

# Chapter 7

## Investment Climate in Lao PDR

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## **Chapter 7**

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*Syviengxay Oraboune*

#### **Abstract**

Lao PDR has various bottlenecks for foreign investors. Macroeconomic instability is the most serious problem. Although investors are satisfied with the low labour costs, high labour turnover rates cause labour shortage. Moreover, the high cost of transportation has reduced the competitiveness of communities in Lao PDR. Many companies in Savannakhet experienced export and import delay.

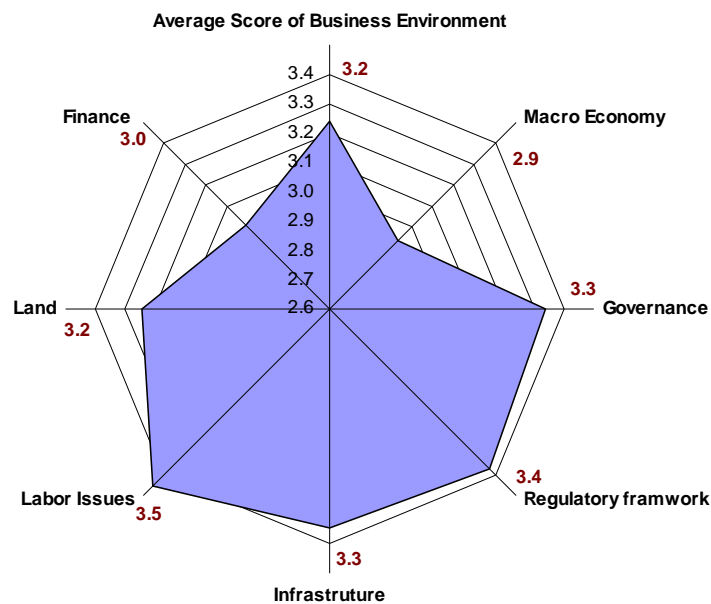
#### **1. Objectives and Characteristics of the Survey**

This ERIA investment climate survey aims to review the investment environment in Lao PDR, in particularly in Vientiane, where there is a selected industrial estate, and in Savvanakhet, which has the Savan-Seno Special Economic Zone (SSEZ) along the East-West Economic Corridor (EWEC). A total of 60 companies (30 foreign direct investment [FDI] companies in Vientiane and 30 firms in Savannakhet, including 15 FDI and 15 local companies with international transactions) were selected as sample companies. Empirical reviews suggest that good investment climate, especially to attract FDI, can stem from lower production cost links. Production cost links for FDI refer to several environmental factors, including business setup, business operations, labour issues, logistics, and other service cost links. The survey analyses the situations in the said areas and the results/findings of the survey are summarised in the following section.

## 2. Results of Investment Climate in Vientiane

Thirty sampled FDI companies were interviewed on the investment climate in Vientiane. From the survey, findings suggest that the overall investment environment in Vientiane is not that attractive to foreign investors. The investment climate was rated on a five-point scale (1 Very poor; 2 Poor; 3 Fair; 4 Good; 5 Excellent) based on such factors as macroeconomy, governance, regulatory framework, infrastructure, labour issues, land, and finance. Results show that the average score given by these companies reached 3.2 only (Figure 1). This indicates that the investment climate in Vientiane is fair although it is much better in infrastructure provision compared to other regions of the country.

Figure 1: Investment Climate/Business Environment in Vientiane



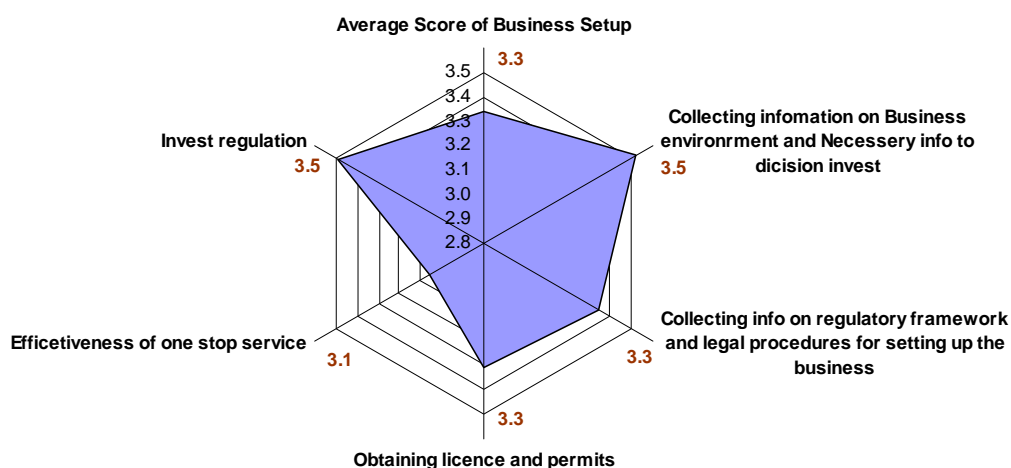
According to the results, of most concern to the companies is the macroeconomic environment, which garnered an average score of lower than 3. Therefore, macroeconomic stability is a very important factor for investors in Vientiane and in Lao PDR as the whole. Although the macroeconomic environment in Lao PDR has improved in recent years, several macrosystems have not been strong enough to secure some external impact. Inflation is still high and fluctuating although it has stayed at one digit for some time. Other monetary policy issues, including those on the

exchange rate, have to be well addressed so as to improve this investment climate in Vientiane.

Labour issues received the highest score at 3.5. Although investors are satisfied with the low labour costs, most have experienced labour turnover. This caused labour shortage for some production periods as well as made it difficult for companies to recruit new labour in Vientiane. Over 40 percent of the companies have labour turnover rate at between 6 percent to 40 percent while over 20 percent experience monthly labour turnover of 11 percent to 40 percent. The survey also reports that at least 5 percent of workers change jobs every month on average.

To determine which cost link environment requires the most attention, the survey analysed the business setup situation in Vientiane, where the average score is slightly above 3.3 (Figure 2). Figure 2 shows that all factors concerning business setup were rated as fairly average, while “One Stop Service” (OSS) garnered the highest concern, receiving the lowest score among all factors. Recently, the Department of Investment Promotion of the Ministry of Planning and Investment implemented the OSS to improve its investment procedures. However, the OSS does not yet cover all the procedures handled by an office of investments, in a sense. Therefore, it is important to

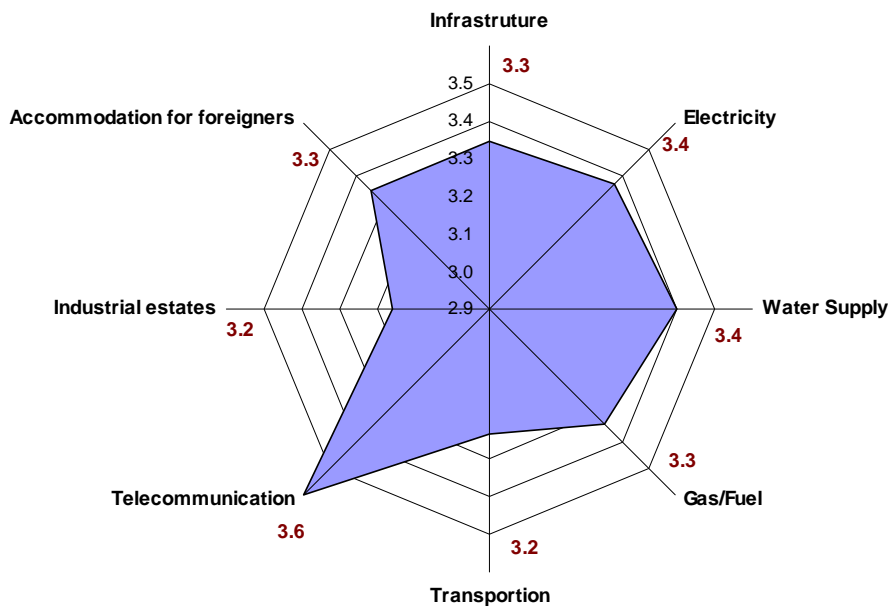
**Figure 2: Business Setup Environment**



have such services gradually improved---by shortening the processing time and reducing the cost of setting up a business---if one were to make Vientiane an attractive investment site.

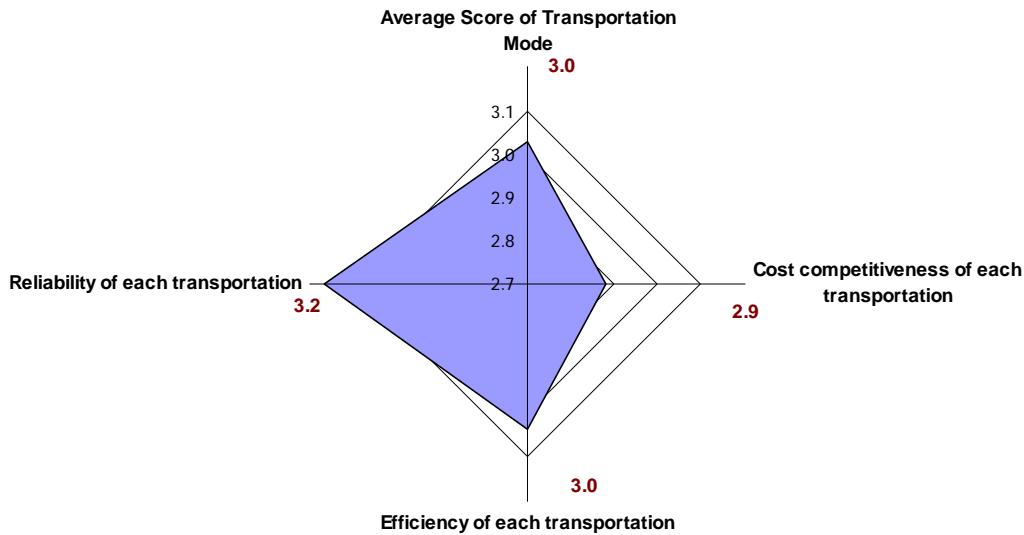
Other cost links such as infrastructure also garnered a fair score of 3.3 (Figure 3), and had industrial estates and transportation as its main areas of concern (average score: 3.2). As earlier mentioned, while Vientiane has been identified as an industrial estate site but there are no other infrastructure (building, road) or even utilities such as water supply in the area.

**Figure 3: Infrastructure**



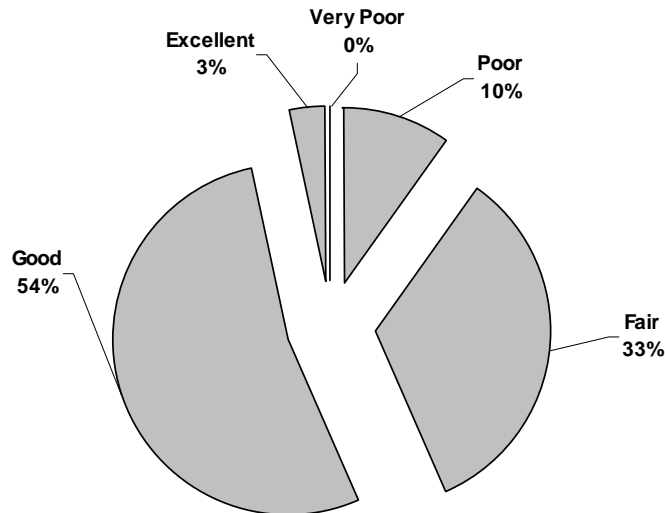
Since there are not many choices of modes of transportation and routes in Vientiane, this has become a bottleneck for the export sector of the country. The high cost of transportation has reduced the competitiveness of communities in Vientiane or in Lao PDR. Therefore, developing more transportation routes is another important consideration. Figure 4 presents the transport score as at only 3.0 while competitiveness has the most transportation-related concern, getting a score of lower than 3.

**Figure 4: Average Score of Transportation Mode for Business in Vientiane**



Finally, the investment climate in Vientiane is at an average of 3.3. This means that the environment is not highly attractive to foreign investors. According to some findings, the most attractive factor is from the external side, including the generalised system of preferences (GSP), and this is not very sustainable. However, when asked about the future of their businesses, almost 60 percent thought that their business still has a bright future while 33 percent believed that their business would fairly continue in the future. Respondents gave this item an average score of 3.5 (Figure 5). Therefore, in this area, Vientiane needs appropriate policies regarding FDIs to make it more attractive to investors.

**Figure 5 Future of Industry  
(Average Score: 3.5)**



### **3. Results from the Investment Climate Survey in Savannakhet**

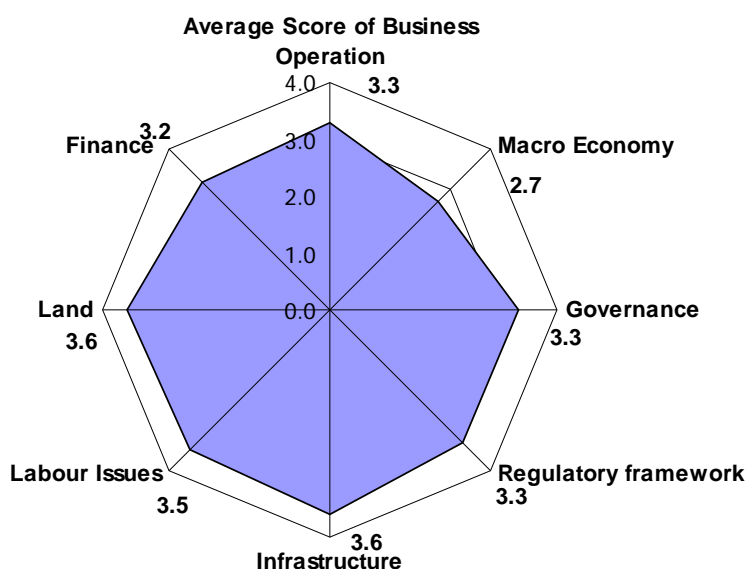
Savannakhet is located in a very strategic area in the East-West Economic Corridor (EWEC). Therefore, to make use of such advantage, the government of Lao PDR introduced the development of a special economic zone called Savan-Seno Special Economic Zone (SSEZ) in the early 2000s. The objective of SSEZ is to attractive FDIs and export-oriented investors to the area.

Similar to what was done in Vientiane, an investment climate survey was conducted in Savannakhet . In sum, 30 sample companies were interviewed for this survey. Out of the 30, 15 were foreign firms and 15 were local companies involved in international transactions.

The overall business or investment environment is generally affected by several factors. Just like in Vientiane, Savannakhet's average score stood at about 3.3 (Figure 6), where the macroeconomic situation elicited the most concern (score of 2.7) when it came to doing business in Savannakhet or in Lao PDR. Business people in Savannakhet have more interaction with Thailand and Vietnam, such that the completion of the EWEC and the second Lao-Thai Friendship bridge is expected to

make them better off compared to the past. This is why the score given to infrastructure reached 3.6.

**Figure 6: Business Operation/Investment Climate Environment in Savannakhet**



From respondents’ perspective, infrastructure in Savannakhet seems to augur their businesses. This is because majority of the sampled companies in Savannakhet are in service and agriculture and are local companies, while firms in Vientiane are FDIs and engaged in manufacturing. Telecommunication and electricity are the most advantaged industries in Savannakhet. Although electricity in Savannakhet is still being importing from Thailand, such will improve after the completion of the Nam Teun 2 hydropower project.

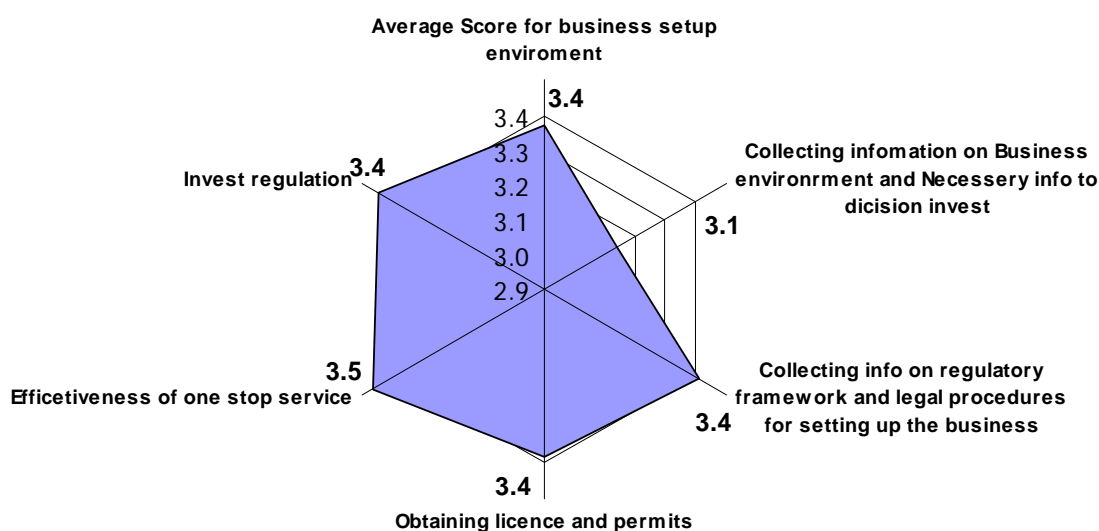
Labour issues scored 3.5, like in Vientiane’s case. There is not much difficulty in finding agricultural workers in Savannakhet, but the area faces a number of constraints on both its skilled and unskilled labour.

Another similarity with Vientiane is that over 90 percent of the companies in Savannakhet pay less than US\$300 per worker, while about 46.7 percent pay under US\$100 per worker per month. About 76 percent of sampled companies experience labour turnover every month. An average of about 5 percent of the total workers change jobs every month.



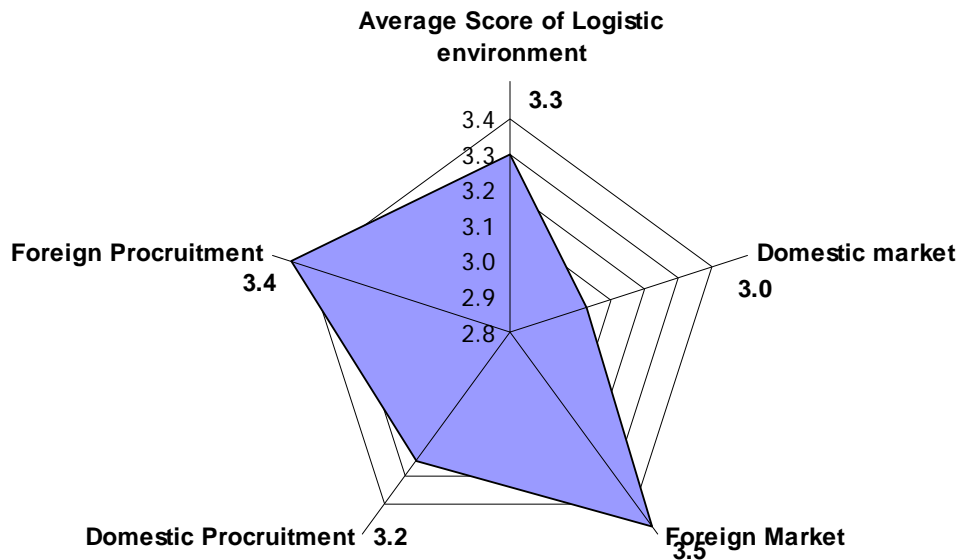
Business setup received an average score of 3.4 (Figure 7), a rating 0.1 higher than in Vientiane. However, note that the majority of the sampled companies in Savannakhet are local firms while most of those in Vientiane are FDIs. Information regarding investment decisionmaking garnered the most concern from respondents. However, there is a lack of publications, figures, and statistics that most foreign investors look for. Local investors cope with such by relying on oral information to help them decide on investments. This is one of the differences in the situation between Vientiane and Savannakhet.

**Figure 7: Business Setup Environment in Savannakhet**



There are other service links that are important concerns. Lao PDR is a land-locked country, which is a constraint to its business environment. Logistics is an important issue in the country, especially in Savannakhet. According to the survey, the logistics-related environment garnered a rating of 3.3, where such concerns centered on the domestic markets. The foreign market is in a much better position in terms of the logistics environment, with an average score of about 3.3 (Figure 8).

**Figure 8: Logistic Related Environment**

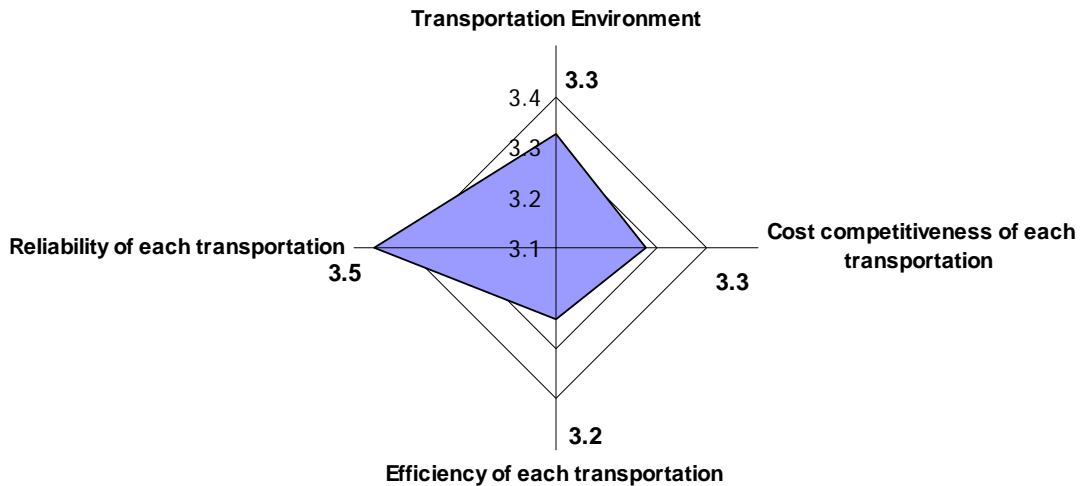


Similar to the case of Vientiane, majority of Savannakhet’s raw materials and components are outsourced. Their access to international suppliers of raw materials is easier when compared to access to local suppliers, since there is lack of information regarding the latter. The average score for foreign and domestic procurement is therefore 3.4 and 3.2, respectively.

When it comes to procurement of raw materials and components from abroad, most concerns centered on nontariff barriers and foreign exchange regulations. On the other hand, the quality of local suppliers’ work is also another concern, as gleaned from its score of about 3.1.

The overall transportation environment received a score of only 3.3, a reflection of the concern over the efficiency of Savannakhet’s transportation sector. In 2008, almost 70 percent of the exporting companies experienced transport delay. According to sample companies about 18 percent of them experienced export delay in two days; 14 percent saw delays of between five days to one week; and 10 percent suffered delays from over one month up to 45 days.

**Figure 9: Transportation Environment**



On the other hand, only 24 percent of the sampled companies did not encounter import delays in 2008. According to sample companies about 10 percent of them experienced import delays of up to 30 days. Altogether, about one-third of the companies experienced an import delay of one week to four weeks in 2008. Such weaknesses significantly annoy business people simply because the longer time means extra costs to business. This directly reduces the competitiveness of doing business in the area.

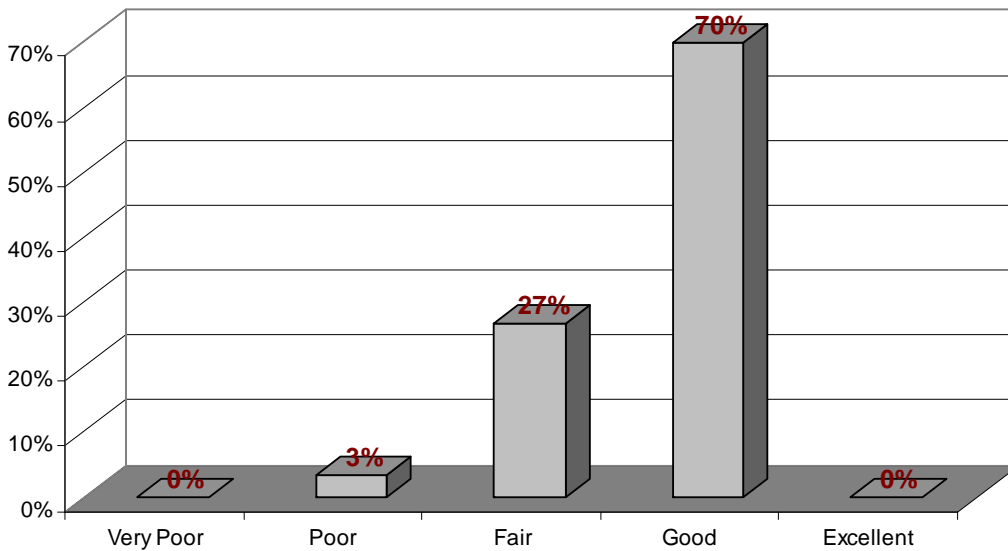
Other related cost links include the governance and regulatory frameworks environment, both of which scored 3.3. Respondents indicated that, not unlike Vientiane’s situation, Savannakhet had to contend with corruption in government. Such respondents, however, do not have problems with crime, theft, and disorder. Results also show that the quality of the government’s service is not satisfactory. Meanwhile, when it comes to the regulatory framework, the protection system of the intellectual property rights (IPR) and tax rate were the biggest causes for concern in Savannakhet. Both issues have a score of less than 3.

On the provision of incentives for the business community in Savannakhet, respondents assigned an overall score of about 3.5 since the business community is generally satisfied with the area’s tax exemption guidelines in the investment law as

well as the regulation of the SSEZ. It is the access to low cost loans that is the biggest concern for the business community. The sampled companies gave these an average score of 3. Some of the related issues of concern, per the survey results, are the high interest rate, short loan period, and complicated guidelines on collaterals. Currently, there is no specific export and import bank in Lao PDR.

Finally, this paper assessed sampled companies' views on future trends in their industry. Most respondents remained optimistic about the future of their businesses. Seventy percent still believe that their business will have a positive trend in the future while 27 percent are fairly optimistic about their businesses. The overall score on the trend of the industry is 3.7 (Figure 10).

**Figure 10: Perspective on Future Trend of Industry (Score 3.7)**



Results from the flowchart approach survey and investment climate questionnaires for Vientiane and Savannakhet suggest that their investment environments are not attractive enough to bring in FDIs. Both were given an overall score of about 3.2 and 3.3, respectively. By reviewing all related factor cost links, we can see that both locations still face a number of obstacles for doing business, including factors related to business setup, business operation, and logistics. As for those factor links, none could score above 3.5. Although there are some FDI in both locations, most

of these companies are in those industries that could benefit from a generalised system of preferences, which Lao PDR receives via its Least Developed Country (LDC) status.

## **Conclusion and Recommendation**

Results of the investment climate survey suggest that the current investment climate of Lao PDR---specifically, Vientiane and Savannakhet---is not highly attractive to investors because of obstacles such as the costs of setting up a business, business operation cost, logistics cost, and other service links costs. The development of more strategic industrial estate/special economic zones in both areas is needed to improve the investment environment. At the same time, targeting industry is an important exercise, which includes identifying a specific industry in each zone so that the business environment in the zone would need to be specific to the targeted industry.

### **4. Policy Recommendations**

Focusing on the development of industrial estate/special economic zone as a way to attract FDIs is significantly important to Lao PDR's industrialization. How one appropriately allocates the industrial estate/SEZ into specific industrial advantages is also a way to achieve the objectives. At the national level, targeting specific industries in neighbouring countries, especially the dynamic economies of China, Thailand, and Vietnam, will have more geographical advantage. The use of an official development assistance (ODA), especially from the origin of target industry/FDI, to provide appropriate environment to the target industry/FDI ensures that the environment is appropriate in terms of the type of infrastructure and other requires links in the areas.

**Vientiane:** Although Vientiane has more advantages than other regions of the country in terms of better infrastructure, the development of its industrial estate is not well recognized. Most manufacturing industries currently concentrate in Vientiane, due to its better infrastructure, regulatory frameworks, and other linked issues. Even in logistics/transportation, Vientiane remains more competitive than other area in Lao

PDR. Although there is no other competitive mean of transportation modes via Bangkok, most manufacturing companies still prefer to locate in Vientiane due to its GSP status.

**Savannakhet:** Savannakhet is located in a very strategic area of the EWEC of the Greater Mekong Sub-region (GMS). Although its location is more strategic than Vientiane's, its infrastructure leaves much to be desired. Survey results show that most exporters from Savannakhet use the road-sea mode via Bangkok rather than via Danang in Vietnam, where the distance is shorter. This indicates that the situation, including the export environment in Danang, is not as competitive as Bangkok's.

Finally, all are in agreement that a SEZ development policy is significant to the industrialization of the country. However, the small population as well as the fact that there is low population density has put a constraint on the labour supply for the SEZs. Such labour shortage might be a constraint to the country's development. Therefore, for industrial estate/SEZ development to take place, an in-depth study as well as a case-by-case review of the potentials and constraints of each area is in order. This way, we can identify an appropriate policy and mechanism for each area.

