

# Lao PDR

National Institute for Economic Research (NIER), Lao PDR

**Leeber Leebouapao**, Vice President

**Amphaphone Sayasenh**, Researcher

## Introduction: Historical Background

The history of present-day Lao PDR dates to the 14th century with Fa Ngum, the first king who successfully united numerous small states and subsequently founded the Kingdom of Lan Xang. The Lan Xang Kingdom was one of the largest states in the region, whose territory encompassed the Mekong River in the middle from north to south. Due to its central geographical location in Southeast Asia, the kingdom became an important centre of trade, becoming wealthy economically and culturally. Lan Xang's territory and power continued to grow until the end of the 17th century. Its rise culminated in the long reign of King Souvigna Vongsa, between 1637 and 1694, at times called the 'Golden Age' in the country. After a period of internal conflict, the kingdom disintegrated in the 18th century into three separate kingdoms – Luang Prabang, Vientiane, and Champasak.

In 1983, it became a French protectorate, with the three territories uniting to form the country of Laos; this altered the borders of the country. Anti-imperialist movements were organised in many parts of the country. Since the 1930s, the battles of the Lao people have been closely connected to the battles of the three countries in Indochina. In 1945, at the end of World War II, Laos briefly gained independence, only to be re-occupied by French troops in early 1946. In 1949, it was granted autonomy by the Government of France; in 1953, it gained full sovereignty, with a constitutional monarchy. Shortly after independence, in late 1955, the United States (US) Department of Defense created a special Programs Evaluation Office to replace French support of

the Royal Lao Army against the Pathet Lao, the communist-supported movement. This marked the beginning of a long civil war, which ended in 1975 with a victorious Pathet Lao. The monarchy was abolished and the Lao People's Democratic Republic (Lao PDR) was established on 2 December 1975.

After the establishment of the Lao PDR, its government adopted a centrally planned economy. Such an economic system is characterised by a high degree of centralisation of economic decisions, strict control, and limited reliance on market forces. What to produce, by whom, and for what uses were subject to administrative decisions. During the first Five-Year Plan 1981–1985, the state continued to control the economy in order to (i) support agriculture–forestry production to ensure food self-sufficiency, (ii) repair existing factories and create a number of new industrial facilities, and (iii) construct basic infrastructure. At the end of the first Five-Year Plan, the Lao PDR achieved some progress towards economic development especially in rice production. However, growth was accompanied by high inflation, large budget deficits, increasing trade deficits, overvalued and multiple exchange rates, and increasing foreign debts. It was against this backdrop that the government reappraised its development strategies and began a series of reform processes.

In November 1986, the Fourth Party Congress approved the New Economic Mechanism (NEM). The reform programme under the NEM includes measures to (i) reform the economic system to allow market forces; (ii) open up the economy; and (iii) stabilise, deregulate, and improve its performance. Although the NEM was endorsed in 1986, reforms started very slowly. The initial reforms in 1986–1988 were limited mainly to improving the structure and performance of state-owned enterprises, selective deregulation of agricultural marketing management, and private sector development and trade reform. Since 1988, the reform process gathered momentum and major measures have been undertaken to improve macroeconomic management, including for fiscal, monetary, and trade policies and state-owned enterprises. At the micro level, price liberalisation, enterprise reform, and improvement of the legal framework were carried out. The first foreign investment law was promulgated in 1988. Price liberalisation, agriculture, and enterprise reforms have been intense. Reforms in fiscal, monetary, and trade policies were considered moderate whereas those of the legal framework were the weakest.

As a result of the reforms, economic performance improved substantially as annual gross domestic product (GDP) growth rates averaged 6%–7% between 1989 and 1994, exchange rates unified and stabilised, and the inflation rate fell from more than 60% in 1989 to 6.8% in 1994 (Than and Tan, 1996: 8). Significantly, most prices are now market-determined, economic decision-making decentralised to a great extent, and

many macroeconomic management instruments have been put in place. In addition, the Lao PDR's economy has become more integrated internationally and regionally because of border agreements with neighbouring countries and the promulgation of the foreign investment law. The major step in international integration was in July 1992 when the country signed the Bali Treaty of Amity and Cooperation in Southeast Asia. With this official action, the Lao PDR won observer status in ASEAN in the same year. This event marked the beginning of the new era in the Lao PDR's regional economic cooperation with its neighbours, particularly with then six countries of ASEAN. Following Viet Nam's membership in ASEAN in 1995, the Lao PDR became a full member in July 1997. The year 2017 marks the 30th anniversary of the Lao PDR's membership in ASEAN and the 50th anniversary of ASEAN. For these special occasions, this paper aims to provide insights on the relationship between the Lao PDR and ASEAN by recounting the historical background of ASEAN–Lao PDR relations over time, analysing the impact of ASEAN integration on the Lao PDR, and assessing the opportunities and constraints of ASEAN from the perspective of the Lao PDR.

## **ASEAN–Lao PDR Relations since 1967**

### **1967–1986: Difficult times for ASEAN–Lao PDR relations**

ASEAN was established in August 1967 when five Southeast Asian countries – Indonesia, Malaysia, the Philippines, Singapore, and Thailand – signed the ASEAN Declaration. Its establishment was amidst rising regional tension and conflicts in Indochina, which needed a regional framework that would promote economic growth, safeguard regional peace and security, and display solidarity against communist insurgency and expansion in Indochina.

In 1967, Laos was undergoing an intense civil war that started in 1955 between the Royal Lao Government, who received support from the US, and the Pathet Lao communist movement under the leadership of the Lao People's Revolutionary Party, who won and founded the Lao PDR in 1975. The communist party negatively viewed ASEAN as a tool of US imperialism.

The period 1975–1986 was characterised by the Cold War. It was an ideological war between socialism led by the Soviet Union and capitalism led by the United States. As mentioned earlier, after the establishment of the Lao PDR in December 1975, the Lao People's Revolutionary Party, the sole leading party, adopted the socialist-oriented political regime and centrally planned economy. As a result, the government emphasised its political and trade relationships mainly with socialist countries, namely the Soviet

Union, Eastern European countries (East Germany, Poland, Czechoslovakia, Bulgaria, Hungary, Rumania), Viet Nam, China, North Korea, and Cuba.

The Lao PDR communist party's view of ASEAN did not improve. Trade relations with Thailand, one of ASEAN's founding members, deteriorated as Thailand strongly supported the US during the civil war era. The Lao PDR's economy remained closed until 1986, when worsened economic conditions and the external environment called for alternative economic policies, resulting in the launch of the NEM in 1986. As a result, the period between 1967 and 1986 is considered a difficult time for ASEAN–Lao PDR relations.

### **1986–1997: Shifting from political isolation to cooperative relation**

In the mid-1980s, the global Cold War was relaxing and gradually ended in most regions. Economic reforms significantly took place in Eastern European countries, led by the Soviet Union, and in East Asian countries, particularly China and Viet Nam. The Lao PDR, with its centrally planned economy, saw a steadily worsening economic situation, declining living standards, and increasing external debts. Concerned about the worsening economic condition and encouraged by the global reform process, the Government of the Lao PDR launched the NEM to shift from a centrally planned economy to a market-oriented system in 1986. Measures to improve macroeconomic management were implemented; these included reforms in fiscal, monetary, and trade policies. At the micro level, price liberalisation and agricultural and non-agricultural enterprise reforms were undertaken.

Those reforms improved economic conditions and people's living standards. In addition, the Lao PDR's foreign relations expanded – from a closed political relationship mainly with socialist countries to a more open one. Its economy became more integrated with the world, especially with Southeast Asian countries, because of border agreements with neighbouring countries and the promulgation of the first foreign investment law in 1988. The political and ideological differences of ASEAN–Lao PDR relations were significantly relaxed and normalised. Driven by economic imperatives, its open-door policy, and improved view of ASEAN, the Lao PDR, in July 1992, signed the Bali Treaty of Amity and Cooperation in Southeast Asia, along with Viet Nam, and acquired observer status. Motivated by Viet Nam's full membership in ASEAN in 1995, the Lao PDR applied for ASEAN membership in March 1996 and became a full member on 23 July 1997. This officially marked its shift from political isolation to cooperative relations with ASEAN. In addition to joining ASEAN, the government also applied for membership in the World Trade Organization (WTO) in July 1997.

## 1997 to present: From cooperative relations to regional integration

The Lao PDR had several reasons and motivations to join ASEAN, foremost of which is the potential benefits in socio-economic development and cooperation, and in political-security affairs. Specifically, it hopes to transform the disadvantage of being a small landlocked country into the advantage of being the land linking ASEAN neighbouring countries with China, where there are bigger markets. Also, by joining ASEAN and applying for WTO membership, the Lao PDR expected to raise its role at regional and international platforms, attract more official development assistance and foreign investment, and expand its trade. The government has, therefore, attached great importance to and supported the deepening and expanding regional and international integration. It has also been greatly responsible for fulfilling commitments under ASEAN and beyond. These have been well evidenced in many policy documents. For example, the 7th Five-Year National Socio-Economic Development Plan (7th NSEDP) for 2011–2015 (GOL, 2011) clearly set the goal for the Lao PDR to help achieve the establishment of the ASEAN Economic Community by 2015. To achieve this goal, the 7th NSEDP listed tasks to be implemented, including developing a legal system to support the establishment of a common market: (i) improving the effectiveness of ASEAN coordination; (ii) creating an enabling and favourable environment for competition especially improving human resources in professional skills and foreign languages; (iii) promoting and protecting intellectual property rights; building transport infrastructure; (iv) improving tax collection; and (v) strengthening e-commerce. The 10-Year Socio-Economic Development Strategy until 2020 and the 8th National Socio-Economic Development Plan (2016–2020) (GOL, 2016a) continue to highlight the importance of regional and international integration for the Lao PDR. These also encourage participation of integration processes with strong ownership and great responsibility. These policy documents clearly show that the country is on the journey towards regional and international integration.

## Impact of ASEAN Integration on the Lao PDR

After a long period of civil war and a decade of centrally planned economic regime, joining ASEAN was an important milestone for the Lao PDR's open-door policy and a major step towards a market-oriented economy. As a member of ASEAN, the Lao PDR must adjust its national policy frameworks, including for security, socio-cultural, and economic development, to be consistent with ASEAN frameworks. The roadmap for an ASEAN Community 2009–2015 – comprising the ASEAN Political-Security Community Blueprint, ASEAN Economic Community Blueprint, and ASEAN Socio-Cultural Blueprint – has improved the policy frameworks of the country in the last

decade. However, it is worth recognising that for trade and investment, the country has not benefited solely from ASEAN's framework but, to a great extent, from the WTO accession process. The Lao PDR submitted its application for WTO membership in July 1997 at the same time it officially became a member of ASEAN. Since then the country has drawn a lot of technical assistance from donors to support its domestic reform and institutional building, and strengthen human resource capacity and coordination mechanism. This improvement in soft infrastructure has been complementary to the implementation of ASEAN commitments. Therefore, when analysing the impact of ASEAN on the Lao PDR, the impact of the WTO accession process should be mentioned.

## **Impact on the Lao PDR's national policies**

Since its membership in ASEAN, the Lao PDR has been actively cooperating with Member States to make the region one of peace, stability, and prosperity. In building the ASEAN Community, the country has attached great importance and attention to this and has implemented the blueprints of the ASEAN Political-Security Community, ASEAN Economic Community, and ASEAN Socio-Cultural Community. By doing so, the Lao PDR has improved and adjusted its national policies accordingly. The government exerted genuine effort to improve the rule of law and transparency by reforming its legal system. The effort has been reinforced by the WTO accession process. For example, since 2000 more than 90 new and amended regulations have been issued, including 26 new laws and 18 decrees. In addition, there is also an effort to increase transparency and public participation by launching a web-based official gazette in 2013. The Lao Official Gazette is an electronic source of all laws and regulations and a platform where the public can provide comments on draft legislations.

In the area of political-security, the country has fostered mutual understanding on the political system, culture, and history among ASEAN Member States through increased cooperation and relation on regional political and security matters, including regular exchange of information at the governmental level. Moreover, the implementation of the ASEAN visa exemption framework, coupled with tourism promotion efforts, has helped boost the number of ASEAN visitors to the Lao PDR and that of Lao visitors to other ASEAN Member States. To a great extent, this has promoted a better understanding among ASEAN peoples of Member States' political systems, culture, and history, especially creating more understanding of the Lao PDR. ASEAN frameworks on other important areas – namely anti-corruption, human rights, traditional and nontraditional security – under this pillar have helped the country improve its policies and legal frameworks. For example, to facilitate the implementation of the ASEAN Convention

Against Trafficking in Persons, especially Women and Children, the Lao government promulgated the new Law on Anti-Human Trafficking.

Within the framework of the ASEAN Economic Community, the country has implemented various measures. On trade in goods, it has made great progress in reducing tariffs and setting up institutions and physical infrastructure to improve trade facilitation. To meet the commitments under the ASEAN Trade in Goods Agreement, the Lao PDR adopted the ASEAN Harmonized Tariff Nomenclature (AHTN) for its tariff classification and reduced its import tariff rates from ASEAN Member States. By the end of 2015, the zero import tariff rate covered 89% of the total 9,558 tariff lines under AHTN version 2012 and will be increased to 96% in 2018. The zero rate is also applied to car import. This is considered an important step in promoting regional trade as tariff rates in the Lao PDR were previously high, including a 40% rate for car import. Although the Lao National Single Window has not yet been operationalised, preparation works taken towards it has greatly improved customs procedures. In 2011, the country launched the electronic customs clearance system, ASYCUDA (Automated System for Customs Data), in two pilot sites and rolled out the system in 10 customs checkpoints by the end of 2015. The ASYCUDA system now operates in all 21 checkpoints, replacing the outdated legacy C-2000. The new system allows for risk-based selectivity, which in turn allows the shift away from 100% physical inspection. The amended Customs Law was approved in December 2011; new articles included provisions for the use of e-transactions and electronic signatures and approvals; the application of administrative appeals; and basis for risk management approaches, advance rulings, post-clearance audit, and measures for infringement.

Another achievement is the launch of the Lao Trade Portal in June 2012. The portal was developed to increase transparency of trade-related regulatory information in compliance with the requirements of the WTO and the National Trade Repository under the ASEAN Trade in Goods Agreement (ATIGA). Since its launch, the Lao Trade Portal has improved its coverage of information by adding more types of trade-related information. Currently, the portal contains all types of information specified in Article 13 of ATIGA, except a list of authorised traders. Under trade in goods, the Lao PDR has to improve implementation of standards and conformance, where it has limited legal and institutional foundation. Thanks to the ASEAN Economic Community framework, the Lao PDR has started building legal and institutional ground and gradually implementing the commitment.

As to trade in services, liberalisation continues to be undertaken progressively under the ASEAN Framework Agreement on Services (AFAS). To deepen the level and widen the coverage of its commitment, the country has revised various domestic regulations for

implementation. It also set up institutional bodies and amended domestic regulations to support the implementation of the Mutual Recognition Arrangements on Professional Services. Other important policy measures taken as a result of ASEAN economic integration include the issuance of the Law on Business Competition and deepening SME promotion.

## Impact on human resource development

As a least developed country and a new member of ASEAN, the Lao PDR has received a tremendous amount of support from development partners and the aid community for its international and regional integration process. Such support is in the form of technical assistance, financial assistance, and, most importantly, capacity - building activities. With the entry of the latter four ASEAN Member States (Viet Nam, the Lao PDR, Myanmar, and Cambodia [CLMV]), there have been concerns about the development gap between the six older ASEAN Member States and the newer four. Against this backdrop, the ASEAN adopted a special programme to narrow the development gap, naming it 'Initiative for ASEAN Integration' or IAI. The IAI is a policy framework aimed at providing special support and technical assistance to the CLMV countries to enhance their capacity in implementing ASEAN commitments and agreements. So far, three work plans have been adopted for 2002–2008, 2009–2015, and 2016–2020. Although the first two work plans have low implementation rates, they have benefited CLMV to a certain extent. Under the IAI, the Singapore Cooperation Programme have provided scholarships for CLMV nationals to study in Singapore and have established four training centres in the four countries. To date, the Singapore Cooperation Programme has more than 12,500 Lao alumni. The Trade Development Facility (TDF), a multi-donor trust fund, has also played a very important role in capacity building in areas related to trade and economic integration. The initial TDF1 covered the period August 2008–March 2013, with TDF2 introduced for the period April 2008–2016 with a 1-year extension. TDF1 addresses the key institutional and operational bottlenecks and capacity gaps that hinder cross-border trade, whereas TDF2 focuses on trade policy, trade facilitation, competitiveness, and diversification. In capacity building, the TDF has supported various training related to trade and economic integration, workshops, and platforms to strengthen coordination mechanisms. For example, it has supported the establishment of the working group on non-tariff measures and provided training on data collection, classification, and impact assessment of such measures. It also provided support in training the public and the private sectors at the provincial level. Still on integration, the Lao PDR received support from the Government of the United States through the implementation of the LUNA projects. These projects support effective and equitable implementation of trade agreements, new laws and regulations at both the national



and subnational levels, including institutional development and building competitive capacities in both the public and the private sectors. Many development partners and communities also provide various types of support for capacity building, including collaboration with the ASEAN Secretariat, and training programmes.

## Impact on economic relations

The Lao PDR started its open-door policy in the late 1980s under the NEM. Since then it has entered into various bilateral and multilateral economic cooperation agreements and partnerships; joining ASEAN is one of them. Yet despite attempts to diversify its economy, the Lao PDR's main economic partners remain its neighbouring countries – Thailand, Viet Nam, and China – because of its landlocked location in the heart of Southeast Asia. Thailand and Viet Nam are ASEAN Member States; and ASEAN frameworks to broaden and deepen regional integration play an important role for the economic development of the Lao PDR, particularly in trade, investment, and tourism.

## Cross-border trade

Since the implementation of its open-door policy, the Lao PDR's international trade has continuously increased, except for a few interruptions during regional and global crises. According to Lao official data submitted to the ASEAN Secretariat, the value of the Lao PDR's total export increased from US\$144 million in 2003 to US\$3,714 million in 2015, an average annual growth rate of 38%. Similarly, the value of total import rose from US\$338 million to US\$3,049 million during the same period, which translated into an average annual growth rate of 27% (Figure 1). Despite impressive growth rates of import and export, the extent of trade openness remains low. The trade-to-GDP ratio was 23.7% in 2003 and increased to 53.85% in 2015, with an average value of 40.82% between 2003 and 2015.

In 2003, the value of Lao export to ASEAN was US\$253 million and accounted for 71% of total export. The value then grew at an average rate of 40% per year and reached US\$2,646 million in 2015. Since the export to ASEAN grew at a similar average rate as total export, its share in total export remains high at 70% on the average. When looking at the disaggregate level, almost all of Lao's export to ASEAN goes to Thailand and Viet Nam. Exports to Thailand on average accounted for 72% of total export to ASEAN or 51% of the total export in 2003–2015, while those to Viet Nam accounted for 21% of total export to ASEAN and 15% of the total export.

Similar to exports, the value of Lao imports from ASEAN also grew remarkably. Expectedly, Lao import from Thailand accounted for the largest proportion in total Lao import from ASEAN; i.e. it accounted for 83% of total Lao import from ASEAN and 61% of total Lao import, on average between 2003 and 2015.

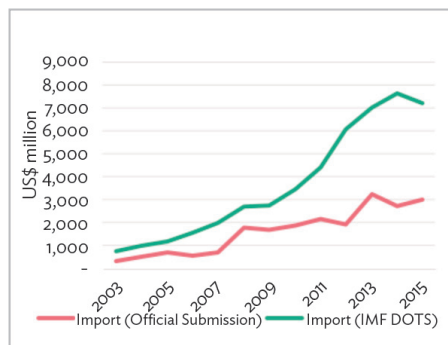
**Figure 1. Value of Import and Export of the Lao PDR**



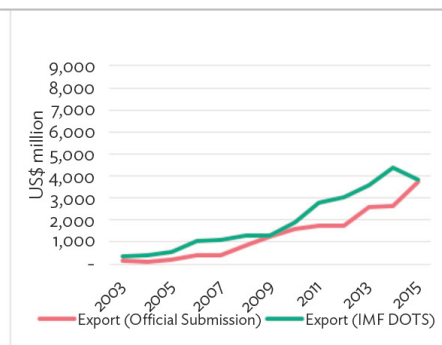
Source: ASEAN Secretariat (2017).

Interestingly, when using the data from the Direction of Trade Statistics of the International Monetary Fund (IMF), which compiled data from the Lao PDR's trading partners, the degree of trade openness of the Lao PDR has been higher, with the trade-to-GDP ratio at 53.78% in 2003 and 87.92% in 2015. Sources of discrepancy come from differences in values of both import and export. Figures 2.A and 2.B show that values of import and export from the Lao official source have been lower than those from the IMF's Direction of Trade Statistics. The discrepancy of import values has been much higher than the discrepancy of export values; and the discrepancy of import has increased over time. Phaydanglobriayao (2017) uses data of import from China and Thailand in 2009 and 2011 from the Lao customs authority and mirrored data from the International Trade Centre's Trade Map to find evidence of tax evasion. The study finds strong evidence of tax evasion both in the values and quantities of Lao import from these two top main trading partners; tax evasion also increased over time. Unit values of Lao imports from Thailand were under-reported for 2009 and 2011, and mislabelled for 2009. Lao imports from China was under-reported for both years. On the contrary, no study has been linked to the discrepancy of Lao export data. However, there have been documentaries, news, and concerns of illegal logging and illegal log exports in the country over the last decade; this could be a source of the export data discrepancy.

**Figure 2.A. Discrepancy of Import Data**



**Figure 2.B. Discrepancy of Export Data**



Source: Authors' calculation based on data from the ASEAN Secretariat and the International Monetary Fund's Direction of Trade Statistics.

Despite discrepancy of import and export data, the mirrored data from the IMF's Direction of Trade Statistics show similar results in terms of ASEAN's role in Lao international trade. The share of Lao import from ASEAN accounted for 73% on average during 2005–2015, and import from Thailand accounted for 88% of total import from ASEAN and 64% of total import during the same period. The share of Lao export to ASEAN in total export averaged at 56.33% in 2005–2015, of which export to Thailand accounted for two-thirds and export to Viet Nam accounted for one-third of total Lao export to ASEAN.

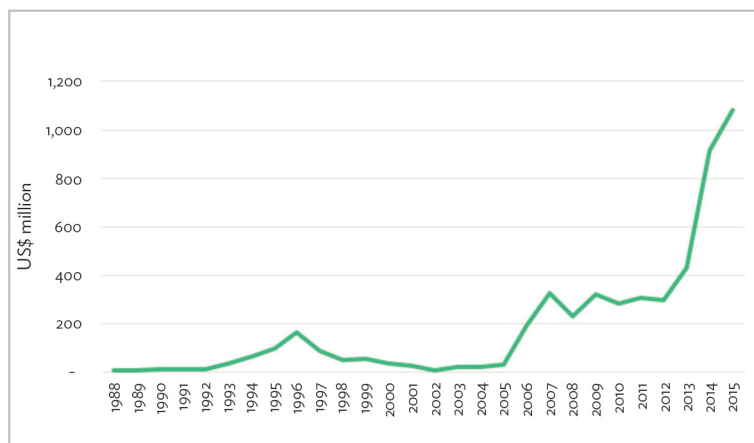
China, the European Union (EU), and the United Kingdom (UK) are major non-ASEAN export markets. Before the mining boom, the share of EU export was 21.55% and that of UK export was 7.2% of total export in 2005, whereas export to China was only 4.3%. After large values of minerals began to be exported to China, the share of export to China dramatically increased to 10.65% in 2008 and to 32.11% in 2015. However, the share of export to the EU declined to 8.74% in 2008 and 4.17% in 2015. This makes China the second-largest export market for the Lao PDR after Thailand.

Lao PDR's cross-border trade is not only concentrated in terms of trading partners but also in terms of export products. Its main export products are copper, electricity, garments, wood and wood products, and agricultural products. Export of these products accounted for almost 80% of total export in 2015.

## Foreign direct investment

At the beginning of the Lao PDR's economic reform and the promulgation of the first foreign investment promotion law in 1989, inflows of foreign direct investment (FDI) were small. Figure 3 shows that FDI in 1988 was US\$2 million; in 1989, US\$4 million; and in 1990, US\$6 million. After the amendment of its investment law and the global economic boom in 1994, FDI in the Lao PDR dramatically increased – from US\$59 million in 1994 to US\$160 million in 1996. FDI then started to decline due to the Asian financial crisis, went down to US\$4 million in 2002 and remained until 2005, when resource sectors, specifically mining and hydropower, started to attract large amounts of FDI. The recent increase has been associated mostly with an increase of investment in the hydropower sector.

**Figure 3. Net Inflows of Foreign Direct Investment, from Balance of Payments**



Source: World Development Indicators, World Bank (2017c).

Before the resources sector boom, Thailand had been the dominant foreign investor in the Lao PDR. Because of the large amount of investment in the hydropower and mining sectors, in 2011 China became the largest investor in the Lao PDR, followed by Viet Nam, and Thailand in third place. As a result, the share of ASEAN FDI in the Lao PDR dropped from 40.7% in 2010 to 20.56% in 2015. The FDI from the balance of payments captures foreign investment using the banking system. Supplementing the balance-of-payments data, the values of FDI approved by the Ministry of Planning and Investment were used to identify countries that are potentially interested in investing in the Lao PDR. Table 1 shows that in 2010–2015, foreign investors from ASEAN who applied for

investment approval in the Lao PDR include those from Viet Nam, Thailand, Singapore, Malaysia, Indonesia, and Cambodia. On average, investors from Viet Nam, Thailand, and Singapore applied for investment projects worth more than US\$10 million, whereas investors from Malaysia, Indonesia, and Cambodia applied for investment approval with values less than US\$600,000 on average.

Table 2 shows that in 2005–2010, the mining sector attracted the largest value of FDI application, followed by electricity generation, services<sup>2</sup>, and agriculture. During 2011–2015, the top values of approved FDI is in electricity generation, followed by mining, and agriculture. Table 2 reflects that over the last decade, foreign investment was concentrated mainly in the natural resource sectors which are capital intensive and generate limited employment opportunities.

**Table 1. Value of Approved FDI from ASEAN Member States, 2010–2015**

Country	Number of Projects	Value of Investment (US\$)
Viet Nam	88	1,132,246,387
Thailand	95	1,038,885,515
Singapore	4	45,720,000
Malaysia	22	6,692,022
Indonesia	1	550,000
Cambodia	2	250,000

FDI = foreign direct investment.

Source: Ministry of Planning and Investment (2017). Data retrieved from Investment Promotion Department's Statistic Database, <http://www.investlaos.gov.la/index.php/resources/statistics>

<sup>2</sup> Excluding construction, hotel and restaurant, banking, wholesale and retail trade, public health, healthcare, telecommunications, consultation, and education. A large portion of investment in this sector is in shopping centres.

**Table 2. Values of Approved FDI, by Sector**

Sector	2005–2010		2011–2015	
	Number of Projects	Value of Investment (US\$)	Number of Projects	Value of Investment (US\$)
Electricity Generation	14	2,048,429,828	30	2,218,526,092
Mining	118	2,109,371,391	164	2,123,422,568
Agriculture	681	1,531,473,828	149	935,040,112
Industry and Handicraft	575	815,478,232	92	399,218,657
Services	394	1,598,584,611	83	137,374,978
Construction	73	295,533,369	20	237,136,000
Hotel and Restaurant	297	260,316,118	45	146,258,474
Banking	14	122,460,347	5	140,483,275
Wholesale and Retail Trade	14	122,460,347	41	35,184,209
Healthcare	8	9,760,000	3	42,528,900
Telecommunication	4	44,779,749	2	35,630,800
Wood Industry	146	133,647,481	9	16,578,725
Garment	32	18,210,030	5	8,140,000
Consultant	101	36,266,832	17	5,296,200
Education	554	11,285,976	3	1,120,000

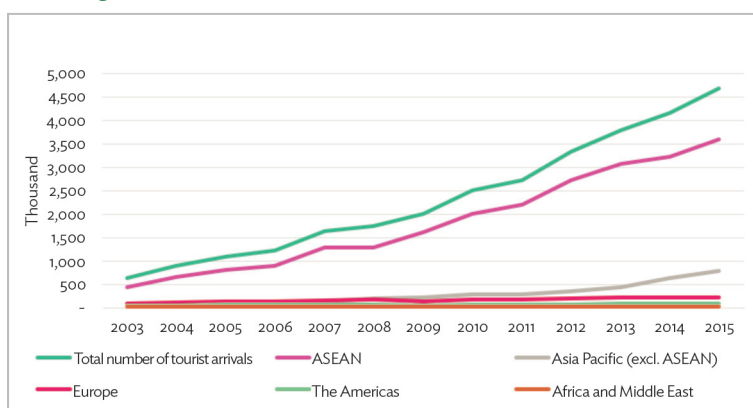
FDI = foreign direct investment.

Source: Ministry of Planning and Investment (2017). Data retrieved from Investment Promotion Department's Statistic Database, <http://www.investlaos.gov.la/index.php/resources/statistics>

## Tourism

Over the last decade, tourist arrivals continuously increased. In 2003, about 636,000 tourists arrived; with an average annual growth of 18.51%, they increased to 4,684,429 in 2015. Visitors from ASEAN represented the largest number of tourist arrivals with an average share of more than 75% during 2003–2015. Overall, tourist arrivals in the Lao PDR from all geographical regions have increased, with those from ASEAN and non-ASEAN Asia-Pacific region showing exceptional growth rates (Figure 4). The rapid rise in the number of tourist arrivals from the Asia-Pacific region was associated with the large increase of visitors from the Republic of Korea and China.

**Figure 4. Number of Tourist Arrivals in the Lao PDR**



Source: Ministry of Information, Culture and Tourism (2010, 2016).

Table 3 shows that the number of tourist arrivals in the Lao PDR from all ASEAN Member States increased in 2010–2015, except for tourist arrivals from Singapore and Malaysia which declined in 2014 and 2015. The table also shows that tourists from Thailand and Viet Nam outnumbered those from the rest of the region. The Lao PDR’s effort to promote tourism, the ASEAN visa exemption scheme, and the country’s participation at regional and international stages have contributed to this increase.

**Table 3. Values of Approved FDI, by Sector**

	2010	2011	2012	2013	2014	2015
Brunei	197	354	533	730	564	865
Cambodia	6,908	7,561	15,140	12,301	15,342	20,625
Indonesia	2,245	3,338	4,256	5,530	4,812	6,019
Malaysia	15,427	17,702	22,785	29,739	24,312	24,095
Myanmar	1,652	1,765	1,730	2,073	2,157	2,661
Philippines	10,341	11,847	14,281	17,759	15,179	16,709
Singapore	6,087	7,130	10,545	12,571	9,621	8,258
Thailand	1,517,064	1,579,941	1,937,612	2,108,566	2,043,761	2,321,352
Viet Nam	431,011	561,586	705,596	868,450	1,108,332	1,187,954

Source: Ministry of Information, Culture and Tourism (2016).

## The Role of the Lao PDR in Regional Integration

The Lao PDR joined ASEAN in 1997 as part of ASEAN enlargement. At the initial stage of enlargement, there have been concerns on roles of new members in region building. However, the Lao PDR, along with other new and founding members, has seen that the 10 ASEAN Member States have fostered regional integration. Already in the pipeline are agendas for deepening integration and making ASEAN a dynamic, rules-based, people-oriented, and people-centred region. As a member of ASEAN, the Lao PDR has attached great importance to fulfilling its commitments and actively engaging in regional activities. Since its membership, the country has been given opportunities to assume the chairmanship of ASEAN in 2004–2005 and 2016. Under its chairmanship, two ASEAN Summits, the 28th and 29th ASEAN Summits, were held in Vientiane back-to-back in September 2016. These are the first two ASEAN Summits following the formal establishment of the ASEAN Community on 31 December 2015 and held in the first year of implementation of the ASEAN Community Vision 2025. During these summits, ASEAN Member States adopted and noted various frameworks and declarations across the three pillars of the ASEAN Community as well as cooperation frameworks between ASEAN and its dialogue partners aiming at ‘Turning Vision into Reality for a Dynamic ASEAN Community’<sup>3</sup>. The outcomes are a total of 57 documents, including IAI Work Plan III and the Master Plan on ASEAN Connectivity 2025, which are integral parts of the ASEAN Community Vision 2025, and other frameworks and declarations to implement the eight priorities of the Lao PDR’s ASEAN Chairmanship in 2016 and three ASEAN Community Blueprints 2025.

The country’s landlocked location bordered by four ASEAN Member States (Cambodia, Myanmar, Thailand, and Viet Nam) and China can be turned and developed into an advantage – as a strategic ‘land bridge’ physically connecting ASEAN Member States and linking the ASEAN region with a big market, like China. For example, a highway and a railway through the Lao PDR could provide the shortest route from the ASEAN region to China.

With its large hydropower potential, the Lao PDR could also supply the region with electricity. Moreover, the country could potentially leapfrog and plug in to regional value chains to enhance ASEAN’s production base.

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<sup>3</sup> This is the theme of the 28th and 29th ASEAN Summits.



## Opportunities and Challenges under ASEAN Integration: the Lao PDR's Perspective

The year 2017 marks the 50th anniversary of the founding of ASEAN. Over the past 5 decades, ASEAN has evolved and overcome various challenges, with steady achievements made in various fronts leading to the formal establishment of the ASEAN Community on 31 December 2015. ASEAN has become a single market and production base with a combined GDP of US\$2.43 trillion in 2015, ranking as the seventh largest economy in the world. Building on the achievements in the implementation of the Roadmap for an ASEAN Community (2009–2015), the post-2015 agendas and ASEAN Community Vision 2025 continue to enhance and consolidate the ASEAN Community through a deeper and more comprehensive integration process to realise a dynamic, rules-based, people-oriented, and people-centred ASEAN Community, with vibrant, sustained, and highly integrated economies. ASEAN integration has contributed to Lao PDR's socio-economic development, to a certain extent, over the country's 20 years of membership. The ASEAN Community and post-2015 agendas will continue to offer great opportunities for the Lao PDR. However, opportunities will not come automatically; they have to be seized by overcoming challenges and constraints. The section below highlights key opportunities and challenges and constraints that the country could face under post-2015 ASEAN integration.

### Enhanced domestic reform

Regional efforts to advance towards the ASEAN Vision 2025 – by completing the implementation of measures unfinished under the 2015 blueprints and implementing new commitments – imply that the Lao PDR would have an anchor to further domestic reform. For example, the rules-based characteristic that has been envisioned would require the country to improve its governance, enhance the rule of law, and combat corruption. Being 'people-oriented and people-centred' would call for the Lao PDR to ensure that its development process and policy are inclusive and sustainable. In addition, the agendas under the ASEAN Economic Community – such as the ASEAN Single Window; trade facilitation; non-tariff measures; investment environment; financial integration; and promotion of micro, small, and medium-sized enterprises (MSMEs) – would all require the Lao PDR to further improve its institutional and regulatory frameworks. These would potentially bring its rules and regulations closer to other more developed members and eventually contribute to its socio-economic development.

However, to push forward the reform and implement commitments would require financial and human resources and good coordination and understanding among stakeholders. On financial resources, fiscal space has been quite limited over the last decade as revenue collection, despite its growth, cannot catch up with expenditure. The fiscal deficit stood at 7.9% (6.2% with grant) of GDP in FY2015–2016 and averaged at 7.8% (3.5%) between FY2004/05 and FY2014/15. The continued leakage of revenue collection and decline in commodity prices<sup>4</sup> have made expansion of revenue challenging. Limited fiscal space would hinder the reform progress and implementation of commitments. For example, implementing trade facilitation measures and the National Single Window would require a large amount of financial resources to put in place both soft and hard infrastructure. Ensuring that relevant officials attend all working group meetings is also challenging under the current situation. On human resources, limited human resource capacity has been a major problem for both the public and the private sectors because of the low quality of education and its limited coverage. The inefficient recruitment system and non-competitive remuneration in the public sector fail to attract many talents and create mismatches in the system. There is also the weak coordination mechanism and knowledge and understanding gaps among line ministries and between the central and local levels.

## Enhanced support for capacity building

As ASEAN integration becomes deeper, broader, and more complex, ASEAN Member States and dialogue partners have attached greater importance to assisting the CLMV countries to meet ASEAN-wide targets and commitments and close the development gaps in the region. IAI Work Plan III, adopted during the 28th and 29th ASEAN Summits in Vientiane, is a policy framework that aims to provide special support and technical assistance to the CLMV countries to enhance their capacity in implementing the commitments. It comprises five strategic areas – food and agriculture; trade facilitation; micro, small, and medium-sized enterprises (MSMEs); education; and health and well-being. It also highlights the low rate of implementation of IAI Work Plan II, and thus sets measures to ensure effective and efficient implementation of IAI Work Plan III. Given the many commitments under ASEAN and the WTO, development partners will likely continue providing support to the Lao PDR in this area.

Over the past decades, support from development partners have contributed substantially to the Lao PDR's capacity development although the scale and the

<sup>4</sup> Since the mining boom, the mining sector has contributed substantially to revenue collection. According to World Bank estimates, revenue from the mining sector accounted for 14% of total revenue in FY2011/12 and continuously declined to 7% in FY2014/15 and estimated to reach 5.3% in FY2015/16.

coverage have been limited. For example, the majority of government officials have limited English skills, especially those in the provinces, and they are among the most in need of capacity enhancement. However, some training programmes require participants to have a certain level of English ability, eventually leaving out those most in need of training. Also, coordination between government and development partners and among development partners, though it has improved, remains ineffective. This results in overlapping of capacity - building programmes and discontinued participation of government officials. Furthermore, there is a lack of national ownership. In various programmes, the government counterpart is in charge only of administrative arrangements and leaves the technical aspects to international or local consultants, resulting in limited transfer of knowledge and capacity building.

## Cross-border trade

With the formal establishment of the ASEAN Economic Community, the Lao PDR now has inexpensive access to a regional market of more than 600 million people. Given the ASEAN frameworks of trade facilitation and ASEAN connectivity, regional and national infrastructure development, and the economic potential of the country, there are opportunities for the country to increase trade diversification. The Lao PDR, Thailand, Malaysia, and Singapore Power Integration Project is, for example, an opportunity for the Lao PDR to broaden its market to export electricity beyond its existing market of Thailand. In addition, there are potential opportunities to plug into regional value chains. The Lao PDR could join regional value chains in certain sectors such as agro-processing, and mechanical and electrical assembly. Potentially, these would boost production and export of agricultural products as well as mechanical and electrical parts, in addition to electricity and its traditional export products. On the import side, consumers would be able to enjoy lower-cost imported goods and increased varieties of choices. Domestic producers would also benefit from cheaper and convenient import of raw materials. Under the ASEAN framework, the Lao PDR has put in place some standards and conformance measures to ensure that under increased trade there are improved tools to protect consumers.

As a least developed country, the Lao PDR has been granted duty-free market access by 38 countries under the Generalized System of Preferences. However, experience has suggested that market access does not guarantee an increase in export as evidenced by limited utilisation of its available trade preferences. Enterprises lack capacity to increase their production, enhance product quality, and identify niche products to export and to penetrate new markets. The Lao PDR also has similar potentials and endowment as its neighbouring ASEAN Member States; but on many fronts, it still lags behind in

such areas as productivity and cost of transportation. Thus, since other countries would also exert effort to grab opportunities, Lao enterprises would find it even harder to compete. On import, reducing tariffs and eliminating non-tariff barriers for import from ASEAN Member States will create competition for domestic producers. Furthermore, if regulatory capacity and infrastructure are not well in place, there will be risks of influx of low quality and harmful imported products.

## Investment

The Lao investment regime has been quite liberalised and the government has attached great importance to investment promotion. By fulfilling ASEAN commitments, the Lao PDR would be able to increase its international reputation and gain more confidence from potential investors. The ASEAN connectivity plan and regional infrastructure development would increase the country's attractiveness for investment.

Due to its natural resource endowment, the Lao PDR has attracted large amounts of foreign investment in mining, hydropower, and agricultural land concession, and these are expected to continue playing important roles. However, experience has suggested that there is weak regulatory capacity and a lack of transparency in screening for quality investment and monitoring to ensure compliance. In non-resource sectors, which can potentially generate jobs, the Lao PDR has many challenges to address to attract foreign investment. Its business environment remains limitedly supportive. According to the World Bank (2017a), the country is 136th in the Ease of Doing Business Index in 2016. In 10 areas under Ease of Doing Business, it is ranked 169th in resolving insolvency, 168th in starting business, 166th in protecting minority investors, 158th in getting electricity, 143rd in paying taxes, and 116th in trading across borders. It also does not perform well in logistics. The World Bank (2017b) ranks the Lao PDR 152th in the Logistics Performance Index. Lack of skills and capacity of its labour force is another discouraging factor in attracting foreign investment. The Lao Development Report 2014 by the World Bank (2014) reveals that the skills problem in the country is deeper and more severe than is generally recognised. The report highlights the very low levels of literacy as the main problem. The adult literacy assessment carried out in six countries, including Viet Nam, China, and the Lao PDR, found that Lao adults had the poorest literacy skills; post-secondary graduates performed almost on par with people with only primary education in Viet Nam. Despite international and regional integration processes driving domestic reform and thus resulting in improved regulatory and institutional improvement, there remains large room for further improvement and urgency to accelerate the reform to make the Lao PDR competitive.

## Movement of skilled labour

Given the limited supply of skilled labour in the country, the last few years saw an increase in skilled labour from ASEAN Member States to the Lao PDR. Some professionals, such as interior designers and architects, take advantage of visa-free tourism visits to perform short-term services. The ASEAN framework on free flow of skilled labour would potentially provide a reference for the Lao PDR to develop its regulatory and institutional foundation to facilitate, promote, and regulate such movement. More high-quality skilled labour could create spillover effects in knowledge transfer. At the same time, it will also push for an improved education system and skills development through regional cooperation.

More skilled labour, preferred by large companies and international organisations, would increase competition against Lao workers who generally have lower quality of education and limited English skills.

## The Way Forward

Deeper and strengthened regional integration will bring opportunities for the Lao PDR to further improve its socio-economic development. However, opportunities are not automatic but need to be grabbed by overcoming challenges and constraints. The following are recommendations to enable the country to do so:

- There must be political will to drive and accelerate domestic reform as required by regulatory and institutional frameworks to fulfil ASEAN commitments, improve the business environment, and enhance the capacity of the public and the private sectors. The Lao PDR also needs to enhance governance and fight corruption.
- Enhance fiscal space by continuing good initiatives to improve revenue collection and reduce unnecessary spending. Fiscal space is essential to support domestic reform, fulfil commitments, and enhance human capacity and development.
- Provide a clear framework to improve effectiveness of support for training and capacity building. This includes clearly identifying areas for assistance and capacity building; strengthening coordination between government and development partners as well as among development partners; taking strong ownership of all activities, especially capacity building for both the public and the private sectors.
- Improve the coverage and quality of the education system. The focus should be beyond primary education and towards the professional level. The Lao PDR needs to look for opportunities for regional cooperation on educational exchanges and learning from ASEAN's best practices.

- In addition to improving the ‘doing business environment’ and enhancing human resource capacity, improve dialogue between relevant government agencies and potential trading partners to identify products for export. Enterprise development and integration policymaking should promote engagement of research institutions and participation of the private sector.

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