

CHAPTER 3

Investment Climate in Lao PDR

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CHAPTER 3

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INTRODUCTION

With the “flying geese” theory of industrialization in Asia (Akamatsu, 1960s), development of industrial estate or SEZ is important as modelled by many countries in the world including those in the ASEAN and East Asian region. It aims to provide a competitive environment among industries from neighbouring countries or elsewhere, anticipating benefits from fragmenting of factories into other regions. Therefore, as learning from other countries’ experiences, the Government of Lao PDR (GOL) had introduced SEZ in early 2000 to provide the necessary infrastructures for the business community including FDI and increased competitiveness.

Since then, the SEZ policy has been formulated and currently developing areas like the Savan-Seno Special Economic Zone (SSEZ) in Savannakhet province, Boten-Dankham in Louangnamtha province, Tongpheung district in Bokeo province, Vientiane Industrial Zone/Site and so on. However, none of the aforementioned SEZ development sites has been completed yet.

The above situation led to this study which aimed to assess the SEZ development situation of Lao PDR as well as the overall investment climate of the country. The study used the flowchart approach to assess the FDI environment of the country with the two

SEZ and/or industrial park development areas as samples. A survey interview was conducted to 10 stakeholders in Vientiane (Industrial Development Site) and another 10 in Savannakhet province (SSEZ).

The study also used an enterprise survey to support the assessment of the investment climate in Lao PDR. The surveys were conducted in Vientiane and Savannakhet where the SEZ and Industrial Zone were located. The survey interviewed 30 enterprises in Vientiane and another 30 enterprises in Savannakhet. A total of 60 enterprise interviews were carried out as to assess the investment climate of Lao PDR.

The report consists of 3 parts. The first part discussed the flow chart approach assessment of industrialization in Lao PDR, analyzing the current situation of SEZ development in Lao PDR. The second part covered the investment climate in Lao PDR, showing the results of the survey in Vientiane and Savannakhet. The last part included the conclusion and key recommendations for the industrialization of Lao PDR.

1. FLOW CHART APPROACH ASSESSMENT OF INDUSTRIALIZATION IN LAO PDR

Using the flow chart approach, the 10 questionnaires were collected in Vientiane from the respondents—2 government staff from the Ministry of Industry and Commerce and Ministry of Planning and Investment; 2 local staff from the Department of Industry and Commerce and Vientiane Industrial Zone Authority; 1 from the Lao National Chamber of Commerce and Industry (LNCCI); and 5 managers of 5 companies in Vientiane including garment, cement, steel, and mining sectors. The other 10 questionnaires were collected in Savannakhet—2 staff from the Savannakhet Provincial Department of

Planning and Investment and Department of Industry and Commerce; 1 staff from the Savan-Xeno SEZ Authority; 1 staff from Savannakhet Chamber of Commerce and Industry; 3 companies (2 FDI and 1 local); 1 from an NGO (World Vision); 1 from JICA; and 1 from a local person. Results of the flow chat approach are shown in Table 1, Table 2, and Figure 1, Figure 2.

The results revealed that at present there is no concrete industrial zone existing in Vientiane, for obvious reasons of the absence of physical infrastructure in the site where the government prepared to develop as industrial zone. The following infrastructures were also identified as necessary to industrial development—electricity, water supply, telecommunication, and transport system. Such development would require huge amount of resources. External sources of funds play a very significant role for the development of industrial zone in Vientiane or in Lao as the whole.

Table 1: Results of the Industrial Cluster Policy Survey in Vientiane (Flowchart Approach)

	1	2	3	4	5	6	7	8	9	10	Results	Problems
1. Do industrial zones exist sufficiently?	X	X	X	O	X	X	O	X	O	X	3	X
Capacity building:												
2. Does water supply exist sufficiently?	x	O	X	X	X	X	O	X	X	O	3	X
3. Does electricity infrastructure exist sufficiently?	O	O	X	X	O	X	X	O	X	O	5	X
4. Does telecommunication infrastructure exist sufficiently?	O	O	X	X	O	X	O	O	O	X	6	X
5. Does transport infrastructure exist sufficiently?	X	O	X	X	X	O	X	X	X	O	3	X
6. Does social infrastructure (schools, hospitals) exist sufficiently?	X	X	X	X	X	X	O	X	O	X	2	X
7. Does institution/lecal system exist sufficiently?	X	O	X	X	X	O	O	X	X	O	4	X
Human resources												
8. Does human resource exist sufficiency?	X	X	X	X	X	X	X	X	O	X	1	X
Living conditions												
9. Are living condition sufficient?	O	O	O	O	X	O	O	O	X	O	8	
Anchor firms												
10. What companies are the target of anchor firms?	O	O	O	O	O	O	O	O	O	O	10	

Source: S. Oraboune, C. Ampayvanh, V. Souliya (interviews in Vientiane on Dec. 8-13, 2008.)

Table 2: Results of Industrial Cluster Policy Survey in Savannakhet (Flow Chart Approach)

	1	2	3	4	5	6	7	8	9	10	Results	Problems
1. Do industrial zones exist sufficiently?	X	O	X	X	X	O	X	O	X	X	3	X
Capacity building:												
2. Does water supply exist sufficiently?	X	X	X	X	X	X	X	O	O	X	2	X
3. Does electricity infrastructure exist sufficiently?	X	O	X	O	O	O	X	O	O	O	7	
4. Does telecommunication infrastructure exist sufficiently?	O	O	O	O	X	O	O	O	O	O	9	
5. Does transport infrastructure exist sufficiently?	O	X	O	X	X	X	X	O	X	X	3	X
6. Does school infrastructure exist sufficiently?	O	X	X	O	X	X	X	X	X	O	3	X
7. Does hospital infrastructure exist sufficiently?	O	X	X	X	X	X	X	X	X	X	1	X
8. Does institution/legal system exist sufficiently?	O	O	X	X	X	O	X	O	X	X	4	X
Human resources												
9. Does skilled labour exist sufficiently?	X	X	X	X	X	X	X	X	X	X	0	X
10. Does unskilled labour exist sufficiently?	X	X	X	X	X	X	X	X	X	O	1	X
Living conditions												
11. Are living condition sufficient?	X	X	X	X	X	O	X	O	O	O	4	X
Anchor firms												
12. What companies are the target of anchor firms?	X	O	O	O	X	O	O	X	X	O	6	X

Source: S. Oraboune, (interviews in Savannakhet on Jan. 14-16, 2009.)

Further development like the Savan-Seno Special Economic Zone (SSEZ) in the late 1990s had the same fate of incomplete structures. According to the survey, only electricity and telecommunication were set-up and somehow benefited some communities in Savannakhet, especially the private sector. At present Savannakhet area imports electricity from Thailand. But the Kip situation affected the price of electricity which reduced the production competitiveness in Lao PDR.

Similarly, the survey affirmed that creating a good business environment would entail installation more infrastructures in the SSEZ. To meet this target, both internal and external resource had to be mobilized. Such would include increasing government budget for infrastructure development along with the improvement in policies that would encourage private sector participation in industrialization. Currently, two

Figure 1: Vientiane's Flowchart

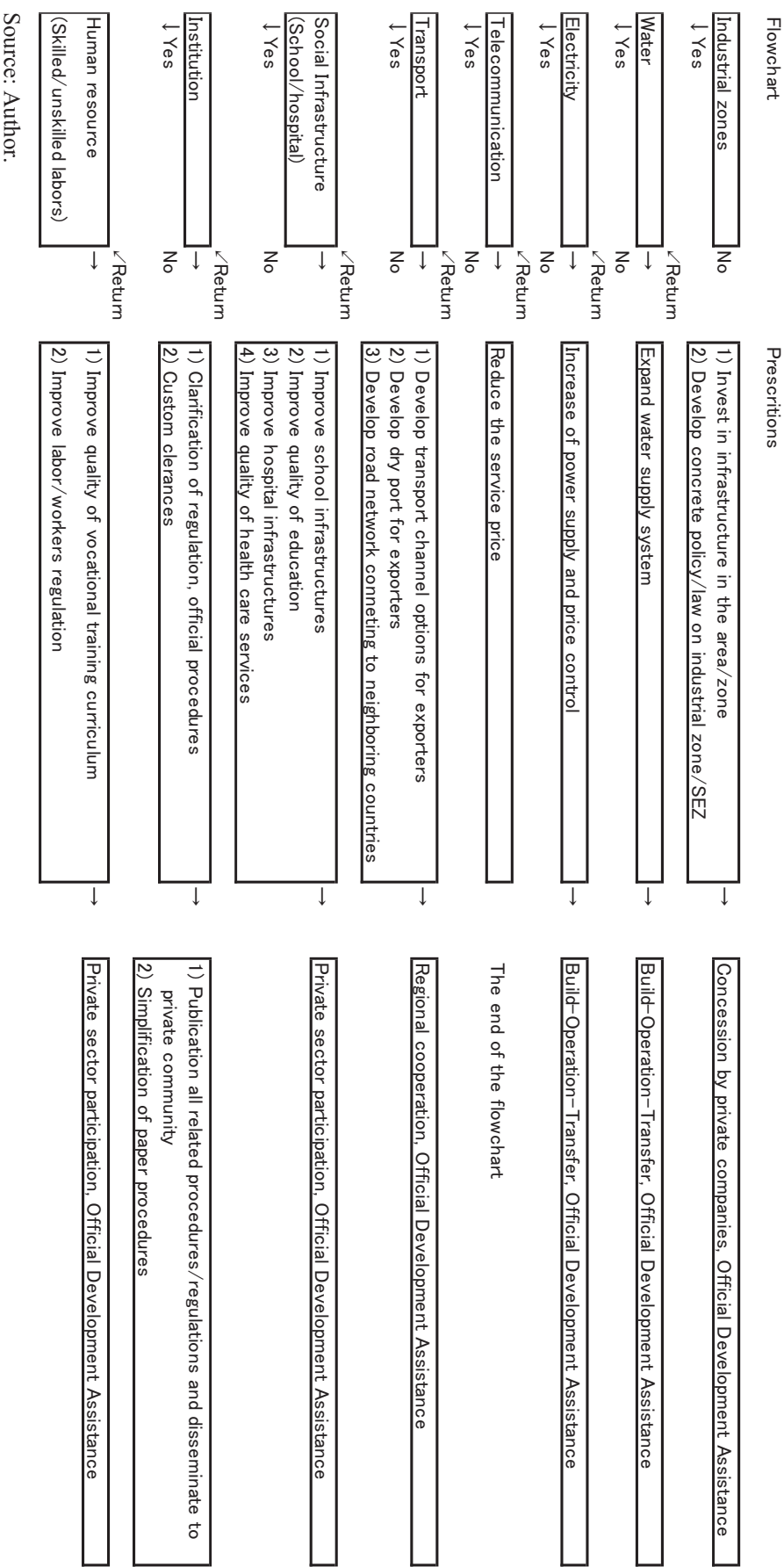
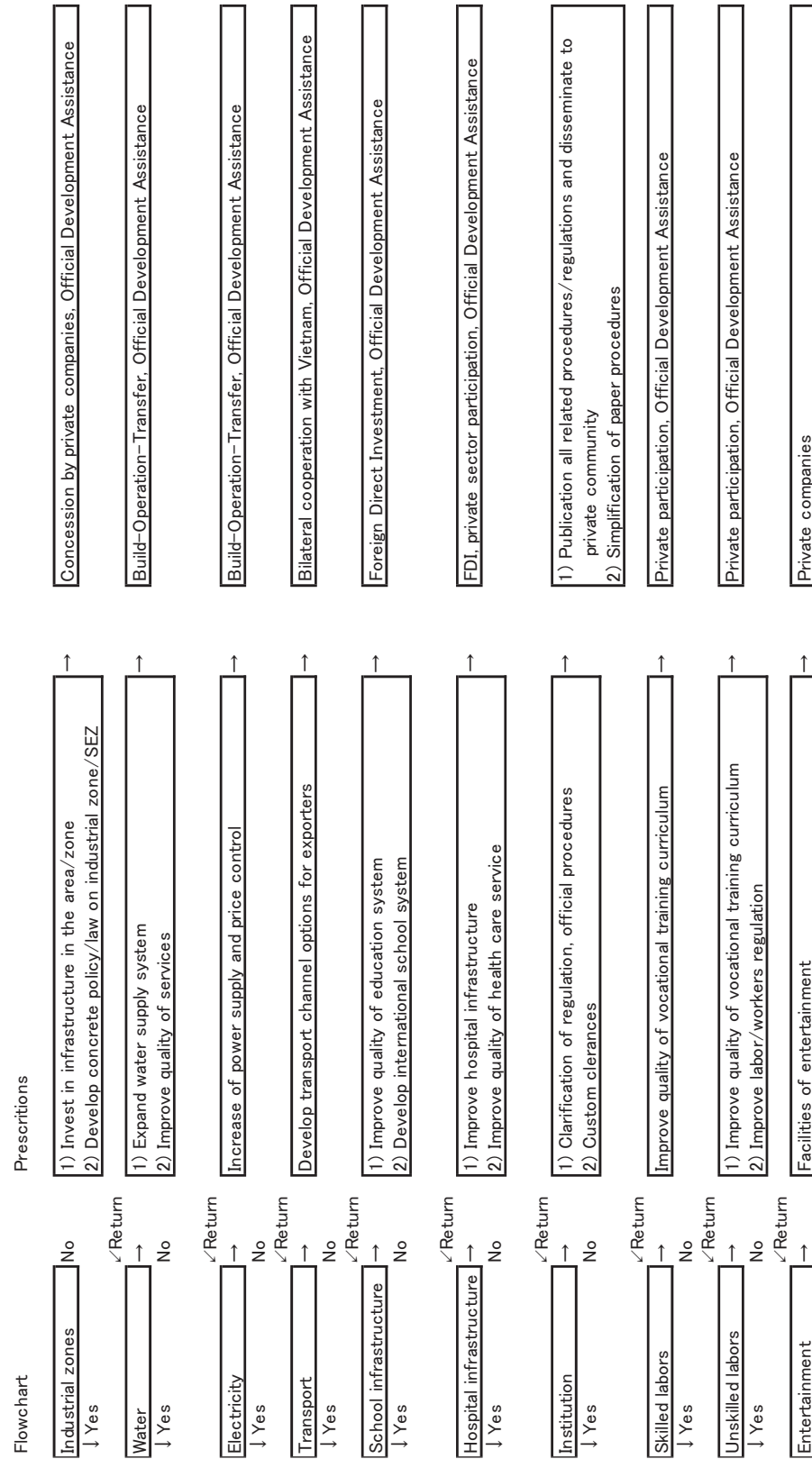


Figure 2: Savannakhet's Flowchart



Source: Author.

companies from Malaysia and Thailand signed concession contracts in the SSEZ. More so, access to ODA can be a potential.

2. INVESTMENT CLIMATE IN LAO PDR

In 1997, Lao PDR introduced economic policies that would shape an attractive business environment. The creation of industrial estates and special economic zones were believed to bring benefits to the country. However, the industrial evolution seemed not impressive. Hence, this survey came about which aimed to review the investment climate in Lao PDR, particularly in Vientiane's selected industrial estate and Savannakhet's SSEZ located at the East-West Economic Corridor (EWEC).

Sixty companies—30 in Vientiane and 30 in Savannakhet—were surveyed. Company representatives were interviewed and results indicated that lower cost of production is a primary factor for choosing to invest in these areas. The production cost referred to are business setup, business operation, labour issues, logistics and other related services.

2.1. Investment Climate Survey in Vientiane

Findings showed that the overall investment climate in Vientiane was not very high attractive to foreign investors. The respondents gave an average of 3.2 rating for macro-economy, governance, regulatory framework, infrastructure, labour issues, land, and finance using a 5-point scale (1 Very poor; 2 Poor; 3 Fair; 4 Good; 5 Excellent) (Table 3. – Table 7). This indicated that the investment climate in Vientiane was much better in terms of infrastructure provision compared to other regions of the country.

Table 3: Issues Related to Business Setup (Vientiane)

Environment business before setup	Avg Score
Collecting information on Business environment and Nec. info for investment decision	3.5
Collecting info on regulatory framework and legal procedures for setting up the business	3.3
Obtaining licence and permits	3.3
Efficetiveness of one stop service	3.1
Investment regulation	3.5

Source: ERIA-CLMV Survey 2008.

Table 4: Issues Related to Business Operation (Vientiane)

Some Environment of Business Process	Avg score
Macro Economy	2.9
Macro stability (Low inflation, Stable exchange rate, etc)	2.9
Governance	3.3
Crime, theft, and disorder	3.4
Quality of policy formulation and implementation	3.6
Quality of the government service	3.3
Quality of the legal system	3.6
Corruption	2.9
Regulatory framework	3.4
Bussiness licencing and operating permits	3.4
Tax rates	3.1
Tax administration	3.1
Labor regulation	3.5
Land regulation	3.4
Finance regulation	3.7
Intellectual property right (IPR) protection	3.4
Infrastruture	3.3
Electricity	3.4
Water Supply	3.4
Gas/Fuel	3.3
Transportion	3.2
Telecommunication	3.6
Industrial estates	3.2
Accommodation for foreigners	3.3
Labor Issues	3.5
Quality of workers	3.2
Quality of middle management	3.6
Quality of engineers	3.6
Labor cost	3.5
Easiness of recruitment of workers	3.1
Labor turnover (Frequency of movement of workers in and out of a company)	3.1
Labour Relation (Labor Strikes, etc.)	4.0
Land	3.2
Office rentals/Land prices	3.2
Finance	3.0
Access to loan	3.0

Source: ERIA-CLMV Survey 2008.

Table 5: Current Investment Incentive (Vientiane)

Current investment incentive	Avg score
Tax incentive (e.g tax holiday)	3.5
Subsidies	2.6
Rent free or subsidized land	3.3
Access to low cost financing	3.1
Exemption form trade restrictions	3.7
Exemption form remittance restrictions	3.3
Exemption form foreign ownership restrictions	3.0
Prioritized supply of unility services such as electricity, telecommunication	3.5

Source: ERIA-CLMV Survey 2008.

Table 6: Issues Related to Logistics (Vientiane)

Some environment Logistics	Avg score
Domestic market	2.9
Domestic market zise	3.0
Purchasing power of local consumers	3.0
Smulling control	2.7
Foreign Market	3.7
Procedures for expoprt to foreign market	3.7
Export tax (Leave it blank if there is no export tax)	3.8
Rules of origin for GSP	3.8
Uncertainly of GSP status in future	3.4
Domestic Procrutment	3.4
Collecting infomation about local suppliers	3.3
Quality of local suppliers base	3.4
Access to capable international suppliers	3.6
Foreign Procrutment	3.4
Procedures for import of raw material / parts and component	3.6
Custom clearance	3.6
Tariff barrier	3.5
Non tariff barrier	3.4
Drawback of import duty and value added tax	3.0
Trade regulation	3.6
Foreign exchange regulation	3.5

Source: ERIA-CLMV Survey 2008.

Table 7: Issues Related to Transportation and Communication (Vientiane)

Transportation Mode		Avg score
Cost competitiveness of each transportation		2.9
1. Land transport		2.9
2. Sea/river transport		3.0
3. Air transport		2.5
4. Communication		3.1
Efficiency of each transportation		3.0
1. Land transport		3.2
2. Sea/river transport		2.7
3. Air transport		2.9
4. Communication		3.3
Reliability of each transportation		3.2
1. Land transport		3.3
2. Sea/river transport		2.9
3. Air transport		3.0
4. Communication		3.4

Source: ERIA-CLMV Survey 2008.

The macroeconomic environment was what most companies were keen of. The average score given by the respondents for this concern was only about 2.9. Lao PDR's macroeconomic situation experienced high and fluctuating inflation rates. Stability would entail improvement in monetary policies like exchange rate.

Labour was deemed of manageable compared to other factors. No labor conflicts had been encountered ever since. Despite the low wages favourable to the investors, frequent turnovers were experienced.

Sometimes, labour shortage happened and recruitment came difficult especially at the peak of production schedules. According to the survey, most of the companies experienced a labour turnover rate of 6-40 percent. Twenty percent of the companies experienced monthly labour turnovers. The survey also reported that at least 5 percent of the workers change jobs every month. [For labour cost, the survey indicated that

monthly wage of workers in Vientiane is still considerable as monthly salary/wage of over 90 percents of workers of those sample companies, they pay less than USD300 per person, out of that 50 percents of them, they pay only less than USD100 per person. Quality of labour was another concern.

Regarding foreign employment, according to the survey, only few companies employed foreign workers due to the limitation of number according to the labor law. However, almost half of the companies surveyed employed foreigners for middle management posts (i.e., engineers). Majority of these foreign workers were Europeans; others were Thai.

Regarding situation of business setup in Vientiane, respondents gave average score at slightly above 3.3. The “One Stop Service” (OSS) is the most concern and received least score comparing to all factors. The implementation of the OSS by the Investment Promotion Department of the Ministry of Planning and Investment is a potential transaction system for a developing industry. However, some operational management problems on the OSS emerged.

The average score of infrastructure situation was also fairly score at about 3.3, where the industrial estates and transportation are the two most concerned with the average score of 3.2. The scores could be attributed to the incomplete industrial sites in Vientiane. The buildings, roads, even utilities like water supply, were the necessary infrastructures to be constructed. Transportation system and road networks were identified as priority concerns. Currently, the route was through Thailand.

Comparing the modes of transport for Lao PDR, the “Road-Sea” transport system was the most effective and available mode compared to “All Road” and “Road-Rail-Road”. The “Road-Sea” via Bangkok is more effective compared to

“Road-Sea” via Danang (Oraboune, 2007). Imports and exports of all companies in Vientiane use the “Road-Sea” mode via Bangkok regardless of country of origin or destination including to and from China, Malaysia, Taiwan, India, Australia, European Union, Japan, etc.

There are several ports in Bangkok. According to the survey, both exports and imports in Vientiane mostly used Khongteuy port in Bangkok. Sixty percent for imports and 73 percent for exports. For imports, Lemchabang port was being used by 20 percent of the company-respondents, Latkabang 13 percent, and Silacha 7 percent. While for exports, 13 percent used Latkabang port, 7 percent each for Lemchabang and Silacha.

The limited transportation routes in Vientiane had become a bottleneck especially for the export sector. The high costs of transportation affected the competitiveness of the business sector. Undeniably, innovation in the transport system was one major consideration in the improvement of investment climate in Vientiane. Such predicament was true for most of the respondents. There were cases like export delays of 5-30 days and import delays of 7-14 days.

On FDI concerns, survey data showed that access to foreign market is the more important reason for investment in Lao PDR rather than upscaling the performance of the domestic market. The reason was because of general system of preferential (GSP) that Lao PDR has, and according to respondents, the future of GSP status is the most concerns. With this point of view, it only showed that the investment climate in Vientiane or in Lao PDR was not so competitive. Majority of the FDI companies in Lao PDR were only using its status as least developed country (LDC) and taking advantage of what the status can bring about to their businesses. Their presences were not because of engaging in a competitive business environment.

The companies conveyed that their raw materials for production came from outsourcing the supply generation to either their subsidiaries or branch/factories abroad. The supply of raw materials within a country through procurement processes was not enough. Therefore, there was some degree of dependence to import the raw materials which incurred labor-intensive inputs.

Further on, service cost is concerned with governance and regulatory framework of the country, specifically in Vientiane. The survey showed an average score of 3.3 for governance and 3.4 for regulatory framework. The scores could be attributed to corruption with a score of lower than 3. Corruption was often due to unclear regulation or procedure in some related sectors which triggered additional cost in the business transactions. Similarly, additional layers of procedures entailed additional time.

Regulatory framework is another significant issue which the investment climate survey revealed. The score was at 3.4. The unclear regulation and procedures in some related sectors to be followed was frustrating for the business community as it prolonged transactions and entailed additional cost as a whole. Tax rates and tax administration were another concern. The government offered many tax exemption or tax holiday but according to the survey, because of the unclear regulation, there have been many extra expenses for doing business in Vientiane.

Review previous tax incentives and other government provisions to the FDI community scored an average of 3.3. The level of subsidies received the lowest score of 2.6. The affected respondents disclosed that they never received any subsidy from the government while others had. Again, another unclear regulation led to poor implementation.

In the overall, the flowchart approach results and investment climate both

confirmed that a 3.3 score saying that investment in Vientiane is fair. This means the business environment is not very attractive to foreign investors. One of the factors that influenced such assessment is the future of GSP. Nonetheless, almost 60 of the respondents still believed that business in Vientiane will improve and have a good future. Only 33 percent think that their business will continue in the future, the average score is 3.5.

It can be concluded that there is a need to review FDI policies in order to provide enabling mechanisms that would improve the investment climate in Vientiane.

2.2. Investment Climate Survey in Savannakhet

Savannakhet is located in a very strategic area especially in the regional route of East-West Economic Corridor (EWEC). Such a strategic location encouraged the government of Lao PDR to develop a special economic zone. Hence, the Savan-Sano Special Economic Zone (SSEZ) came about in the early 2000s. It envisions to create an attractive environment for FDI and other export-oriented investors.

The development of the SSEZ required huge financial resources for infrastructures. With the government's budget constraints, the participation of foreign investors in the Lao PDR economy became an economic strategy. Currently, there are two companies awarded concessions in the area..

The SSEZ has 4 zones (A, B, C, and D). Zone D is first to be prepared for construction; zones A, B, and C will follow..

Table 8 – Table 12 illustrates the investment climate in Savannakhet. Of the 30 companies-respondents, 15 are foreign and 15 are local. Like in Vientiane, in the overall,

considering all factors affecting the business environment, Savannakhet was rated 3.3. However, the macroeconomic situation in Savannakhet was rated 2.7 by the respondents.

Business people in Savannakhet have more interaction with Thailand and Vietnam, so that after the completion of the EWEC and the second Lao-Thai Friendship bridge, business transaction improved, that reason for a 3.6 infrastructure rating. This rating could be attributed to the service and agriculture nature of the local companies in Savannakhet compared to Vientiane's which were mostly in the manufacturing business. Telecommunications and electricity are more established in Savannakhet, though electricity is still being imported from Thailand. It is anticipated that with the completion of Nam Teun 2 hydropower project, electricity in Savannakhet will improve.

Labour issues scored 3.5 similar to Vientiane. However, this might be because of their there has not much difficulty in finding agriculture workers in Savannakhet, while the flowchart survey has indicated the constraint both skilled and unskilled labours in Savannakhet.

Similarly to Vientiane, monthly labor wage is of over 90 percent of all companies pay one less than USD300 per worker, and out of that about half (46.7%) of all sample pay less than USD100 per worker per month.

However, regarding labor turnover, about 76 percent of all sample companies experience of labor turnover every month, and the average change is about 5 percent of the workers change their job every month.

Regarding foreign employment, 42 percent of foreign workers are Vietnamese and 38 percent are Chinese. Middle management foreign employees are Thai (45%) and European (34%). Foreign engineers in Savannakhet are 50 percent Thai, 23 percent

Table 8: Issues Related to Business Setup (Savannakhet)

Environment business before setup	Avg Score
Collecting information on Business environment and Nec. info for investment decision	3.1
Collecting info on regulatory framework and legal procedures for setting up the business	3.4
Obtaining licence and permits	3.4
Effictiveness of one stop service	3.5
Invest regulation	3.4

Source: ERIA-CLMV Survey 2008.

Table 9: Issues Related to Business Operation (Savannakhet)

Some Environment of Business Operation	Avg score
Macro Economy	2.7
Macro stability (Low inflation, Stable exchange rate, etc)	2.7
Average Score of Governance	3.3
Crime, theft, and disorder	3.7
Quality of policy formulation and implementation	3.3
Quality of the government service	3.2
Quality of the legal system	3.5
Corruption	2.9
Regulatory framework	3.3
Bussiness licencing and operating permits	3.6
Tax rates	2.9
Tax administration	3.2
Labor regulation	3.7
Land regulation	3.6
Finance regulation	3.3
Intellectual property right (IPR) protection	2.9
Infrastructure	3.6
Electricity	3.8
Water Supply	3.5
Gas/Fuel	3.7
Transportation	3.4
Telecommunication	3.8
Industrial estates	3.5
Accommodation for foreigners	3.6
Labour Issues	3.5
Quality of workers	3.2
Quality of middle management	3.5
Quality of engineers	3.6
Labor cost	3.5
Easiness of recruitment of workers	3.0
Labor turnover (Frequency of movement of workers in and out of a company)	3.2
Labour Relation (Labor Strikes, etc.)	4.3
Land	3.6
Office rentals/Land prices	3.6
Finance	3.2
Access to loan	3.2

Source: ERIA-CLMV Survey 2008.

Table 10: Current Investment Incentive (Savannakhet)

Some environment Logistics	Avg score
Domestic market	3.0
Domestic market size	3.2
Purchasing power of local consumers	3.3
Smuggling control	2.6
Foreign Market	3.5
Procedures for export to foreign market	3.4
Export tax	4.0
Rules of origin for GSP	3.4
Uncertainty of GSP status in future	3.1
Domestic Procurement	3.2
Collecting information about local suppliers	2.9
Quality of local suppliers base	3.1
Access to capable international suppliers	3.7
Foreign Procurement	3.4
Procedures for import of raw material / parts and component	3.6
Custom clearance	3.5
Tariff barrier	3.5
Non tariff barrier	3.1
Drawback of import duty and value added tax	3.6
Trade regulation	3.6
Foreign exchange regulation	3.2

Source: ERIA-CLMV Survey 2008.

Table 11: Issues Related to Logistics (Savannakhet)

Some environment Logistics	Avg score
Domestic market	3.0
Domestic market size	3.2
Purchasing power of local consumers	3.3
Smuggling control	2.6
Foreign Market	3.5
Procedures for export to foreign market	3.4
Export tax	4.0
Rules of origin for GSP	3.4
Uncertainty of GSP status in future	3.1
Domestic Procurement	3.2
Collecting information about local suppliers	2.9
Quality of local suppliers base	3.1
Access to capable international suppliers	3.7
Foreign Procurement	3.4
Procedures for import of raw material / parts and component	3.6
Custom clearance	3.5
Tariff barrier	3.5
Non tariff barrier	3.1
Drawback of import duty and value added tax	3.6
Trade regulation	3.6
Foreign exchange regulation	3.2

Source: ERIA-CLMV Survey 2008.

Table 12: Issues Related to Transportation and Communication (Savannakhet)

Transportation Mode		Avg score
Cost competitiveness of each transportation		3.3
1. Land transport		3.4
2. Sea/river transport		3.2
3. Air transport		3.1
4. Communication		3.5
Efficiency of each transportation		3.2
1. Land transport		3.3
2. Sea/river transport		3.3
3. Air transport		3.1
4. Communication		3.2
Reliability of each transportation		3.5
1. Land transport		3.6
2. Sea/river transport		3.3
3. Air transport		3.4
4. Communication		3.5

Source: ERIA-CLMV Survey 2008.

Chinese, and 11 percent Vietnamese.

Regarding business setup, the average score is at 3.4. Majority of sample companies in Savannakhet are local companies while most of sample companies in Vientiane are FDI. Investment decision making is an issue. The lack of information affects a good investment decision among foreign and local investors. This situation is an important concern Savannakhet which was not raised in Vientiane.

Service links is an important issue as well. Lao PDR, being a land locked country has some disadvantages in terms of logistics in business transactions. This concern was given a 3.3 rating by the respondents. Domestic markets including size, purchasing power and smuggling control and other relate procedures had lower score then the issues related to foreign market.

Majority of the raw materials were outsourced in Savannakhet. Outsourcing is

affected by non-tariff barriers and foreign exchange regulation. According to the respondents, access to international suppliers of raw materials is much easier than local suppliers. This is simply due to the lack of information on where to find local suppliers. Aside from access to local suppliers, their quality of work or products produced was also another concern. Hence, a score of 3.1.

Sixty percent of the raw materials were imported, the rest were provided by the domestic market. Imports were coming from Thailand, China, Vietnam, and Japan. Almost half (43%) of the companies (FDI) surveyed are export-oriented and mainly produce goods for foreign market. Thirty percent were local companies for domestic market only, and the rest were 17 percent catering to both domestic and foreign markets.

For the import and export routes, companies used a variation of transport modes like road, sea, and air. Import routes were from Bangkok through the friendship bridge in Savannakhet (40%), other companies used the friendship bridge from Mukdahan (23%). Imports from Vietnam passed through road no. 9; China used road no. 13 through the Luang Namtha province in the northern region of Lao PDR.

The same as in Vientiane, enterprises in Savannakhet used the Khongteuy port for their imports. The survey showed that over 72 percent of them used Khongteuy port, about 18 percent used Lemchabang, and 9 percent used Danang port. However, those companies used only two sea ports in Bangkok including Khongteuy and Lemchabang.

Very few of them import raw materials by air. Those who import by air transact directly from the country of origin going to Lao PDR through the Wattay airport. Transfer of goods from Wattay airport in Vientiane going to Savannakhet was through roads. Only one-fourth of the companies engaged in import used the Suvannabhoum airport in Bangkok before transporting to the Wattay airport in Vientiane. Since the

Savannakhet airport re-opened in August 2008, this would improve the air transportation transactions between Savannakhet and Vientiane, as well as Bangkok.

Regarding exports, 60 percent of the companies export their products abroad by land using the second friendship bridge either to Bangkok and to Mukdahan province of Thailand. The survey also showed that 40 percent of them export their products to Vietnam—Danang port in Vietnam or road no. 13 (South) to Cambodia.

Almost half of the companies used sea to export their products to other destinations in the world. Over 90 percent of those who export their products by sea mode using the ports in Thailand and only about 8 percent of them used seaports in Vietnam. Exporters in Savannakhet used only Khongteuy (78.6%) and Lemchabang (14.3%) in Bangkok, and the rest used Danang port. There was only one company that export by air using Wattay airport in Vientiane while 75 percent used the Thai airway services.

On the overall transportation environment, a 3.3 rating was given by the respondents, where efficiency in transport systems has been a major concern. In 2008, almost 70 percent of those companies said they experienced transport delays. According to the survey, 18 percent of them experienced export delay in two days, 14 percent experienced delay between 5 days to one week, and 10 percent experienced delay from more than one month.

On the other hand, only 24 percent of the companies did not experience import delay in 2008. Some 10 percent experienced import delay up to 30 days. Altogether there are about one third of those companies experienced import delay from one week up to four weeks in 2008. This experience brought annoyance to business people affecting their competitiveness as well as costs.

Foreign market was much better at 3.5 score while domestic market was only about 3. This is consistent with the small market situation of Lao PDR where there is limited purchasing power of local people. Most FDI in Savannakhet is also export-oriented. Similarly to Vientiane, general system of preferential (GSP) status is a primary concern of companies. This showed that those FDI including local export companies received more benefits from GSP rather than the competitiveness situation of doing business in Savannakhet. Utilization of GSP to attract FDI is more of the business game plan despite knowing that, creating a competitive environment is more significant to ensure sustainability of their businesses.

With regard to cost concerns like governance and regulatory frameworks environment, both scored at 3.3. Being not so big difference from Vientiane scores, the companies identified corruption as the most pressing governance issue compared to problems on crime, theft, and disorder. The quality of government service was also another identified dissatisfaction concern from the respondents.

On the regulatory framework, the protection system for intellectual property rights (IPR) and tax rate were indicated as most problematic in Savannakhet. Both issues scored less than 3. IPR laws are rarely disseminated. There lack information materials about laws, regulations, procedures, and guidelines that would help the businesses in understand and undertake IPR processes. Moreover, the unclear regulation on tax collection or tax rates affects business processes where companies became victims of occasional collections of tax/commission and/or donations.

Regarding provision of incentives for business community in Savannakhet, the overall score is about 3.5. The companies were satisfied of tax exemption and other investment benefits provided in the SSEZ regulation. However, access to low cost loans

raised some concerns for the business community. According to the companies, they gave a score at an average of only 3. According to the survey interview, they experienced high interest rate, short-term loan period, and complicated collaterals. Currently, there is no specific bank for import and export in Lao PDR.

The respondents sent feedbacks about their views on the SEZ in Savannakhet. They said that the development of the SEZ would help improve business/investment environment in the area. They hoped that the SEZ would provide necessary infrastructure for business, improve procedures like setting-up of business and custom clearance by providing OSS in the zone.

Finally, views on future trend of the industry were also sought. Most of them were optimistic. Some 70 percent of the companies still believe that they have a good business in the future and 27 percent of them fairly optimistic of their business. The overall score regarding future trend of their industry is at 3.7.

Based on the flowchart approach and investment climate questionnaires, results showed that the investment environment in Vientiane and Savannakhet was not very attractive to foreign direct investment. Vientiane got a score of about 3.2 and Savannakhet got 3.3. In the various factors discussed, obstacles were apparent from business setup to business operation to logistics. A more pressing concern is the prevailing general system of preferential (GSP) status which seemed to hinder a more healthy business transaction among its stakeholders.

CONCLUSION AND RECOMMENDATION

In conclusion, the results of both surveys suggested that the current investment climate

of Lao PDR—Vientiane and Savannakhet—is not very eye-catching to investors due to the many obstacles in business transactions—business set up, business operation cost, logistic cost and other service links costs. Therefore, development of more strategic industrial estate or special economic zone in both areas is needed in order to improve the investment climate. At the same time, targeting of industry is an important strategy to consider so as to know the specific industry for each zone. In this way, the kind of business environment that will be created in the zone will meet specific needs of the industry.

However, in order to develop the industrial estate/SEZ requires huge amount of investment for the necessary infrastructures to attract the FDIs. With the limited domestic budget, external fund sourcing from official development assistance both bilateral and multilateral, FDI, etc., is necessary for the envisioned industrialization of the Lao PDR.

Policy Recommendations

Focusing on the development of industrial estate/special economic zone in order to provide competitive environment to attract FDI is significant to the industrialization of Lao PDR. The industrial estate/SEZ is a strategic consideration to achieve Lao PDR's economic development objectives. At the national level, targeting of specific industries in with the dynamic economies of China, Thailand and Vietnam are potentials. Lao PDR being an LDC is indeed in need of ODA. Utilization of ODA is aimed to provide an enabling environment to the target industry/FDI in terms of infrastructures and other necessary support for economic development.

In the case of Vientiane, despite being advantageous compared to the other

regions of the country in terms of better infrastructures, the development of industrial estate is not impressive. Although the case, most of the manufacturing industries are concentrated in Vientiane, due to better infrastructures, better regulatory frameworks, and other linked issues. Vientiane is more competitive also with regard to logistics and transport system. There is no other choice for transport mode via Bangkok, but due to the advantage of GSP status, those manufacturing industries still prefer Vientiane.

Therefore, for the development of industrial estate in Vientiane, focusing on manufacturing industry can be a potential strategy. Targeting production fragmentation of industries from northern and north-eastern part of Thailand is also a potential due to area proximity.

In the case of Savannakhet, despite its being strategically located in the EWEC of the Greater Mekong Sub-region (GMS), because of the poor infrastructure (roads and ports), exports preferred to access the road-sea via Bangkok. The Danang route in Vietnam is a shorter distance but was not so much a choice to transport products.

Savannakhet province is the largest province in Lao PDR in terms of population which can be an advantage in terms of labour. But only 115,852 people (2007 data) lived in the city (Kaysone Phomvihane district), of which only about 50 percent is labour force. Labour supply becomes a problem because the labour population tend to be divided into Vientiane and Savannakhet. It is suggested that Savannakhet can develop other types of industries not the same as Vientiane in order to also classify the kind of expertise their labour force can provide. This can be part of an improvement of labour policy.

Finally, the SEZ development policy is indeed significant for the industrialization of Lao PDR. However, taking the situation of small population and at the same time

people live very fragmented, has put a constraint in labour supply to the industrialization process in SEZ. If the labour issue is not considered carefully as the SEZ continue its development, labour shortage might be a constraint. Therefore, in order to ensure the continuous improvement in the industrial estate/SEZ development, more in-dept study is needed in order to be fully aware of the potentials and constraints in each area. This way, specific problems can be addressed with appropriate policies and mechanisms.

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