses in the Lao health system: shortages of trained personnel, modern facilities and equipment, and medical supplies. In rural areas, hospitals often serve hundreds of thousands of people but have just a few dozen intensive care unit (ICU) beds. While Laos has implemented an effective campaign to vaccinate its population, it is completely reliant on donated vaccines, which have been in short supply.

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Given this context, and in recognition of the five-year anniversary of the U.S.-Lao PDR Comprehensive Partnership, the United States has an opportunity to reset its relationship with Laos by establishing an economic partnership that responds to the priorities of the current Lao government and aligns with U.S. foreign policy goals in the region. The United States has operated a very active embassy in Vientiane since 1992, with USAID playing an important role in building stronger ties with the country by promoting sustainable development through economic, governance, and health programs. As Laos embarks on the next stage of its Covid-19 response, USAID can accompany these efforts by focusing on policy priorities and revitalizing certain sectors to drive the next phase of the U.S.-Lao relationship. On this journey, USAID should not only work with government, civil society, and other development partners but also capitalize on U.S. entrepreneurship and technological innovation.

Figure 1: Pillars of the Lao National Socio-Economic Development Plan (2021–2025)

Objective: “To fully focus on socio-economic development based on the existing potentials in order to help the country effectively achieve the LDC’s criteria through quality, inclusive and green growth and achieve the SDGs by 2030.”

<p>ECONOMY</p> <ul style="list-style-type: none"> ▪ Diversify the economy ▪ Ensure macroeconomic stability ▪ Identify and grow potential sectors ▪ Improve the business environment ▪ Expand access to credit and finance ▪ Develop regions based on their potential 	<p>HUMAN CAPITAL</p> <ul style="list-style-type: none"> ▪ Increase educational opportunities and improve the quality of education ▪ Improve and manage the labor market ▪ Make labor more efficient ▪ Harmonize market demand with research and development
<p>WELL-BEING</p> <ul style="list-style-type: none"> ▪ Reduce poverty through rural development ▪ Increase the standard of living ▪ Improve labor and social welfare ▪ Clear UXO ▪ Promote equality 	<p>ENVIRONMENT</p> <ul style="list-style-type: none"> ▪ Manage and use natural resources sustainably ▪ Improve forest management ▪ Promote development and growth in accordance with the National Green Growth Strategy ▪ Ensure disaster and climate-change preparedness ▪ Conduct environmental and social impact assessments ▪ Create a clean environment in urban and rural areas
<p>INTEGRATION AND CONNECTIVITY</p> <ul style="list-style-type: none"> ▪ Increase bilateral, multilateral, and other cooperation ▪ Engage with international organizations such as the ASEAN Economic Community, the Greater Mekong Subregion, and the WTO ▪ Integrate internet and banking systems ▪ Expand domestic and regional transportation networks such as the Laos-China railway ▪ Build out logistical, digital, and telecommunications infrastructure 	<p>GOVERNANCE</p> <ul style="list-style-type: none"> ▪ Improve coordination mechanisms at all levels ▪ Streamline the government structure and number of officials ▪ Create consistent and oriented laws and regulations ▪ Implement the “Three Builds” decentralization process ▪ Ensure political and social stability ▪ Promote community participation in development projects ▪ Undertake spatial and urban planning

Source: Phonevanh Outhavong, “The Initial Concept of the 9th NSEDP (2021-2025),” Ministry of Planning and Investment, PowerPoint presentation, n.d., https://rtm.org.la/wp-content/uploads/2019/11/2019-RTIM-Pre-Consultation-on-NSEDP-and-State-Budget-Plan_Initial-Concept-of-the-9th-NSEDP_English.pdf.

Opportunities for U.S.-Lao Cooperation

Prior to the signing of the U.S.-Lao PDR Comprehensive Partnership, the United States allocated \$3 million to Laos each year. Since the 2016 agreement, this assistance has steadily increased. **USAID's budget** for Laos grew from \$6 million in 2016 to over \$30 million in 2020, plus additional funding to address the impacts of Covid-19. Programming has focused on health, education, social services, governance, and economic development. USAID projects its budget for fiscal year (FY) 2021 and FY 2022 will be over **\$30 million annually**.

Within this context, there are several areas that are ripe for greater cooperation between the two countries. Some of these opportunities are more immediate: for example, in the coming 12 months, the United States can help the Lao government with its vaccination campaign. This not only includes Covid-19 vaccines but also inoculations for other diseases that have been neglected due to the pandemic, such as measles and tuberculosis. It also entails continuing USAID's investments in buttressing health systems, improving nutrition, and expanding access to diarrhea treatment, Vitamin A supplements, and deworming treatments for **children** under five. Vaccine diplomacy and other U.S. efforts relating to Covid-19 have helped move health systems in the right direction, but further initiatives will need to build upon existing efforts if they are to address Laos's healthcare gaps.

At the same time, the overall economic outlook for Laos remains brittle. The post-Covid-19 economic recovery offers an opportunity to invest in sectors that can modernize the economy and generate quality employment. This is important because Laos remains a very young country: **59 percent** of the population is under 25. To take advantage of this demographic dividend, more emphasis should be given to improving education outcomes and widening economic opportunities. Sectors such as digital connectivity, transportation, local small and medium-sized enterprises (SMEs), renewable energy, as well as more sophisticated agricultural production can become strong conduits for employment and for diversifying the Lao economy. This is a second area where USAID has a comparative advantage and could collaborate with the Lao government, external donors, and the U.S. business community.

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Yet the Lao business environment is still not conducive to attracting FDI comparable to what neighboring countries currently receive. Long before the Covid-19 pandemic, Laos was experiencing structural challenges in its governance and business climate. The country's governance challenges—such as bureaucratic inefficiencies, corruption, and a lack of transparency—have obstructed more successful development efforts. Laos also ranks very low in such global benchmarks as the World Bank's **Ease of Doing Business Index** and the **World Economic Forum's** Global Competitiveness Index. According to the World Bank, the government **needs to** simplify regulations and “[make] the business and trade environment more transparent and predictable, thereby levelling the playing field, encouraging entry, and increasing competition.” USAID has a strong track record in providing technical assistance to countries in these areas. Thus, a third area of cooperation in the medium term could focus on strengthening the enabling environment for the private sector.

RECOVERING FROM THE COVID-19 PANDEMIC

Throughout the past year, the Lao economy has struggled to recover from the effects of the Covid-19 pandemic due to multiple lockdowns. The government instituted a second lockdown in April 2021, and a third lockdown has been in place since September in response to the country's most significant surge of Covid-19 cases (particularly the Delta variant) and deaths since the pandemic started. Economic **recovery** will **require** a multifaceted approach that includes supporting vulnerable populations such as women and migrants as well as diversifying supply chains and strengthening local SMEs' connections with multinational firms.

The Lao health system is another area in which to concentrate recovery efforts. Even before the pandemic, it contended with numerous challenges, including limited government funding, deteriorating and outdated health infrastructure, a lack of qualified medical personnel, and poor outbreak response and monitoring. Laos has some of Southeast Asia's **highest rates** of child and maternal mortality and malnutrition, especially because only a small fraction of children and women are covered by health insurance. The government has spent **less than 2.5 percent** of its gross domestic product (GDP) per year on healthcare over the last 10 years. Overall, health systems and life expectancy have improved in the country, but workers have struggled to reach rural populations to provide them with basic healthcare.

The United States has an opportunity to strengthen its relationship with Laos by bridging the population's health needs during the pandemic. Laos's current health shortfalls include faltering measles vaccination rates, which dropped from 41.5 percent in 2018 to 37 percent in 2020, and endemic malaria, diphtheria, tuberculosis, human immunodeficiency virus (HIV), and polio. USAID has taken charge in health initiatives over the last two years: it provided **50,000 malaria test kits** in November 2020, committed \$700,000 to help **eradicate malaria** in July 2021, and launched a **new program** in March 2021 to combat HIV/AIDS as a part of the President's Emergency Plan for AIDS Relief (PEPFAR).

More importantly, there are signs of high vaccine demand among the Lao population. In a **business pulse survey** conducted by the World Bank, 87 percent of Lao respondents indicated they were willing to receive the Covid-19 vaccine. There is significant potential for the United States to provide high-quality, effective vaccines to meet this demand. The United States has already provided over \$10 million to help with the pandemic in Laos, donated **1 million vaccines** to the country through COVAX, and helped with vaccination rollout efforts. This has had a positive public and governmental reception, upon which the agency should continue to build.

IMPROVING TRANSPARENCY AND THE BUSINESS ENVIRONMENT

Multinational companies, which play an important role in encouraging innovation and generating jobs, can provide important benefits to local SMEs. FDI into Laos—largely in its electricity and agriculture sectors—grew from \$333 million in 2010 to \$1.7 billion in 2017, mainly from Vietnam, Thailand, and China. In 2018, China alone accounted for **79 percent** of all FDI inflows. Laos has begun to take further steps to open its economy. For example, in July 2021 it **announced** its intention to become the first LDC to join the WTO's Information Technology Agreement (ITA) and ITA Expansion. The move would eliminate tariffs on high-tech products, helping to integrate Laos into global value chains and encourage more FDI.

Despite positive investment trends, Laos only receives a fraction of all FDI flows into the Southeast Asia region—which totaled **\$136 billion** in 2020, reflecting a global FDI contraction caused by the Covid-19 pandemic. Investors were already hesitant to invest in the country because of concerns over the environment, natural-resource exploitation, and accessibility for tourism. Moreover, the absence of transparency, high cost of doing business, and lack of investment in local firms have hindered private-sector growth and investment. The pandemic has provoked further uncertainty, causing firms to **reduce investment** in Laos in 2020 and potentially cut more investment in the future.

TARGETING STRATEGIC SECTORS

Economic growth in Laos in the past three years has largely been spurred by its reliance on natural resources. In addition to agricultural products, the country has focused on exporting energy from its hydropower projects along the Mekong River. Many Lao engage in subsistence agriculture, which provides more than 60 percent of **employment** but has low productivity, constituting only 17 percent of the country's GDP. Economic analysis conducted by the **Asian Development Bank** highlights the need for the country to diversify exports and production to modernize the economy.

Value-Added Agriculture

The agriculture sector is a critical—but heavily underutilized—part of the Lao economy. Only **10 percent** of land area is dedicated to agriculture, even though **80 percent** of rural Lao are subsistence farmers. Rice cultivation plays a dominant role in the country's agrarian economy, accounting for **50 percent of national agricultural output** and **73 percent of total employment**. Other important commercial crops include **coffee, sugarcane, cassava, maize, and bananas**. However, the agriculture sector has grown at a slower rate than Laos's overall GDP.

Agriculture has the potential to be a key driver in reducing poverty, increasing economic growth, and encouraging development cooperation. But unlocking Laos's agricultural potential will require more than just diversifying crops and increasing production. To transform the rural economy, Laos will need public investment in building better irrigation systems, improving on-farm crop storage, diversifying supply chains, and identifying new markets. For example, expanding irrigation to farmlands can greatly increase crop yield, aid in crop diversification, and improve community resilience to climate-change-exacerbated droughts. Although Laos has more freshwater per person than any country in Southeast Asia, of the 80 percent of Lao who depend on farming livelihoods, only **20 percent** are connected to irrigation channels. During the wet season, water is plentiful and results in productive crop yields. However, because many subsistence farmers lack access to irrigation, only **4 percent** of land farmed during the wet season is cultivated during the dry season, and only **38 percent** of irrigated land produces crops during the dry season. Agricultural resiliency will also be important to weather droughts and other natural disasters made worse by climate change.

To transform the rural economy, Laos will need public investment in building better irrigation systems, improving on-farm crop storage, diversifying supply chains, and identifying new markets.

Renewable Energy

Laos has committed to becoming the “**battery of Southeast Asia**” to provide power to neighboring Thailand and Vietnam. It has thus ramped up construction of dams along the Mekong River. However, its neighbors have begun to veer away from hydroelectric projects **due to concerns** about their impact on the environment and on communities who make their living from the river. In January 2021, the Thai government **threatened to refuse** a power purchasing agreement (PPA) for the \$2 billion Sanakham Dam project being built by China Datang out of concern for its environmental impact. Year by year, the Mekong River's flow is disrupted because of dams upstream, affecting the number of fish caught, displacing Lao communities, and negatively impacting quality of life.

In this regard, the country has an opportunity to shift toward using cleaner energy sources. USAID programs, particularly the [LUNA II Project](#), have helped Laos promote more sustainable economic policies and a more balanced energy sector. There has also been increased investment interest in floating photovoltaic (FPV) solar panels, which sit on bodies of water instead of land; they can be integrated into man-made reservoirs and rivers and complement hydroelectric power produced during the Lao dry season. In July 2021, the Lao government and Electricité De France [signed an agreement](#) to develop a 240-megawatt floating solar project near the Nam Theun 2 hydropower plant. This is another area where USAID could form a similar partnership to encourage more sustainable energy projects.

Connectivity

In addition, both transportation and internet connectivity are important as Laos strives to link its markets with its neighbors' and the global economy. However, because it lacks domestic resources, the country has largely relied on [bilateral and multilateral donors and on FDI](#) to complete infrastructure projects. Operational railways are “[almost nonexistent](#),” though the Laos-China railway (part of the Belt and Road Initiative) is almost complete and will link Vientiane to the city of Kunming in southern China.

At the same time, there is a huge digital divide in the country: internet access is sharply divided along urban and rural lines. Overall, only [26 percent](#) of Lao had access to the internet in 2017, the lowest connectivity rate in Southeast Asia. Cost is a major reason for lack of internet service; in a country where the income averages between \$200 and \$300 a month, fixed broadband in Laos costs an average of [\\$53.41](#) per month in 2020. This price has decreased from \$231.76 per month in [2017](#), but it is still financially inaccessible to many. In addition, those with internet still experience a “[slow or very slow](#)” connection.

However, Covid-19 has served as a catalyst for better digital adoption and connectivity. A [World Bank business pulse survey](#) conducted in April–May 2021 found that 16 percent of Lao businesses invested in digital technologies during the pandemic, helping to cushion the loss of in-person sales. Such digitalization encourages inclusive e-commerce and expands use of information and communication technology, while also allowing SMEs to access more markets and financial services. [Mobile phones](#) have also permeated Laos, with the country's mobile subscription rate at 87 percent and mobile broadband internet access at around 35 percent. Through its new Digital Strategy, USAID has an opportunity to help bridge the digital divide in the country—helping to transform Lao livelihoods, bring new businesses and customers, create jobs, and expand access to healthcare and other government services.

Conclusion: The Path Forward

The United States has the best opportunity in decades to reset economic relations with Laos. Although the countries share a complicated history, renewed relations in the past decade—particularly the comprehensive partnership agreement under President Obama—offer numerous areas of cooperation to advance sustainable, meaningful development in the region. These include economic sectors where the United States (and USAID in particular) have a comparative advantage, as well as cross-cutting themes such as strengthening the business climate and overall governance performance. The Lao government's goal of graduating from LDC status, together with the Covid-19 pandemic, may create new opportunities to strengthen that relationship.

The U.S.-Lao relationship could also help counter China's significant presence in the region. China's extractive initiatives in Laos benefit primarily China and have either had a neutral or detrimental impact on the majority of the Lao population. This provides opportunities for the United States to promote a more sustainable and inclusive development path. In building the U.S.-Lao relationship and fostering greater trust, Washington will have to engage with allies working in the country, including Japan and Australia, as well as tap into the Asian Development Bank's deep knowledge and presence in the region. Engaging with neighboring Thailand, Vietnam, and Cambodia will also be important, not only because of their trade with Laos but also because they have cultural affinities and expertise in sectors the country hopes to develop. In this regard, regional connectivity projects—both in transportation and information technology—can deliver more economic integration and connect the country to global markets. ■

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