

Chapter 2

The Phasing of Development Paths

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Chapter 2

The Phasing of Development Paths

The year 2016 is a unique year in the history of development planning in Lao PDR. In addition to the 8th Five Year Plan (2016–2020), the Government of Lao PDR presented a longer-term development plan – the Vision 2030 and 10 Year Development Strategy (2016–2025). This chapter briefly reviews these official plans, and then discusses how fostering industrial clusters and regional core cities can support efforts to achieve the targets set out in these plans.

2.1. 8th Five Year Plan, 10 Year Development Strategy, and Vision 2030

The 8th Five Year Plan or National Socio-economic Development Plan (2016–2020) (8th NSEDP) is set in the context of mid- and long-term government planning, particularly the 10 Year Development Strategy to 2025 and Vision 2030. Note that in this report the NSEDP is used interchangeably with Five Year Plan. These plans were approved by the National Assembly on 22 April 2016. Overall, the aim of the 8th NSEDP is to move Lao PDR out of the least developed country (LDC) category. Growth of productivity, consolidation of knowledge and skills, materialisation of comparative advantage, acquisition and application of science and technology, and continued diversification of the economy constitute central parts of these official plans. These components, which will transform the Lao PDR economy, require huge public and private investments, well-coordinated industrial policies, interconnected agriculture and services, education and technology, and greater integration into the regional and global economy and its value chains.

Both the 10 Year Development Strategy and the 8th NSEDP are designed in the context of changing domestic and global socio-economic environments. They also aim to become a guide to long-term development policies formulated by the government. Vision 2030 and the 10 Year Development Strategy will provide comprehensive

guidance for the 8th Five Year NSEDP and beyond. In terms of income, the 10 Year Development Strategy aims to double per capita gross national income (GNI) of Lao PDR by 2020, and Vision 2030 aims to quadruple per capita GNI by 2030. These short-, mid- and longer-term plans rely heavily on investment from and trade with neighbouring countries and other international partners. As a consequence, domestic, regional, and international economic environments are crucial to the success of these plans. The changing domestic and global environments, which are challenging or relevant to the Lao PDR economy, are as follows:

- Recent falls in commodity prices, for instance, suggest that over-reliance on the mining sector should be avoided.
- Government prioritises energy (hydro) over mining, but the prospects for the energy sector are also uncertain due to intense potential competition from Myanmar, which is likely to begin exporting power to the same markets as Lao PDR does.
- The Asian Economic Community (AEC) and transition from the Greater Mekong Sub-region (GMS) to the Association of Southeast Asian Nations (ASEAN) present both opportunities and threats.
- The emergence of new players (South–South and the increasing relevance of Lao PDR to its major South–South partners [Viet Nam, Thailand, China, Malaysia, and India]), the development of new financial institutions and functions (Asian Infrastructure Investment Bank, BRICS [Brazil, Russia, India, China, and South Africa], South–South Exchange Trust Fund, and One Belt One Road), and existing development banks having recently strengthened their loan functions (the Asian Development Bank [ADB] and the Japan Bank for International Cooperation [JBIC]), could present new opportunities for Lao PDR.

By taking into account the above-mentioned recent trends, Vision 2030 aims to achieve the following objectives:

- Ensure political and social stability.
- Achieve per capita income in 2030 four times that of 2015.

- Become an Upper Middle Income Country (the initiative to avoid the middle income trap).
- Have an industrialised and modernised economy with strong supporting infrastructure.
- Assure better living standards, human capital development, social security, and people being protected by law.
- Ensure smaller disparity between urban and rural areas.
- Conserve natural resources and use them efficiently.
- Ensure competitiveness, connectivity, and integration with the regional and global economies.

Based on the above objectives of Vision 2030, the priorities of the 10 Year Development Strategy have been set to cover seven sub-strategies as follows:

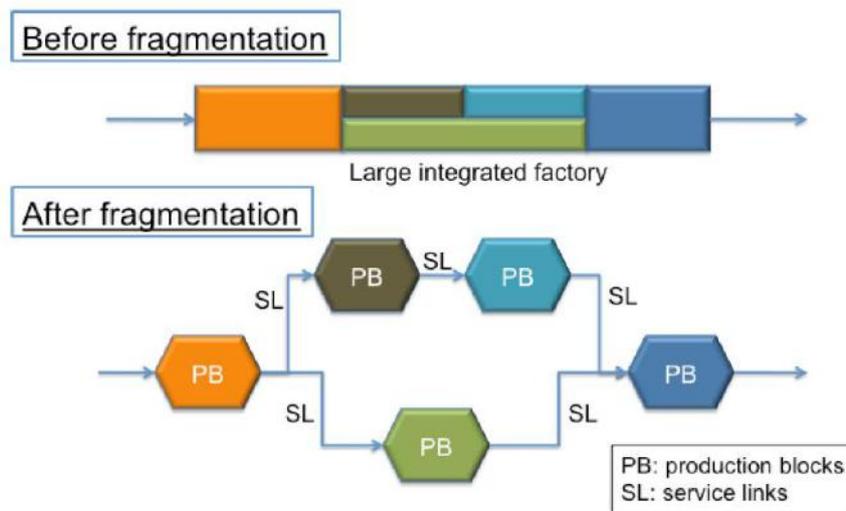
- (1) Pursuing continuous, quality, balanced, sustainable, and green growth;
- (2) Fully graduating from LDC status by 2020, and making progress on sustainable development goals (SDGs) (UNDP website);
- (3) Human resources development;
- (4) Sustainable and efficient utilisation and preservation of natural resources;
- (5) Enhancing people's democratic administration system according to law;
- (6) Global and regional integration and connectivity; and
- (7) Industrialising and modernising the country;

2.2. Participation in Production Networks and Formation of Midsize Agglomerations

Industrialisation in Asia has changed significantly since Japan's strive to catch up with Western powers at the beginning of the Meiji Period (1868–1912). At that time, several modern industries were grown, mostly from scratch, through strong support from and full protection by the government. This model was later adopted by nearby countries,

which resulted in the Newly Industrialised Economies (NIEs) in Asia. But adopting this strategy has become increasingly difficult because transport costs (broadly defined as ‘service link costs’) on a global scale have recently decreased due to technological progress, even though it is not impossible (Figure 2.1).

Figure 2.1. The Fragmentation Theory



Source: ERIA (2015).

A reduction in service link costs through the use of more efficient transport technologies has made production – which had once taken place in large integrated factories – economically viable by carrying out different processes in different locations with different comparative advantages. Such a change is evident from the global patterns of foreign direct investment (FDI) flows. Labour-intensive production processes were relocated to lower-wage developing countries, whereas capital and skill-intensive processes, such as research and development (R&D), remained or expanded in industrialised countries. In other words, since the mid-1980s, the world economy has started to shift from traditional ‘industry-by-industry’ to ‘process-by-process’ international division of labour (ERIA, 2015: CADP 2.0). This has been especially the case in the ASEAN region since the 1980s. Participation in fragmented production networks, through active promotion of inward direct investment, has been

the most important growth engine in most countries, including the wealthy city states of Singapore and Brunei Darussalam, upper middle-income Malaysia and middle-income Thailand, Indonesia, Philippines, and Viet Nam, and low-income countries such as Lao PDR, Cambodia, and Myanmar.

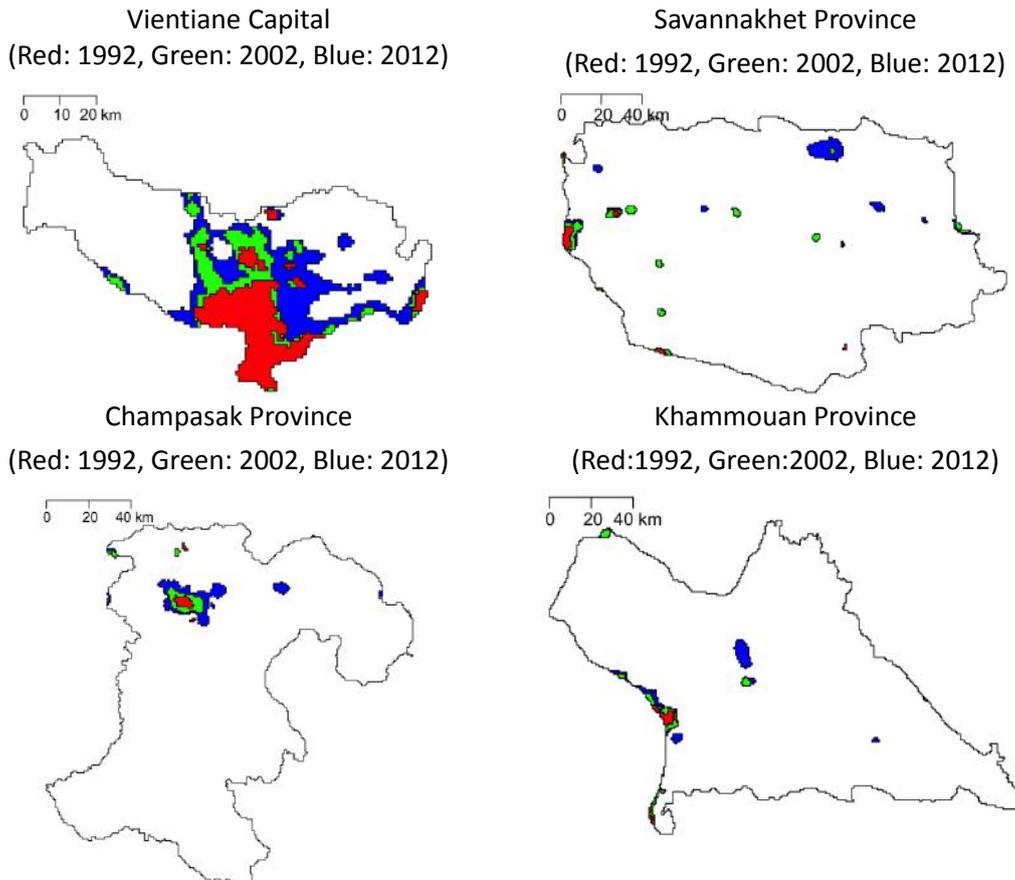
Reducing service link costs is clearly very important for any cities or countries if they wish to participate in production networks. But how to reduce these costs is not straightforward. Good infrastructure, both hard and soft, must be installed and efficiently operated. However, infrastructure alone would not be sufficient. Although modern bridges significantly reduce transportation costs across rivers, more would be needed to attract substantial production blocks. The economics of agglomeration, as developed in recent years, provides useful insights. In essence, agglomeration or concentration of production factors and producers generates feedback effects that create larger agglomerations in particular locations. Lao PDR currently is well behind the rest of ASEAN in terms of both the number and size of its agglomerations. For Lao PDR to be able to continue to grow in the medium and longer term, formation of several midsize agglomerations is absolutely necessary.

2.3. Regional Core Cities and Rural Developments

Addressing regional disparity is another major goal of Lao PDR's official mid- to long-term development plans. It is not difficult to see that while per capita GDP increased more than sevenfold since 1990s, the rise has been concentrated in the capital city, major provinces, and areas close to Thailand. Conventionally, rural development has been considered independently without explicitly taking into account urban (city) development (Hayami, 2007). But in reality, rural and urban areas dynamically interact during the process of development (World Bank and International Monetary Fund, 2013). On the one hand, cities depend on surplus labour and agricultural products from rural areas during the early stage of industrialisation. Rural areas, as a whole, are

also significant markets for goods manufactured in cities. On the other hand, rural areas cannot do without cities to sell their products.

**Figure 2.2. Urban Area Expansion in Major Provinces
(Based on Night-time Light Observed from Space)**

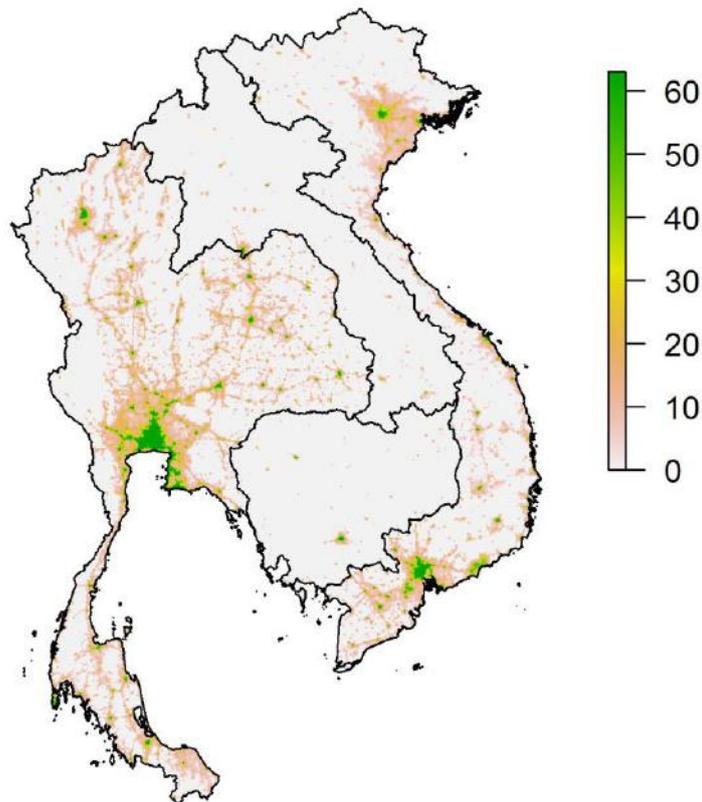


Source: Created by the author (Keola) based on Defense Meteorological Satellite Program–Operational Landscan System (DMSP–OLS) and Global Administrative Unit Layers (GAUL).

Figure 2.2 shows how city development in Lao PDR since 1990s has been concentrated in the capital city. The lit area, a proxy of an area with better infrastructure, in Vientiane Capital, was about 486 square kilometres (km^2) in 1992, which is much larger than 34–60 km^2 in other selected provinces. The lit area in the Vientiane Capital grew to about 1,314 km^2 in 2012. The lit area in Savannakhet was only about 60 km^2 in 1992, and although it expanded significantly to about 372 km^2 in 2012, the new agglomerations are scattered over a much larger area. Due to large-scale mineral

extraction in Sepon in rural Savannakhet, it has expanded to the largest lit area in Savannakhet. The lit area in Champasak is concentrated in the conventional city area but it is much smaller than Vientiane Capital. The lit area in Khammouan is small, but scattered with a significant expansion in the non-city (hydropower plant) area.

**Figure 2.3. Urban Areas in Selected Countries of the Indochinese Peninsula
(Based on Night-time Light in 2012)**



Source: Created by the author (Keola) based on DMSP-OLS and GAUL.

The overall picture of lit areas, including cities in Lao PDR and selected countries in the Indochinese peninsula, is shown in Figure 2.3. Several agglomerations are conspicuous. Lao PDR and Cambodia have an absolute shortage of cities compared with neighbouring countries such as Thailand and Viet Nam. In particular, the capital city of Lao PDR is relatively small and far away from most other regions of the country, and therefore, it would be difficult for Vientiane Capital to develop as a city alone without improving connectivity with the neighbouring regions. In subsequent chapters, this

report will elaborate on how industrial estates and enhanced industries are needed to address the regional disparity that exists in Lao PDR.

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