

# BUILDING EXPORT COMPETITIVENESS IN LAOS

## Background Report



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## CURRENCY EQUIVALENTS

(As of end October, 2006)

Currency           Lao Kip  
Currency Unit   =   Kip  
US\$1.00       =   9,888 Kip

**FISCAL YEAR:** October 1 – September 30

## ABBREVIATIONS AND ACRONYMS

ACFTA	ASEAN-China Free Trade Agreement	DDFI	Department for the Promotion and Management of Domestic and Foreign Investment
ACV	Agreement on Customs Valuation	DISM	Department of Intellectual Property, Standardization and Metrology
AFTA	ASEAN Free Trade Area	DLF	Department of Livestock and Fisheries
AGOA	African Growth and Opportunity Act	DTIS	Diagnostic Trade Integration Study
AHPADA	Asian Handicraft Promotion & Development Association	EBA	Everything But Arms
AHTN	ASEAN Harmonized Tariff Nomenclature	EC-15	European Economic Community of 15 nations
APD	Agriculture Promotion Bank	EHP	Early Harvest Program
		ERIT	Economic Research Institute for Trade
ASEAN	Association of South East Asia Nations	ESEWA	Enterprise Support for Empowering Women and Artisans
ATC	Agreement on Textiles and Clothing	FAO	Food and Agriculture Organization
BAF	Bunker Adjustment Factor	FCL	Full Container Load/ Full Carload
BCEL	Banque pour le Commerce Extérieur Lao	FDA	Food and Drug Administration
BOL	Bank of Laos	FDD	Food and Drug Department
BTA	Bilateral Trade Agreement	FDI	Foreign Direct Investment
CAF	Currency Adjustment Factor	FIAS	Foreign Investment Advisory Service
CEPT	Common Effective Preferential Tariff	FMD	Food and Mouth Disease
CGE	Computable General Equilibrium	FOB	Free on Board
CPI	Committee for Planning and Investment	FTD	Foreign Trade Department
C&F	Cost and Freight	FTO	Fair Trade Organization

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GATS	General Agreement on Trade in Services	MOF	Ministry of Finance
GATT	General Arrangement on Tariff and Trade	MIH	Ministry of Industry and Handicraft
GBO	Grassroots Business Organizations	MFA	Multi-Fiber Arrangement
GEL	General Exception List	MFN	Most Favored Nation
GDP	Gross Domestic Product	MOH	Ministry of Health
GNI	Gross National Income	MPDF	Mekong Private Sector Development Facility
GOL	Government of Laos	NAB	National Accreditation Body
GPA	Government Procurement Agreement	NAHC	National Animal Health Center
GSP	Generalized System of Preferences	NEM	New Economic Mechanism
GTAP	Global Trade Analysis Project	NGPES	National Growth and Poverty Eradication Strategy
GTZ	German Agency for Technical Cooperation	NPD	National Phytosanitary Database
HACCP	Hazard Analysis and Critical Control Point	NPPO	National Plant Protection Organization
HS	Harmonized System	NSC	National Statistic Center
ICT	Information and Communication Technology	NSEDP	National Socio-Economic Development Plan
IDA	International Development Association	NTA	Lao National Tourism Authority
IF	Integrated Framework	NTB	Non-tariff Barrier
IFAT	International Federation for Alternative Trade	NTM	Non-tariff Measure
IFC	International Finance Cooperation	NTR	Normal Trade Relations
IMF	International Monetary Fund	NWFP	Non-wood Forest Products
IPPC	International Plant Protection Convention	NZAID	New Zealand Agency for International Development
ISO	International Standards Organization	PMO	Prime Minister Office
ISPM	International Standards for Phyto-sanitary Measure	PRA	Pest Risk Analysis
ITA	Information Technology Agreement	PRSP	Poverty Reduction Strategy Paper
ITC	International Trade Center	SAARC	South Asian Association for Regional Cooperation
JICA	Japan International Cooperation Agency	SEZ	Special Economic Zone
LCD	Lao Customs Department	SIDA	Swedish International Development Cooperation Agency
LCL	Less than/loose Container Load	SME	Small and Medium Enterprise
LDC	Least Developed Country	SMTQ	Standardization, Metrology, Testing and Quality
LECS	Lao Expenditure and Consumption Survey	SPS	Sanitary and Phyto-sanitary Agreement
LHG	Lao Handicraft Group	SRT	State Railway of Thailand
LIFFA	Lao International Freight Forwarders Association	STEA	Science, Technology, and Environment Agency
LNCCI	Lao National Chamber of Commerce and Industry	TBT	Technical Barriers to Trade
MAF	Ministry of Agriculture and Forestry	TIFFA	Thai International Freight Forwarders Association
MCTPC	Ministry of Communication, Transportation, Post and Construction	TRIMS	Trade-Related Investment Measures
MFTR	Memorandum on Foreign Trade Regime	TRIPS	Trade-related aspects of Intellectual Property Rights
MOC	Ministry of Commerce	UAP	Unprocessed Agricultural Products
		UNDP	United Nations Development Program
		USDA	United States Department of Agriculture
		FAS	Foreign Agriculture Services

## ACKNOWLEDGEMENTS

This report was prepared by a team consisting of Mona Haddad (Task Team Leader); George Fane (Australian National University) and Khamlusa Nuansavanh (National University of Laos): trade policy and trade and poverty; Paul Brenton: market access; Philip Schuler, Maika Oshikawa (WTO), and Phouvieng Phongsa (WTO and Ministry of Commerce, Laos): WTO; John Arnold (consultant): trade facilitation; Michel Zarnowieki and William Ledrew (consultant): customs; Kees van Der Meer (standards); J. E. Austin (consultants): export competitiveness; IMF: macro assessment; Amanda Carlier: business environment.

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## A NOTE ON PROCESS

Following the preliminary DTIS mission, the government requested the Bank to follow a practical approach with a focus on export competitiveness. To that end, the DTIS included a series of workshops with private sector and government stakeholders. During March 2005 (main mission) and July 2005, eight workshops on cluster export competitiveness were organized with a strong participatory and consultative approach (six in Vientiane on agriculture, light manufacturing and tourism; one in Savannakhet; and one in Luang Prabang on tourism). The workshops aimed at (i) providing an opportunity for the private sector and the government to discuss together the constraints they face in exporting; (ii) learning from best practice around the developing world on how clusters managed to improve their export competitiveness; (iii) allowing local stakeholders to come up with a SWAT analysis and an action plan on what needs to be done in Laos.

The DTIS benefited greatly from the work done for the National Export Strategy (NES) that was being undertaken by the government with the assistance of ITC. Recommendations from the DTIS work and the NES were merged in the export competitiveness component of the draft Action Matrix. Discussions with the government and IF agencies took place on how to incorporate the DTIS findings into the five-year plan of the government.

In March 2006, a workshop to discuss the draft Action Matrix was organized in Vientiane (modeled after the IF Simulation Workshop in Addis Ababa in September 2005, but discussing a real Action Matrix with real stakeholders). The workshop brought together representatives from the government, private sector, and donor community. It aimed at debating and agreeing on priorities of the Action Matrix within each group and across the three groups. In addition, two awareness raising workshops were organized in March 2006 in Luang Prabang and Pakse and included representatives from various provinces. The workshops aimed to share the main results of the DTIS and the draft Action Matrix, and seek feedback from the provinces. The workshops were supported by the World Bank and led by Mme Khemmani Pholsena (IF focal point in Laos).

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## Chapter 1: Macroeconomic Setting, Opportunities, and Challenges Ahead

Recent macroeconomic performance in Laos has been encouraging, with the economy now enjoying stable macroeconomic conditions and relatively robust economic growth. Significant challenges remain, however, notably in fiscal management and financial sector reform. They need to be overcome for Laos to sustain macroeconomic stability and achieve its long-run development potential. Strengthening the economy's external competitiveness, through trade reforms and measures to improve the business environment, will also be critical to attract the private investment that is needed to widen the resource base and diversify exports.

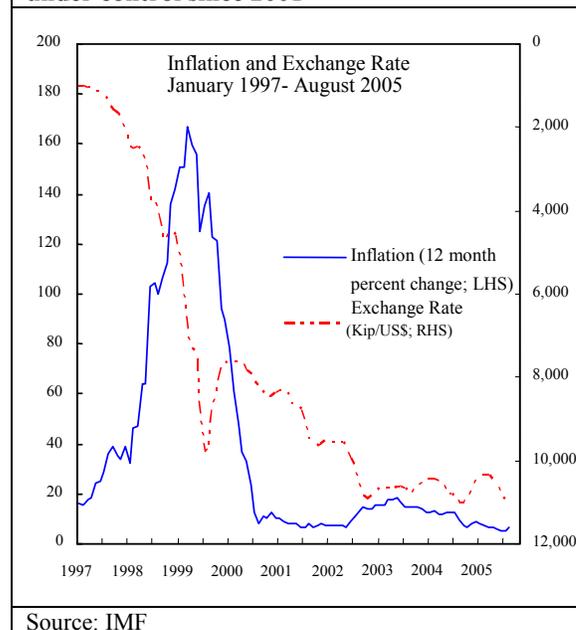
### The macroeconomic setting

Laos began the transition from a centrally planned to a market economy in 1986, when the government introduced the "New Economic Mechanism". Over the next decade, steady progress was made in transforming the economy: price controls were removed, the exchange rate system was unified, tariffs were rationalized, a two-tier banking system was introduced, the government's monopoly on trade was removed, the number of state-owned enterprises was sharply reduced and private enterprises were allowed to operate. Reforms stalled in the second half of the 1990s, as Laos struggled with a major economic crisis, stemming from a breakdown in macroeconomic management in the wake of the Asian crisis.

The government launched a successful stabilization program in late 1999, and by early 2001 the Kip had stabilized and inflation had been reduced to single digits (Figure 1). However, the economic situation remained fragile. The fiscal position was weak, as budget revenues remained very low, and the state commercial banks, which account for over half of the assets of the banking system

were insolvent, weighed down by high levels of non-performing loans, which accounted for almost 90 percent of the state banks' loans. The broader structural reform agenda also needed to be revived to place the economy on the path of sustained growth and poverty reduction.

**Figure 1. Inflation and exchange rate under control since 2001**



The fifth National Socio-economic Development Plan (NSED) (2001–2005), which was supported by an IMF PRGF arrangement and programs by the World Bank and ADB, sought to address these challenges. One of the primary objectives was to sustain the stabilization effort, through strengthening public finances. Raising budget revenues and strengthening expenditure management were the main priority, complemented by reform of the state banks and state-owned enterprises to strengthen the broader fiscal position. The development plan also sought to accelerate structural reforms to develop the private sector and facilitate greater regional integration through trade reforms associated with Laos' obligations under the ASEAN Free Trade Area (AFTA) and preparations for accession

to the WTO. The government has prioritized investment in infrastructure and social services under the National Growth and Poverty Eradication Strategy. Development of the country's natural resources were also accorded high priority.

Macroeconomic performance under the fifth NSEDP has been relatively encouraging. Apart from a brief interruption in 2002–2003, Laos has enjoyed stable macroeconomic conditions. In the last few years, the Kip has traded within a relatively narrow band, inflation has remained in single digits, and external reserves have remained comfortable at around three months of imports. The economy has also enjoyed buoyant growth since 2003, driven largely by a surge in mining activity. Much credit for this favorable performance is due to a commitment to disciplined monetary and fiscal policies, and in particular a firm adherence to avoiding monetary financing of the budget deficit.

The pace of structural reform has been slower than envisaged, however, leaving many underlying weaknesses unaddressed. In particular, progress in strengthening fiscal management has been slow and uneven, due to capacity constraints and a difficulty in advancing reforms in a decentralized environment.<sup>1</sup> Budget revenues have fallen significantly since the start of the plan,<sup>2</sup> putting excessive pressures on expenditure compression, and raising concerns about fiscal sustainability. Expenditure management also remains weak, undermining progress in reducing domestic arrears and improving public services, most critically in education and health. The state banks remain in a precarious financial position, and the banking system as a whole is still severely under-

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<sup>1</sup> In 2000, the government took steps to decentralize fiscal management, which resulted in a weakening of central control over revenue administration and treasury operations.

<sup>2</sup> The revenue-to-GDP ratio is estimated at 11 percent in 2004/05, two percentage points below its 1999/00 level.

developed.<sup>3</sup> Lastly, while some progress has been made in trade and other private sector reforms,<sup>4</sup> the country's economic base is fragile and over-dependent on a narrow range of commodities.

### **Economic outlook and challenges**

The economic outlook for Laos is favorable, provided that progress is made in structural reform. Economic growth should remain strong during the next few years—in the range of 7–7½ percent—with the stimulus from the Nam Theun 2 (NT2) hydroelectric project and a number of large mining projects more than offsetting a weakening of garment exports following the expiry of the Multifiber Arrangement (MFA) quota system. Further integration of the economy into the region will likely provide additional stimulus particularly in the agriculture and tourism sectors. The external outlook is also expected to remain reasonably buoyant. While the external current account deficit is projected to increase in the next few years, due to a surge in capital imports associated with the NT2 and mining projects, this is expected to be financed by increased capital inflows—mainly foreign direct investment—and external reserves are expected to remain at relatively comfortable levels.

Significant challenges will need to be overcome for Laos to sustain its recent macroeconomic performance, and achieve its longer-term goal of graduating from the group

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<sup>3</sup> The degree of monetization—M2 is under 20 percent of GDP—and credit extension (10 percent of GDP) are both very low relative to other low-income countries. Banking services are also very limited (for example there are currently only 11 ATMs throughout the entire country).

<sup>4</sup> Key reforms include further trade liberalization under AFTA, the ratification of AFTA's Early Harvest Program with China, the establishment of normal trade relations (NTR) with the United States, and the initiation of steps towards WTO membership.

of least developed countries by 2020.<sup>5</sup> In particular, the fiscal position is fragile, with weak revenue collections and rising spending pressures putting strains on the budget. The impact of the tariff reduction resulting from implementation of the AFTA obligations is likely to be mitigated by increased imports and reduced revenue leakages after customs administration reforms (Box 1). Public debt is high at about 80 percent, and the budget will have to absorb significant liabilities when the state banks are fully recapitalized. More generally, the financial sector needs to be strengthened to provide a well functioning payment system and efficient financial intermediation, and private sector investment is needed to widen the resource base and diversify exports. The latter is particularly important, as the large projects that will drive growth in the next few years have few linkages with the rest of the economy and will not by themselves provide much growth in employment opportunities.

The government's National Growth and Poverty Eradication Strategy (NGPES) has highlighted many of the key reforms that are needed to overcome these challenges. While there is a broad consensus on the main direction of reform, the details of the policy priorities still need to be fleshed out in a number of areas. This paper focuses on three key priority areas:

***Strengthening fiscal management is a first priority area.*** There is a broad consensus that revenue mobilization continues to be the main fiscal priority. This is critical given Laos' high public debt and its substantial development needs. The need for accelerated progress is heightened by the impending loss of customs revenue associated with the tariff reductions under AFTA (Box 1). While the introduction of a VAT remains the main tax

policy change in the medium term,<sup>6</sup> the immediate priority is to strengthen tax and customs administration.

The main challenge on this front has been to centralize control over the tax and customs operations in the provinces. In the customs area, some steps have been taken to improve central oversight over provincial customs posts, although this remains a challenge. Progress has been slower on the tax side. The authorities have been encouraged, as a first step, to integrate the administration of large tax payers into a single unit under central government control, but there is little consensus on how to proceed on this front. Strengthening the technical capacity in both the customs and tax administrations also remains a priority.

On the expenditure side, the priority is to strengthen the planning and execution of the government budget, as weaknesses in the public expenditure management system are widespread. As on the revenue side, a lack of central treasury control over provinces has aggravated underlying capacity constraints, resulting in weak control over expenditures and poor fiscal reporting. The Government has launched a Public Expenditure Management Strengthening Program, with the support of the World Bank. The main priorities in the short run will be to:

- (i) strengthen control over provincial treasuries, notably with regard to transmission of national revenues to the center;
- (ii) improve budget planning and execution, by updating the budget's nomenclature and developing supporting accounting systems; and
- (iii) develop a central government cash management system.

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<sup>5</sup> This would require sustained growth of 6–7 percent over an extended period.

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<sup>6</sup> The introduction of the VAT is likely to be delayed until 2008, to provide adequate preparatory time.

Progress in strengthening fiscal management is likely to require reforms to the broader framework of center-province fiscal relations. Provinces are unlikely to cede control over revenue and treasury operations until such a framework is in place. A review is needed of the regulatory framework for fiscal relations between the central government and the provinces, to clarify the assignment of revenue and expenditure responsibilities and develop a robust mechanism for inter-governmental transfers.

**Establishing a functioning banking system is a second priority area.** Laos needs an efficient banking system to achieve the government's development goals and meet the competitive challenges of regional integration. The main emphasis continues to be on the reform of the state banks, as they dominate the banking system.<sup>7</sup> As noted above, progress in restructuring the state banks has been slow, and they remain deeply insolvent. Given the difficulties in restructuring the state banks, greater priority needs to be given to finding strategic partners for the banks to strengthen their technical expertise and provide them with the autonomy needed to run a successful banking operation. In the interim, the focus is on improving the governance frameworks of the state banks, in order to streamline the bank's management structures, strengthen their performance indicators, and ensure a sound lending framework.

Steps also need to be taken to strengthen the general banking environment. One priority has been to facilitate the entrance of strong strategic investors into the banking system. The key next step in this process is to secure passage of amendments to the banking law to allow foreign banks to operate on a nationwide basis on equal terms with domestic banks. Prudential oversight of the banking system also needs to be strengthened. In addition to improving the regulatory framework and building up the Bank of Laos's supervisory

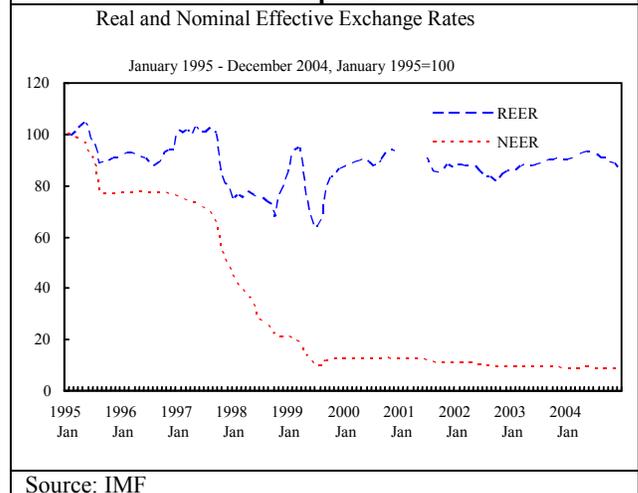
<sup>7</sup> The three main state banks—BCEL, LDB, and APB—account for over two thirds of total deposits.

capacity, the scope of bank supervision needs to be broadened beyond the state banks, to assess the soundness of the private banks. The first step in this regard would be to develop standard financial soundness indicators for the banking system to identify potential areas of vulnerability.

**Improving competitiveness is a third priority area.**

Conventional macroeconomic assessments of competitiveness using real effective exchange rates do not suggest any major competitiveness concerns. Indeed, Laos' real exchange rate is broadly unchanged from its pre-crisis levels in the mid-1990s (Figure 2). However, other approaches, involving a more detailed assessment of the various elements that make up the investment climate, suggest that competitiveness is a major impediment to attracting investment to Laos.

**Figure 2. The real effective exchange rate is not a source of concern for competitiveness**



Poor infrastructure is one key impediment. The state of Laos's infrastructure lags far behind other countries in the region. There is no railway system and the road network has a very low density—less than a hundred meters of road per square kilometer—and less than half the roads are paved. A quarter of the district centers lack year-round access and the situation is even worse at the village level. The lack of infrastructure is a major obstacle to the development of an integrated domestic

market. Access to export markets is also difficult. In addition to the difficulty of getting goods to the border, cumbersome customs procedures and governance problems at the border raise transport costs and increase delivery times for key exports (e.g., garments and agricultural products). As a landlocked country, Laos' trade is sensitive to the transit procedures in neighboring countries, which can add to the costs of shipping goods.

The business environment is also very difficult. While Laos has cheaper labor than other countries in the region, productivity is also lower, and it has higher than average electricity, telecommunications and rental costs. Laos ranks 144<sup>th</sup> out of 145 countries in terms of the length of time that it takes to start a business and 150<sup>th</sup> out of 161 in a recent Heritage Foundation study on the cost of doing business. Limited foreign investment and low numbers of domestic private firms are an indication of how difficult the investment environment is in Laos. In a country of 5.5 million people, there are only a few hundred manufacturing firms with more than 10 employees.

The basic framework for the reform agenda has already been established in the NGPES, which appropriately stresses the need to:

- (i) improve the business climate by creating a predictable and transparent policy environment;
- (ii) streamline administrative procedures and regulations that are an obstacle to domestic and foreign private investment; and
- (iii) strengthen market institutions, including most notably those related to dispute resolution and contract enforcement.

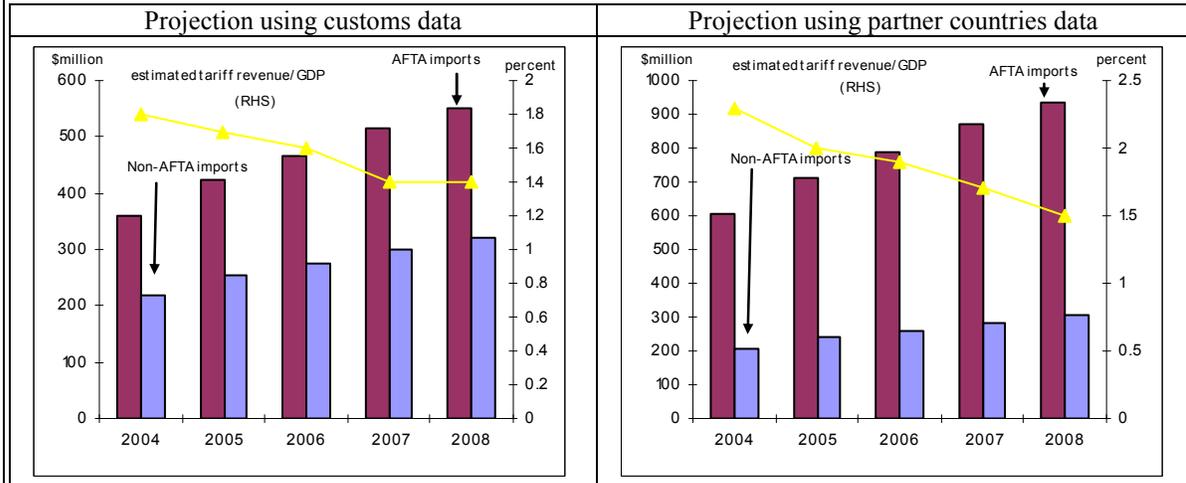
The remaining chapters of this study will address the main elements of the reform agenda to strengthen Laos' competitiveness, placing special emphasis on trade facilitation and reforms to the business environment.

### Box 1. Impact of AFTA and ACFTA on tariff revenue

The impact on revenue of tariff reductions resulting from implementation of AFTA and the ASEAN China Free Trade Agreement (ACFTA) will be mitigated by the increase in the value of trade and, potentially, by the reduction in revenue leakage following customs administrative reforms. Two projections are undertaken, using different datasets.

The baseline projection uses Lao customs data and assumes that the revenue leakage continues. It projects a rapid increase in imports driven by economic growth and reductions in tariffs. The US\$ value of imports from AFTA and non-AFTA countries is projected to increase by over 50 and 45 percent respectively over the period 2006-08. Under this scenario, full implementation of AFTA and ACFTA is expected to cause a gradual and moderate decline in tariff revenue—from 1.8 percent of GDP in 2004 to 1.4 percent in 2008. (As a point of reference, if the free trade agreements were not implemented and all imports were subject to MFN tariff rates, revenues would be expected to be around 2.1 percent of GDP in 2008.)

An alternative projection uses trade statistics from partner countries and shows potential revenue gains from fully taxing all trade flows (rather than just those that are captured by Lao customs). Tariff revenue would then be significantly higher than current collections. Projected revenues would have been 2.3 percent of GDP in 2004, and would fall to 1.5 percent of GDP in 2008 under full implementation of AFTA and ACFTA. This suggests that customs reform could help claw back some of the revenue loss from implementation of the agreements.



Note: Both projections assume: (i) full transmission of tariff changes to domestic prices of imported goods; (ii) own-price elasticity of import demand based on the WITS estimates for HS chapters; (iii) zero cross-price elasticity of import; (iv) income elasticity of unity is assumed for the relationship between import and GDP growths in US dollar terms; and (v) international unit price for each item remains constant through out the forecast period. Gross domestic production growth projections include the impact of tariff reduction on economic activity through better access to external markets and increased competition at home. Projections are constructed at the HS 6-digit level using import items that matched with tariff lines from the AFTA and ACFTA agreements. Both projections take into account exempted goods, which include capital goods, non-passenger transport equipment, and industrial machinery.

The Lao customs data used are inconsistent with those provided by trade partners. In 2004, Lao imports reported by customs were only half the figure based on partner countries data (from COMTRADE). The difference is likely to be attributable to smuggling, misreporting, and the granting of ad hoc tariff exemptions by provinces. Under-reporting is significant in relatively highly-taxed items such as beverages and tobacco, and machinery and transport goods.

Source: World Bank

## Chapter 2: Trade Policy

Trade in Laos has been liberalized substantially in recent years under the direction of the New Economic Mechanism (NEM) which in the 1980s launched the country's transition from a centrally planned to a market economy. Trade liberalization has also been driven by regional agreements, especially AFTA. Tariffs are now low on average, and still coming down as implementation of AFTA commitments proceeds. Import licenses have also been streamlined, but more can be done to make them more transparent, and ultimately they need to be removed or replaced by more appropriate regulation.

To a large extent, trade policy is now shaped by the regional and bilateral agreements that Laos has engaged in. These include AFTA, the Early Harvest Program (EHP) of the ASEAN China Free Trade Agreement (ACFTA), and the bilateral trade agreement with the United States (BTA).<sup>1</sup> There is a risk that implementation of these agreements could lead to some fragmentation of tariff policy and additional administrative burdens for government and traders. In the longer term, Laos may be expected to commit to reduce its Most Favored Nation (MFN) tariffs as a condition of joining the WTO. This would reduce some of the risks of trade diversion that are inherent in the current differentiation of tariffs according to the country of origin of imports. In the meantime, it would make sense for the Ministry of Commerce to factor in the risks of trade diversion in its consideration of future tariff reform.

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<sup>1</sup> Laos is also a signatory to the Bangkok agreement, whose membership includes Bangladesh, India, Republic of Korea, Sri Lanka and China. Laos has not, however, extended any tariff concessions under the agreement, so it as yet has little impact on trade policy.

### Import duties and effective protection

*A major turning point in tariff policy started in 1993.* As part of the NEM, the Lao government gave firms autonomy to engage in international trade and in 1993 it began to reduce the taxes on trade. Even after the 1993 reforms there were 12 different tariff bands, with rates that ranged from 5 percent to 100 percent. A major reform in 1995 was to reduce tariffs to moderate levels. The top rate was lowered to 40 percent and the number of bands reduced to six: 5 percent, 10 percent, 15 percent, 20 percent, 30 percent, and 40 percent. In addition to these reductions in tariffs, export taxes have now been abolished.

### *MFN tariffs are low, and so is dispersion.*

The average MFN unweighted tariff is 10 percent, and the weighted average is 13 percent. Tariff dispersion, measured by the standard deviation, is also quite low (Table 1). Tariffs are also low relative to countries in the region and countries with similar income level—IDA countries—(Figure 1).

**Table 1. Profile of MFN tariff structure in Laos**

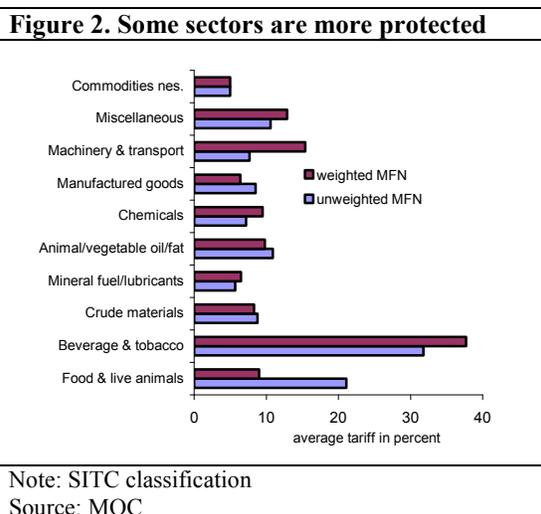
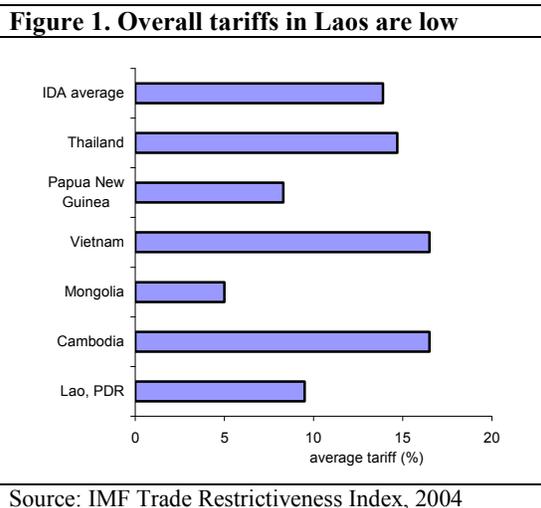
	Unweighted tariff (%)	Weighted tariff (%)
Average	10.3	13.2
Median	5.0	
Standard deviation	(8.6)	(11.9)
Maximum	40.0	
Minimum	5.0	

Source: MOC

### *Some sectors still enjoy higher protection.*

The average weighted tariff in manufacturing sector (13 percent) is higher than in agricultural sector (7 percent). Within agricultural sector, by far the most highly protected sub-sector is fruits and vegetables, with an average duty rate of 25 percent (Figure 2). Within the

manufacturing sector, the highest tariffs are on food processing, wood products, furniture, and motor vehicles.



***Effective protection is probably highest for production of processed food and beverages, and lowest for the major export products such as garments and furniture.*** It is difficult to calculate effective rates of protection for Lao industries because there is no input-output table for Laos and because no price comparisons are available for the many goods that are not directly tradable—some because of licensing, but most because of high transport costs<sup>2</sup>. However, it is clear

<sup>2</sup>Further, the willingness of central and provincial authorities to use discretionary

that firms in the modern manufacturing sector that have obtained investment licenses from the Committee for Planning and Investment (CPI) under the Foreign or Domestic Investment Laws, receive substantial effective protection. This is because, for imports of raw materials and semi finished goods that are part of their approved business plans, they need only pay import duty rates at a special concessionary duty rate of 1 percent, and approved imports of capital equipment can be imported duty free.

Among sectors in which domestic production is substantial, those with the highest effective rates are probably those producing processed foods and beverages. The average MFN tariff for manufacturing sectors producing processed meat and fish is 29.8 percent and that for prepared vegetables is 30.0 percent (Table 2). The corresponding rate for processed cereals is 18.6 percent and other food, beverages and tobacco the average tariff rate is 17.8 percent. Other sectors producing for the domestic market that receive substantial effective protection are chemicals (including cement and soaps and detergents) with an average tariff rate of 13.9 percent; rubber and plastic products, with an average tariff rate of 12.0 percent; and footwear with an average tariff rate of 11.2 percent.

The effective rate of protection for the garment sector is probably close to zero, since raw materials and capital enter duty free and most of the output is exported. Similarly, although there are high average tariff rates on wood products (29.8 percent) and furniture (17.9 percent), these sectors probably also receive little effective protection. Since furniture and wood products are important exports for Laos, the high tariffs on them are probably largely

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controls over imports to protect local producers could mean that levels of protection are much higher than calculations at a single point in time would suggest.

redundant. If there is competition between domestic producers, it will of course drive down the domestic price to the price received by exporters. If domestic markets are monopolized, or operated by oligopolistic cartels, domestic producers can

make use of tariffs to keep domestic prices above those that they receive for their exports, but this is unlikely to be the case in furniture and wood products since there are many firms in these sectors.

**Table 2. Tariffs are still high for manufacturing sectors with large domestic production**

	% Share 2001/02	% Share 2003/04	MFN 2005	AFTA 2005	AFTA 2009
Meat and fish	0.0	0.0	29.8	13.1	0.7
Sugar and cocoa	1.2	1.2	10.3	9.4	4.1
Cereals, processed	0.5	0.2	18.6	12.6	1.8
Vegetables, prepared	0.0	0.0	30.0	20.2	3.0
Other food, beverages & tobacco	7.6	4.0	17.8	13.7	2.4
Chemicals, organic & inorganic	1.1	0.6	5.0	4.0	0.0
Pharmaceuticals	0.4	0.7	9.8	7.8	4.9
Fertilizers	0.4	1.2	5.0	4.1	0.0
Other chemicals	2.8	1.2	13.9	10.5	2.4
Plastic & rubber products	3.2	2.4	12.0	9.7	1.7
Hides, leather	0.1	0.1	10.7	10.4	1.9
Wood products	0.2	0.1	29.8	18.7	2.6
Paper & printing	1.1	1.2	6.9	6.9	1.4
Textiles	1.3	0.9	8.4	5.7	0.0
Apparel	1.8	0.9	9.9	5.8	1.2
Footwear etc.	0.4	0.3	11.2	8.4	0.4
Cement, stone, glass	2.5	2.5	5.1	4.7	0.3
Iron & steel	6.0	5.9	5.0	5.0	0.1
Other metals	1.1	1.3	8.6	7.7	3.3
Machinery	17.6	25.7	8.5	8.4	0.5
Motor vehicles	14.7	14.4	24.7	22.0	11.7
Other vehicles	2.4	0.3	10.0	9.7	9.3
Precision machinery	1.1	1.5	5.6	5.3	0.0
Furniture	0.7	0.1	17.9	12.9	2.5
Other manufactures	0.2	0.2	13.8	12.2	2.2
Imports, not elsewhere classified	0.8	0.6	0.0	0.0	0.0
<b>Manufacturing</b>	<b>67.4</b>	<b>69.2</b>	<b>13.1</b>	<b>11.4</b>	<b>3.7</b>
<b>Whole economy</b>	<b>100.0</b>	<b>100.0</b>	<b>11.3</b>	<b>10.1</b>	<b>3.9</b>

Note: The import shares are the shares of dutiable imports in the sector as a percentage of dutiable imports.

Source: MOC.

## Trade reform under AFTA

*Tariffs are even lower for imports from ASEAN countries, which are the major trading partners for Laos.* Laos joined the AFTA in July 1997. Under this agreement, each member announced a schedule of Common Effective Preferential Tariff (CEPT) rates that are available to other members. The availability of the preferential CEPT rates has to be phased in gradually. The six 'original' ASEAN members have already reduced their CEPT

rates to between zero and 5 percent and made these rates applicable to all imports except for 'sensitive' Unprocessed Agricultural Products (UAP) and a relatively small number of items that are permanently excluded on the grounds of religion, moral, health or public safety. To implement the AFTA agreement, all imports, classified by Harmonized System (HS) code, must be placed on one of the following four lists:

- The Inclusion List (IL) of items for which importers pay only the CEPT rate of the importing country, rather than the MFN tariff, provided that: (i) the item is on the IL of exporting country; (ii) 40 percent of the sale price of the item comprises value added in ASEAN countries; (iii) if the items listed in the IL have a CEPT rate at 20 percent or less in the exporting country the same item should also have the CEPT rate at 20 percent or less in the importing country.
- The Temporary Exclusion List (TEL) of items that must be gradually moved onto the IL in accordance with a specified schedule.
- The Sensitive List (SL) of Unprocessed Agricultural Products (UAPs) that will be liberalized by 2015. For Laos, this list includes products such as rice, in various stages of processing, and pork carcasses.
- The General Exception List (GEL) of items for which there are no commitments to reduce tariffs. Some of these items are those covered by Article XX of GATT, such as those that could threaten national security, public morals, health, religion or the preservation of the national heritage. Trade in these items is banned with all countries, whether or not they are members of ASEAN. In addition, there are 71 non-prohibited GEL items that can be imported into Laos, but with respect to which it has made no AFTA commitments. Examples include weapons, sporting guns and alcoholic beverages. In the case of beer, which is produced locally and subject to a 40 percent import duty, it appears that the restrictive trade arrangements are imposed to protect the local producer.<sup>3</sup>

Initially, Laos placed almost all items on the TEL or on one of the other still more restrictive lists. However, Laos has

announced a schedule according to which items would be moved from the TEL to the IL in tranches. All items originally on the TEL were to be moved to the IL by January 1<sup>st</sup>, 2005. The tranches were roughly equal in terms of the number of items transferred each year, but the first items to be transferred were the least 'sensitive' ones. Obviously the least sensitive items were those that were not imported at all; after these items had been transferred to the IL, the next to be selected were those that were imported only in small quantities and those that did not compete with domestic production and for which duty rates were usually relatively low. As consequence of items being selected in this way the value of trade per item was relatively low for the items that were moved to the IL in the initial tranches and the bulk of items by value were to be transferred to the IL in the last two tranches (Table 3 summarizes the schedule).

About half of the 855 items that remained on the TEL after January 1<sup>st</sup>, 2003 were scheduled to be moved to the IL on January 1<sup>st</sup>, 2004 and the remainder on January 1<sup>st</sup>, 2005.<sup>4</sup> In accordance with this schedule, the TEL has indeed been abolished, but the legislative enactments needed to give effect to the new CEPT rates have not yet been passed. As a result, the rates that are currently being applied to the items transferred to the IL on January 1<sup>st</sup>, 2004 and 2005 are no lower than the MFN rates. This means that the abolition of the TEL has not yet had any real effect. The necessary enactments are currently at the National Assembly and were expected to be passed before the end of 2005. In the meantime, the applied CEPT rates are unchanged from January 1<sup>st</sup>, 2003.

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<sup>3</sup> In 2004, Laos adopted the ASEAN Harmonized Tariff Nomenclature (AHTN) which is based on the HS 2002. This resulted in an expansion of the number of tariff lines to 10,690 items from 3,551 in the HS 1996.

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<sup>4</sup> In Table 3, these 855 items are represented by the difference between the 3,389 items scheduled for inclusion in the IL on January 1<sup>st</sup>, 2005 and the 2,534 items already on the IL at January 1<sup>st</sup>, 2003.

**Table 3. Coverage of the AFTA lists**

	No. of items (HS code)	% of all items	% of dutiable imports	% of all imports
IL 2001	1,673	47.1	16.4	19.6
IL 2002	2,098	59.1	19.3	24.2
IL 2003	2,534	71.4	44.7	44.9
IL 2004	2,961	83.4	65.6	67.0
IL 2005	3,389	95.4	95.9	93.9
SL	88	2.5	0.6	0.6
GEL	74	2.1	3.5	3.5
Total	3551	100.0	100.0	100.0

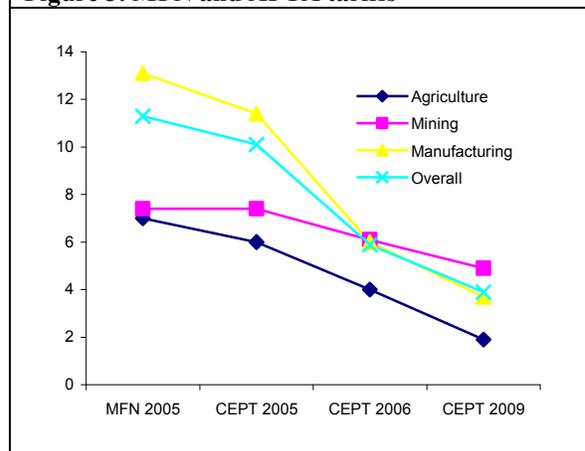
Note: “Dutiable imports” include imports to be used by approved investment projects, even though the duty on such imports is only 1 percent. “All imports” means “dutiable imports” plus “exempt imports”, where the latter are imports by government ministries, diplomatic imports and imports by projects funded by foreign bilateral donors.

Source: Department of Customs, Ministry of Finance.

**The AFTA preference is still low—at only one percentage point below the MFN rate.** The duty rates on imports from ASEAN members under CEPT scheme have been reduced. However, as of 2005, the average AFTA preference is only 1.2 percentage points: the average import-weighted CEPT rate is 10.1 percent, while the average MFN tariff is 11.3 percent. Part of the reason for the small size of the AFTA preferences is that Laos lagged behind the agreed CEPT schedule in 2004 and 2005. Further, and much larger, reductions in the CEPT rates are scheduled for the period 2005–2009; if they occur, the average CEPT tariff will be only 3.9 percent by 2009 (Figure 3).<sup>5</sup>

<sup>5</sup> Note: The CEPT rates shown for 2005 include only the reductions in CEPT that have actually been implemented (reductions originally scheduled for 2004 and 2005 have not yet been implemented; therefore the CEPT rates shown here for 2005 are essentially unchanged from those originally scheduled for 2003). The CEPT rates shown for 2006 and 2009 are those that are scheduled for these years. For these rates to be achieved it will be necessary for Laos to get back on schedule by implementing the CEPT reductions originally scheduled for 2004 and 2005 and then also implementing the reductions scheduled for years that are still in the future.

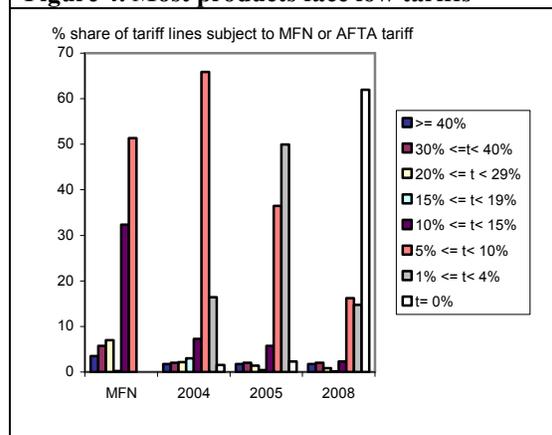
**Figure 3. MFN and AFTA tariffs**



Source: World Bank estimates from data supplied by Department of Customs. Averages are imported weighted averages using dutiable imports only.

**By the time AFTA is fully implemented, most products will face a zero tariff, and the vast majority will face a tariff of under 5 percent.** Currently, over 80 percent of tariff lines are subject to tariffs which are less than 5 percent (Figure 4). With AFTA implementation, the share of tariff lines subject to tariffs above 5 percent will be negligible, and will encompass the most sensitive products.

**Figure 4. Most products face low tariffs**



Source: MOC

Tariffs on agricultural trade with China have been slightly reduced as a result of the Early Harvest Program (EHP). Much more substantial reductions have been scheduled under this program for the period 2006–2009 (Table 4).

**Table 4. Impact of Early Harvest Program on tariffs in 2009**

	% Share 2003/04	2009 AFTA No EHP	2009 AFTA + EHP	Reduction due to EHP
Livestock	0.2	6.6	3.2	3.4
Fishing	0.1	0.2	0.2	0.0
Dairy	1.1	4.5	0.2	4.3
Other animals	0.0	0.0	0.0	0.0
Fruit, vegetables etc.	0.2	4.1	3.3	0.8
Cereals, excluding rice	1.1	0.0	0.0	0.0
Rice	1.3	5.0	5.0	0.0
Milled agricultural products	0.5	0.0	0.0	0.0
Edible oils and fats	0.1	0.1	0.1	0.0
Animal fats	0.2	0.1	0.1	0.0
<b>Agriculture, total</b>	<b>4.4</b>	<b>3.1</b>	<b>1.9</b>	<b>1.2</b>
<b>Whole economy</b>	<b>100.0</b>	<b>4.0</b>	<b>3.9</b>	<b>0.1</b>

Source: MOC

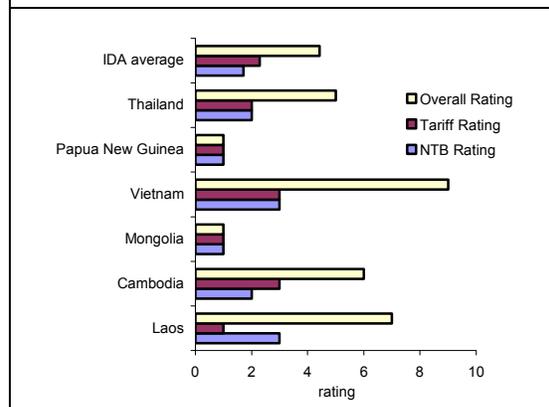
### Non-tariff barriers to imports

While overall tariffs are low and streamlined to a large extent, the situation of non-tariff barriers remains opaque. The IMF trade restrictiveness index for 2004 shows that while Lao tariffs rate well, its non-tariff barriers do not (Figure 5).

*Non-tariff barriers have been eased in theory but in practice remain a source of friction.* Significant administrative and non-tariff barriers to trade remain, but are now much lower than they used to be. The process of relaxing non-tariff barriers has been a gradual one that began with the introduction of the New Economic Mechanism in 1986 and that is still continuing. By 2005, exchange rate controls were no longer a significant barrier to trade, customs clearance and other administrative procedures for importing and exporting had been simplified, and import licensing requirements had been reduced to those aimed at monitoring and registration (although these still cause unwarranted delays).

**Foreign exchange controls.** The rationing of foreign exchange at the official rate was a major problem in the period 1997–99. It arose in part because the Asian crisis reduced the demand for Lao exports in

**Figure 5. Comparing Lao trade restrictiveness with other countries**



Note: overall rating: 1 (most open) to 10 (most restrictive); tariff rating: 1 (average tariff less than 10%) to 5 (average tariff over 25%); NTB rating: 1 (less than 1% of production covered by NTBs) to 3 (more than 25% of production covered by NTBs); overall TRI: 1 (less restrictive) to 10 (more restrictive).

Source: IMF Trade Restrictiveness Index

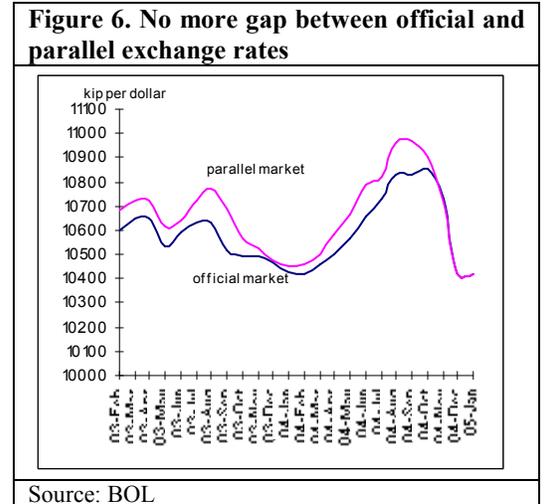
Thailand and other Asian countries. A much more important factor was that greatly increased government spending, particularly on irrigation projects, was not matched by increased revenues and the deficit was financed by borrowing from the Bank of Laos (BOL). The reluctance of the BOL and the government to allow the official exchange rate to depreciate in line with the rapid domestic inflation led to a wide

divergence between the price of foreign exchange in the official and parallel markets. The largest divergence occurred in March 1999, when the parallel market rate was 51 percent above the official rate.

As recently as 2002, foreign exchange controls were operated in conjunction with restrictive import licensing under a system that was a survival from the period of central planning and direct government control over the enterprise sector. Under this system, the government drew up an annual ‘import-export balance plan’. Projections were made by the central bank, the BOL, of the likely sources and uses of foreign exchange. As part of this process, firms were required to submit estimates of their expected annual foreign exchange earnings. They also had to submit requests for allocations of foreign exchange to pay for their projected import requirements. Once each firm’s plan, or amended plan, had been approved it formed the basis of that firm’s access to the foreign exchange needed to pay for imports. As an incentive to export, firms with export earnings were given ready access to their own foreign exchange earnings if they wished to use them to pay for their own imports, whereas firms without foreign exchange earnings were unlikely to obtain as much foreign exchange as they wished.

By 2002, the BOL had largely eliminated the gap between the price of foreign exchange in the official and parallel markets—since January 2004, the average divergence has been only 0.6 percent (Figure 6). Following the resolution of the foreign exchange crisis, import licensing has been relaxed and access to foreign exchange has been eased. Although foreign exchange controls and import licensing have been greatly liberalized in practice since 1999, the import licensing decrees have not been rescinded and the list of products subject to import licensing is largely unchanged. What has happened is rather that the increased availability of foreign exchange, the devaluation of the kip at the official rate and the BOL’s relatively tight monetary policy

since 2000 have combined to eliminate excess demand for foreign exchange at the official rate and import licenses that were once tightly restricted are now freely available.



The controls and decrees have been retained partly as a registration measure and partly as a safety measure in case of the recurrence of a foreign exchange crisis. While it is no longer a problem to get approval for the import-export plan, in practice the process is not always transparent and often a hassle to firms. If a company changes its export-import plan during the year, it has to have it re-approved. Some firms have indicated that they have to pay an informal “fee” to get their plans approved. Others have complained about delays in obtaining the approval (Chapter 8 cites an example of a factory for whom the approval process takes around two months, and requires gaining approvals from three different ministries, and Chapter 5 indicates that it can take up to two weeks to get approvals for individual shipments under these plans). While few firms complain about not receiving the foreign exchange they need, maintaining such a system is no longer necessary.

**Import licenses.** Import licensing is regulated by Decree No. 205 of the Prime Minister’s Office, issued on 11 October 2001, and by Notices No. 284 and 285 of 17 March 2004 of the MOC. These two

notices, which are updated annually, set out the lists of goods to which the particular provisions in Decree 205 apply.

Notice 284 defines the lists of prohibited imports. These include many products that appear uncontroversial because they are related to public safety and morals and not to protection of domestic producers. Examples include explosives, weapons, drugs, pornography, dangerous chemicals and industrial wastes and wild animals. Besides these uncontroversial bans, there are also bans on importing sawn timber, wood products and forestry products.

Notice 285 deals with licenses for imports that are not banned. It specifies that import licenses are needed to import a range of products. These include:

1. Petrol and gas.
2. Vehicles and parts for assembling vehicles of any type other than bicycles and plowing machinery.
3. Diamonds.
4. Cement.
5. Steel.
6. Fresh or frozen meat, fish.
7. Canned fruit.
8. Milk products.
9. Prepared food, including canned foods.
10. Coloring and preserving products for foods.
11. Sugar substitutes.
12. Beverages.
13. Food seasoning products, including soy sauce.
14. Human medicines.
15. Animal medicines.
16. Animals and animals for breeding.
17. All raw and semi-manufactured products used in manufacturing.
18. Fertilizers and pesticides.
19. Video cassettes, CDs, movies etc.
20. Computer games.
21. Sculptures and paintings.
22. Sporting guns.
23. Chemicals.
24. Gold and silver ingots.
25. Telephone, fax, and telecommunications equipment.

Most of these licensing requirements are merely ‘technical measures’ that are used for quality control, safety, animal quarantine or SPS. While such technical measures can potentially be used for protective purposes,

both government officials and private sector firms reported that the restrictive nature of import licensing is now much less than it was even five years ago. As recently as 2002, there was a general provision that allowed MOC or line ministries to impose licensing requirements on any imports of any product they might choose. This provision has now gone, although the corresponding provision for exports is still in place. In the case of exports, the provision has been maintained so that the authorities can try to hold down the domestic prices of sensitive items. Price monitoring is applied in the case of 30 products.<sup>6</sup> The authorities do not have the resources to subsidize these products, nor to enforce rigid price controls, but they can in some cases put downward pressure on domestic prices by restricting exports, in particular rice and live animals. In practice, it appears to be the case that export licensing is now seldom, if ever, used restrictively.

The two products for which import licensing is most restrictive are cement and steel rods for construction. In both cases, import licensing is used to protect domestic producers—as is the case in many developed and developing countries. The licensing of imports of motor vehicles is now used as a registration device and importers have mostly been allowed to import as many vehicles as they want.

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<sup>6</sup> They include: 1. Fuel and gas, 2. All kinds of steel for construction, 3. Cement, 4. Roof floor and wall tiles, 5. Zinc, 6. Sawn wood, 7. All kinds of paint for houses, 8. PVC pipes, 9. Tractors, 10. Water pumps, 11. Thrashing machines, 12. Fertilizer, 13. Animal feed, 14. Milling machines, 15. Rice mills, 16. Bicycles, 17. Motorcycles, 18. Student uniform, 19. Writing equipment, 20. Raw materials for factories, 21. Medicines, 22. Rice, 23. Sugar, 24. Soy sauce, 25. Fish sauce, 26. Monosodium glutamate, 27. Vegetable oil, 28. Flour, 29. Meat (cattle swine and poultry), and 30. Sea fish and fresh water fish.

***Removing import licensing restrictions at the provincial level has been slow.*** In addition to the licensing requirements applied by the central government, there are at least 214 non-tariff measures (NTMs) on imports at the provincial government level (see [www.aseansecretariat.org](http://www.aseansecretariat.org)). Of these 214 provincial NTMs, 15 percent apply to agricultural products, 1 percent apply to fuels, 23 percent apply to other minerals, 43 percent apply to chemicals (including fertilizers), 14 percent apply to iron and steel and 4 percent apply to other manufactures. All the NTMs listed are administered by provincial trade offices. Some provincial governments have been slow to implement directives from the central government. As a result, directives from the central government to relax import licensing restrictions have not necessarily been implemented by the customs posts in the provinces.

#### **Current import procedures**

***Obtaining a license to import is still not straightforward despite the authorities' efforts to simplify the process.*** Goods to be imported into Laos can be categorized into 3 main groups: 1) general goods, 2) goods subject to approval by relevant authorities, 3) prohibited goods. General goods are those that neither fall under the list of controlled nor prohibited goods. The list of controlled goods is provided in the MOC's Notification no. 285/MOC.FTD of 17 March 2004 while prohibited goods are stipulated in the Notification no. 284/MOC.FTD of 17 March 2004. The procedure for importation of goods has recently been simplified as detailed in the Prime Minister's Notification No. 1691/PMO dated 7 October 2004.

***Import procedures for general goods.*** Goods which are not subject to import prohibition and government controls can be imported by a simplified procedure<sup>7</sup>. *First,*

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<sup>7</sup> These goods are mainly non-agricultural products such as textiles and footwear, plastics,

an importer submits an import plan for approval from provincial trade offices in the provinces, Vientiane capital or special governing zone. The import plan specifies total value of goods to be imported within the semi-annual or annual period. The importer forwards the import plan to the trade authority at border checkpoints for monitoring actual importation. *Second,* the importer proceeds with the trade and customs clearance at the single window service at border checkpoints. Thereafter, goods can be taken out of the warehouse (Figure 7).

The import procedure has been simplified with the introduction of the import (indicative) plan. It replaces the import-export equilibration plan which in the past required the balancing of imports with exports. The Ministry of Commerce plans for the total amount of imports at the national level in a given year and then allocates to each province. The provincial trade authorities then divide the allocated amount to traders in their jurisdiction. Items and amount of goods to be imported each time are deducted against the overall indicative plan. There is no penalty for non utilization of the approved amount. The business can request an additional amount when the import plan has been depleted.

***Import procedures for goods under control of relevant authorities.*** Notification no. 285/MOC.FTD contains a detailed list of goods to be imported subject to technical regulations of relevant authorities. Imports subject to control cover a wide range of products. The Ministry of Agriculture and Forestry administers controls over goods falling under 1,325 tariff lines (out of the total 10,690 lines under the 2005 AHTN). Goods falling under 1,028 tariff lines are controlled by the Ministry of Health, while

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rubber, consumer goods, etc. Specifically, the goods fall under HS headings from chapter 26 to 97 (except chapter 30, 31, 49, 77, 88, and 93). As of 2005, general goods accounted for around 65.5 percent of total tariff lines.

the Ministry of Communication, Transport, Post and Construction controls goods under 1,026 lines, and MOC controls goods under 952 lines. It is worth noting that the goods under control measures administered by these four ministries also face higher tariffs (around 18-24% as compared to an average of 10% for all goods).

The MOC is responsible for monitoring the importation of vehicles and parts as well as fuel and gas. To import these items, traders need first to submit a request to the Foreign Trade Department of the Ministry of Commerce. Once approved, the importer can go to a single window service and clear goods from the Customs warehouse.

For other controlled goods, the importer needs to submit a request to relevant authorities then take the relevant documents to the single window service before clearing goods out of the warehouse. Relevant authorities include: Science Technology and Environment Agency, Ministry of Health, Ministry of Agriculture and Forestry, Ministry of Industry and Handicraft, Ministry of Information and Culture, Ministry of Communication, Transport, Post and Construction, and Bank of Laos.

***Import procedures for prohibited goods.*** The Ministry of Commerce (Foreign Trade Department) issues an updated list of goods for which importation is prohibited. The current list is provided in Notification of the Ministry of Commerce No. 284/MOC.FTD. The notification identifies 131 tariff lines applying to goods subject to import prohibition.<sup>8</sup> The goods prohibited for import are those which pose a serious threat to the national economy, society, public morals, national culture and traditions, health and safety, and the environment. In exceptional cases, some prohibited items can

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<sup>8</sup> The majority of goods covered in the notification have not been assigned an HS code. These include narcotics, materials affecting national culture and customs, industrial waste, right-handed steering wheel vehicles, etc.

be imported subject to approval from the Prime Minister's Office (PMO) as stipulated in Article 8 of the Prime Minister's Decree on Export and Import Administration No. 205/PMO of 11 October 2001 and Ministry of Commerce's Regulation on Procedures for import and export of controlled goods from trade authorities No. 106/MOC.FTD of 25 January 2002.

***Import procedures for investors with concessional tariff rates.*** The Lao government promotes domestic and foreign investment in most economic sectors. Investors can import raw materials and vehicles for production and pay customs duties at only 1 percent. In this case, prior to importation, the importer needs to obtain approval from the Committee for Planning and Investment. In interviews with traders, many complained that this process is quite lengthy—it takes approximately 2-3 weeks to obtain a certificate for tariff concessions. After that the normal import procedures apply.

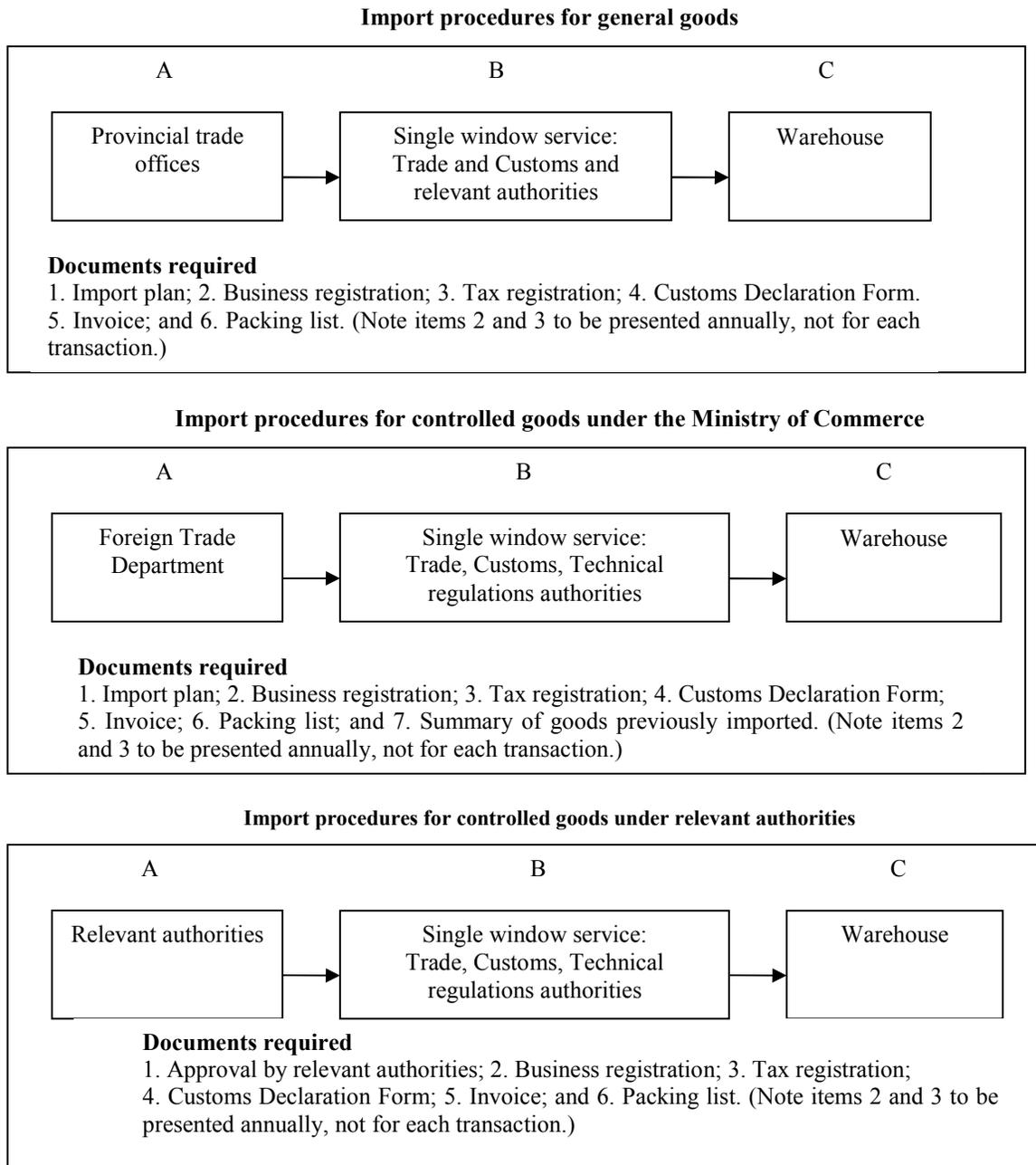
### **The incentive regime for exporters**

***Export taxes and licenses.*** Export licensing is regulated by the same decrees and notices that are used to regulate import licensing—namely, Decree No.205 of the PMO, issued on 11 October 2001, and by Notices No. 284 and 285 of 17 March 2004 of the MOC. Prohibited exports are explosives, weapons, drugs, antiques, wild animals, logs and sawn timber, pornography and currency printing equipment. The most important of these bans is that on exports of logs and sawn timber. This is imposed partly for environmental reasons, partly to prevent the illegal logging of national forests, and also to promote value addition.

Notice 285 deals with licenses for exports that are not banned. The goods that require export licenses are the following:

1. Diamonds.
2. Minerals.

**Figure 7. Import procedures in Laos for different categories of goods**



3. Seeds (both of plants and fish and animal reproductive materials in any form).
4. Breeding animals and products derived from animals.
5. Wooden products.
6. Forestry products.
7. Other products, as notified from time to time by line ministries.

Some of these restrictions are used to prevent illegal exploitation of natural resources. Most of the others are of minor importance although item 7 obviously gives the government the power to immediately impose whatever export licenses it may wish to impose without the need to issue a new decree or notice. At present, no additional licensing is in force.

**Duty exemptions for exporters.** Some anti-trade bias is an inevitable consequence of restricting imports in order to protect domestic industries. Import restrictions not only reduce imports but also exports by raising domestic prices and wages. In addition, tariffs on capital goods and imported inputs directly raise exporters' costs and therefore reduce their competitiveness. This latter problem can be reduced by schemes that allow exporting firms to have duty-free access to imported inputs. While usually better than nothing, such schemes are a poor substitute for free trade since they do not provide exporting firms with access to domestic factors of production at the prices that would obtain under free trade. Besides providing only partial relief from the anti-trade bias of import taxes, schemes to provide exporters with duty-free access to imported inputs have often been plagued by administrative problems, including not only inevitable monitoring costs and delays, but also fraud.

There are three main kinds of schemes to provide exporters with access to imported inputs at free trade prices:

- **Duty drawbacks:** import duties are paid when the imported inputs enter the country, but are refunded by the customs department when the finished products into which they have been incorporated are exported.
- **Duty exemptions, or 'temporary importation':** imports of inputs into products that are to be exported are exempted from duty, but the importer has to provide some guarantee that the product will indeed eventually be exported. Usually, the products that have avoided duty must be stored in bonded warehouses, which the customs department has the right to enter in order to check that the exempt items have not been sold to domestic buyers.
- **Free Trade Zones, or Special Economic Zones:** there are no domestic customs controls on trade between foreign countries and all the factories and warehouses in the zones; however,

domestic customs controls do apply to trade between each zone and the rest of the domestic economy.

Laos allows duty exemptions on raw materials for exporters and is in the early stage of setting up special economic zones. There appears to be a need to introduce a duty drawback scheme to provide exemptions for imported inputs used by indirect exporters. Most exporters use packaging and labeling inputs that are supplied by firms that specialize in these services. Garment exporters often use local firms to perform specialist functions, such as embroidery. There are undoubtedly many more examples and the importance of indirect exporters will increase as the manufacturing sector grows. In Laos, it appears that indirect exporters generally pay duty on their inputs. The reason is that since they sell some of their output domestically, as well as selling some to final exporters, it is seldom practical for them to use the bonded warehouse operations that are typically used by specialist exporters as part of a duty exemption system. Without a duty drawback scheme, the cost of the services supplied by indirect exporters is raised by tariffs on their inputs and this disadvantages the final exporters. Now that Laos has developed a substantial manufactured export sector, there is probably a need for a duty drawback scheme and there is a case for technical assistance to investigate this possible need.

### **Current export procedures**

Similarly to imports, export goods can also be classified into three groups: 1) general goods, 2) controlled goods, and 3) prohibited goods. Detailed export procedures are stipulated in the Prime Minister Notification No. 1691/PMO dated 7 October 2004.

#### **Export procedures for general goods.**

Goods which are not subject to government control and prohibition, can be exported without any license. (Goods classified to

around 83 percent of all HS commodity codes fall into this category.) Exporters need only to prepare necessary documentation such as business and tax registration, invoice, packing list and in some circumstances certificate of origin for preferential treatment purpose to present to the single window service at the border checkpoints. The goods can be inspected and released for shipping in a relatively simple manner (Figure 8).

***Export procedures for controlled goods.*** Goods subject to approval from relevant authorities prior to export are provided in the Notification no. 285/MOC.FTD of 17 March 2004. The Foreign Trade Department of the MOC oversees the exportation of diamond (rough and unwrought) and minerals. All other types of goods are subject to approval by relevant authorities. Goods classified to around 16 percent of all HS commodity codes are subject to government control. The majority of such goods are under the control of the Ministry of Agriculture and Forestry and Ministry of Health. To export these products, the exporters first submit a request to the relevant authority. Once this has been approved, they can go to the single window service and clear goods.

***Export procedures for prohibited goods.*** The export of goods which pose a serious threat to the national economy, society, public morale, national culture and traditions, health and safety, and the environment is prohibited. The current list of prohibited goods is provided in Notification of the MOC No. 284/MOC.FTD dated 17 March 2004. As with the prohibited import list, the notification identifies 131 tariff lines that cover goods subject to export prohibition.<sup>9</sup> The procedure is that the exporter first needs

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<sup>9</sup> The majority of goods covered in the notification have not been assigned an HS code. These include narcotics, Buddha images, wild life, etc.

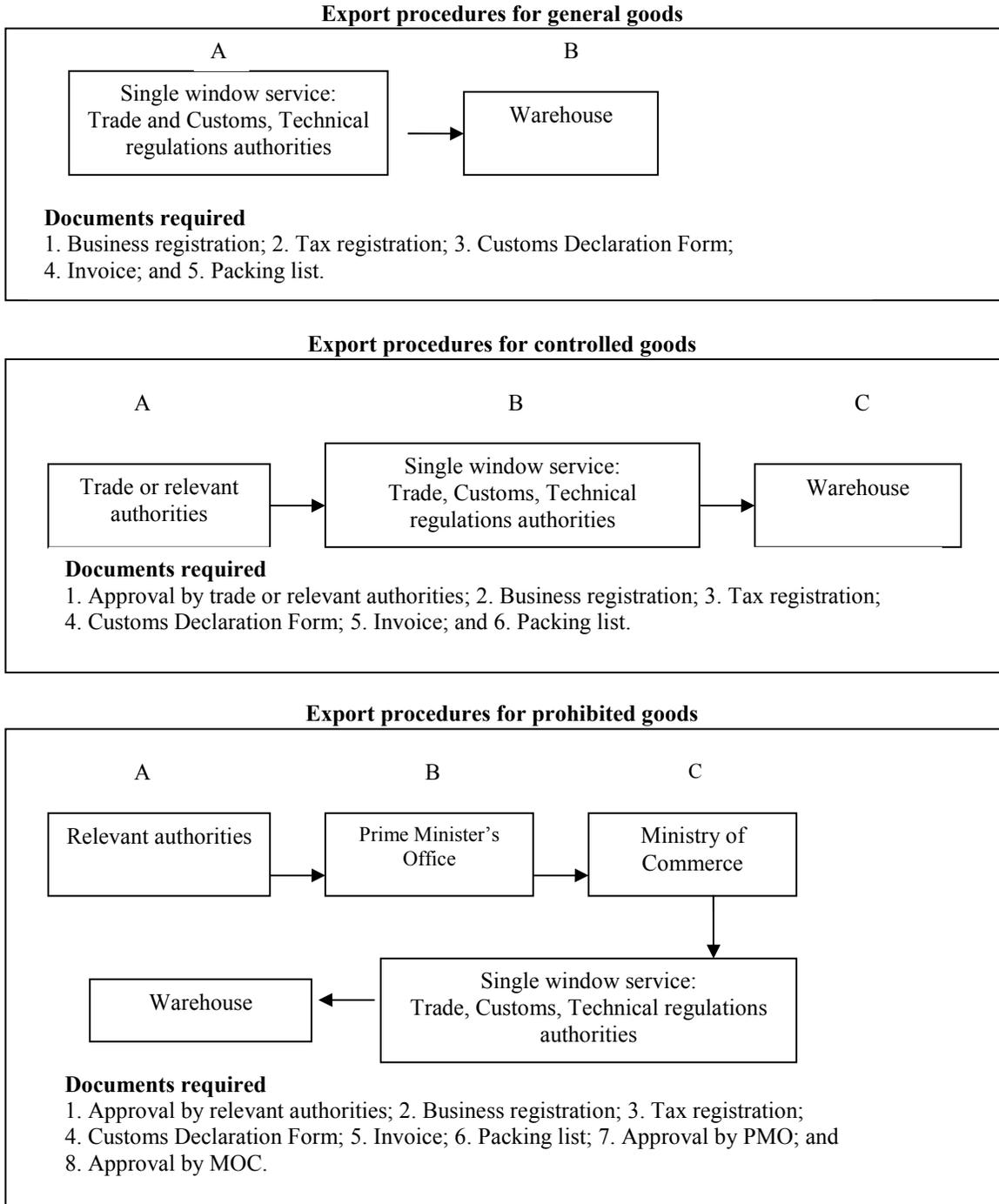
to submit the export request to relevant authorities. Then approval from the PMO must be obtained. Once approved, the exporter can present the approvals and supporting documentation to the single window service and clear goods.

## **Conclusion**

Laos has an open trade regime. On average, tariffs are reasonably low, and the degree of dispersion is quite moderate. The average tariff applicable to most imports will decline further as Laos implements the AFTA and other bilateral and regional agreements. While this reduction in the average tariff on imports should reduce costs of importation—and in turn the costs of exporting—the proliferation of different rates applicable to identical goods does have some downsides. Administration and compliance are made more complex, and the scope for duty evasion is increased. There are also risks of trade diversion: goods are imported from less competitive sources because traders face lower tariffs. The government should bear these costs in mind as the scope arises in the future to rationalize the tariff regime (for example in the context of accession to the WTO).

On the non-tariff side, while *de facto* non-tariff barriers are not constraining trade, the fact that they still exist, and are implemented often in a non-transparent way that leaves room for bribes and controls, reduces the effect of the positive steps that Laos has been undertaking to liberalize its trade regime. The licensing system is more complicated than it needs to be, and can be dismantled without much impact. Doing so will send a positive message to the business community. As discussed in other chapters, the way in which the trade system is administered does add to the costs and uncertainty of trade, which in turn impacts on the efficiency of exports and the attractiveness of the country as a destination for export oriented investment.

**Figure 8. Export procedures for different categories of products**



## Chapter 3: Regional and Global Market Access Issues for Laos

Laos is making significant progress in reducing the anti-export bias of past trade policies and in pursuing a growth strategy that recognizes the key role that openness to trade must play. But if the country faces major barriers in overseas markets, it will not be able to reap the full potential of the comparative advantages it possesses. With the wide range of preferences given to Laos, especially given its least developed country status, market access should not be an issue. But it turns out that Laos is not making full use of the preferences available to it—while part of the problem is certainly due to supply constraints in the country and lack of competitiveness in certain sectors, the other part of the problem is due to complex rules of origin and difficulty in managing them. Unless rules of origin are simplified, it would be difficult for Laos to take advantage of them. This chapter discusses the geographic and commodity structure of Lao exports and imports, then reviews the main factors affecting access to overseas markets for Lao exporters.

### The structure of trade<sup>1</sup>

*Europe has become the largest export market for Laos in recent years, although adjacent countries are still important trading partners.* High-income countries and the EC-15 in particular, have strongly gained in importance for Laos in their function as export markets between 1990-93 and 2000-03 (Table 1).<sup>2</sup> Among low-income

countries, Thailand is losing in relative importance—41 percent of Lao exports went into Thailand in the early 1990s, but only 27 percent after 2000. The share of exports going to Southeast Asia remained roughly constant, but Vietnam is gaining in importance and now receives 24 percent of Lao exports as compared to 12 percent one decade ago. Within high-income countries, 84 percent of exports went to the EC-15 in 2000-03, compared with 67 percent in 1990-93. The relative importance of high-income North America and Asia as export market has declined.

**Table 1. Geographical structure of Lao exports**  
Share of exports in percent

	1990-1993	2000-2003
<b>HIGH INCOME</b>	38.04	43.34
EC-15	25.33	36.60
Europe	0.65	1.63
North America	5.01	2.41
Oceania	0.03	0.19
Asia	7.02	2.51
Middle East	0.00	0.00
Caribbean	0.00	0.00
<b>LOW INCOME</b>	61.96	56.66
South Asia	0.83	0.09
Southeast Asia	57.68	54.76
China (mainland)	(3.36)	(2.55)
Thailand	(41.47)	(27.48)
Vietnam	(12.04)	(23.94)
Oceania	0.00	0.01
North Africa	0.01	0.08
Latin America	0.13	0.07
Sub-Saharan Africa	0.50	0.11
Middle East	0.01	0.09
<b>WORLD (\$000s)</b>	471.59	1317.84

Source: IMF Direction of Trade Statistics

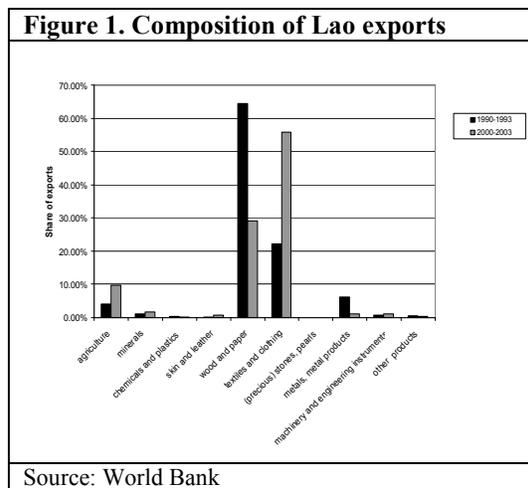
*The structure of exports is changing.* A decade ago, the Lao export structure was

aggregation of sectoral data for imports and exports from COMTRADE is substantially lower than the IMF data. Better data recording systems will have to be put in place in order to allow for a more detailed analysis.

<sup>1</sup> For caveats on discrepancies in the trade data reported by Laos, see Box 1.

<sup>2</sup> Mirror data from COMTRADE for the sectoral analysis of exports and imports. The data does not perfectly match data from the IMF Direction of Trade Statistics, which is only available for total imports and exports. However, there are a number of problems in using the COMTRADE data. In particular, data for Thailand is not available in COMTRADE for 2002 (IMF data show a total of \$94m of exports to and \$404m of imports from Thailand for that year) and the

dominated by wood products that were mainly shipped to Thailand (Figure 1). While the share of wood product exports has more than halved, the share of clothes in exports has more than doubled (and increased more than sevenfold in value terms) and now represents more than 50 percent of exports. Wood product exports have increased by some 40 percent between the early 1990s and the early 2000s and continue to go primarily to Thailand. Most of the textile exports go the EC-15 countries. Metals have become nearly irrelevant as an export good whereas coffee has gained somewhat in importance.



**Most imports originate from Thailand, followed by Vietnam and China, and their share has grown over the past decade.** Imports from high-income countries increased by less than 40 percent, while imports from low-income countries have nearly quadrupled and now represent 90 percent of all imports (Table 2). Thailand, China, and Vietnam alone account for 82 percent of total Lao imports. The most significant change over the past decade is the decline in the share of imports from high-income Asia (which includes Japan, Korea, and Singapore), and the increase in the share of imports from Thailand.

**Table 2. Geographical structure of Lao imports**

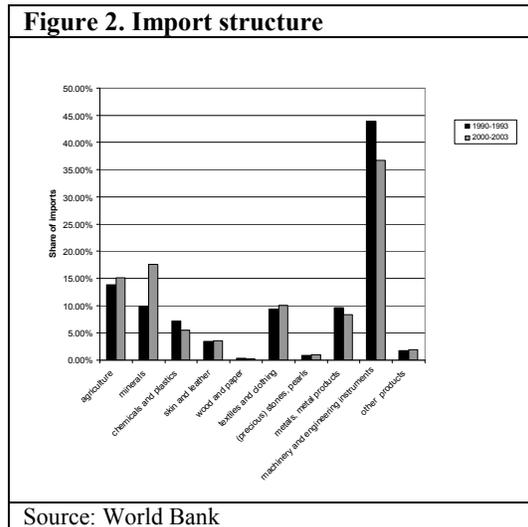
	Share of imports in percent	
	1990-1993	2000-2003
<b>HIGH INCOME</b>	23.44	10.04
EC-15	6.43	5.52
Europe	0.16	0.21
North America	0.91	0.63
Oceania	3.18	1.23
Asia	12.76	2.44
Middle East	0.00	0.00
Caribbean	0.00	0.00
<b>LOW INCOME</b>	76.56	89.96
South Asia	0.30	0.70
Southeast Asia	73.71	88.50
China (mainland)	(10.90)	(9.09)
Thailand	(52.73)	(62.21)
Vietnam	(6.01)	(10.61)
Oceania	0.00	0.00
North Africa	0.00	0.00
Latin America	0.09	0.02
Sub-Saharan Africa	0.01	0.10
Middle East	0.06	0.00
Eastern Europe and Central Asia	2.39	0.64
<b>WORLD (\$000s)</b>	831.47	2654.03

Source: IMF Direction of Trade Statistics

**Imports are concentrated in fuels and machinery.** Imports of alcoholic beverages (mainly from Singapore) and bottled water (from Thailand) have increased strongly over the past decade. The data suggest that fuels come mainly from Thailand.<sup>3</sup> The largest share of imports in machinery is from Thailand, followed by China and Japan. These three trading partners represent nearly 90 percent of all imports in chapters 84, 86, and 87 of the Harmonized System. Generally, imports are strongly concentrated, with four chapters (HS27—mineral fuels, HS84—nuclear reactors, broilers etc., HS85—electrical machinery, and HS87—vehicles and parts) representing more than half of all Lao imports. Nearly all imports in the textiles category are fabrics or

<sup>3</sup> COMTRADE data suggests that a quarter of Lao imports of fuel in the decade came from Algeria, but the IMF direction of trade data do not confirm this trade flow.

cotton, mainly originating in Thailand (Figure 2).



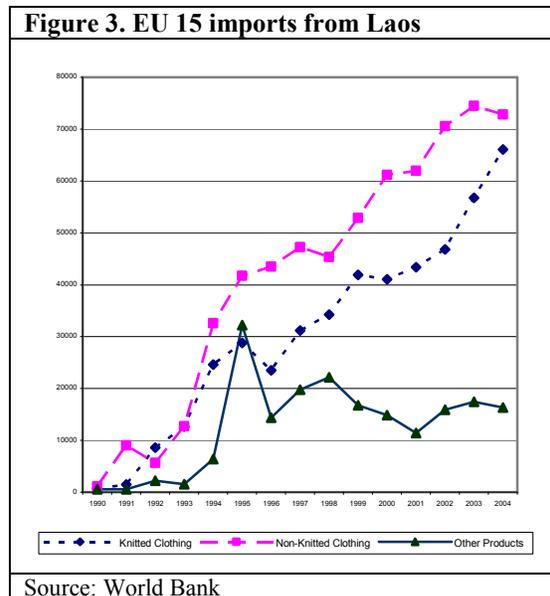
**Box 1. Discrepancies in Trade Data**  
 There are large discrepancies among the estimates of im- and exports provided by different agencies in Laos (see analysis by Brenning et al. 2002). They are the result of discrepancies in coverage and errors of measurement. Possible sources of measurement error include the failure of customs officials at border check points to record trade flows correctly, the failure of MOC officials to record licensing data correctly, the non-use of import licenses and computational errors in processing raw data. Differences in coverage include differences in treatment of re-exports, transit trade, informal border trade estimates, and

**Market access conditions in the EU**

The EU is currently the largest single market for Lao exports. Exports of Laos to the EU have grown strongly over the past 15 years, driven by exports of clothing products—their share in total exports to the EU has been steadily rising and now accounts for around 90 percent of Lao exports to the EU (Figure 3).

*Is export of clothing to the EU driven by trade preferences?* An important issue is the extent to which this growth in clothing exports to the EU has been driven by trade preferences, both direct, in the form of the GSP and now Everything But Arms (EBA),

and indirect, in the form of the constraints on other competitor countries under the Agreement on Textiles and Clothing (ATC). If these preferences have been driving export growth then Laos may be vulnerable to their erosion, immediately in the form of the end of the ATC and over time if the Doha Round of WTO negotiations are successful and MFN tariff rates decline in the EU.



*Laos is eligible to export all products to the EU duty free and quota free under EBA preferences.* The introduction of the EBA has not obviously changed the pace of growth of clothing exports to the EU. This reflects that prior to the EBA all of Lao exports to the EU were already allowed to enter duty free under provisions in the GSP for LDCs and were also free of quotas throughout the 1990s.<sup>4</sup> However, clothing exports were excluded from GSP preferences in 1995 until 1997 due to an EU ruling that Laos was systematically violating the GSP rules of origin. It appears that exports from Laos contained imported content in violation of the rule of origin yet

<sup>4</sup> Laos is not exporting the agricultural products that were previously subject to duties under the GSP that have been removed under the EBA.

were being certified as originating in Laos. Preferences were reestablished in 1997 following the EU acceptance of a derogation from the rule of origin allowing for the use of ASEAN and then SAARC raw materials to count as originating content in the clothing exports of Laos, subject to specific tariff quotas. As the graph above suggests this issue with the rules of origin appears to have affected exports of knitted clothing (which dropped during 1995-97) rather than non-knitted clothing.

*GSP preferences are important in stimulating exports of clothing to the EU.* Table 3 shows the value and utilization of EU preferences in 2001. Unfortunately, more recent data have not been made available to us by the EU Commission, but the picture revealed by these data is unlikely to have changed. The table shows that a high proportion of exports to the EU are eligible for preferences and that most of these preferences relate to exports of manufactures, reflecting the importance of clothing exports. Almost 60 percent of the exports that were eligible for preferences actually requested preferences in 2001 under the EBA. This is the fourth highest rate of utilization among the 49 EBA beneficiary countries. Actual preferences used in the EU market were equivalent to 6.6 percent of the value of total exports in 2001 (more than 9 million Euros). If, however, preferences had been fully utilized the transfer would have amounted to more than 11 percent of exports (or more than 16 million Euros).<sup>5</sup>

<sup>5</sup> The extent to which the available rents are actually obtained by suppliers in Laos will depend upon a number of factors including the nature of competition in the industry and the rules and regulations governing the granting of preferential access. If there is little effective competition among buyers/importers of the product then the suppliers/exporters may be unable to acquire much of the price premium. Ozden and Olareaga (2003) find evidence that only one third of the available rents for African exports of clothing to the US under AGOA actually accrue to the exporters. Satisfying the rules governing preferences and proving

**Table 3. Exports of Laos to the EU and the utilization of available preferences (2001)**

	Total	Agriculture	Manufacturing
Total exports (Euro 000)	143716	8436	135280
Exports eligible for preferences	133872	617	133256
Preferences requested	78878	504	78374
Ratio of exports eligible for preferences to total exports (%)	93.2	7.3	98.5
Rate of utilization of preferences (preferences requested/eligible for preferences) (%)	58.9	81.8	58.8
Value of preferences as a share of total exports to the EU (%)	6.6	1.0	7.0

Source: Eurostat

*Why are these preferences not being fully utilized?*<sup>6</sup> The main reason why financial

conformity with those rules raises costs which reduces the extent to which the preferences raise actual returns.

<sup>6</sup> It is important to recognize that the utilization rates we present do not capture situations where the rules of origin are prohibitive, in that they prevent any preferential exports and there are no exports at the full duty. In other words, they may be cases where the beneficiaries can only export with preferences but the rules of origin constrain any take up of those preferences. In this sense the utilization rates understate the constraining impact of the rules of origin. It is also important to note that the under-utilization of preferences that we observe, the fact that some exports do not request and therefore are not granted the preferential access to which they are in principle eligible, cannot reflect the inability of the recipients to meet other requirements to access the relevant market, such as health and safety or sanitary requirements or deficiencies in their infrastructure, as is sometimes suggested. Lack of infrastructure might explain why there is a very muted response from trade to preferences but cannot explain why at the border some products that are eligible for preferences do not request those preferences. Differences across exporters in their understanding of how to utilize

incentives such as trade preferences are not fully exploited, that is why traders forego a transfer of money that is available to them, is that there must be some accompanying costs that outweigh the benefits. The main cost factor relating to trade preferences are the rules of origin. For processed manufactured products the rules of origin stipulate the amount of processing or the nature of the domestic processing that must take place to ensure a substantial transformation has taken place and to confer origin.

*EU rules of origin for clothing require double transformation, i.e. production from yarn; in the case of Laos this requirement is, however, partly offset by regional and bilateral cumulation allowances as well as a special derogation from double transformation for a certain number of categories of textiles.* EU rules of origin require a double transformation to take place in the beneficiary with the yarn being woven into fabric and then the fabric cut and made-up into clothing. Countries cannot import fabrics and make them up into clothing and receive preferential access, which constrains the value of the scheme for countries which do not have an efficient textile industry.

However, in the case of Laos, this restrictiveness is eased under the Derogation to the EC Preferential Rules of Origin which was granted to Laos garment manufacturers in 1997 as well as under ASEAN Regional Cumulation since 1996 and Bilateral Cumulation with the EC since 1997. In particular, under the Derogation, Lao manufacturers do not have to follow the double transformation process for a certain number of textile categories and certain quantitative limits, allowing them to import fabric from ASEAN, SAARC or ACP countries. However, they still have to meet certain less restrictive transformation criteria. In addition, Laos benefits from regional (diagonal) and bilateral cumulation.

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preferences may explain some of the observed under-utilization.

The EU is currently reviewing its rules of origin under the GSP further, and this will also apply to exports under the EBA. The review has been initiated by the recognition that the impact of the GSP on trade and development has been constrained by the rules of origin.

### **Box 2. Economic impact of restrictive rules of origin schemes**

Restrictive rules of origin are often supported by the argument that they are necessary to encourage substantial value-added activities in developing countries and as a mechanism for encouraging the development of integrated production structures within individual developing countries, or within regional groups of countries through cumulation mechanisms, to maximize the impact on employment and to ensure that it is not just low value-added activities that are undertaken in the developing countries. However, there are important problems with this view. First, such rules discriminate against small countries where the possibilities for local sourcing are limited or non-existent. Since most developing countries are small countries they are particularly disadvantaged by restrictive rules of origin relative to larger countries. Second, there is no evidence that strict rules of origin over the past 30 years have done anything to stimulate the development of integrated production structures in developing countries. In fact such arguments have become redundant in light of technological changes and global trade liberalization that have led to the fragmentation of production processes and the development of global networks of sourcing. Strict rules of origin act to constrain the ability of firms to integrate into these global and regional production networks and, as has materialized in practice to dampen the location of any new value-added activities in the clothing sector. Finally, it should not be forgotten that these strict rules of origin are the result of a process involving import competing firms in the preference granting country. Strict rules of origin act to protect clothing firms from competition from preferences receiving countries.

Source: Paul Brenton, World Bank

*The impact of the ATC phase out on Lao exports to the EU has been mixed so far.* With regard to the ATC, Lao exports to the EU remained quota free throughout the 1990s and 2000s, although there was a period when they were subject to surveillance. In contrast, EU imports from

other Asian suppliers, and in particular China and India, were subject to quantitative limits. These quotas were removed at the end of 2004 which, in principle, ushered in a new era of competition in global clothing markets. Information for the first 5 months of 2005 shows that the value of Lao exports to the EU declined by about 11 percent compared to the first 5 months of 2004 (Table 4). This initial information on the impact of quota removal in the EU also shows diverse performance across product/quota categories. Eurostat data show that Lao exports of men's shirts and other garments to the EU fell by 30 percent or more. However, the value of exports of trousers (the main export category) fell by only 8 percent, while exports to the EU of T-shirts actually increased.

**Table 4. Value of EU imports of textiles and clothing from Laos (million Euro)**

	Jan- May 2004	Jan- May 2005	Change (%)
Total	47	42	-11
Total of products liberalized at end 2004	43	39	-9
<b>Key categories</b>			
T-shirts	9	10	3
Pullovers	4	4	-16
Trousers (not knitted)	13	12	-8
Men's Shirts	6	4	-30
Trousers (knitted)	2	2	-17
Other garments (not knitted)	2	1	-35
Sum of key categories	36	32	-11

Source: Eurostat

This difference in performance across categories does not appear to reflect the strength of competition from China in the EU market. To compare, the value of Chinese exports increased most strongly for trousers (400%), while exports of T-shirts to the EU over this period increased by more

than 115 per cent and exports of men's shirts rose by 95 percent.

It is clearly too early to make firm conclusions about the impact of the end of textile and clothing quotas on Lao exports to the EU, even more so now that the EU has introduced safeguard measures to limit the expansion of Chinese exports. Of relevance to Laos are limits on T-shirts and trousers. Nevertheless, it would appear that although pressure from Chinese competitors in the EU market has been increasing, it is still possible for Lao exporters to maintain and even increase exports to the EU.

***Lao exports of textiles and clothing in the EU market are more similar to those of Bangladesh than China.***

To what extent may Lao exports of clothing as a group be affected by competition from China, India and other suppliers in the EU market? Table 5 presents a measure of the similarity of Lao exports of clothing to the EU to that of other suppliers. The higher the value of the similarity index, the more the export structures of each pair of countries match or overlap and the greater the potential competitive pressure. This measure suggests that the degree of similarity between exports from Laos and those of China is not high relative to the similarity to the exports of other countries. The degree of overlap of export structures is highest with Bangladesh, which, being an LDC, has exactly the same market access conditions as Laos.

To conclude, competitive conditions in the EU textiles and clothing market have intensified following the removal of quotas, but the impact on Laos may be limited by the fact that China and India seem to be exporting different products than Laos. In addition, export prospects would be increased by measures that simplify the rules of origin for the EBA and allow Lao exporters to make more effective use of the available tariff preferences. Nevertheless, in the medium term the government should be looking to support an industry that can be sustained without trade preferences.

**Table 5. Similarity of clothing (HS 61 and 62) exports to the EU in 2003**

	Laos	Bangladesh	Cambodia	China	India	Thailand	Vietnam
Laos							
Bangladesh	61.7						
Cambodia	52.8	55.7					
China	26.7	21.4	19.5				
India	41.2	45.4	28.5	38			
Thailand	55.2	57	57.1	42.7	43.3		
Vietnam	39.8	33.9	24.7	54.8	33.6	39	

Calculated at the 8-digit level of the HS using data from the COMEXT database of the EU. The value of the similarity index lies between 0 and 100, higher values indicating greater similarity.

### Access to the US

In 2005 Laos has been granted normal trade relations by the US. Normal trade relation status ensures that exports from Laos to the US will now be subject to the standard, most favored nation (MFN) tariffs. Prior to this, exports from Laos were subject to the autonomous duties in the US tariff schedule, which exceed the MFN rates often by a large margin (Table 6). The average applied duty in 2004 was around 35 percent, whilst when MFN rates are applied to this bundle of exports the average tariff falls to just over 11 percent. The difference between autonomous and MFN duties is particularly pronounced for clothing (HS 61 and 62), products that currently account for around two-thirds of Lao exports to the US. The average tariff on these products will fall from over 50 percent to less than 20 percent. On the other hand, tariffs on certain key exports to the US, such as coffee, tea and spices (HS 09) and wood products (HS 44), will change little since the autonomous rate is very low or zero. Hence, at least initially, the move to normal trade relations appears to offer the greatest opportunities for

increased exports in the clothing sector.

This large fall in applied tariffs could provide a substantial stimulus to exports to the US, if there is the capacity to increase supply in Laos. A simple partial equilibrium simulation of the direct impact of lower tariffs on Lao exports suggests that the value of trade would increase by more than 50 percent from \$3.2 million to over \$5 million. However, this is likely to vastly understate the potential for increased exports from Laos to the US. The use of trade-weighted averages hides the fact that there may be certain products where Laos has a capacity to export but where tariffs were prohibitive before normal trade relations were granted. Figure 4 shows that exports from Cambodia to the US were virtually zero prior to the granting of normal trade relations in 1996. In the subsequent 9 years exports to the US have increased dramatically to reach around \$1.5 billion in 2004. In contrast, Lao exports to the US are currently less than \$5 million. In part, this reflects the opportunities that existed for Cambodia to increase exports of clothing whilst quotas under the Agreement of Textiles and Clothing were still in place to limit exports from China and other large Asian suppliers.

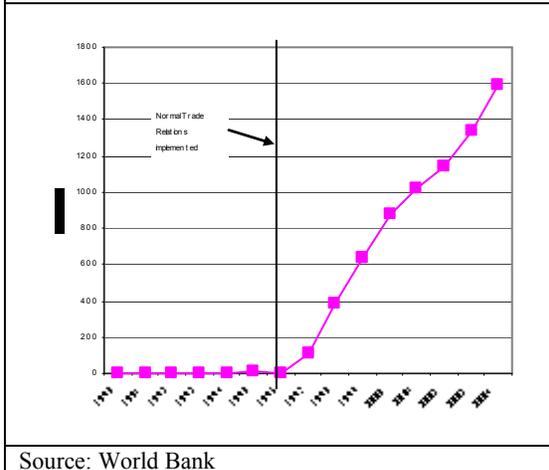
**Table 6. Tariffs and Lao exports to the US in 2004**

	Export (\$)	Duty-Free Entry (\$)	Weighted Ave. Tariffs (Non-NTR)	Weighted Ave. Tariffs (NTR)	Share (%)
Total	3,214,160	335,856	35.1	11.4	100.0
Agriculture	391,320	302,430	6.2	0.2	12.2
Manufacture	2,822,840	33,426	39.1	13.0	87.8
HS 09	302,430	302,430	0.0	0.0	9.4
HS 44	642,276	0	1.5	0.1	20.0
HS 61	1,862,471	0	51.0	17.1	57.9
HS 62	239,810	0	50.1	19.1	7.5

Source: US ITC database

As these quotas were removed at the end of 2004, clothing exporters in Laos will have to face a more competitive environment as they seek to increase their presence in the US market. Nevertheless, the liberalization of US tariffs offers substantial opportunities for the expansion of Laos' exports. The challenge is to ensure that there is a local business climate and trade facilitating infrastructure that allows Laos exporters to exploit these opportunities.

**Figure 4. Cambodia's exports to the US before and after normal trade relations**



*Laos could obtain GSP from the US following its accession to the WTO.* The US offers trade preferences to developing countries under its GSP scheme. This scheme reduces tariffs to beneficiary countries on a range of products (subject to a 35% value-added rule of origin). However, many agricultural products and textiles and clothing are excluded from preferences. Laos is not currently eligible for GSP preferences in the US due to the following conditions which govern access to the scheme:

“The President shall not designate any country a beneficiary developing country

under this subchapter if any of the following applies:

- Such country is a Communist country, unless--
  - (i) the products of such country receive nondiscriminatory treatment,
  - (ii) such country is a WTO Member (as such term is defined in section 3501(10) of this title) and a member of the International Monetary Fund, and
  - (iii) such country is not dominated or controlled by international communism.”

Laos passed the first hurdle when the BTA entered into force. Laos is already a member of the IMF. Clause (iii) is rather vague. So, WTO membership would appear to be the final hurdle that Laos must pass to be considered for GSP treatment in the US. Nevertheless, the impact of the GSP on Laos is likely to be limited due to the exclusion of clothing and a range of agricultural products.

#### Access to the Japanese market

*Compared to exports to the EU, Laos currently exports little to the Japanese market despite its relative proximity.* The value of exports has actually fallen from \$107 million to \$65 million from the early 1990s to the beginning of this century. In 2003 exports to the EU were nearly 20 times greater than those to Japan. Laos is eligible for preferences under the Japanese GSP. Table 6 summarizes the structure of exports to Japan and preferences in 2002. Most of the value of preferences accrues to wood products, but the tariff and the margin of preference of these products is relatively low.

**Table 7. Lao Exports to Japan and Utilization of Preferences (2002)**

	Export Value (yen)	Eligible for Preferences	Preferences Requested	Value of Preferences	Value of Preferences as % of Total Export
<b>TOTAL</b>	837,091	385,928	287,409	34,733	4.1
Agriculture	2,705	0	0	0	0.0
Manufacture	834,386	385,928	287,409	34,733	4.2
44 Woods articles	650,810	213,187	212,899	10,219	1.6
61 Clothing, knitted	82,293	82,293	6,732	779	0.9
62 Clothing not knitted	54,701	54,701	45,707	4,084	7.5

Source: Japan Ministry of Trade

*Laos has benefited from preferences in non-knitted clothing exports to Japan, partly because of easier rules of origin.*

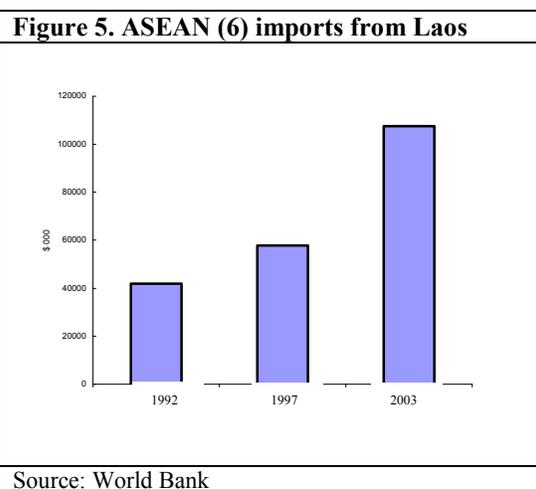
The margins of preferences are larger for clothing products. There is, however, an interesting difference between knitted and non-knitted clothing products. The rate of utilization of preferences for non-knitted products was 84 percent and considerably higher than the rate of utilization of preferences for knitted products, 8.2 percent.

Here again the rules of origin are likely to be important since the rules for knitted products are more restrictive than those for non-knitted products. The rule for most knitted products requires manufacture from fibers, so that imported yarn cannot be used. The rule for many, but not all, non-knitted products allows for manufacture from imported textile fabrics. A liberalization of these rules on knitted products could stimulate greater exports to Japan and at the least allow for greater utilization of preferences on existing amounts of exports.

#### **Access to East Asian markets and ASEAN**

Laos is a member of ASEAN and the ASEAN Free Trade Area (AFTA), but there has been little preferential access for Lao exporters. Because Laos has been slow to implement its commitments under AFTA's Common Effective Preferential Tariff agreement, given the symmetrical nature of preference eligibility, Lao exporters have had limited eligibility for preferences in other member country markets. Nevertheless, exports to the original 6

ASEAN members, and especially Thailand, have grown strongly during the 1990s and early 2000s (see Figure 5), although as shown earlier the share of these countries in total exports has declined.



Thailand is the key market, accounting for over 96 per cent of Lao exports to the original ASEAN member countries. Exports to Thailand, in turn, are dominated by wood products, which account for around 80 per cent of the total. In addition to the ASEAN agreement, Laos has also signed a bilateral agreement with Thailand, which offers preferences for 26 products comprising edible oil seeds, hides and skins and certain wood products. MFN tariffs in Thailand on hides and skins and wood products are rather low. The key product exported to Thailand is sawn wood, the average MFN tariff for which is less than 4 percent.

So, exports to ASEAN countries are highly concentrated by country (Thailand) and by

product (sawn wood). There is substantial scope for export diversification and indeed a need for this to reduce vulnerability to country and product specific shocks. Whilst the ASEAN members markets offer important opportunities for trade expansion it is most unlikely that export growth will be driven by tariff preferences, given the low MFN tariffs applied to most products in these countries. Export diversification and growth will have to be driven by strong capacity to compete, underpinned by effective export promotion activities and cheap and accessible trade-supporting infrastructure services.

One area where ASEAN membership can be leveraged to support export diversification and growth in Laos is standards and standards supporting infrastructure, metrology, testing certification and accreditation. For an initial 20 key product groups, mainly electric and electronic products, members have adopted as national regulations the agreed international norms. Members that do not adopt any of the identified international standards as their national standards still need to accept products from partners which comply with these international standards unless they can demonstrate an inability to accept the international standard due to “climatic conditions or infrastructural reasons”. In addition, a further 71 standards relating to safety for electrical products and electromagnetic compatibility were due to be adopted by July 2004.

In addition to this process of harmonization around international standards, ASEAN members have been implementing a sectoral strategy of mutual recognition of conformity assessment results. Under these agreements members accept test reports and certificates from approved bodies in another member state so that exported products need not be re-tested or certified in the destination markets. Both harmonization and mutual recognition of testing procedures are important initiatives to reduce technical barriers to trade and therefore trade costs. It

is important that Laos has the institutional capacity to effectively exploit the opportunities for export facilitation that are offered by the ASEAN program on standards and conformity assessment.

## **Conclusions**

Market access conditions are important determinants of export opportunities. The coming years will see important changes in market access to key markets. In Europe, which has been the main market for export growth over the past decade, competition in clothing products has intensified following the removal of quotas on countries such as India and China. Nevertheless, Lao exporters remain eligible for tariff preferences under the EC GSP/EBA. Measures should be taken such that utilization of these preferences can be increased further. In the longer term, however, it will be important for the clothing sector to adjust to a situation where it can compete across the board without tariff preferences.

In the US, new opportunities for exports are arising as Laos is granted normal trade relation status and some very high tariffs are reduced to the levels faced by other countries in the region such as Cambodia. In ASEAN, a wider set of preferences should be available in partner countries as Laos has allowed for a broad range of products to be moved to its inclusion list under the CEPT. However, the size of the preference margin for many products will remain relatively small.

The ability to exploit the opportunities that are available to exporters in Laos will depend on underlying competitiveness and the trade supporting framework that provides information on export markets and opportunities, that provides suitable and low cost infrastructure services (such as financial services, telecommunications, energy, transportation) and appropriate and efficient trade facilitation services, including those relating to standards and conformity

assessment, customs and ports. Domestic trade policy is also important in the extent that it allows exporters access to the intermediate inputs they require at world prices. An effective trade strategy is one which brings these factors together under a vision of export led growth, which identifies the main barriers to exports and leads a concerted effort to prioritize and combat the main constraints to trade. A key element

that Laos needs to address in developing its trade strategy is the lack of product diversification in key export markets. Exports to the EU are concentrated in clothing; exports to ASEAN are dominated by wood products. Identifying and alleviating the main factors that constrain diversification will be crucial to allow for a more broad-based expansion of exports in the short and medium terms.

## Chapter 4: Leveraging Lao WTO Accession for Growth and Development

Joining the World Trade Organization provides an important avenue for greater integration of Laos into the global economy. Membership adds certainty and transparency to the policies faced by Lao exporters as well as foreign companies wanting to do business in Laos. Membership gives the country access to an impartial, rules-based dispute settlement process. As a member, Laos will have a seat at the table as world trade rules are negotiated. The process of accession itself can reinforce the country's economic policy reforms, which have been underway since the mid-1980s and were strengthened when joining the ASEAN in 1997. It is these benefits—and not so much greater market access—that would accrue to Laos from WTO accession.

But the road to accession is not going to be an easy one. Acceding countries face a long, complex and often difficult process for achieving WTO membership. Accession especially challenges least developed countries, which frequently lack the capacity to understand and negotiate highly technical matters—often in a foreign language—as well as financial means and institutional setup to support negotiations. In addition, many economic benefits of WTO membership associated with increased market access opportunities do not accrue automatically to developing countries. Governments must work with private-sector stakeholders to build the capacity to exploit opportunities of WTO membership.

At two recent conferences on WTO accession, participants concluded that countries which have benefited from WTO accession are those that enter negotiations with a clear vision of how they want to use WTO membership as a tool to advance their economic development agendas—WTO membership is a means to an end, not an end

in itself.<sup>1</sup> WTO accession presents Laos with opportunities to improve its trade policy and the country's economic competitiveness. It also presents challenges in terms of institutional reforms that tax the capacity of the government and private sector. Donors and international agencies can provide assistance to help Laos realize these opportunities and overcome the challenges. The vision must come from the country itself.

### True benefits for Lao WTO membership

*Market access is not an important benefit from WTO accession.* Market access usually dominates attention given to WTO accession. But Lao exporters already receive MFN treatment or better in the markets of their major buyers. Other ASEAN members grant preferential access on a reciprocal basis, and most OECD countries unilaterally offer low or zero duty treatment on imports from Laos through programs such as the Generalized System of Preferences (GSP) or, in the case of the EU, through the Everything But Arms initiative. Lao membership in the WTO gives its exporters the assurance that at the minimum their goods will continue to receive MFN treatment.<sup>2</sup> Furthermore, developed country

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<sup>1</sup> These conferences were held in November 2004 and January 2005, and are summarized in GTZ, *Accession to the WTO: Country Experiences and Technical Assistance*, forthcoming 2005. Participants included government officials from acceding countries, academic researchers, and representatives from international agencies and bilateral donors.

<sup>2</sup> The only possible market access gain that might accrue from WTO membership is GSP treatment from the US. US laws prohibit extending GSP treatment to communist countries, unless they (i) already receive MFN treatment; (ii) are members of the WTO and

members have committed to providing duty-free and quota free market access to at least 97% of products originating from all LDC WTO members by 2008, following a decision at its Ministerial Conference in Hong Kong in December 2005.<sup>3</sup>

***WTO accession can be an anchor for Laos's own reforms.*** In general, the economic benefits of WTO membership are determined by the nature of a country's own policies, not tariff reductions received in any particular foreign market. Membership in the WTO raises the costs of reneging on past trade policy commitments. This helps policymakers resist protectionist pressures from special interests groups, thereby helping them implement policies that benefit the economy as a whole. Many developing countries therefore look to WTO membership to provide an external anchor for changes they have made to their own trade policies.

The use of WTO membership as a lever for reforms is especially important for Laos and other countries making the transition from central planning to a market economy. The process of negotiating membership and complying with WTO rules requires countries in transition to create the basic laws, policies, and institutions that support a market economy, including, for example, basing the trade regime on the rule of law and publishing all trade-related regulations. These measures in turn help create an investment climate that is more predictable and that reduces transaction costs for

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IMF; and (iii) "are not dominated or controlled by international communism." (Title 19, the U.S. Code, Section 2462). In addition, the legislation that would extend the preferential treatment that African LDCs receive to Asian LDCs, if passed by the Congress, will not benefit Laos unless it is a WTO member since AGOA is treated in the law as an enhancement of GSP. (Tariff Relief Assistance for Developing Economies Act of 2005).

<sup>3</sup> This is subject to the conclusion of the current Doha Development negotiations, as part of the single undertaking.

importers, exporters, and investors. In addition to strengthening the foundations of a market economy, joining the WTO can reinforce reforms of domestic economic policies. Nowhere is this more evident than in East Asia. China, Cambodia, and Vietnam are three examples of countries that treat WTO membership as an integral tool to reinforce their economic reform programs.

***WTO members provide duty-free transit to landlocked member countries.*** Transit through neighboring member countries is of particular importance to a landlocked country.<sup>4</sup> Article 5 of the GATT requires WTO members to commit to providing duty-free transit via most convenient route to other members' shipments:

*There shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport.*

WTO membership provides a legal benchmark for establishing transit arrangements with neighboring countries. The WTO's dispute settlement procedures could be used if neighboring country governments impose restrictions that discriminate against Lao goods in transit in favor of other products from other countries or in favor of their own nationals.

***Membership in the WTO will give Laos a seat at the table when countries negotiate the rules governing international trade.*** Among the issues being discussed in the current round of negotiations (known as the

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<sup>4</sup> Nepal's 1989 application to join the GATT, made in the wake of Indian restrictions on transit, was motivated almost entirely by GATT Article 5.

Doha Development Agenda: DDA), those that are important for Lao trade include:

- *Agriculture*: Laos would benefit from negotiations to achieve substantial improvements in market access, reduction in all forms of export subsidies as well as in trade-distorting domestic support.
- *Non-agricultural market access*: The DDA mandates for reduction and elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing and least developed country members.
- *Services*: Laos is expected to gain from the services negotiations, including through the plurilateral request-offer process in sectors of exporting interest to LDCs and movements of workers (mode 4).
- *Trade facilitation*: Laos would benefit from stronger disciplines on transit rights and increased transparency of customs procedures, as well as technical assistance and capacity building.
- *Developing country's increased participation in world trading system*: The country would benefit from the negotiations to address implementation issues and concerns, special and differential treatment, and technical assistance to strengthen negotiating and exporting capacities of developing and least developed country members.
- *Disciplines on anti-dumping*: As a country in transition from central planning, Laos could become vulnerable to anti-dumping actions by other countries. Stronger disciplines on anti-dumping could force WTO members to use less discriminatory and more transparent policies.
- *Access to patented drugs*: Laos would benefit from greater flexibility under the TRIPS Agreement to use compulsory licensing and parallel

imports to ensure access to patented medicines. WTO members decided in late 2005 to extend the transition period for LDCs in fully implementing the TRIPS Agreement from 2006 to 1 July 2013. They also agreed to make amendments to patents and public health permanent. Laos needs to ensure that over the course of its accession, it does not accept terms that could limit its ability to utilize this flexibility.<sup>5</sup>

***The WTO dispute resolution mechanism puts a small and poor country like Laos on equal footing with other members.*** Dispute resolution is another reason why most countries seek to join the WTO. Access to the WTO's dispute settlement procedures is a fundamental benefit of membership, giving a member legal recourse to contest protectionist trade policies. As the dispute settlement is based on rules and an impartial examination of countries' policies, it treats all WTO members equally. This allows small and poor countries to compensate for their lack of political power in trade disputes with larger and richer partners. While most cases involve disputes between industrialized countries, since they export and import the most, the WTO's dispute settlement process has enabled small countries to challenge larger ones. For example, soon after Ecuador joined the WTO, it quickly used the process to challenge the EU's banana import policies.

But developing countries face financial constraints in bringing disputes to Geneva.<sup>6</sup>

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<sup>5</sup> WTO document: WT/L/641.

<sup>6</sup> Shaffer (2003) cites estimates of approximately \$200,000 in legal fees just to bring a small case to the panel stage; lawyers for Fuji and Kodak billed their clients \$10 million in the U.S. case against Japan on photographic film. The governments invested additional resources in the case. Gregory Shaffer, "How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies," ICTSD Resource Paper No. 5, (Geneva: ICTSD; March 2003).

The more significant constraint for many countries is that trade negotiators in Geneva are not engaged with the business community at home. The trade ministry must first create institutions to work with exporters to identify foreign trade barriers, develop the capacity to evaluate which barriers are actionable under different trade agreements, and finally identify the most appropriate forum for pursuing the dispute.

### **Status of negotiations**

The WTO accession process involves four stages:

1. The candidate formally submits an application. Once this is accepted by WTO members, a working party is established to examine the applicant's trade regime and to discuss the terms of accession.
2. The fact-finding stage starts with the submission by the applicant government of the Memorandum on the Foreign Trade Regime (MFTR), the document detailing its trade regime, and is followed by exchanges of questions and replies between members and the applicant.
3. The candidate and negotiating party then negotiate terms of accession, in other words, the concessions that the applicant is willing to make for WTO membership in terms of market access and rules. These are summarized in the Report of the Working Party and the schedules of concessions.
4. WTO members adopt the Protocol of Accession, which sets out the terms that the applicant has negotiated for its membership. Membership will be effective 30 days after the candidate country informs members of its ratification of the Accession Protocol.

***Laos is currently in the fact-finding phase of accession negotiations.*** A working party to consider the Lao application to join the WTO was formed in 1998. Laos submitted its Memorandum of the Foreign Trade

Regime in 2001. The working party held the first meeting in October 2004. The next working party meeting has not yet been scheduled, although it is expected that it will be held by the last quarter of 2006. In advance of that meeting, working party members expect the government to submit a number of documents describing aspects of the country's trade regime in more detail. These include standard questionnaires on agriculture, standards and technical regulations, services, and intellectual property rights.<sup>7</sup> The government has received additional questions about specific issues presented in its MFTR (such written questions are circulated for each meeting). The government must submit an initial legislative action plan listing laws that need to be passed or amended to comply with WTO rules. In addition to these documents, WTO members may expect candidate countries to circulate any new trade-related laws to the working party on an ongoing basis, since WTO transparency provisions require members and acceding countries to notify and publish trade-related legislation once it has been enacted.

***Although market access negotiations capture most of the attention in public debates, WTO accession documents filed in other countries' accession negotiations suggest that compliance with WTO rules occupies more of the working party's attention.*** After WTO members feel they sufficiently understand the current state of the Lao trade regime, the accession process will begin to focus more on negotiation of market access commitments (on both goods and services), possible caps or cuts in agricultural subsidies, and reforms needed to bring the trade regime into compliance with WTO rules. Laos will negotiate market access commitments bilaterally with interested members of the working party,

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<sup>7</sup> These are also known by the document code numbers assigned by the WTO Secretariat: ACC/4 (agriculture), ACC/5 (services), ACC/8 (standards), and ACC/9 (intellectual property rights).

although all bilateral commitments are consolidated into a single offer that is extended on an MFN basis. Plurilateral negotiations will take place to discuss agricultural subsidies—both their current level, as reported in ACC/4, and any reductions. At the same time, Laos will continue to meet with all members of the working party to discuss the status of legal and institutional reforms, particularly whether or not new laws ensure compliance with WTO rules.

*Although no prize is awarded for the quickest accession, Laos could be better off joining before the Doha Round is concluded to avoid having to adhere to new disciplines that WTO members adopt.* The amount of time spent between the first working party meeting and the adoption of the working party report varies substantially.

Large countries, such as China and Russia, spend well over a decade in negotiations because of their size and their importance to the world trading system. Smaller countries generally face less scrutiny, and the pace of their negotiations is set primarily by their willingness and capacity to negotiate. Cambodia, Kyrgyzstan, Mongolia and Nepal—countries at roughly the same level of development as Laos—spent between 2.5 and 12 years negotiating their membership in the WTO (Table 1). To date, Laos has been advancing through the process at a relatively deliberate pace compared to its counterparts in the region. If Laos accelerates its negotiations, it could potentially complete the process before the conclusion of the Doha Development Agenda.

**Table 1. Milestones in Selected Asian WTO Accession Negotiations**

	Working party formed	Memorandum of the Foreign Trade Regime circulated	First working party meeting held	Report of the working party adopted
Nepal	1989	1990	2000	2003
Mongolia	1991	1992	1993	1996
Cambodia	1994	1999	2001	2003
Vietnam	1995	1996	1998	
Kyrgyz Republic	(Apr) 1996	(Aug) 1996	1997	1998
Laos	1998	2001	2004	
Bhutan	1999	2003	2004	
Tajikistan	2001	2003	2004	

Source: WTO accession reports

## Negotiation issues

WTO rules say little about the requirements of membership and the accession process. Article 12 of the Agreement Establishing the World Trade Organization states that any country may accede to the WTO “on terms agreed between it and the WTO.” The salient feature is that new members *negotiate* the conditions of their membership.<sup>8</sup> There are no WTO rules specifying universal, objective membership

criteria such as maximum tariff levels or minimum reductions in tariff rates or amounts of domestic support to agriculture. Each new member’s protocol of accession is different.

**Membership requirements are becoming more demanding.** There is a visible escalation in the demands that existing WTO members place on candidate countries. Some complain that new members must commit to greater liberalization and internal reforms than existing members agreed to undertake in past negotiating rounds. For example, most candidate countries are asked to join the Government Procurement Agreement

<sup>8</sup> Moreover, only the candidate country makes concessions during accession negotiations.

(GPA) and the Information Technology Agreement (ITA), two codes that are optional for current members.

***WTO members have agreed to moderate their demands with respect to LDC candidates.*** In 2002 the WTO General Council adopted a new policy on LDC accessions.<sup>9</sup> These guidelines call for substantial facilitation of the accession process by exercising restraint on WTO members in seeking concessions and commitments on trade in goods and services from acceding LDCs. In particular, they stress that LDCs are under no obligation to join plurilateral agreements, including the GPA, ITA and sectoral initiatives. They also allow LDCs to benefit from the special and differential treatment provisions under WTO agreements. The emerging convention is that members ask LDCs to provide an action plan for implementing agreements when requesting transitional periods. They also call for targeted and coordinated technical assistance and capacity building such as in the context of the IF. These provisions provide greater flexibility to Lao negotiators, and they should also facilitate the implementation process.

Applicant countries at more advanced levels of development may face higher demands over the course of their accession negotiations; however, the special circumstances of LDCs, including Laos, have been recognized through the adoption of the 2002 General Council Decision on accession of LDCs.<sup>10</sup> This is to facilitate and accelerate negotiations with acceding LDCs in accordance with paragraph 42 of the Doha Ministerial Declaration<sup>11</sup> and the mandate in paragraph 18(iii) of the WTO Work Program on LDCs.<sup>12</sup> The accession in a more simplified manner by both Cambodia and Nepal reflects this spirit.<sup>13</sup>

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<sup>9</sup> WT/L/508

<sup>10</sup> WT/L/508

<sup>11</sup> WTO document: WT/MIN(01)/DEC/1

<sup>12</sup> WTO document: WT/COMTD/LDC/11

<sup>13</sup> Transition periods have been extended more readily to LDC applicants, allowing them greater flexibility for bringing their foreign trade regime into

The rest of this section discusses negotiations over market access and agricultural subsidies, where Laos has flexibility in choosing how much to liberalize. It then summarizes negotiations over Lao compliance with WTO rules, where Laos retains some flexibility in choosing when to reform, but very little room to choose which policies to adopt.

***Tariff bindings.*** Like all WTO members, Laos will need to commit to keeping customs duties on all products below ceiling levels.<sup>14</sup> These levels are negotiated and are known as tariff bindings. All new members to the WTO have bound all tariff lines. For some products, countries negotiate bindings that are well above currently applied rates, meaning that tariffs are not reduced as a condition of membership. For others, existing members insist on ceilings lower than currently applied rates. The trend is increasingly for acceding countries to bind their tariffs close to their currently applied MFN levels for most products. As LDCs, Nepal and Cambodia received more leeway to negotiate tariff bindings above their applied rates. The maximum bound rate on manufactured products in Nepal's offer is 60 percent and the average bound rate is 24 percent, while the average applied rate (in 2002) is 14 percent. Laos can expect similar flexibility.

WTO members will likely ask Laos to join the Information Technology Agreement (ITA), an optional WTO agreement under which countries eliminate all duties on information technology on an MFN basis, as well as what are known as sectoral agreements. The latter are informal agreements to eliminate duties on certain sets of products.<sup>15</sup> To date no LDC has joined the ITA.

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WTO conformity. WTO document: WT/ACC/10/Rev.3.

<sup>14</sup> During the Uruguay Round, GATT signatories agreed to bind 100 percent of agricultural tariff lines and substantially increased the share of non-agricultural products subject to tariff bindings. Members acceding since the Uruguay Round have bound 100 percent of non-agricultural as well as agricultural tariff lines.

<sup>15</sup> Sectoral agreements cover such disparate products as chemicals, dairy products, and medical equipment. These emerged as a negotiating modality during the

Neither Cambodia nor Nepal signed any of the informal sectoral agreements when they joined the WTO.

The Lao government can expect requests from some WTO members to “multilateralize” its past preferential liberalization. Laos has negotiated preferential agreements, either regionally or bilaterally. Given that a core principle of the GATT is non-discrimination, other WTO members could ask that these preferences be extended to them as well. This has been the experience faced by some acceding countries. GATT Article XXIV and GATS Article V allow any members to conclude free trade agreements without the necessity to extend those terms on an MFN basis. The 1979 Enabling Clause also provides more flexibility for developing countries and least developed countries to engage in these preferential arrangements.

**Agricultural subsidies.** During the Uruguay Round, GATT members negotiated commitments on agricultural subsidies, agreeing to reduce trade-distorting domestic support that was being provided above a *de minimis* level.<sup>16</sup> This threshold is 10 percent of the total level of production for developing countries and 5 percent for others. These levels have been used in accession negotiations, although subject to some variation (Table 2). Many low-income

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Uruguay Round and are still treated as such by some WTO members. They are not recognized as WTO agreements, unlike the Information Technology Agreement.

<sup>16</sup> Subsidies that governments make conditional upon a particular level of production or export are considered to be trade-distorting. Where markets function well, the introduction of such subsidies reduces overall economic welfare. In general, government support known as 'green box' for research and development, pest and disease control, services provided to the rural community as a whole, extension services, marketing services, etc. are not considered to be trade-distorting under the Agreement on Agriculture. Under the Agreement on Agriculture, existing developing country members were allowed to exclude from their calculations certain types of support that was considered trade-distorting when provided by developed country governments, such as investment support and input subsidies ('development box').

countries that have completed the accession process since the Uruguay Round, including the two LDC members, did not provide subsidies exceeding their *de minimis* level, and therefore did not need to make any cuts from existing levels. Given that the government currently provides few, if any, subsidies that affect international trade flows, it seems unlikely that Laos will be asked to reduce existing subsidies.

Instead, negotiations will likely revolve around whether Laos will bind export subsidies at zero and commit to keeping trade-distorting domestic support that the government might introduce in the future below a certain threshold. During the Uruguay Round, existing LDC members were also exempted from the requirement to reduce, and ultimately eliminate, export subsidies on agricultural products. Laos has room to negotiate whether it will forego export subsidies. Cambodia chose to bind export subsidies at zero upon accession. Nepal did not. A request to reserve the right to provide export subsidies will be stronger if it demonstrates how export subsidies help agricultural markets work better.<sup>17</sup>

The choice of the base years used to compute existing support levels has been contentious in some accession negotiations, especially in those that have lasted for a decade or more.<sup>18</sup>

**Services commitments.** While acceding countries must set ceilings on all products, the scope as well as depth of services sector commitments is negotiated, and these vary from country to country.<sup>19</sup> The GATS provides

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<sup>17</sup> Practical cases where export subsidies can be defended on economic welfare grounds are rare. In most cases they simply transfer income from the society as a whole to politically favored special interest groups.

<sup>18</sup> Laos may be asked to reproduce the ACC/4 worksheet in the future, or to update, if its negotiations are not concluded within a few years.

<sup>19</sup> Generally, acceding countries are required to submit checklist on measures affecting trade in services (WT/ACC/5). In practice, some members understand difficulties faced in compiling those measures, notably by Cambodia, and are willing to open negotiations on specific commitments rather than expect a full response to the services checklist.

flexibility for developing and least developed countries in services negotiations, notably in the GATS Preamble as well as Articles IV and XIX. Specifically, GATS Art XIX:2 provides that: "The process of liberalization shall take place *with due respect for national policy objectives and the level of development....*". This article also states that "There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access *in line with their development situation* and, when making access to their markets available to foreign service suppliers, *attaching to such access conditions aimed at achieving the objectives referred to in Article IV.*" In addition, guidelines on services scheduling<sup>20</sup> and negotiating<sup>21</sup> as well as the General Council's Decision on LDC accession<sup>22</sup> recognize the special needs of LDCs and call for additional flexibilities so as to facilitate their involvement in trade in services negotiations and liberalization.

All countries that have joined the WTO since its inception have undertaken at least some form of commitments in business services (notably professional services such as accounting, legal, and architecture), construction, and financial services. Most new members have made commitments in some subsectors in distribution, environment, tourism, and education services. A somewhat smaller share of members also made commitments in certain sub-sectors within communications—mostly telecom and courier services but fewer in postal and audiovisual services. The social services, health, and recreational services sectors have experienced relatively fewer commitments. Developing countries have phased in certain commitments over time. Nepal and Cambodia made commitments in fewer sectors than did most other new WTO members thanks to the 2002 General Council Decision facilitating LDC accession.

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<sup>20</sup> WTO document: S/L/92

<sup>21</sup> WTO document: S/L/93

<sup>22</sup> WTO document: WT/L/508

The economic implications of services liberalization are not measured simply by the number of sectors a country includes in, or excludes from, its services offer. Sectors differ in the need for regulation and in their role as inputs into the production of exports. But opening services sectors too fast, or without the proper regulatory framework in place, is not a viable option. It would be important for Laos to revisit the terms of preferential trading agreements with some countries in the negotiations of the next one to allow a more feasible program that would end in a win-win situation for all. The agreements themselves are meant to align Laos' trade regime, including rule-making and market access liberalization with international practices. It would be advisable to abandon those WTO-incompatible agreements once Laos accedes to the WTO and let the multilateral trade rules prevail.

**Customs valuation.** WTO rules require all members to use the transaction value principle when assessing ad valorem customs duties; the use of reference prices or minimum values is prohibited.<sup>23</sup> Unless the overall customs administration is improved, employing GATT valuation rules creates an incentive for importers to falsify their invoices to evade customs duties.<sup>24</sup> The Customs Department currently applies the transaction value principle to a limited degree. The National Assembly has recently approved the revised Customs Law designed to implement the transaction value principle, as well as facilitate customs modernization more generally. Several agencies have provided technical assistance in recent years, including the IMF, UNDP, and France. More will be needed in the future.

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<sup>23</sup> Under this principle, the customs inspectors use the price paid or payable in the market when determining the amount of customs duties owed. The ASEAN Customs Code of Conduct of 1995 commits ASEAN members to implementing GATT valuation rules.

<sup>24</sup> For more information, see Luc De Wulf and José Sokol, eds., *Customs Modernization Handbook*, Washington: The World Bank, 2005.

**Table 2. Agricultural support commitments of new WTO members**

Member	Accession Year	Base Years	<i>de minimis</i> level	Base support exceeds <i>de minimis</i> ?	Reduction commitment
Cambodia	2003 <sup>a</sup>	1998–2000	10%	no	
Nepal	2003 <sup>a</sup>	1996–1998	10%	no	
Macedonia	2003	1998–2000	5%	yes	0%
Armenia	2003	1995–1997	10%/5% <sup>b</sup>	no	
Chinese Taipei	2002	1990–1992	5%	yes	20%
China	2001	1996–1998	8.50%	no	
Moldova	2001	1995–1997	5%	yes	20%
Lithuania	2001	1995–1997	5%	yes	20%
Croatia	2000	1996–1998	5%	yes	20%
Oman	2000	1994–1996	10%	no	
Albania	2000	1996–1998	5%	no	
Georgia	2000	1996–1998	5%	no	
Jordan	2000	1994–1996	10%	yes	13%
Estonia	1999	1995–1997	5%	no	
Latvia	1999	1994–1996	8%/5% <sup>b</sup>	no	
Kyrgyzstan	1998	1994–1996	5%	no	
Panama	1997	1991–1993	10%	no	
Mongolia	1997	n.a.	10%	no	
Bulgaria	1996	1986–1988	5%	yes	79%
Ecuador	1996	n.a.	10%	no	

<sup>a</sup> Cambodia and Nepal completed negotiations in 2003; ratification came later.

<sup>b</sup> Armenia and Latvia negotiated transitional periods where they agreed to keep trade-distorting support below a higher *de minimis* initially but eventually reduce support below a lower *de minimis* level. Sources: WTO accession protocols for Nepal and Cambodia. For other countries, data are taken from Lars Brink, “New Members of the WTO: Their Commitments in Agriculture and Provisions Proposed in the Doha Negotiations,” paper presented at the International Conference on Agricultural Policy Reform and the WTO, Capri, June 23–26, 2003.

The decentralization of Lao customs administration is likely to attract attention in WTO accession negotiations. WTO members will seek assurances that customs procedures are applied identically across provinces. This is not the case at present.

Securing a transition period for implementing the customs valuation agreement should be an important priority for Lao negotiators. Both Cambodia and Nepal negotiated transition periods (five and three years, respectively).<sup>25</sup> The first step is to prepare an action plan for customs reform (see Chapter 6).

<sup>25</sup> All other 18 acceding members committed to apply the customs valuation agreement by the date of accession.

**Standards.** The TBT and SPS agreements recognize the right of countries to restrict imports when necessary to protect human, animal or plant life or health. But these agreements limit exercise of that right to measures that do not discriminate between countries with the same conditions and that are not disguised restrictions on trade. Members must notify others of all new draft standards and technical regulations, allowing others time to comment. The agreement further obligates members to impose such restrictions only to the extent necessary to protect life and health, and on the basis of scientific principles. The TBT agreement extends the basic principles of transparency, non-discrimination, and trade facilitation to the processes of developing standards and conducting conformity

assessment. Members are encouraged to recognize unilaterally other WTO members' regulations when they are equivalent to domestic regulations, and do not require additional testing or certification. The ultimate objective of these agreements is to screen out only harmful products while facilitating trade in safe products.

Laos currently maintains very few standards.<sup>26</sup> Indeed the entire standards regime—including all institutions involved in setting standards, conducting conformity assessment, and enforcing regulations—is still in its infancy and lags behind that of other countries in the region. The country has been working to develop its standards regime in recent years. A food safety law was passed in 2004, and the government is considering draft veterinary and phytosanitary laws. Both UNIDO and the EC have been working with the Science, Technology and Environment Agency (STEA) to develop a program to build capacity in metrology, standardization, and procedures for testing industrial products. Despite these steps, much more work remains to be done. All standards-related laws will need to include language reflecting obligations required by WTO rules (e.g., notification requirements, non-discrimination, use of international standards, etc.) and other international agreements. Many steps are needed to build an effective standards regime. This section focuses solely on the enquiry point mechanism, which is unique to WTO rules, and the issue of negotiating a transition period to implement WTO rules.

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<sup>26</sup> As discussed below, some of the existing import licensing requirements have objectives similar to standards and technical regulations. The Regulation on Import and Export Licensing also lists technical certification as a requirement for obtaining an import license (Article 5), although MOC officials suggested to the DTIS team that this requirement is not always enforced in practice.

Both the SPS and TBT agreements require Laos to designate organizations responsible for notifying other WTO members of any new standards or technical regulations and for responding to enquiries from other members about any new or existing measures.<sup>27</sup> In other accession negotiations, WTO members have expressed a preference for a single enquiry point rather than multiple enquiry points, each addressing requests about different issues covered by the SPS agreement. Some recently acceding countries operate a single enquiry point covering both TBT and SPS agreements. The government could consider appointing STEA as the single enquiry point for these agreements.

Developing a standards regime takes time and costs money, so Lao trade negotiators should treat securing a reasonable transition period to implement the TBT and SPS agreements as a high priority. Nepal negotiated a three-year period for both agreements; Cambodia negotiated a three-year period for the TBT agreement and four years for the SPS agreement.<sup>28</sup> Submitting an action plan is a necessary precondition to receiving a transition period (as well as to coordinating technical assistance). As several donors and agencies are already working with the government on standards issues, negotiators should approach these organizations in drafting the action plan and technical assistance required.

***Customs duties and import licensing.*** One of the fundamental principles of the GATT is that countries use only ordinary customs

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<sup>27</sup> Enquiry points must provide information on measures taken by local governments and non-governmental organizations, not just those introduced by the central government. The TBT agreement also requires standardization bodies to publish their work programs every six months. (The TBT Committee encourages WTO members to do so via the internet.)

<sup>28</sup> Except for Ecuador, no other new WTO member has received a transitional period; all have pledged to fully implement both the TBT and SPS agreements upon accession.

duties as trade policy instruments. This means eliminating quantitative restrictions and trade taxes other than ordinary customs duties, as well as ensuring that internal taxation, licensing requirements, subsidies, standards, foreign exchange controls, etc. are not used in a protectionist manner. Very few import bans, licensing requirements, and ad valorem administrative fees remain.

The government will need to replace any administrative fees based on the value of a product or investment with fees based on the government's administrative costs, which involves relatively simple calculations. In the case of import prohibitions, negotiators will need to present economic justifications for maintaining these bans.

There is currently some ambiguity about Lao import licensing requirements. WTO agreements require import licensing to be transparent and as simple as possible, and governments should use automatic licensing procedures whenever feasible. Members must notify other countries when proposing to introduce new licensing requirements. These agreements do not specify when licensing is permitted or prohibited, although they imply that countries should use them sparingly and for purposes other than to discourage international trade.

In Laos, the MFTR states that all goods require licenses—this kind of licensing was put in place during the East Asian financial crisis for foreign exchange control (see Chapter 2 on Trade Policy). In subsequent filings with the WTO, the government reported that the licensing requirements had been reduced in scope. Furthermore, it reported that the licensing program was temporary and applied on a case by case basis—these licenses aim at quantitative or other restrictions to imports. Although in practice most licensing requirements have been phased out, Laos can expect WTO members to request that it clarifies current requirements and shortens the list of products that require licenses. Achieving greater transparency and predictability is

straightforward: publish widely all licensing rules and ensure that only these rules are applied in practice. Addressing the scope of licensing is less straightforward. In some cases the economic justification for licensing may be weak. In others the objectives are sound but the country could achieve those objectives more cost-effectively using other methods.

For example, the Ministry of Commerce officials use licensing to gather trade data on trade flows. But gathering data directly from customs declarations could yield more complete and accurate statistics. Other examples show that many import licenses requirements act as proxies for technical regulations or health and safety standards (e.g., beverages and food products) in that they purportedly screen out unsafe products. A well-functioning standards regime would screen out unsafe products while imposing fewer transaction costs on the economy.

In both of these examples, the government will need to expand capacity in other areas to achieve its objectives in the absence of licensing. What does this mean for WTO accession negotiations? Lao negotiators should plan to develop action plans showing how and when these institutional improvements will be made.<sup>29</sup> The Agreement on Import Licensing granted original developing member countries a two-year grace period to implement automatic licensing procedures in line with the agreement (Article 2). Thus far all acceding countries, including the two LDCs (Nepal and Cambodia), have committed to apply the agreement by the date of accession.

Import licenses are reportedly required for agricultural and food products, raw materials and semi-manufactured inputs used in manufacturing and some non-agriculture goods, including cement and steel rods. It

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<sup>29</sup> The specific requirements of customs modernization and SPS reforms are discussed in other Chapters of the DTIS.

will be difficult for Lao negotiators to defend these requirements, as they appear to be nothing more than policies to protect domestic producers from import competition. A fundamental pillar of the GATT is that ordinary customs duties are to be the only tool available for that purpose. The use of import licensing as a trade policy tool in place of a tariff is difficult to defend on economic grounds since licensing costs money while tariffs raise revenue.

WTO members will want to see legislation that explicitly limits the government's authority to require import and export licenses to only those situations permitted under Articles XX and XXI of the GATT. Under these articles import and export restrictions can be maintained only on the grounds of public morals, national security, environmental protection or health and safety. Such laws should also incorporate the Agreement on Import Licensing Procedures' requirement to notify other WTO members of changes in licensing requirements.

**National treatment.** WTO agreements require members to provide national treatment in internal taxation and other charges, etc. "National treatment" means that policies treat foreign products no less favorably than domestic goods. VAT and excise tax rates must be applied in the same way to imports as locally supplied articles. Most acceding countries, including the two LDCs Nepal and Cambodia, agreed to eliminate violations of national treatment in internal taxation by the date of accession.<sup>30</sup> Foreign-owned firms must enjoy the same right to export or import as locally-owned firms (whether private or public). Countries in the transition from socialism have received the most scrutiny on national treatment in trading rights, due to the legacy

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<sup>30</sup> Ecuador received a one-year transition period, Bulgaria and Lithuania received transition periods for certain tobacco products and alcoholic beverages, and Armenia applied VAT to agriculture gradually.

of state management of foreign trade under central planning. Most are asked to explicitly commit that they will comply with GATT rules by the date of accession.<sup>31</sup>

**TRIMS and export processing zones.** Laos conditions certain investment incentives on trade performance. The foreign investment law provides for reduced rates of customs duty on imported inputs used to achieve import substitution targets, and the domestic investment law also reportedly contains measures proscribed by the Agreement on Trade-Related Investment Measures (TRIMS).

Developing countries that have acceded to the WTO received a transition period to implement the TRIMS agreement. But all new members, including Cambodia and Nepal, agreed to eliminate by the date of accession any measures inconsistent with the TRIMS agreement. All new members have agreed to apply all WTO rules to free zones or special economic areas (such as export processing zones).

The export processing zone that is about to be established in Savannakhet is providing incentives for investors. Some of these incentives may not be WTO-compatible and will have to be revised as a requirement for accession.

**Intellectual property rights.** The TRIPS agreement requires WTO members to provide minimum levels of protection for the full range of intellectual property rights: patents, trademarks, copyrights and related rights, geographical indications, industrial design, lay-out design of integrated circuits, and trade secrets. The agreement essentially incorporates into WTO rules the standards

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<sup>31</sup> Cambodia received a transition period to bring the right to trade pharmaceuticals in line with the GATT. China stated that it would apply the same limitations of trading rights to domestic firms that it applied to foreign firms, and at the same time progressively liberalize trading rights for all firms.

of intellectual property rights protection that prevail in most industrial countries and in a number of international treaties.

The Lao intellectual property rights regime is at an early stage of development. The government has provided trademark protection for the past decade under a prime minister's decree. STEA began accepting patent applications in 2004 under a similar decree, although no patents have yet been granted.<sup>32</sup> The National Assembly is considering a draft intellectual property law. This would provide the legal framework for new regulations on each form of intellectual property rights protection. Other countries acceding to the WTO have found it necessary to amend a number of other laws, such as commercial, civil, and customs codes, to comply with the TRIPS agreement. Once new rights are established in law, the government will need to create the institutional infrastructure to administer, enforce and adjudicate these rights. As part of these reforms, administration of intellectual property rights could at some time be transferred to line ministries, such as the Ministry of Information and Culture and the Ministry of Commerce, so that STEA can focus instead on policy development and coordination. The scope for doing this will be determined by the levels of expertise available in the line ministries, and the overall institutional development agenda will challenge the government's resources. Some donors have been providing assistance, and more will be needed.

Lao negotiators have requested a transition period to implement the TRIPS agreement.<sup>33</sup> As in other areas, the government will need to submit an action plan that identifies the steps it will take during the transition period

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<sup>32</sup> STEA officials estimated that each patent application will take around four years to process

<sup>33</sup> Nepal and Cambodia each negotiated three-year transition periods. Except for Ecuador, which received a one-year transition, all other new WTO members pledged to implement the TRIPS agreement upon accession.

to bring the current regime into compliance with WTO rules. As they prepare this action plan, negotiators should bear in mind that strengthening intellectual property rights protection transfers money from consumers to property rights holders. In the long run, stronger protection should also create incentives for increased investment in new technologies and creative endeavors, though this depends on the existence of institutions that connect investors with inventors and creators (e.g., venture capital markets). It also depends on the establishment of legal methods, and sometimes new organizations (e.g., copyright collection organizations), to channel payments from rights users to rights owners. These institutions do not appear overnight, and they depend critically on the rule of law and well-functioning capital markets.

In the 2001 Doha Declaration on TRIPS and Public Health, WTO members agreed that LDCs may delay extending patent protection to pharmaceuticals until 2016 as one means of ensuring the supply of essential drugs at low costs.<sup>34</sup> The WHO and others have advocated that the government incorporate this provision into the draft intellectual property law.

### **WTO accession: what's in it for Laos**

Laos can use the WTO accession process to its best advantage. First, recognizing that accession negotiations challenge the government's capacity to make and implement trade policy, the country can use the opportunity to strengthen and improve trade policy institutions. Second, Laos can use the obligation to comply with WTO rules on customs, standards, and intellectual property to make the economy more competitive. Finally, Lao negotiators can use the market access negotiations to improve exporters' access to critical services inputs and to comprehensively identify defensive interests.

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<sup>34</sup> WTO document WT/MIN(01)/DEC/2 of 21 November 2001.

**Greater transparency to attract more investment.** Perhaps the principal benefits to transition countries of WTO membership and the accession process come from the WTO's transparency and rule of law requirements. Potential foreign investors and traders currently lack access to information about the Lao trade regime. In addition, there is a perception among businesspeople that laws and regulations as written do not correspond to how they are applied in practice. In some cases, actual procedures are more liberal than the written rules. Many trade restrictions that are on the books, e.g., foreign exchange limitations and licensing requirements, are not implemented in practice. Even in these cases, the lack of transparency and predictability introduces transaction costs that can deter needed investment.

If the country is going to benefit from WTO membership, the government must take the transparency requirements to heart. GATT Art X on transparency in trade in goods states that "Laws, regulations, judicial decisions and administrative rulings of general application...shall be published promptly in such a manner as to enable governments and traders to become acquainted with them."<sup>35</sup> GATS Article III mirrors this text on trade in services. When trade rules become final, they should be disseminated widely and distributed in brochure form to traders and other stakeholders. Trade-related laws and regulations should be amended to reflect notification requirements of WTO and other international agreements, in addition to introducing a standard provision that the government must solicit comments from stakeholders on new regulations.

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<sup>35</sup> GATT Article X also provides that "The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private."

**Improved trade policy process and institutions.** Experience from other accessions demonstrates that the structure of a country's trade policy making institutions shapes policy outcomes. Laos will benefit from WTO membership if it constructs a policy process that focuses on trade as a means of achieving economic policy objectives. This will require improving inter-ministerial coordination, reorienting units of the Foreign Trade Department along functional lines, and strengthening institutions for public engagement.

Inter-ministerial coordination is the *sine qua non* of an effective trade policy process. Trade agreements and the policies that can influence a country's competitiveness exceed the ambit of any single ministry. Although the government has already put in place an inter-ministerial Steering Committee for WTO accession, there is room for improving inter-ministerial coordination to speed up progress in completing the fact-finding stage of WTO negotiations. For example, certain checklist documents had not been completed because different ministries were unclear about who was responsible for them, though by now most of them have been completed. Staff working in the secretariat responsible for supporting WTO negotiations noted that staff in line ministries have not always been empowered to cooperate with the secretariat. Similar problems affect trade policy making in most countries. To overcome them, a country must strengthen coordinating mechanisms at two levels. At the top, a subset of the cabinet of ministers, chaired at the deputy prime minister level, must oversee trade negotiations. As Laos moves into the bargaining phase of WTO negotiations, direct involvement from the top levels of political leadership will be needed to broker compromises across ministries. At the operational level, the inter-ministerial task force working on accession may need to be expanded and its

members may need to be given the authority and budget to support trade negotiations.<sup>36</sup>

There is also fragmentation within the group of officials responsible for trade negotiations, which results from dividing negotiators into units according to the negotiating forum. For example, until recently, officials working on AFTA negotiations worked out of the Ministry of Foreign Affairs rather than the Foreign Trade Department of the Ministry of Commerce. Even within the Foreign Trade Department, bilateral, regional and multilateral negotiations are managed by different units. Since most trade agreements address many of the same issues (e.g. services, market access, standards, trade facilitation, etc.), it may be more efficient to organize trade experts along functional lines rather than by trade agreement.

***Customs modernization to improve trade facilitation.*** Without improved trade facilitation the Lao economy will not benefit from improved market access that comes from WTO membership. Laos can use the requirement to comply with the WTO customs valuation agreement and other international conventions to advance the pace of customs modernization. It can also tap into specialized technical assistance to benefit from the trade facilitation program under discussion at the WTO (See Chapter 6 on Customs).

***Increased standards and quality management to benefit high-value agriculture exports.*** As with customs modernization, the Lao economy can benefit from WTO membership if the government uses the requirements of the TBT and SPS

Agreements to introduce a market-oriented national standards regime. This will enhance the ability of Lao exporters to exploit foreign markets for high-value products. A country's standards regime represents an important element of the business climate. When the standards regime introduces new transaction costs—through lack of transparency and harmonization, for example—it reduces the economy's competitiveness and discourages new investment. Constructing a new standards regime will take many years, and the government should focus on implementing first those obligations of WTO rules that bring the most immediate payoff—mainly the enquiry point mechanism and the aspects of the SPS Agreement that facilitate exports of high-value agriculture products (see Chapter 7 on SPS issues).

The notification and enquiry points can play an important role in both commercial diplomacy and export promotion. They can disseminate information about standards (both foreign and domestic) to the business community, help them to incorporate international standards into their production processes, and use feedback from exporters to identify foreign standards that are merely protectionist tools in disguise. Lao businesses will benefit from the establishment of an enquiry point as an export promotion tool as soon as it is established—there is no reason to postpone implementation of this part of the WTO agreements. Once Laos joins the WTO, the enquiry point can then be used to challenge other countries' standards and technical regulations. Doing so will require that the government develop a mechanism to first distribute other countries' WTO notifications to the Lao business community and then channel exporters' comments on them back to trade negotiators in Geneva.

As noted earlier, the government faces the challenge of choosing an institutional location or locations for the WTO enquiry points. The trend is for countries to

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<sup>36</sup> Cambodia eventually created a task force of 100 senior officials to assist the inter-ministerial coordinating committee in accession negotiations. For details see Sok Siphana, "Preparing for a WTO Accession Negotiation: Cambodia Country Case Study," presented at the conference "Preparing for and Evaluating WTO Accessions," Geneva, January 27, 2005.

designate one enquiry point for each agreement, and sometimes even to operate a single enquiry point that handles notifications and enquiries for both agreements. Consolidating the planned two SPS enquiry points would economize on administrative resources. These should remain in the Ministry of Agriculture and Forestry if the government chooses to operate separate SPS and TBT enquiry points. If the enquiry points are to be used for export promotion and commercial diplomacy, the Ministry of Commerce would be a more appropriate location than STEA for the TBT enquiry point, given its greater administrative capacity, its closer relationship with the business community, and its leadership role in trade negotiations. This does not mean that STEA should be entirely isolated from the enquiry point mechanism. But given STEA's location in the Prime Minister's Office, its role is more appropriately science and technology policy development, and in the longer run it would make sense to release it from the burden of maintaining the enquiry point function.

***Tariff bindings negotiations to consolidate trade agreements.*** While setting ceilings on tariff rates benefits the economy in a general way, perhaps the most important contribution of WTO accession and membership is to rationalize the process of negotiating tariff reductions across trade agreements. To bargain effectively with the WTO working party, the Foreign Trade Department will need to consolidate all negotiations over tariffs rates, reviewing all bilateral and regional agreements for any preferential rates, and analyzing effects of any tariff liberalization or binding. Negotiators will need to use this analysis to back up arguments to maintain any large gaps between applied rates and proposed ceiling bindings.<sup>37</sup> To fully benefit from

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<sup>37</sup> Research conducted in other countries suggests that an economy is generally better served by binding relatively close to the applied rates rather than maintaining high binding overhang. Other studies, notably by UNCTAD,

WTO membership, the trade department also needs the capacity to identify its offensive interests in tariff negotiations, i.e., market access barriers to either current exports or products the country expects to export in the future.

***Services sector liberalization to support efficient production and exports.*** Lao negotiators will soon need to submit an initial offer of services sector commitments to the WTO working party. Laos is also negotiating services liberalization at the regional level as a member of ASEAN. Services are becoming increasingly important in bilateral trade agreements as well. Developing a consistent strategy for services liberalization and a sound regulatory framework will help the Lao economy benefit from WTO membership as well as regional and bilateral agreements.

Different services sectors present different challenges and opportunities for liberalization. At one extreme are sectors where Laos has a comparative advantage as an exporter of services. The chief example is tourism. GATS commitments can complement a broader program to develop high-value tourism (e.g., eco-tourism, heritage-tourism, cultural-tourism, adventure-tourism).

The Lao economy can also benefit from commitments in sectors where imported services are used as inputs in the production of exportables. Foreign providers of business services (e.g., market research and consulting), technical services, and accounting services can help Lao exporters take advantage of foreign market access opportunities and identify new markets.

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argue that the difference between applied and bound rates could serve as a 'policy space' for developing countries. Under the WTO framework, tariffs are the only legitimate tool for protecting domestic industries in light of LDCs' limited capacity to deploy other complicated measures such as antidumping, countervailing duties or other safeguards.

Regulations that raise the cost of importing such services create an anti-export bias, which undermines the export promotion strategy.

In some sectors—notably professional services, health, and education—the existence of professional standards or credentials gives consumers greater assurance about the technical competence of service providers. Developing new credentialing procedures or harmonizing existing standards with those prevailing in the exporting country can help Lao consumers benefit from liberalization in these sectors.<sup>38</sup>

Research elsewhere suggests large macroeconomic gains to liberalization of backbone services, such as transportation, telecommunications, and finance. Since all sectors of the economy use these services, reducing costs through greater competition increases productivity of the economy as a whole. Yet many of these sectors are also subject to well-known market failures (most notably banking). In those cases, external liberalization must be sequenced with regulatory reforms (such as establishing independent regulators, developing prudential regulations, and ensuring universal service), privatization, and de-monopolization. Technical assistance will be needed to support the necessary regulatory reforms.

Trade negotiators will need to work through the list of service sectors and, in each sector, meet with enterprises that use the imported services and other stakeholders to identify costs and benefits of liberalization. They

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<sup>38</sup> In the quest to balance consumer and business concerns, one should not introduce unnecessarily restrictive sector-specific regulations when a more generic consumer-protection framework will achieve the same goal. General consumer protection laws, NGOs (e.g., better business bureau), and investigative journalism can protect the public from unscrupulous computer programmers, for example, more effectively than by trying to establish a professional licensing system for programmers.

will then need to work with the Ministry of Justice, the National Assembly, and other government agencies to identify regulations, laws, practices that affect trade in each service.

*Using trademarks and copyrights as commercial tools.* As a WTO member, Laos will need to enforce the full range of intellectual property rights. Compliance with some parts of the TRIPS agreement may impose net costs on the economy and require institutional strengthening over the short and medium terms, and should be phased in gradually. However, compliance in other areas can bring immediate benefits. Workshops on export promotion held by the ITC and by the DTIS team pointed out the commercial benefits of using trademarks and copyrights to distinguish Lao products in the global marketplace. Lao businesses can use these instruments to prevent others from imitating the unique designs and packaging of their products.

The government is already working on writing legislation to introduce or expand legal rights. The next steps are to educate businesspeople about the benefits of using intellectual property rights, improve administrative systems for registration, and train the judiciary to handle intellectual property cases.

### **Immediate technical assistance priorities**

Negotiating WTO accession is a long process, which taxes the capacity of developing countries such as Laos. Technical assistance from donors and international agencies can help Laos build the capacity necessary to complete this process and to implement WTO commitments in a way that fits its development objectives. The immediate priorities facing Lao negotiators are to complete and update the checklist documents and legislative action plan, conduct economic analysis to support

market access negotiations, and overcome fragmentation in trade policy making.

***Complete the checklist documents and legislative action plan.*** The government is required to complete the legislative action plan and checklist documents on services, intellectual property rights, standards, and agricultural support to maintain the momentum of the negotiations. As of July 2005, the government received assistance to prepare the following checklist documents:

- ACC/4 (agricultural subsidies): technical assistance from Canada
- ACC/8 (illustrative TBT/SPS measures): technical assistance from the EC
- ACC/9 (TRIPS implementation): technical assistance from the EC

These are purely descriptive and technical documents, and have been discussed in general terms in workshops and seminars conducted over the past several years. For example, the EC sent several missions in late 2004 and early 2005 to help with preparation of the standards checklist, and UNCTAD has conducted a number of seminars reviewing WTO reporting requirements.

Based on discussions at the Ministry of Commerce and Ministry of Justice during the DTIS technical mission, it would seem reasonable for the Foreign Trade Department to take the lead and to manage revisions to the action plan on an ongoing basis, since the document will provide a snapshot of progress the government is making in legal reforms, and the Foreign Trade Department is the focal point for work on WTO accession negotiations. Preparing and maintaining revisions to the document will require close cooperation between the Ministry of Commerce, Ministry of Justice, Prime Minister's Office, and the National Assembly. Donors can provide advice on the format of this document, but they cannot force cooperation between these ministries.

In the medium term, the government should consider working with donors and civil

society to establish independent think-tanks to evaluate policy, the economic and social impact of WTO accession measures, and legislation. Currently, the MOC has its Economic Research Institute for Trade (ERIT) but assistance is needed to strengthen its capacity for research and analysis. Other educational and research institutes in the country include the National Economic Research Institute (NERI), National Organization for the Study of Public Administration (NOSPA), and the Faculty of Economics and Business Administration. The EC have supported the creation of policy and legal advice centers to conduct such research in a number of Eastern European countries, which might serve as models for Laos.<sup>39</sup>

***Conduct economic analysis to support market access negotiations.***

Trade negotiations to date have not been supported by economic analysis of either the benefits or the costs of trade agreements. This observation is not new; it has been raised by others, both in the government and in the donor community. The need for in-house analytical capacity as well as independent research capacity will become critical in the coming years as Laos pursues more bilateral and regional negotiations, in addition to making commitments to WTO members.

UNDP's forthcoming *Laos National Human Development Report*, which focuses on trade, is a first step. The next is to drill down to the product and sector level to evaluate the effects of trade barriers and trade liberalization in greater detail. Analysts can use partial equilibrium models with relatively little technical background and data. Donors can support training of government officials and independent researchers in using this methodology. Many researchers find that computable general equilibrium (CGE) models are

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<sup>39</sup> Examples are the Ukrainian-European Policy and Legal Advice Centre ([www.ueplac.kiev.ua](http://www.ueplac.kiev.ua)) and the Georgian-European Legal Advice Centre ([www.geplac.org](http://www.geplac.org)).

indispensable for evaluating the effects of trade agreements. No CGE model of the Lao economy yet exists. The most cost-effective way to build one is to commission the development of a social accounting matrix for submission to the Global Trade Analysis Project (GTAP), so that the Lao economy can be broken out of the 'Rest of Southeast Asia' aggregate in the GTAP database and made available as a separate module in the GTAP model of the global economy.

In the medium term, donors should work to build the capacity to conduct international economic policy analysis in the government (e.g., ERIT and the National Economic Research Institute), in the Faculty of Economics and Business Administration at the National University of Laos, and in independent think-tanks. Through the International Development Research Centre, Canada supports networks of research organizations in Africa and Latin America. These networks have enhanced the quality of trade policy analysis available to trade negotiators in those regions.

Only this depth of analysis would equip Laos to fully exploit benefits from WTO membership and address the potential challenges.

***Consolidate the trade policy establishment.***

Fragmentation within the Foreign Trade Department also constrains effective trade negotiations. Staff are organized by negotiating forum: the Multilateral Trade Division handles multilateral negotiations; the Bilateral Division oversees bilateral trade agreements; and work on ASEAN has recently been strengthened by moving in teams from the Ministry of Foreign Affairs. Trade agreements in all fora address many of the same issues, however, so this division of labor can prevent staff from developing the necessary experience on specific issue areas and ensuring that different trade agreements reflect the government's economic priorities. Organizing the Foreign Trade Department along functional lines (e.g., services liberalization, tariffs, etc.) would facilitate evaluation of challenges and opportunities Laos faces in its commercial diplomacy. It will also ensure greater consistency across trade agreements.

Any structural reorganization of the Foreign Trade Department is a medium term priority—ad hoc measures to improve coordination across divisions can work in the short term, given the small size of the department. Donor assistance could be useful in funding a functional review of the department and provide support for retraining after reorganization.

## Chapter 5: Tailoring the Logistics Sector to the Export Potential

Much has been made of the fact that Laos is a landlocked country, but this condition has three dimensions—physical isolation from foreign markets, efficiency of logistic services, and availability of infrastructure and border crossings. *Physical isolation* is not a significant problem since the distance between Lao cities and gateway ports in Thailand and Vietnam is less than 700 km, a day's travel by truck.

*Efficiency of logistic services* depends on the quality, variety, and cost of logistic services. These are being enhanced through improved access to logistic services in neighboring countries, especially Thailand. The Transit Agreement with Thailand, proposed in 1999 and ratified in 2004, will expand competition and should provide a significant reduction in logistics costs. Remaining difficulties associated with cost and availability are a result of the small traffic volumes rather than the fact that the country is landlocked.

*Availability of infrastructure and border crossings* (which include the capacity and productivity of the land borders, the international ports and airports) is limited by the number of official international crossings and the cumbersome procedures at both crossings and gateway ports add time and cost and reduce reliability of delivery. Efforts to improve the efficiency of Laos-Thailand border crossings and the Thai ports have been successful but lack consistency and sustainability. As a result, examples of world-class facilitation exist alongside restrictive practices and rent-seeking activities.

The development of the logistics sector has to be tailored to the export possibilities of Laos. Most Lao firms and exporters are small. While larger Lao companies have access to efficient supply chains and can compete with companies in neighboring

countries in select export markets, smaller companies do not have this access and must operate at a competitive disadvantage—at least a week is required to move goods from a Lao factory to the point of loading on a mainline vessel.

Laos increasingly benefits from unfettered access to the Thai transport and logistic system which offers a large number of competing providers and a better quality of service than could be sustained by Lao service providers given the relatively small volumes shipped to and from Laos. This is less true, however, in the case of Vietnam where the border crossings are located far from urban areas and the roads are not as well developed.

The basic strategy for improving supply chains is to reduce intermediaries, minimize cargo handlings, and strengthen domestic logistics service providers while improving access to foreign service providers. This would entail reducing and simplifying procedures throughout the supply chain; developing a consolidation service for small freight shipments; establishing an inland container depot/dry port near the border; and provide technical assistance to the Customs Department and the logistics industry to develop their capabilities.

### 1. Where does the logistics sector stand?

#### Logistics, trade, and exports

*The logistics sector should be evaluated in relation to the trade and production profile in Laos.* The formal private sector in Laos is small both in terms of number and size of firms. There are less than 1,000 registered private firms with assets greater than \$100,000. Less than 100 of these firms have more than 100 employees. Of the 560 firms with 10 or more employees, about half are located in either Vientiane (capital and

province) or Savannakhet. The largest firms are the garment factories, which employ on average about 400 workers. Other medium-sized industries are involved in wood processing and products, construction, tourism, and commercial agriculture and forestry.

Laos' principal trading partners are Thailand and Vietnam. Most of the imports arrive through the capital, Vientiane and Savannakhet province, while the majority of exports are shipped through the South, especially Pakse of Champasack province, where the main producing areas for export commodities (wood, coffee) are located. The volume of trade at different crossing points is underestimated because of the large scale smuggling of consumer goods into and out of Laos along its porous borders (Table 1).

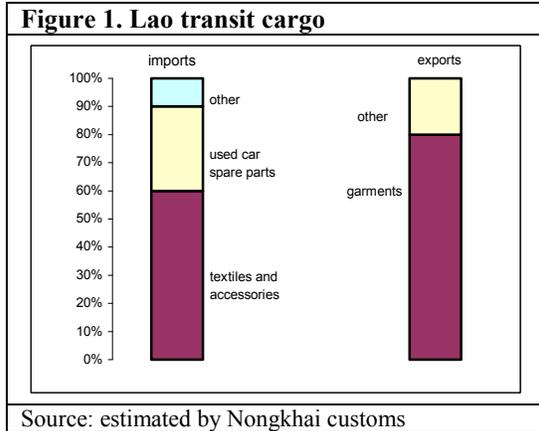
**Table 1. Thai-Lao transit trade**  
(million US\$)

Border Post	To Laos		From Laos	
	2004	2003	2004	2003
Nongkhai	155.36	135.17	145.76	143.66
Mukdahan	6.35	7.20	108.15	33.41
Piboon	18.68	16.83	6.22	6.36
Nakorn Phanom	1.07	0.47	7.18	5.79
Other	1.16	1.59	4.20	6.19
<b>TOTAL</b>	<b>182.62</b>	<b>161.26</b>	<b>271.51</b>	<b>195.41</b>

Source: Adapted from Royal Thai Customs (2005)

*As Lao exports develop, they would need to move to larger orders and tighter order cycles—which require more sophisticated and efficient logistics.* The major export industries—garments, wood products, and food products—transit through Thailand (Figure 1). In the **garment industry**, nearly all inputs are imported. At present, lengthy input supply chains prevent Lao manufacturers from competing in markets with shorter order cycle times, e.g. three months or less. Growth and competitiveness are therefore limited by inbound logistics. Moreover, Lao garment manufacturers do not enjoy economies of scale; they gain some advantage for their size by competing

in the small order market. However this advantage is also disappearing as automation allows even larger Chinese firms to produce orders of less than 10 thousand pieces.



In the **wood processing industry**, most legal exports of logs or simple sawn timber are sent to Thailand and Vietnam for further processing. A relatively small proportion (less than 10 percent) is finished products, e.g. furniture and parquet flooring. The major constraint in the past was the cumbersome logistics associated with procuring natural wood. This has largely been eliminated with the establishment of teak and eucalyptus plantations, which provide an increasing supply of the necessary inputs for production of wood products. The major constraint now is the quality and scale of production. Manufacturers are unable to meet the larger orders and tighter order cycles of the major retailers and must aim for smaller retailers, either within the region or in countries where they have established a special relationship with individual buyers.

In **agriculture**, the low density of production, difficult terrain, and limited road infrastructure result in relatively high transportation costs and reduced competitiveness compared to Laos' neighbors. The production of the major agricultural export—coffee—is concentrated in the Southern highlands on the Bolovens Plateau, which despite its elevation has good

access to the Thai border. Lao producers have also been increasing the volume of fresh vegetables shipped from this area by road to the markets in Bangkok and from Northern Laos to Japan using air-freight. There are also small shipments of glutinous rice to niche markets. None of these involve processing other than sorting and packing (and roasting in the case of coffee) due to the lack of scale and limited infrastructure in the rural areas. The only processed food exported in significant volume is Lao beer, but even this trade is constrained by marketing channels and logistics. Like many other developing countries, Laos has very limited opportunities to expand its food industry because of fundamental changes in international markets. The growing role of large-scale retailers and their demand for large volumes of relatively uniform quality goods supplied throughout the year has precluded small producers from participating. The traditional markets in Europe are becoming increasingly challenging because of the need to deliver quickly, at low cost, and with consistent quality. There are also increasingly stringent phytosanitary standards and requirements for traceability that necessitate not only better post-harvest technologies but also secure supply chains from farm to market. The more attractive outlets for Lao producers are specialty stores, especially ethnic grocery stores, and auctions. They require smaller shipments and less uniformity of product. However, the logistics of supplying these markets can be challenging and entail greater commercial risk, especially for goods sold on consignment.

### Land transport

***Road is the primary mode of transport carrying about two thirds of freight traffic and its share is growing.*** The waterways carry most of the remainder in the form of bulk commodities moving along the Mekong (see map in Appendix 1). The road network includes some 32,600 km of which about one quarter are national roads and less

than 1/6 are paved (Table 2). Because of relatively low road density, a large portion of the population is more than 5 km from an all-weather road and a significant portion of the villages are not accessible during the rainy season.

**Table 2. Lao road network**

	Paved	Gravel	Earth
National	3,830	2,118	1,212
Provincial	337	3,947	4,666
North	1,420	2,180	1,952
Central	1,587	2,149	1,968
South	1,161	1,734	1,957

Source: MCTPC 2002

Recent investments in road infrastructure have focused on restoring the arterial road network—especially NR13 which runs down the center of the country—as well as some links connecting Laos to Vietnam and China. For the latter, the major undertakings were the rehabilitation of the East-West connection between Savannakhet and Lao Bao and the construction of the Northern economic corridor connecting Thailand and China. The National Growth and Poverty Eradication Strategy prioritizes transport infrastructure (along with health, education and infrastructure), and around one-third of the government budget is allocated to the Ministry of Communication Transport Post and Construction, most of which is for road construction and maintenance.

Traffic on the national roads remains relatively light with volumes of 250-1,000 vehicles or less per day. Most of the maintenance of the road network is financed through a fuel levy, heavy vehicle surcharge, international transit fees and road user charges collected as part of the Road Maintenance Fund.

***While the domestic network is limited, much of the country has access to the extensive road network in Thailand*** through major crossings at Nongkhai/Thanaleng, Mukdahan/Savannakhet, and Chong Mek/Pakse. These three main transit

corridors connect Bangkok with the North, Center, and South of the country. Nongkhai is 620 kilometers by road from Bangkok along a four-lane highway that is also used by trucks carrying cargo to and from Northern Thailand. Savannakhet is 663 kilometers from Bangkok on Provincial Road 212 through Mukdahan to Ubon Ratchathani and then via Thai National Highway 23. There are plans to widen this route to four lanes between Laem Chabang and Ubon Ratchathani, which should reduce transit times. From Pakse, the distance to Bangkok is 747 kilometers. The connection is via Lao NR 16 to the border and then via Provincial Road 217 to Ubon Ratchathani. There are bridges at the crossings at Vientiane and Pakse and one is under construction at Savannakhet.

***The connections to Vietnam are not as well developed.*** Under the Agreement on Road Transport signed in 1996 between Laos and Vietnam, eight checkpoints were designated. The major crossing is in the center of the country at Lao Bao, at the eastern end of the East-West Corridor. The distance from Lao Bao to Da Nang port is 260 kilometers. Access to Hanoi/Haiphong port is through Tay Trang (650 kilometers).

These corridors have much less transit traffic than the Thai routes. While they provide shorter access to the sea (Table 3), the roads are narrower, slower, and more difficult to traverse. They cannot support significant container traffic without improvement. Furthermore, the Vietnamese ports do not offer the same level of service as the Thai ports. Most of the Lao imports and exports transiting Vietnam use the port of Danang. Three other ports—Cua Lo, Xuan Hai, and Quy Nhon—are occasionally used. The port Vung Ang, constructed specifically for Lao cargo by the government of Vietnam, does not currently present an attractive option.

The principal corridor is from Kunming through Boten to Houayxay to Thailand. This includes (i) a 198-km, four-lane

expressway just south of Kunming, which is now the main route from Kunming to Yuanjiang; (ii) a 216-km expressway from Yuanjiang to Mohei; and (iii) an existing highway from Mohei to the China-Laos border. The upgrading of the last two is expected to be completed in 2006. The Lao section of the corridor—NR 3, connecting Boten on the border with China with Houayxay on the border with Thailand—is also in the process of being upgraded. Given the good road connections between Bangkok and Singapore and from Kunming to Beijing, the North-South Economic Corridor could eventually extend from the Chinese capital to the tip of the Malay Peninsula.

**Table 3. Distance to International Ports (km)**

	Bang- kok	Cua Lo	Vung Ang	Danang	Vinh
Luang Prabang	1,032	787			
Vientiane	642	397	666	961	
Paksane		257			580
Savannakhet	663		429	508	
Pakse	747		597	553	

Source: World Bank

***There are several border checkpoints with China, but the most promising corridor is the North-South extending from Beijing to Singapore.*** Under the Agreement on International Road Transport between China and Laos (December 3, 1993), three border checkpoints between the two countries were selected (Table 4). A fourth checkpoint is not yet accepted by Laos.

**Table 4. Border crossings into China**

Laos	National Route	China
Boten (Luang Namtha)	NR13	Bohane
Lanthuy (Phongsaly)	NR1	Paksa
Paka (Phongsaly)	NR19	Ban Chom

Source: World Bank

***The most extensively used corridor is the one connecting Bangkok to Vientiane.*** The volume of transit traffic on the other corridors has remained relatively small despite the improvement in the roads.

## **Inbound and outbound supply chains via Bangkok**

Prior to the revision of the Lao-Thai Transit Agreement in 2004 (Box 1), the structure of the basic supply chains for imports and exports had not changed substantially for some time. If the changes allowed under

### **Box 1. Lao-Thai Transit Agreement**

The agreement grants the right to both Thai and Lao trucking companies, private and public, to carry goods between the two countries or in transit to a third country by road or international port. It requires that the trucking companies be licensed to provide international transport services. This licensing can come from either country or a third country that has bilateral agreements with the two. It also requires that the transporters comply with national laws and regulations while transiting that country. At the same time, it prohibits carriage of domestic cargo by trucks registered in the other country and transshipment of the goods to other than domestic operators, while moving in transit through the other country.

The agreement calls for facilitation of the cross-border movement and avoidance of unnecessary customs inspection subject to provision of proper transport document. For overseas shipments, the agreement specifies direct movement between the Laos and either the warehouse for transit goods in Bangkok or directly to/from the ship. Also under this agreement and complementary procedures introduced by Laos Customs, full containers can be moved directly from the factory to the port.

Parallel with this transit agreement, the Thai government relaxed the limitation on transit clearance agents and trucking companies that could be used for goods in transit to and from Bangkok. Originally, only five forwarders/transport companies were authorized to perform this activity. This was later increased to 13 but now the restriction on the transport companies has been eliminated. Under this agreement, these companies can arrange the complete factory-to-port and port-to-warehouse movements but must be bonded. This has led to a dramatic drop in the inclusive freight rates for transport of goods to Bangkok.

this agreement can be combined with a reorganization of consolidation activities cost for the movement of goods between and revision of customs procedures, there would be significant reductions in time and their origin/destination in Laos and the transshipment terminal in Singapore.

***Outbound transport movement.*** The typical supply chains for exports are shown in Table 5.

*Option XI:* The basic movement involves a six- or eight-wheel Lao truck transporting exports from the point of production across the border to Nongkhai. From there, the cargo is transferred in a back-to-back operation to an eight- or ten-wheel Thai truck and transported to the Bangkok ports where it is stuffed into a container and loaded onto a vessel for transport to Singapore. If the consignment is large enough, then the cargo is shipped as an FCL container; if not, the cargo is consolidated with other cargoes having the same destination and shipped as an LCL container. While domestic Lao containers are now allowed for the movement between Nongkhai and Bangkok, mostly Thai containers are used—typically coming empty from Bangkok.

In recent years, shipping lines worldwide have introduced en route reconsolidation, allowing LCL cargo to be consolidated not for their final destination but for their next point of transshipment. This process reduces the time required to consolidate cargo since the container is loaded with cargo moving to the next transshipment port. This is already done in Thailand as some of the cargo shipped out of Bangkok is reconsolidated in Singapore or Tanjung Pelepas, but it is not known how widespread this practice has become.

*Option X2:* A significant savings in time and cost can be achieved by consolidating the cargo into a container at Nongkhai, thus eliminating a more expensive consolidation

**Table 5. Transport chain between export factory and Singapore**

X1			LCL/FCL
X2			LCL/FCL
X3			LCL/FCL
X4			FCL
Origin	Thanaleng	Nongkhai	Bangkok
			Singapore

in Bangkok. This has not been done because of Thai Customs restrictions as well as limitations by the shipping lines on the movement of marine containers outside of the ports.

*Option X3:* Since the new transit agreement allows for direct movement of containers from Laos to the port of Bangkok, it will be possible to consolidate cargoes into containers at the customs facility at Thanaleng and transport them direct to the port. This is already being done.

*Option X4:* In some cases the cargo is loaded at the producers' factories with customs permission and oversight; these containers are then sealed and moved directly to the port after a brief inspection of the cargo documents at Nongkhai customs. Although this arrangement offers substantial savings for FCL cargo, it is not widely practiced. Customs have limited its use claiming a lack of manpower to provide proper supervision. A different arrangement would be required for LCL cargo to be consolidated within Laos. Lao Customs would have to authorize forwarders to provide consolidation services at bonded facilities under their supervision. As there are limited volumes of cargo for individual ports, the time for consolidation of a container would make the service uncompetitive unless the forwarders could arrange for reconsolidation en route. If a dry port were established near Vientiane Capital, then the shipping lines could take

receipt of the LCL cargo and arrange for consolidation up to Singapore where the cargo would be reconsolidated.

***Inbound transport movement.*** The situation for imports is similar as shown in Table 6.

*Option M1:* For the traditional procedure, containers arriving at Bangkok are unloaded and the cargo reloaded into eight- or ten-wheel Thai trucks for transport to Nongkhai where the cargo is transferred to a Lao truck in a back-to-back operation. This cargo is delivered to the customs facility at Thanaleng where it is unloaded and stored. Subsequently, the consignee arranges for inspection and clearance of the cargo after which it is loaded onto another truck and sent for final delivery.

*Option M2:* There are circumstances in which an FCL shipment remains in the container and is delivered to Nongkhai where the container is unloaded. However, this requires customs approval and was relatively infrequent until the recent Lao-Thai agreement was signed.

*Option M3:* Under the new agreement, it is possible for these FCL containers to be transported directly to the customs facility at Thanaleng. There the container is unloaded and stored until the consignee arranges for clearance and delivery of the cargo.

*Option M6:* A more efficient arrangement would be for direct delivery to the consignee's warehouse or a designated bonded warehouse, but Lao Customs has been unwilling to permit this except for certain re-exports delivered to bonded factories.

*Options M4 and M5:* The options available for transporting LCL cargo are more limited. There is no provision for LCL containers to be transported from Bangkok to Nongkhai (M4) or Thanaleng (M5) even under the new arrangement. This requires that an inland

container depot or dry port be established at one of these locations. Then the forwarder or the shipping line would arrange for the container to be moved inland where the container would be unloaded and the cargo stored until the individual consignees clear their cargo and transport it to the final destination. Obviously, a dry port in Thanaleng would be the preferable alternative as it would involve fewer movements and avoid Thai customs.

**Table 6. Transport chains for imports from Singapore to destination**

M1	LCL			
M2	FCL			
M3	FCL			
M4	LCL			
M5	LCL			
M6	FCL			
Singapore		Bangkok	Nongkhai	Thanaleng   Destination

*While direct movements between factory and port would reduce the time and cost of transport, they do not solve the problem of empty backhauls.* Efforts to simplify the transport chain typically focus on the cargo handling activities in order to reduce the time and cost of transport. While the introduction of direct movements (options X4 and M6) will reduce the costs for handling, it will not necessarily reduce the total cost of transport because of the backhaul issue. In order to transport a loaded container in both directions, it is necessary to have cargo available to load into the container within a few days of when it has been unloaded. This must be cargo that will be carried on the shipping line that owns or controls the container and that requires the same type of box (20', 40' or 45', standard or high cube, with or without

special features). If there is no suitable cargo available, the shipping line will move the empty container to the nearest container storage depot. Since there is no such depot in Laos or near the border, the containers return to Bangkok. The situation is more difficult from an export perspective because the shipping line must deliver an empty box to the loading point at the agreed time. If there is no container storage depot nearby, then it must be sent from the nearest depot, in this case Bangkok. For this reason, the transport of a container either inbound or outbound usually involves an empty move and the container thus incurs the cost for a round trip.

Empty backhauls are less of a problem for loose cargo as there are more opportunities for finding cargo for the other leg of the

journey. For one thing, there is no requirement to return to a depot and no need to match the cargo to a specific shipping line. More important, Thai trucks delivering loose cargo to Nongkhai or Thanaleng can carry domestic cargo on the return trip to Bangkok. Similarly, Thai trucks delivering domestic goods to the Northeast can pick up Lao export cargo at Thanaleng or Nongkhai. It is more difficult for Lao trucks to do the same since they cannot carry Thai domestic cargo and it is difficult to coordinate movements of Lao cargo to and from Bangkok.

### Trucking services and tariffs

***The Lao trucking industry is highly fragmented and largely informal.*** There are relatively few articulated trucks and almost no container chassis. The majority of trucks are either very old Russian or used Korean and Japanese trucks. Most trucking is provided by independent operators, with one or two 6- or 10-wheel, rigid body trucks. Even formal (registered) trucking companies have relatively small fleets and rely on independent operators for peak capacity. The characteristics of the four largest fleets are shown in Table 7.

***Lao trucks have difficulty operating in Thailand and are therefore at a cost disadvantage.*** Lao trucks are used for long domestic movements (up to 800 km) and for carrying cargo to Vietnamese ports. They do not operate in Thailand because of certification requirements, alternate side of the road operations and, most important, lack of backhaul cargo. For trade with Thailand, the predominant direction of cargo

is inbound. Lao trucks have trouble competing for this traffic because they cannot carry domestic Thai cargo on the outbound leg. For trade with third countries (international cargo through Thailand), the primary flow is outbound but Lao trucking companies do not have an effective mechanism for booking import cargoes on the return journey. Since Thai trucks are able to carry cargo in both directions, they can quote lower rates. For international trade through Vietnam's ports, the Lao truck operators have resolved the backhaul problem by transporting exports up to the port and allowing the driver to wait on the border during the return trip to pick up shipments from Vietnamese truckers who are unwilling to enter Laos.

***Transit rates through Thailand have dropped as a result of the new transit agreement.*** The trucks used to transport Lao imports and exports are either 18-wheel articulated trucks carrying containers or 10-wheel rigid body trucks carrying loose cargo. The 10-wheel trucks can carry the equivalent of a TEU (up to 25 m<sup>3</sup>), but charge significantly less per trip. Lao 10-wheelers carry cargo from Vientiane to Nongkhai where there is a back-to-back transfer to Thai 10-wheelers for the movement under bond from Nongkhai to Bangkok. Under the new transit agreement, the 10-wheel trucks are able to avoid transshipment at Nongkhai but the cargo must still move under customs bond.

The freight rate for a 10-wheel truck moving between Vientiane and the Thai ports with transshipment at Nongkhai is about Baht 10 thousand, about \$250 at the current

**Table 7. Large Lao trucking fleets**

Company	Vehicle Type	Vehicle Fleet	Purchased	Financing	Market
Boulin	Used Japanese	24 articulated	1997	Self-finance	Lao Beer
No. 1	Old Russian	18 10-wheel	-	Government	WFP, Vietnam
SMT	Used Korean	4 10-wheel, 7 6-wheel, 4 articulated	1998	Bank	Vientiane-Nongkhai
Lao Freight	Used Japanese	5 10-wheel, 2 articulated	-	-	

Source: World Bank

exchange rate (Table 8). In contrast, the freight rate for an articulated truck with 20- or 40-foot container has until recently been between Baht 27-31 thousand, i.e. \$700 and \$800.<sup>1</sup> There was a Baht 8-10 thousand (\$200-\$250) drop in container haulage rates as a response to the revised new transit agreement. Most of rate drop was due to the increase in the number of Thai trucking companies allowed to compete for the haulage of cargo under customs bond rather than an opening of the market to Lao truckers. More than 164 Thai trucking companies have received a permit to transport international transit traffic, although so far only 20-30 have deposited the required one million Baht bond with the Customs Department.<sup>2</sup> None of the Lao trucking companies have received a permit, although some are forming joint ventures with Thai companies that have this permit.

**Table 8. Typical freight rates**

	'000 Baht	US\$	Notes
<b>10 wheel truck - one way</b>			
Nongkhai-Bangkok	9.5	245-275	
Vientiane-Nongkhai	2.5	60-80	
Vientiane-Bangkok	15.6	400	
<b>Articulated truck (loaded 40' container on trailer with empty return)</b>			
Thanaleng-Bangkok			
Before	27-31.2	700-800	freight only
	39-47	1000-1200	all in
Now	19.5- 21.5	500-550	freight only
	33.2	850	all in
	36.0	925	40'

"All in" includes clearance charges and handling

Freight rates now appear competitive assuming a load factor of 85 percent for a 10-wheel vehicle and 65 percent for an 18-wheel truck. While there may be some further reduction in rates if competition increases and load factors improve, this will

<sup>1</sup> Because of similar transport distances, the rates charged for the movements between Bangkok Port and either Pakse or Savannakhet are similar to those for Vientiane.

<sup>2</sup> The rest limit their activities to direct trade between Thailand and Laos.

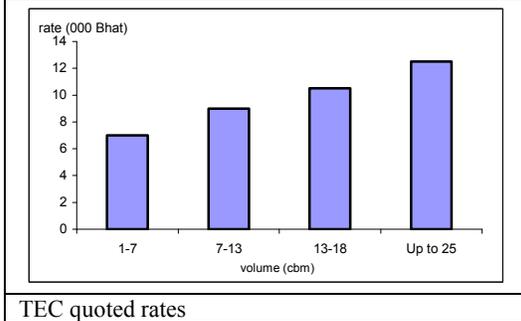
be marginal as transit rates are rapidly approaching parity with domestic movements for comparable distances.

*Further reductions in the door-to-port charges for movements of Lao exports and imports will derive from fewer cargo handlings and lower agent charges.* Agent charges currently amount to about \$300-\$350 for a 40-foot container. This charge includes a fee for clearance of the container at Bangkok Port, Nongkhai or Thanaleng of about Baht 2.5-3 thousand, exclusive of duties. In addition, there is an unloading fee at either Bangkok or Thanaleng of Baht 1-2 thousand and a slightly higher fee for transshipment at Nongkhai.<sup>3</sup> There is also a refundable security deposit, which can amount of \$2,500 per container, that is paid to the shipping line for containers leaving the port as well as demurrage charges for any delays. With the simplification of movements allowing containers and, eventually loose cargo, to bypass Nongkhai, there should be a drop in handling charges of about Baht 2 thousand per container/truck. Increased competition among clearance agents should yield an additional savings of 1-1.5 thousand Baht.

*Of the various logistics problems facing Lao foreign trade, the one that has the greatest impact on competitiveness for the SMEs is the cost for moving LTL/LCL cargo.* The transport of loose cargo is charged based on volume (Figure 2), unless the shipper pays for the entire truck. Assuming a capacity of 25 m<sup>3</sup> for a 10-wheel truck, then the charge for a load of mixed consignments would range from 19.5-21 thousand Baht for two consignments to 30-35 thousand Baht for five consignments. Since this is significantly more than the truck rate, shippers ship their goods on partially loaded trucks. It should be possible to eliminate this problem through efforts by consolidators in Vientiane or Nongkhai.

<sup>3</sup> The usage fee levied at Thanaleng by the Lao Authorities is around \$90 per truck

**Figure 2. Freight rates for LTL movements Nongkhai-Bangkok**



### Transit time

One of the major concerns of Lao exporters is to improve transit time—inbound carrying inputs for production and outbound delivering products to the market. In order to understand where the bottlenecks occur, it is necessary to consider the total order cycle (Table 9). Lao producers of high value goods can meet order times of 1-2 months when using airfreight or shipping to regional markets. Otherwise, the typical order time is around 3-4 months.

In order to identify the appropriate initiatives to reduce the order time, it is necessary to distinguish between the domestic/transit component of the supply chain and the international component. The domestic/transit component includes the movement between the Lao origin/destination and the port at which the cargo is loaded to/unloaded from the mainline vessel. For this component, time and reliability of these movements are less of a problem because the supply chains are relatively simple and the distances relatively short.

*The time for the outbound movement from Vientiane to Bangkok is short and predictable.* The time from Vientiane to the Bangkok port has been about 1½ days and the time in port prior to loading has been 1-3 days (Table 10). The time is shorter for FCL containers. The cargo then moves on daily scheduled feeder services to Singapore or on less frequent services to Port Kelang,

Tanjung Pelepas, or Hong Kong, where it is transhipped to the mainline vessel.

**Table 9. Generic order cycle**

Actor	Activity	Time	Mode
Buyer	Order Product	2-60	Phone, Fax, email
Buyer	Open Letter of Credit	1-2	
Buyer, Producer	Order Input Materials	1	Phone, Fax, Email
Supplier	Production of Inputs	7-14	
Supplier	Ship Supplies to Bangkok	1-2	Air
Producer's Forwarder	Clear Cargo	7-14	Water
	Transport Supplies to Thanaleng	1	Road Transport
Clearance Agent	Clear Cargo	½	
Producer's Forwarder	Deliver Supplies to Factory	½-2	Road Transport
Producer	Production	14-42	
Producer's Forwarder	Ship Product to Bangkok	1	Road Transport
Forwarder	Clear Cargo	½	
Forwarder	Load Ship	1-2	
Shipping Line/Airline	Shipping Line to Destination Port/Airport	1-3	Air
		14-28	Water
Buyer's Forwarder	Ship Product to Final Destination	1-4	Water of Air Transport
Producer	Receive Payment	1	Electronic Transfer
	Total (excluding Order Time)	33-60	Airfreight
		53-120	Sea Freight

Source: World Bank

**Table 10. Outbound transit times**

	Time	Distance
<i>Travel times</i>		
Vientiane-Nongkhai	1 hour	24 km
Nongkhai-Bangkok	1-1 ½ days	640 km
Port	7-11 hours*	
<i>Sailing times</i>		
Bangkok Port–Singapore	2 days	831 n.m
Danang–Singapore	2¼ days	940 n.m
Bangkok Port–Hong Kong	3 ½ days	1490 n.m.
Danang–Hong Kong	1¼ days	520 n.m

Source: World Bank

Because the feeder vessels operate on day-of-the-week schedules out of Bangkok ports, exporters can schedule their shipments from the factory to the transshipment port with relatively little slack time. From Bangkok, there is a two-day sailing time to Singapore where the shipment is loaded on the mainline vessel nominated by the buyer.<sup>4</sup> The slack time in Singapore to catch the mainline vessel can be as little as one day or as much as five days. The average is about two days implying that within 6-8 days from leaving the factory, the cargo can be onboard a mainline vessel headed for its major destination. The recent revisions in the transit agreement should simplify the movement from factory to port allowing a reduction in transit time of ½ day.

The movement from Vientiane to Bangkok can incur unexpected delays due to Thai customs procedures but this rarely exceeds 1½ days. The reliability is relatively high for movements from Bangkok outward because these are all scheduled services and are generally chosen by the buyer to meet a fixed delivery date. The time in port has become shorter and more predictable so that the exporter can schedule the entire movement from the factory with a high degree of reliability.

*The inbound movements are similar in timing except for the customs clearance times, which are longer and less predictable at both the Thai ports and Thanaleng.* The typical time in Bangkok is 2-4 days. In Thanaleng it is 1-2 days assuming there is no problem with documentation. Although there have been significant attempts at reforming both the

<sup>4</sup> An analysis of the supply-chain for garments moving from Vientiane to Rotterdam considering alternative routes indicated that the route through Danang cost nearly \$1,000 more for a TEU than through the Thai ports. The route through Port Kelang, although a longer distance by land, offered some advantages because it has direct calls.

Thai and Lao customs, their performance remains unpredictable and their procedures lack transparency. If the revised transit agreement were fully implemented and Lao Customs re-established its procedures for clearing cargo at the warehouses of the larger traders/manufacturers, then it should be possible to reduce the time from unloading at Bangkok port to when the container is delivered to the consignee to 4-5 days for most shipments.

### Ocean shipping cost and time

*The impact of the improvement in logistics on exporters depends largely on the size of the exporters and the value of their exports.*

The freight rates and sailing times for the transshipment ports with destinations to Europe and the US West Coast are shown in Table 11 along with the frequency of service.

**Table 11. Shipping rates from Thai ports via Singapore**

Destination	USD 20'/40'	Transit Time	Frequency
Singapore Port	420/830	2	Daily
Port of Tanjung Pelepas	420/830	2-3	2-3 times a week
Port Klang	550/900	3	Weekly
Rotterdam Port	1400/2800	18-22	Weekly
Los Angeles Port	2000/2600	16-20	Weekly

Notes: FAK Rates to Singapore & Port Klang inclusive of bunker adjustment factor (BAF); Rotterdam's rate inclusive of BAF but subject to currency adjustment factor (CAF)  
Source: Compiled from industry

Logistics costs from the factory to the destination port are 15-20 percent of the C&F value to Europe and North America for low value shipments such as knock-down furniture, but as little as 4-6 percent for high value shipments such as specialty garments. This means that a further reduction in the cost of inland movement of \$200 for high-value products would represent a reduction in C&F costs of only about 1 percent.

The movement from the factory to Bangkok port amounts to only about 1/10 of the total trip time from factory to destination port in Europe or North America but about 1/3 and 1/5 of the cost for the movement, respectively. This proportion is larger for smaller containers since the land transport costs are not significantly different between a 20' and 40' box, whereas the ocean freight for a 20' box is lower by almost 50 percent. The proportion is even higher for LCL shipments, since the land transport costs are much greater but ocean freight rates are the same.

Since most of the competition faced by Lao exporters is from within the Asian region, the relevant cost comparator is C&F Singapore. Although the inland movement accounts for about 80 percent of the logistics cost up to Singapore, it accounts for only about 6 percent of the C&F value for low value goods and 1½ percent for high value goods.

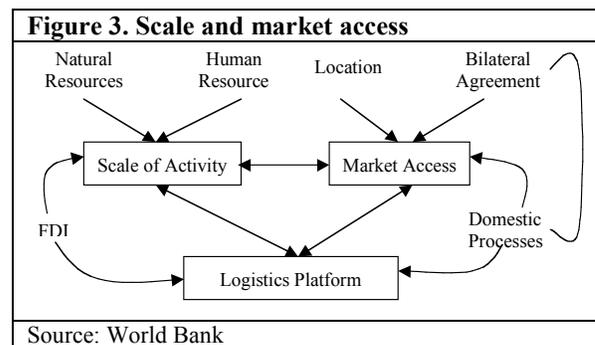
Improvements in logistics will therefore have relatively little impact on the competitive position of the larger exporters producing medium to high value goods for export to Europe and North America. In contrast, the benefits will be significant for exporters of low value goods and also those exporting within the region. The greatest benefits will be for the smaller exporters who use a significant amount of imported inputs and whose shipments are primarily LCL cargoes in 20-foot containers.

## 2. What can be done?

### Developing logistic services tailored to small-scale shipments

An effective logistics platform is needed to create competitive advantage for exports and establish an efficient distribution system for imports. Two factors can improve competitive position—scale and market access (Figure 3). Scale is constrained by the availability of resources—not only capital and materials but also human

resources, especially managerial skills. Access is determined not only by location relative to the principal markets and major transport routes but also by the agreements governing bilateral and multilateral trade and cross-border movements of goods.



*Since Lao production activities are limited in scale, they require a logistics platform capable of handling smaller shipments efficiently.* Because market access is limited by lack of a major gateway, minimum ICT infrastructure, and cumbersome shipping processes, it is necessary that this logistics platform has simplified supply chains and efficient communications among the participants in the supply chains. It is also necessary that the logistics platform has low transactions costs and high reliability in meeting delivery schedules while supporting a variety of cargo forms and shipment routes.

Much of the polemics associated with the high cost of transport for landlocked and other isolated countries, ignore the fact that small cargo volumes are more costly to transport.<sup>5</sup> Since Lao companies are small-to-medium scale, they are at a competitive disadvantage in terms not only of cost of production but also marketing and logistics. For marketing, larger transactions produce lower unit costs as well as a larger revenue base to support better quality marketing

<sup>5</sup> For example, it is much less costly to ship goods to Europe from China rather than from Bangkok and to Manila from Bangkok rather than from Mindanao.

efforts. For logistics, the unit costs of transport and documentation decline with the size of consignments. In addition, larger volumes attract greater competition among providers and more frequent service.

Lao exporters have sought to overcome the disadvantages of size by focusing on market niches that are less interesting to larger producers. This implies contract manufacturing for smaller retailers who require more personalized service and smaller orders. These markets require greater agility to respond to changing demand and more frequent design changes. Buyers assume responsibility for design, quality control and marketing and provide most of the inputs and logistics.

***For smaller exporters, improvements in logistics require strategies to consolidate cargo in order to achieve economies of scale.*** Most inputs are procured C&F Bangkok while products are sold FOB Bangkok. Since the suppliers and buyers nominate the port and shipping line, Lao exporters' control over the supply chain is limited to domestic movements. They use Lao forwarders for exports and Thai forwarders for imports. A significant portion of exports are transported as loose cargo from Laos then consolidated by Thai forwarders in either Nongkhai or Bangkok. The reverse process applies for inputs. In order for smaller exporters to improve their logistics, they need better opportunities for consolidating cargo in order to take advantage of economies of scale in transport. To achieve this it is necessary to strengthen the abilities of freight forwarders to handle these shipments both individually and with their international partners.

Only as their business grows can producers expand their role in terms of value added and thereby strengthen competitive position. For supply chains, this implies the development of efficient logistics for increasing shipment sizes. At present, only a few large exporters are able to ship containers from their factory, it is necessary

that all be able to receive and ship containers at their factory. Initially this would require reliance on Thai logistics providers to arrange the shipments from/to Bangkok, but eventually Lao forwarders would participate.

***At the same time, it is necessary to develop larger transport companies in order to improve fleet management.*** To improve the quality of road transport, it is necessary to develop larger transport companies with improved fleet management. Not only does this allow these companies to handle larger orders but also to improve their efficiency by automating cargo booking and fleet management. While it would be difficult to increase the size of these firms through capital investment given current market conditions, they can be expanded through mergers and contracting arrangements. Mergers among Lao companies involved in international road transport would not affect competition since there is increasing number of Thai companies entering the transit market as a result of the new transit agreement. They would have little impact on competition in the domestic market given the highly fragmented structure of the trucking industry. Alternatively, larger firms can expand through subcontracting of independent truckers as well as joint ventures with larger Thai logistics providers. Both are already occurring.

The need for increased shipment size and improved fleet utilization suggests that certain proposals for improving transport are unlikely to succeed. For example, the utilization of the Vietnamese port specifically constructed for Lao cargo is unlikely to be attractive because there is insufficient cargo to attract larger, more efficient vessels. The frequency and range of services offered are not comparable to those available in Bangkok or Danang. Similarly, the proposed extension of the Thai rail system to Thanaleng is unlikely to offer a competitive service. While it would permit an increase in the size of shipments, and lower cost transport for fully loaded 40'

containers and empty containers, there is insufficient traffic to justify an acceptable frequency of unit train operations.<sup>6</sup> Without a daily service from Nongkhai, road transport would continue to be dominant and rail would only carry the less time-sensitive empty containers.

***Access to the transit market is still limited.***

For logistics service providers, access to the market for transporting transit cargo is limited. While the new transit agreement nominally provides open access for Lao transporters, the procedures for licensing Lao trucks and drivers to operate in Thailand is less clear. Furthermore, in order to compete, Lao trucking companies will need to invest in new trucks that can operate efficiently in Thailand and to improve management capacity and skills in order to compete with the relatively well-organized Thai logistics industry. Lao forwarding companies do not have brokerage services to arrange backhaul shipments from Thai and Vietnamese ports. The limited information regarding availability of loads, especially for backhaul moves, increases the cost of transport.

***Efforts to increase market share of Lao providers can be done through joint ventures with Thai and other foreign companies.*** Most of the major integrated international logistics service providers, 4PLs, have regional offices in Bangkok and provide a full range of services. In Laos, there are limited business opportunities so they provide transport services primarily for project cargo, personal effects, and donor supplied imports. Foreign sellers and buyers have difficulty nominating Lao logistics service providers because they lack

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<sup>6</sup> The only existing unit train operation in Thailand is between the port and rail ICD at Lad Krabang. In order for the State Railway of Thailand (SRT) to consider offering daily rail freight service in Nongkhai to and from Thai ports, there should be freight traffic of at least 40 to 50 TEUs both ways. The SRT maximum wagonload is 36 tons on an 8 wheel- bogey and 15 tons and a 4-wheel bogey.

knowledge of their qualifications. Efforts to increase market share of Lao providers must be done through joint ventures with Thai and other foreign companies. Indeed, both SMT and Lao freight have already developed such relationships but their participation is generally limited to the movement up to Nongkhai.

**Reducing regulation**

The current emphasis in the global market is to reduce order times. This places additional pressure on exporters to reduce their delivery times for inputs and lead times for export. Bureaucratic procedures that delay these transactions create a competitive disadvantage. They also discourage potential foreign investors interested in establishing trade-oriented businesses. Since these investors have multi-country operations, they cannot jeopardize their reputation with customers by establishing production activities that cannot meet agreed delivery schedules or adjust production to changes in demand.

***While efforts to reduce regulatory delays usually focus on improvements in the customs procedures, more significant delays and impediments result from government controls over import and export.*** Laos' procedures are among the most restrictive in the region (see Chapters 2 and 6). These require not only registration of companies that engage in trade, but also annual trading licenses specifying the volume that will be traded, and authorizations for each shipment that must be checked against the annual allocation. The time required to obtain these authorizations is said to average about two weeks because of the need to process the documents through different agencies, each in a different location. For importers and exporters located outside of Vientiane Capital, there is the additional delay of processing the documents through the provincial offices. These procedures combined with the requirement to prepare a plan of annual imports requirements may be

appropriate for a closed economy but are inappropriate for an open economy actively involved in trade. Relatively few exporters have annual orders from their buyers. Instead they must be able to respond quickly to new orders. These orders have at most a six-month lead-time and during that period, it is likely that there will be adjustments in the amount ordered. Even for manufacturers with long-term orders, these represent only a portion of their total output.

***In contrast to this heavy-handed regulation of trade transactions, Laos has minimal regulation of logistics services.*** This is advantageous as logistics is a dynamic area. Significant changes are continuing to occur in supply chain management and the configuration of 4<sup>th</sup> party logistics. Attempts to regulate this industry would limit its ability to change and discourage participation by foreign service providers.

Market forces should be sufficient to regulate performance especially where there is competition from international providers. However, a proactive approach will be required by the industry to upgrade the quality of its services. While there have been some efforts by LIFFA to provide training, more needs to be done to improve standards and make both the providers and users aware of these standards. Formal regulation can contribute to this effort by improving the allocation of liability for cargo losses and for providing cargo insurance for logistics companies at reasonable prices. It can also be used to facilitate customs clearance by licensing customs clearance agents. Currently there is no such requirement and consignees clear about 80 percent of the goods delivered to Thanaleng. This not only increases delays and malfeasance but also discourages the introduction of modern procedures and technology. Furthermore, without a professional clearance agent organization, Lao customs has no channel through which to communicate changes in procedures.

Another area in which government regulation could enhance trade is product certification. The government should take an active role in enforcing standards applied by trade partners, e.g. quality of material used, country of origin, and chemical content. This does not imply that government labs should do the testing, as these are usually inefficient and often ineffective, but rather that the government should oversee private testing facilities and reporting procedures (see Chapter 7 on SPS).

### **Implementing the transit agreement with Thailand**

Many of the features of an effective transit corridor through Thailand have been implemented on a piecemeal basis. The 2004 agreement between Laos and Thailand for movement of goods in transit is an attempt to introduce a more comprehensive arrangement.

While this agreement has provided significant liberalization in the movement of goods between Laos and Thailand, full implementation will require further clarification concerning the following:

- *Requirements that Lao trucks must meet in order to operate on Thai roads.* While the transit agreement allows for Lao truck operators to haul transit cargo to/from Bangkok, there is the usual provision requiring that these trucks conform to local regulations. These regulations should not be a serious impediment, but without a clear statement of what regulations apply, it is likely that the initial efforts of Lao truckers to operate in Thailand will fail.
- *Procedures for sealing cargo in transit.* Thai customs continue to remove the seals from import containers destined for Laos and affix their own seals. They also continue to replace Lao seals with their own on export containers at the time they enter Thailand. There is no reason to replace these seals or to inspect the contents of the containers,

- except in exceptional situations and then only in the presence of Laotian customs.
- *Procedure for bonded movements.* Within Thailand, TIFFA provides Thai trucking companies with guarantees for payment of duties for goods moving in transit should they fail to exit Thailand. The trucking companies must also be bonded for carriage of goods in transit. Comparable arrangements need to be established for Lao truckers and forwarders possibly through a joint arrangement with TIFFA.
- *Service charges for transit movements.* The agreement leaves these extraneous charges to subsequent discussions, but indicates that they should not exceed the rates for comparable domestic services. It is important not only to agree on these rates but also to make them known and to provide better enforcement in order to reduce informal charges

#### **Improving customs procedures for transit**

*Despite recent improvements, the Lao customs procedures for clearing imports and exports and the Thai customs procedures for clearing transit cargo do not yet meet international standards.* The process for clearing import and export cargo has been greatly simplified in recent years. The commodity classification has been converted to the Harmonized System (HS). A single administrative document similar but not identical to the UN Layout Key format was introduced in 2000. This document is used for imports, exports, and transit goods, and replaced 16 documents. Direct clearance of goods at the factory is permitted in certain situations. The average time to clear cargo has been substantially reduced both in Laos and at the transit facilities in Klong Toey. Despite these improvements, the Lao customs procedures for clearing imports and exports and the Thai customs procedures for clearing transit cargo remain unnecessarily cumbersome. Furthermore, some of the gains achieved through past reforms have been offset by new procedures that add costs, both formal

and informal, without providing significant advantages. An example is the decision to require all imported fabrics and other inputs for garment manufacturing to be cleared at Thanaleng rather than at the factory.

Without discounting past efforts to improve procedures, Lao Customs has not adopted a policy of facilitating trade. It continues to introduce new regulations without consulting stakeholders or considering the impact on trade facilitation. A recent example is the decision in 2004 to stop clearing any imports at the warehouses of larger importers and to require they be cleared through Thanaleng. This not only increased the handling costs but also the damage to cargo as a result of third parties involvement in the handling of cargo.<sup>7</sup>

*The practice of changing customs procedures without sufficient advance notice is particularly troublesome for small-scale importers and exporters.* Large firms have frequent interaction with customs officials and stay informed of changes in procedures. They can adjust more easily even when this involves additional costs, both formal and informal, and delays. Smaller industries interact less frequently with customs and have difficulties responding to changes they see as arbitrary and unpredictable. As a result, they are more likely to experience significant delays and losses each time a change is introduced.

A similar form of discrimination against smaller traders occurs as a result of variation in customs procedures at different border crossings. Both appointments of customs officials and control of their activity are a provincial rather than national responsibility. Since customs lacks a unified management, there is considerable variation in performance and in the level of informal payments. As a result, cargoes are

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<sup>7</sup> It also reduces accountability as claims for damage could not be processed without delaying the delivery of cargo and increases levels of informal payments

often rerouted several hundred kilometers (from Vientiane to Savannakhet) to obtain more favorable treatment. Larger traders are able to reroute cargo to exploit these differences but small and medium size enterprises do not have similar opportunities due to the small size of their shipments.

Although Lao Customs procedures are intended to reduce the level of illegal trade, most illegal trade occurs not at the border crossings but along the long stretches of Laos' porous border. Illegal imports have the benefit of avoiding not only duties and taxes but also informal costs and delays involved in complying with customs procedures. As a result, many of the procedures introduced by customs have been counterproductive.

For Lao Customs, the most important reform goals to speed up transit goods include: (i) an institutional commitment to trade facilitation in accordance with the goals for the Kyoto Convention; (ii) immediate attention to clearance of goods under temporary admission and associated exports; (iii) establishment of bonded facilities at exporters' factories allowing containerized goods, both inbound and outbound to be cleared at the factory. The changes in procedures needed to address problems of transparency and corruption are:

- reduction in the number of signatures required,
- computerization of customs documents,
- introduction of direct trader input and channeling.

As is common for most countries, there are also a number of complementary certification procedures associated with obtaining health, safety, and environment. These occur in parallel with customs procedures but are not as closely monitored. Although they only affect certain cargoes, they can be significant sources of delay. Parallel efforts are needed to simplify and

computerize the procedures and documents used by these other departments.

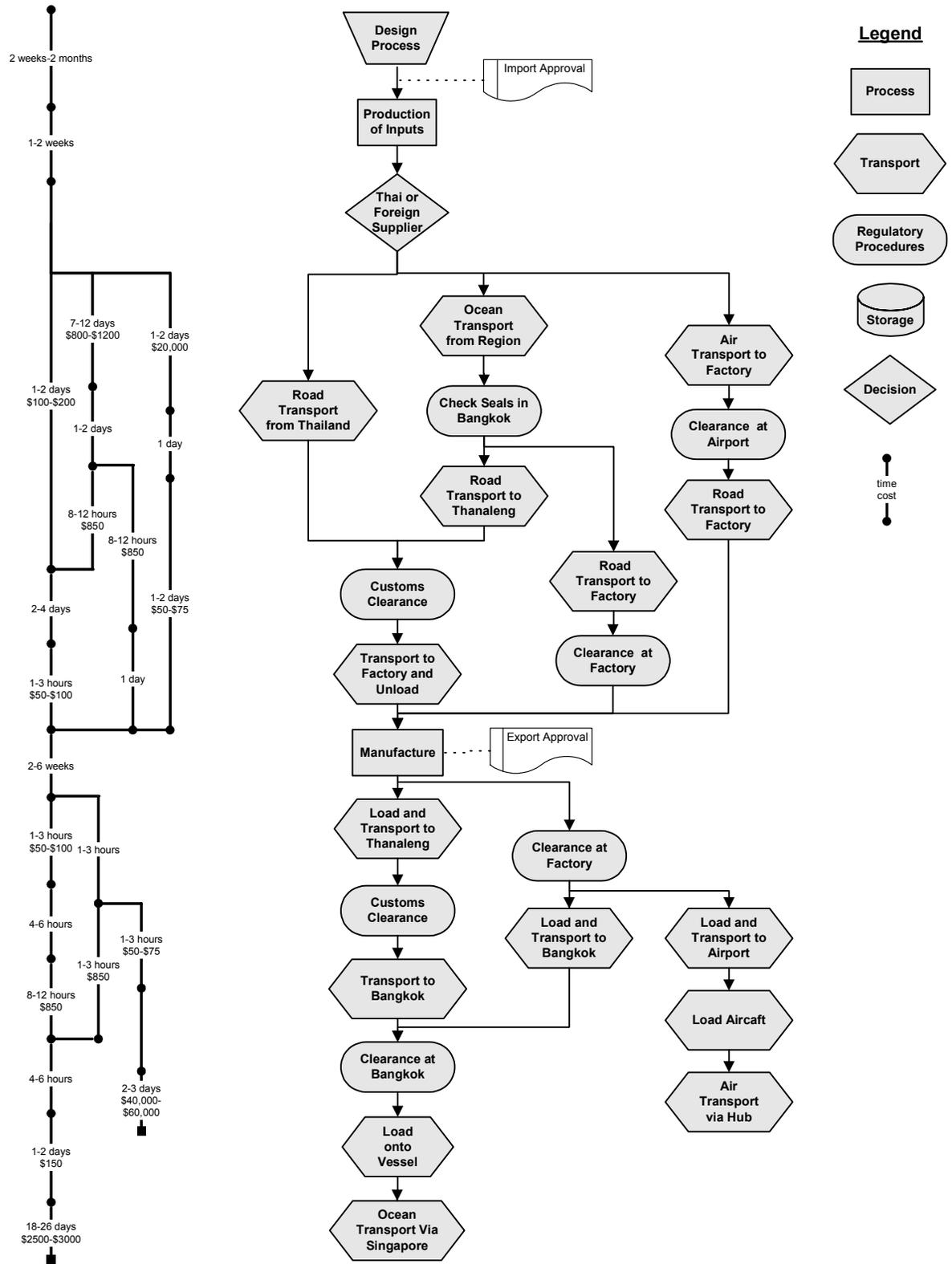
***Improvements in Thai customs procedures are necessary.*** The new transit agreement with Thailand, if fully implemented, promises to greatly simplify the movement of goods. As part of the implementation, Thai customs procedures regarding transit cargoes need to be brought in line with international practices. This extends beyond the problems of lack of transparency and informal payments. Although Thai customs have established a procedure for a time-bound movement of transit goods under bond, they continue to inspect cargoes, including containerized cargo, at the point of entry, and to replace the seal placed on the container by the customs authority at the point of shipment. This practice appears to have arisen because of an ambiguity in the Customs Law regarding handling of transit cargoes. If this is the case, then an amendment to the Law should be introduced.

Vietnam has more restrictive procedures than Thailand. As a result, Lao importers and exporters rarely use these routes. This is unlikely to change significantly despite with the current MOU for developing a common border crossing facility. Even with significant simplification in procedures, there would still be major disincentives due to the longer travel times, poorer road networks and fewer sailings from the Vietnamese ports. Danang currently handles only about 35 thousand TEU versus over 3 million TEU for the ports in Bangkok.

### **Improving supply chain performance**

The options for improving supply chain performance can be understood by considering the typical supply chain for garments shown in Figure 4, which includes both the inbound chain for inputs and the outbound chain for products. The times for the various logistics activities are estimates based on current performance. The transport costs are for loaded 40' containers.

**Figure 4. Supply chain for garment production**  
(Cost per FEU/16-20 tons)



The costs for cargo clearance have not been included but, exclusive of duties, these would be relatively small. Various modal options are included. The imports are trucked from suppliers in Thailand or shipped by water or air from suppliers elsewhere in East Asia. The exports are shipped by sea or air to destinations in Europe and North America.

The different modal combinations produce different ranges of order cycle times. Most of the variation in time for each combination is explained by the time for manufacturing, which can range from 2 weeks for smaller orders to 6 weeks for very large orders (exclusive of the time for the design phase). Because of cost, most shipments use either a road-ocean or ocean-ocean combinations. Assuming that the transactions associated with procurement, order processing, licensing for import and export shipments, other government approvals and financing add another two weeks, the cycle time would be 2-3 months. If this is an initial order for a specific product, then there is also the time for design which can be as little as two weeks but is more likely to be at least a month. The result is an order cycle of 3-5 months (this can be reduced by about ½ month using airfreight for the outbound movement, but the increase in cost is prohibitive except for high value cargo).

These order cycles have improved in recent years as transit times to/from Bangkok have decreased, the frequency of feeder services at Thai ports have increased and the times for port and customs clearance has been reduced. Additional reductions will be more difficult to achieve. The restoration of the practice of clearing both inputs and products at the point of manufacture could reduce the order cycle by an estimated of 2-4 ½ days. Simplification of the procedures for moving containers inland could provide an additional savings of about 2 days for imported inputs but at most a day for products being exported. Maintaining an inventory of inputs could reduce the order cycle by 1-4 weeks. However, this is only

possible for repeat orders and presents a significant commercial risk unless there is a firm order.

Significant savings in the costs for logistics will be more difficult to realize. Additional reductions in the cost for door-to-port and port-to-door transport could provide a savings over about \$400 or 8-10 percent. Simplification and automation of customs procedures would reduce the informal costs for clearing cargo and allow manufacturers to take advantage of the temporary admission status for inputs. These informal costs have not been determined but the savings would likely be in excess of \$500 for an FEU shipment of inputs (imports) plus a similar shipment of products (exports).

If the growth path for Lao exports is to focus on niche markets, then it is necessary to look at the flexibility of the complete supply chain. This includes not only logistics but also the facilitation of other non-production activities. Supply chain management involves not only efficient movement and storage of goods but also rapid information flows, low cost financial transactions and tight control on product quality throughout the supply chain. This has not been a problem because of the simple structure of the supply chains and because the exporters' control over the chain is limited. The practice of purchasing inputs on a C&F Bangkok basis and selling them on an FOB Bangkok basis has limited the role of Lao and Thai forwarders to control of the port-factory-port movement while international forwarders manage the foreign portion of the movement. However, if Laos is to expand its trade and compete effectively with its neighbors, it will have to further shorten order cycles while guaranteeing the same order fulfillment rates offered by competitors in the surrounding countries. This will require tighter integration of movements and further reduction of procedural delays at the borders and gateways. This will also require greater use of ITC systems to speed the transmission

and processing of information and to make procedures more transparency.

Assuming that growth in Lao trade derives from an increase in the number of small-scale producers rather than the introduction of large-scale factories, similar to those in Vietnam and China, then the supply chains will have to handle larger numbers of smaller shipments. They must also provide greater flexibility and variety. Airfreight shipments are expected to increase as exports of perishables and high value goods increase. Door-to-door movements are expected to increase as buyers order for delivery to specific retail outlets or inland distribution centers. Most important LCL movements are expected to increase.

### **Developing LCL logistics**

The development of an efficient supply chain for small shipments, specifically LTL or LCL consignments has been slow to evolve. Consolidation was traditionally performed at the port of export. This procedure allows shipment of full container with mixed consignments so as to minimize the logistics cost, including those for handling of and damage to cargo. However, it also increases transit time by as much as one week while waiting to acquire sufficient cargo for onward shipment to the destination port. Furthermore, it was only applicable for the shipments going to the major destinations.

Over the last decade, forwarders and shipping companies have combined improvements in consolidation strategies developed by global manufacturers and larger retail chains with advances in electronic interchange of cargo data to introduce a new strategy involving multiple consolidations in a door-to-door movement. The initial consolidation occurs close to the source of production while the final deconsolidation occurs close to the

destination.<sup>8</sup> This process reduces the delays for each consolidation. It also increases the portion of the trip from origin to final destination that is containerized. This strategy is information-intensive but not necessarily capital intensive and can be replicated for relatively small traffic volumes.

Each consolidation is for cargo that is routed through the next major transshipment hub. This expands the range of eligible cargo that can be loaded in a container, thus reducing the time to fill that container. With the decrease in the cost of deconsolidating a container and cross-loading its contents into other containers, the trade-off between time and cost favors more frequent consolidations. Shippers of individual consignments benefit from the savings associated with a door-to-door container movement. Such a system would significantly improve the competitive position of the smaller Lao exporters, which export primarily LCL shipments.

The challenge is to replicate this system despite the small volume of traffic. There have been efforts in this direction already, as cargo is being consolidated into domestic containers for shipment to Bangkok. But so far this has not been cost competitive as the cargo typically moves in an open truck. In order to be competitive, movements in domestic and maritime containers must be tightly integrated. This requires improved cross docking in Bangkok and better

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<sup>8</sup> As a hypothetical example, for a shipment from Vientiane to Brussels, the cargo would initially be consolidated in Vientiane in a domestic container with other goods destined for Bangkok. It would then be reconsolidated in Bangkok in a marine container with other shipments for Singapore. At Singapore, the cargo would be reconsolidated in a marine container with other shipments for Rotterdam. At Rotterdam the cargo would be reconsolidated in a van with other cargo destined for Brussels. A shipping company or international forwarder would arrange this entire movement.

integration between domestic and international freight forwarders and transport companies.

At present, most of the consolidation into maritime containers takes place at the transit warehouse located in the port. There is some consolidation of both maritime and domestic containers as part of the back-to-back transshipment operation on the Thai side of the Friendship Bridge. This activity could be shifted to the exporter's factory if there is sufficient volume or otherwise be performed at a bonded container freight station equipped for cross-docking operations. The service should be provided by the private sector on a competitive basis. Because of the need to coordinate the deconsolidation/ reconsolidation activities, it may be necessary for the same party to provide the service in both Vientiane and Bangkok.

The system could also be used for consolidated shipments of imports. If a container has multiple consignments, it should be possible to move the container directly to Laos for deconsolidation.<sup>9</sup> However, if the container has a mix of consignments with some for Thailand, it would be necessary to deconsolidate in the port. The Lao cargo could then be reconsolidated into a domestic container and moved under bond to the deconsolidation warehouse in Laos.

A system for efficient movement LCL shipments between Laos and the Thai ports would require not only consolidation/ deconsolidation services at each end but also secure transport and the supporting information systems. An efficient land transport service for consolidated shipments would make use of enclosed vans, domestic containers or maritime containers depending on timing and cargo availability. These

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<sup>9</sup> The current requirement of Thai customs that the cargoes be deconsolidated in Bangkok does not appear to be consistent with the transit agreement or with international practice.

would ensure the safety of the cargo while allowing for proper sealing of the cargo. The seals would be modern electronic seals possibly with RFID to provide additional comfort to the Thai customs. This transport services would be contracted from Lao land Thai trucking companies operating under the recently signed transit agreement, which allows for consolidated loads to move directly from the factory or bonded consolidation warehouse to the port.

An information system is required to coordinate and track the handling and transport of individual consignments. This system should also have the capability to prepare plans for the deconsolidation/ reconsolidation activity and report on the contents of the domestic containers to customs and the logistic services providers. Eventually it should provide information on the location of individual consignments in a domestic container or marine container in order to speed the cross-docking operation and coordinate the movement of the reconsolidated shipments to the seaport or airport from which the goods will be exported.

The information system should also be integrated with the information required by Lao customs, initially as hardcopy and subsequently as part of the DTI system, to expedite the processing of customs documents. The system should also provide internet-accessible information to the exporters. The international transport companies and logistics service providers already have these systems, as do the Thai ports and customs. However the Lao logistics industry and customs services lack this capability.

In order to implement this system for small-scale industries, it is necessary to have the following items:

1. Study of commercial viability including: forecasts of the volume of consolidated cargo exported over the next five years by major destinations, the savings from the introduction of an efficient

consolidation/deconsolidation operation in Vientiane and Bangkok and the revenues that would be generated by such an operation;

2. Agreement between Thai and Lao Customs for facilitated movement of consolidated shipments under bond between bonded warehouses in Laos and Bangkok;
3. Bonded warehouse for consolidation of cargo with a competitively bid concession for operating the warehouse;
4. Expedited procedure for processing of consolidated shipments in Bangkok;
5. Competition in the provision of deconsolidation/reconsolidation services in Bangkok;
6. Information system to supply the information required by customs, international transporters and forwarders to plan and coordinate the movement of consolidated shipments.

The timeframe for putting the system in place includes three phases. It is expected that the initial traffic study and financial feasibility could be completed within a few months. Time to complete the new arrangements with the Thai and Lao customs is indeterminate, although with goodwill it should be possible within four to six months. While the systems analysis and design for the information system would require four to six months, the implementation would likely stretch over a year or more depending on the ability to interface with the customs.

Relatively little capital investment would be required. The information system would utilize existing EDI protocol and a simple data structure. It could be expanded later to include information on the size and physical position of individual consignments. Facilities are available for consolidation/reconsolidation activities but these may not be appropriate for efficient cross docking and cargo inspection, in which case they should be replaced. However, the cost of such warehouse/cross-dock facilities is relatively modest.

### **Inland container depot/dry port**

The most dramatic developments in the configuration of supply chains in the 1980s focused on large volume, especially FCL, shipments. This included relocation of warehousing from the retail outlets to distribution centers located near the major import ports, e.g. Rotterdam's Distripark. This was followed in the 1990s by the movement of these distribution centers up the supply chain to the transshipment hubs, e.g. Singapore Distripark, and from there to the ports in the countries of production, e.g. Saigon. This last phase allowed for consolidation of products from multiple contract manufacturers into full container loads for individual urban markets or retail outlets. In parallel, the storage function of the distribution centers located near the import ports was replaced with a cross-docking function that minimized the delivery time for cargoes.

***Establishing an inland container depot can reduce transport cost of containerized cargo.*** The implementation of the transit agreement with Thailand and increase in competition among trucking companies and clearance agents has produced a substantial reduction in the rates for transport of containerized cargo. However, these rates are still high relative to those for movement of loose cargo because of higher truck operating costs and, more importantly, the need to reposition empty containers from the unloading point for imports to Bangkok and from Bangkok to the point of loading for exports. In order to reduce this problem, it is proposed to establish an ICD that would operate as a dry port.

While foreign shippers can currently designate Vientiane as their port of destination, this is rarely done since it is expensive to have shipping lines arrange the inbound transport. As a result, most import containers are designated for delivery to Bangkok and the consignees or their representative arrange for onward movement. If the shipment is in a container,

then the consignee incurs the additional costs for transport in bond and for payment of detention and demurrage charges for the container (after a specified free period).<sup>10</sup> If the cargo is deconsolidated and moved inland as loose cargo, then the transport is less because the empty backhaul is avoided along with other charges. With an ICD/dry port, the inland transport for import containers having Vientiane as their port of destination can be arranged jointly for all shipping lines through one or more trucking companies.<sup>11</sup> This arrangement would reduce the overheads associated with this movement. It would also eliminate the need for a bank guarantee or the detention charges during this move. For exports, the shipping lines could issue a bill of lading with Vientiane as the origin port and then assume responsibility for transportation to the ports in Bangkok and beyond.

The ICD/dry port can also be used to store empty containers after their import cargo has been unloaded. These boxes can be subsequently loaded with Lao export cargo or repositioned for loading of Thai export cargo. This arrangement would not only reduce the time required for delivering an empty container to the factory but also increase the percentage of loaded backhauls and therefore reduce trucking costs. If successful, this could increase the load factor for articulated trucks by as much as 10-20 percent, thereby potentially reducing freight rates by 8-16 percent. At the same time, it would largely eliminate the detention charges paid by the importers and exporters.

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<sup>10</sup> Demurrage is calculated from date of discharge of full container up until the date the full container is cleared out of port. Detention period is calculated from the date the full container is cleared out of port up until the date the container is returned empty by the consignee to the carriers stack in port.

<sup>11</sup> As an example, the operators of the ICD in Sialkot, Pakistan also provide a trucking service between the ICD and Karachi which is one of the best organized trucking operations in Pakistan.

While this project has attractive features, it might be difficult to realize because the small volume of traffic. The opportunities for unloading the import containers and reloading them with export cargo may be limited by the shipping line that owns the containers. Imports come primarily from East Asia and are carried on regional carriers, whereas most exports are shipped to Europe or the US on large international carriers. Before proceeding with this project, it will be necessary to prepare a forecast of container traffic by origin/destination. From this, it can be determined if there will be sufficient bidirectional container movements to justify participation by the shipping lines and if there will be sufficient revenues to make the ICD commercially viable.

A proposal has already been prepared by a private operator for establishing an ICD at a new location near Thanaleng. The final choice of location should be part of a broader strategy for improving supply chain performance. A marketing study is needed to identify the performance characteristics needed to make the ICD successful, including the level of coordination with customs and transport services. It is expected that in the first stage, the ICD would require only a few hectare with ground slots for up to 200 TEU and one or two top loaders or reachstackers. Loaded boxes would be stacked three high and empties up to four high. The operator should be a third party selected through competitive bidding.<sup>12</sup>

### **Proposed short-term initiatives to improve logistics in Laos**

There are a number of initiatives that Laos can undertake to improve the performance of the supply chains for goods traded with neighboring and foreign countries, and thereby increase the competitiveness of

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<sup>12</sup> Given the diversity of shipping lines, it is unlikely that a consortium of shipping lines could be formed to operate the ICD.

exports and reduce the cost of imports. Most include changes in procedures that require relatively little investment. These would build on existing practices and either simplify them or remove key constraints.

**1. Simplify procedures for factory-to-port container movements along the Vientiane-Bangkok corridor.** This could begin as a pilot project to introduced changes that will facilitate major trades, specifically imports for and exports from the garments and wood products industries. These changes would include:

- Checking of containerized cargo on the Thai side would be limited to inspection of seals. Physical inspections would not be conducted except based on specific intelligence regarding the contents.
- Transit permits for exports would be issued at the Friendship Bridge and imports documents would be checked there. Information regarding imports including the approvals would be transmitted electronically between the transit warehouse at Bangkok and the customs office in Vientiane.
- Containerized goods would be transported direct from the port to the importer's warehouse and from the exporter's factory to the port. Clearance of inbound and outbound full container loads would take place at the warehouses.

The program would begin with the larger exporters then expand within a short time to the major importers, e.g. WFP, Unilever, Trio, and finally to the smaller traders. It would begin with the corridor between Vientiane and Bangkok and later be expanded to other corridors. Since this project would require an increase in the workload of customs and other border officials, procedures would have to be developed to increase staff and improve scheduling of their activities.

**2. Develop a consolidation service for small freight shipments on the Vientiane-Bangkok corridor.** The current practice of consolidating loads at Nongkhai would be replaced by a similar activity at a container freight station in Vientiane. Export cargo would be loaded into either marine or domestic containers equipped with modern electronic seals and moved in transit to the ports. The cargo in the domestic containers would be reconsolidated into marine containers. In the reverse direction, LCL cargo imports would move directly to the freight station or, if the consignments were for multiple destinations, would be consolidated into domestic containers at the Bangkok transit warehouse and moved under seal to the Vientiane CFS. This facility would be accessible not only to domestic forwarders but also to Thai and foreign companies that have a presence in the Vientiane market. The operation of the CFS and the consolidation/deconsolidation facility in Bangkok would be contracted out on a competitive basis. This initiative would require an agreement from Thai customs to treat these movements in the same way as FCL shipments.

**3. Establish an Inland Container Depot/Dry Port near the border where the shipping lines could deliver loaded containers and receive cargo for loading into empty containers.** The ICD would also provide a focal point for transactions with both the shipping lines and the trucking companies. It would allow importers to return empty containers to the ICD rather than to Bangkok. Similarly, it would act as a dispatch point for empty containers to be loaded with exports thus reducing the transport of empty containers to Bangkok. This facility would also allow repositioning empties to shippers within Thailand as well as to container yards around Bangkok using a single trailer or rail wagon for two 20' containers.<sup>13</sup>

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<sup>13</sup> Thai customs has identified as area for constructing an ICD in Nongkhai. This should be considered in the marketing study which

**4. Reduce the number of signatures required to clear cargo.** Once accepted this could be combined with a procedure for electronic submission of these documents and for expedited approvals in order to reduce the incidence of informal payments. There are a number of systems available for this purpose of which ASYCUDA is the most widely used, but not necessarily the best for small-scale applications. The system would be developed in phases beginning with Direct Trader Input built around the SAD and incorporating valuation and accounting modules. Subsequent phases would address inspection, selectivity and risk management.

**5. Reduce the regulation of imports and exports.** This would include elimination of annual projections and approvals for individual shipments.

**6. License customs clearance agents.** This would include certification of technical knowledge combined with a commitment to remain current on customs procedures. It would also include a requirement for bonding individual customs agents.

**7. Provide assistance to the logistics industry to develop their capability.** For the trucking companies this would involve financing for equipment suitable for hauling containers on the roads in Thailand. The financing would be in the form of lending directly to the trucking companies or to companies that lease trucks. For the forwarding companies, this would involve training in modern logistics based on programs available directly through TIFFA or from UNCTAD or the Bank's Distance Learning Program as well as establishment of a program for self certification.

**8. Monitor clearance times and productivity at the border crossings.** The data collected would be used to evaluate not only the effectiveness of the customs and related

border activities, but also the impact of various initiatives on improving these activities. There are a number of standard indicators. Some measure the effectiveness of trade facilitation, e.g. times for individual processes and total in-out time, while others measure the efficiency of the resources used, e.g. number of clearances per customs agent or signatures required.

None of these initiatives involve significant capital investment with the exceptions of the financing of trucks and the establishment of the ICD. Even then the amounts would be less than \$5 million. The consolidation service would be developed by the private sector but would require relatively little investment assuming that existing warehousing space is available. The development of a Direct Trader Input system with supporting modules and equipment for installation in Vientiane should cost less than \$1 million although a rollout of the system for the entire country and the expansion of modules could cost about twice as much. The other initiatives might require some technical assistance, but these are relatively common reforms for which there is considerable experience

It is difficult to quantify the benefits without developing a more detailed project scope and a more careful analysis of trade patterns. However, it is possible to indicate the impact in terms of effect on supply chain performance (Table 12).

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would be prepared leading up to the establishment of a Lao ICD.

**Table 12. The expected benefits from the proposed initiatives**

Initiative	Competition	Time	Cost	Reliability	Losses	Informal Payments
Pilot to Simplify Transit Process		++	+	++	+	++
Establish Bonded CFS			++		+	
Establish Dry/Port ICD		+	++	+		
Process Simplification and Direct Trader Input		+	+	+		++
Simplify Export Approvals		++		+		+
License Clearance Agents		+		++		+
Assistance for Logistics Industry	++	+	+	++		+
Monitor Performance		++	+	+	+	+

**Map of Laos**



Source: CIA factbook

## Chapter 6: Customs Update

Despite major progress and reform effort, customs remain a stumbling block to imports and exports. Importers complain about lengthy, costly, and unpredictable procedures. The capacity of the Customs Department is still weak, the authority over Customs clearance is spread across ministries and regions, and informal payments are still widespread. Much remains to be done to make the Customs Department a modern one, including in the areas of legislation, organization structure, human resources, computerization, clearing procedures, and enforcement. Donor assistance in this area would also need to be well coordinated.

### **Lengthy, costly, and unpredictable procedures**

The Lao Customs Department (LCD), supported by extensive technical assistance, has undergone for several years a reform and modernization process, but continues to suffer from a lack of institutional capacity and weak performance.<sup>1</sup> Progress has been inhibited by weak capacity within the Department, characterized by insufficient numbers of qualified staff at the Departmental headquarters and unqualified and poorly trained field staff. The Customs Department does not exercise full control over the operation of provincial offices and border checkpoints as provincial authorities have been delegated responsibility for their management and operation including the recruitment, transfer and promotion of staff, and collection of duty. (In some cases, different provincial clearance locations even offered “discounted” duty rates.)

***Importers face difficulties in clearing goods.*** According to one importer, the cost

of shipping one container from Marseilles to Bangkok is between \$600 and \$700, and \$1,200 from Bangkok to Vientiane. Although this is not entirely due to the LCD (permits have to be obtained from the Ministry of commerce, the Ministry of health carries out sanitary and phytosanitary inspections, shipments may take up to three weeks from Bangkok to the Lao border), Customs are still considered the major impediment:

- Practically every shipment is physically inspected, and often sampled – this is partly necessitated by the fact that no risk management system is in place; customs officers sometimes have limited professional skills and their performance further suffers due to understaffing and lack of equipment; clearance rules—and sometimes tariffs—vary from one clearance station to another; and updated documentation is usually unavailable;
- Levels of duty can be very high, thus encouraging systematic under-valuation;<sup>2</sup>
- Smuggling (estimated by Customs at over one billion Kips per year in lost revenue) and fraud are widespread,<sup>3</sup> with significant under-reporting of goods at approved points of entry, thus making it

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<sup>2</sup> Altogether, tariff on excise goods represents 90 percent of the value, to which unofficial payments must be added.

<sup>3</sup> Although Lao Customs procedures are intended to reduce the level of illegal trade, most illegal trade occurs along the long stretches of the country’s porous border rather than at the crossings. Illegal imports have the benefit of avoiding not only duties and taxes, but also informal costs and delays involved in complying with customs procedures. As a result, many of the procedures introduced by customs to reduce illegal trade have been counterproductive.

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<sup>1</sup> A reformed action plan including the establishment of a national customs administration with a vertical management structure has been proposed to the government, it has, however, not been approved until now.

uncompetitive for importers to work honestly;

- Inward processing procedures are complicated (until recently, licenses required 18 different steps and 14 signatures – 3 from customs and the others from other relevant agencies – with a delay of 10 to 15 days to obtain an authorization for an operation), suffer from lack of codification, and imports under the *Code des Investissements* (subject to only a one percent payment on raw material) are often abused;
- Corruption is a major problem, with payments requested at every step, including for the provision of overtime or on the premise clearance<sup>4</sup>, but can result, when routine payments are made, in predictable service, and keeps clearance delays within 24 hours;

***The organization of the LCD is weak.*** The absence of a national Customs administration with a vertical management structure has resulted in inconsistent application of the law and regulations, weak revenue performance, inappropriate decision making respecting tariff, valuation and penalty matters, and uncoordinated human resource management. Provincial authorities reportedly overstep their authorities and have been granting exemptions, varying tariff rates and customs value, and settling seizure cases. In addition, other government departments, most noticeably the Ministry of Commerce are involved in functions that are within the purview of the customs administration, resulting in duplication of efforts and related delays in border clearances. At field level, officials have limited documentation, which is often not updated.

***Procedures are control oriented, yet ineffective.*** Clearance of goods, as observed at Friendship Bridge and Thanaleng

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<sup>4</sup> A figure of \$10 paid directly to the Customs officer was mentioned by importers.

Customs house, is based on the following steps:

- Entering trucks<sup>5</sup> are weighed, submit the Thai carrier report, and are logged into a manual register;
- A few Thai trucks are allowed to proceed to Vientiane (essentially oil tankers and perishables), but need to take on board a Lao police officer, for road safety reasons; all other trucks are transferred to Thanaleng Customs house under a rudimentary, and potentially insecure, transit control scheme;
- Trucks arriving at Thanaleng are again weighed, the transit procedure is cleared, and the trucks are unloaded under Customs control into a warehouse (on average, Customs detect between 30 and 40 cases of under-reporting of cargo per month), and the carrier report information is captured both in a manual register and into a standalone Excel worksheet, for subsequent inventory control;
- Within 10 days, importers are required to lodge a declaration for clearance which is submitted to Customs, entered into a manual register, then keyed into the Customs computer system by Customs officials;
- Importers must also produce a MOC permit, which is issued locally, at a charge.<sup>6</sup>
- Duty is paid locally at a Treasury window, by cash or certified check;
- Every consignment is inspected;
- If the inspection is satisfactory, the goods are released.

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<sup>5</sup> The bridge is open from 6 am to 10 pm while the Customs house operates from 8 am. to 4 pm, with the possibility of clearing goods outside working hours, subject to a pre-notification. There are between 10 and 100 trucks per day.

<sup>6</sup> This permit is also required from travelers importing goods in excess of the duty free allowance (imports in excess of 250,000 Kips).

**Valuation of goods.** Customs applies the transaction value principle to a limited degree, and extensive use is made of price lists issued by Customs (and by the MOC). The LCD has difficulty maintaining up to date lists and often the reference values are not representative of actual prices. In order to ensure reasonable revenue collection on sensitive products such as liquor and wine, tobacco and mobile phones, the LCD has introduced a system under which specific (or *forfait*) duty rates are established through a form of contract with individual importers. This practice avoids difficulties in establishing actual values for these high revenue risk goods and assessing *ad valorem* rates of duty and tax.

### **Major customs issues**

**Customs clearance.** Although in the past few years the LCD has (a) introduced the AHTN tariff classification based on the International Harmonized System (HS) nomenclature, (b) introduced a modern declaration form, and (c) carried out some streamlining of procedures, clearance still includes redundant steps, risk management techniques are not employed, and virtually all goods are inspected. These inspections produce very few results and appear to have become a mechanical procedure carried out as a matter of simple routine. In Thanaleng, importers are allowed inside the administrative area of the declaration lodging position, creating unwanted private contacts between importers and officials, and defeating the purpose of the tentative single window approach. The use of manual registers is not clear, except it provides some level of control over keying-in of data by Customs officials. The existing computer system is not used effectively (for example, it does not assign a declaration number), and suffers from unreliable and untimely data caused by poor quality Customs declarations by traders, excessive input errors and the failure of many Customs houses to transmit data or send in declarations in a timely manner. The fundamental Customs principle of self assessment is not being

practiced at many Customs houses where officers complete declarations on behalf of importers/exporters. This procedure is not in line with modern Customs principles and practices or with international standards. It makes it extremely difficult for Customs to impose any sanctions in cases of fraudulent declarations as the declaration is questionably not that of the importer.<sup>7</sup>

**Uncoordinated processing by several government inspection and control agencies.** At some border locations up to 10 separate government inspection and regulatory agencies intervene in the clearance of goods, vehicles and people. Practically all imported goods are thus inspected several times. Involvement of many of these agencies in routine processing and inspection operations at the border is not necessary, and their functions could be delegated to primary agencies (such as Customs or immigration) with no loss of regulatory control or revenue. The border clearance process is characterized by different documents often containing the same information, and permit/license requirements that cause excessive delays. The Ministry of Commerce's involvement in the import and export process functions duplicates Customs procedures; prohibited goods and goods subject to technical regulations face the extra hurdle of issuance of "import licenses". (MOC staff at Customs houses also verify and authorize the declared value of the shipments through this permit); MOC authorities indicate that they require this permit in order to collect essential trade data that is not provided by Customs on a timely, accurate basis, but it would be more effective if the MOC and Customs would jointly explore ways to improve the provision of such data.

**Control over cargo and transit is weak.** The MOC is involved in the control of goods in international transit through Laos. An MOC official acknowledges transit

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<sup>7</sup> These penalties, when they exist, are in any case very low and have limited deterrent effect.

goods by signing the document submitted by the freight forwarder and records it for statistics. The customs official will then issue a permit accompanying the respective goods to the bonded warehouse. The permit is subsequently cancelled when the goods are re-exported.

The Customs transit control procedures, while manual, are compatible with the requirements of the WCO Convention on the Harmonization and Simplification of Customs Procedures (Kyoto Convention). Similarly, the procedures are in accordance with the provisions of Article V and VIII of the GATT. However, Customs assesses duty at a reduced rate for transit goods, a practice that is incompatible with Article VIII. Control over vehicles entering at Friendship Bridge and destined to Thanaleng is only based on a token system, and while there are currently few reported irregularities (only one case per month on average), should traffic increase significantly, risks of fraud would also increase considerably. At Thanaleng, Customs do not match their computer registry of arriving cargo against the warehouse operator's computerized inventory control system.

***The Customs Department does not exercise full managerial control over field operations and lacks the human resource capacity to carry out its headquarters responsibilities.***

Responsibility for administration of the Customs houses and checkpoints in the 18 provinces, including human resource management and budget allocation including payment of staff salaries, has been largely delegated to the Provincial Governments by the Government of Laos. While improvements have been noted recently, the assessment, collection and remittance of Customs revenue to the National Treasury have been problematic with revenue being retained by the provincial treasury authorities. Instances have been reported of provincial officials exceeding their authority by granting duty exemptions and concessionary rates of duty and settling enforcement cases. The LCD

does not have control over the recruitment, training, deployment and discipline of their staff. Thus standards of recruitment and promotion are not consistently applied, and trained staff are often rotated or transferred out of the department to be replaced by untrained officers. Levels of staff competence and specialized Customs knowledge are therefore weakened. Although the recently-introduced monitoring and control program has helped strengthen the role of the Department in the management and supervision of field operations, the absence of a national Customs administration with a vertical management structure impedes the provision of consistent Customs services and policy application throughout the country.

***Valuation procedures are not in accordance with the WTO's Agreement on Customs Valuation (ACV)***<sup>8</sup>. Although the use of minimum price lists is sensible considering the low capacity of the Customs field offices and the need to protect revenue collections, the LCD will need to undertake a comprehensive program to develop the management systems, organization, infrastructure, and staff capacity to implement the transaction value under the ACV. Customs should develop a valuation reference database. Full implementation of transaction value is a long term undertaking and a clear strategy and transition plan will be required. The *forfait* system used for high duty imports results in lower effective rates, and does not address revenue evasion through under-declaration of quantities. While arguably a transparent approach, it is a practice that is of questionable value and one that should be phased out. The LCD should consider special measures to ensure proper reporting and valuation of these goods such as centralized clearance procedures, close monitoring by the Post clearance Division of all transactions,

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<sup>8</sup> However, the revised Customs Law which came into effect in early 2006 contains provisions on GATT valuation.

maintaining up-to-date price lists based on information from the country of supply.

### **Progress in reform and performance**

***In spite of these limitations, the LCD has made real efforts to improve its capacity and performance and to establish a national Customs administration:***

***a. Implementation of the revised Customs Law, which will provide a sound basis for modernization.*** The previous Customs Law did not provide a sound legal basis for the modernization of the Customs administration and did not comply with WTO requirements. Major deficiencies included limited powers of Customs officers, unclear rights and obligations of traders, inadequate Customs valuation, origin, and appeal provisions, and limited flexibility to adapt to new procedures including automation. With technical assistance from the IMF, the LCD has drafted a new customs law, which entered into force in early 2006. It establishes a modern flexible legislative base for the department and will fully meet WTO requirements and international standards such as the WCO Kyoto Convention.

***b. Implementation of an automated Customs database system (C-2000).*** The current system (C-2000) was developed locally with technical assistance under UNDP project 96/005; it provides a basic level of Customs transaction data capture, storage and reporting at some 21 sites. The system's operational functionality is limited to declaration processing, daily revenue reporting and statistical and management reporting. Automated sites submit data to the central server either by dial up modem, or on floppy discs. Declaration data from non-automated sites is input to the system at headquarters. With assistance from the UNDP, some improvements to the system are underway, including preparation of a user manual, provision of staff training and stabilization of the system.

***c. Establishment of a post clearance audit function.*** The post clearance unit was established two years ago with IMF technical assistance. Its staff of 13 is responsible for (i) the review of declarations, re-assessment of duty, and collection, and (ii) the preparation of a reference price system. Although all declarations are, in principle, subject to post release review, in practice the unit only checks specific sectors, such as automobiles, construction material, and electrical equipment.<sup>9</sup> 7745 reviews took place in 2003/2004, and 46 cases were detected.

***d. Implementation of international agreements.*** Customs has implemented the ASEAN Harmonized Tariff Nomenclature (AHTN), and is a signatory to the ASEAN Free Trade Agreement (AFTA) including implementation of the tariff reductions under the Common Effective Preferential Tariff (CEPT) scheme. Further, there are plans to implement ASEAN rules such as the Cargo Processing Model and the ASEAN Single Window.

Under the provisions of the GMS Agreement on the Cross Border Transport of People and Goods, the Government of Laos has committed to streamlining border clearance procedures and to removing non-physical barriers to trade. A key initiative under the Agreement is the establishment of mutual carrier rights that will enable transport vehicles from GMS countries to operate throughout the Sub-Region. Currently, commercial vehicles arriving from Thailand (and departing Laos) are not allowed as a general rule to proceed inland and all cargo must be transferred to domestic vehicles. This transshipment results in delays, loss of goods through breakage and pilferage, and in additional costs to traders. The Transport Agreement provides for improved clearance processes through such initiatives as Single Stop Inspection, Single Window Processing and improved cooperation and exchange of

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<sup>9</sup> Declarations can be reviewed for a period of three years after the initial import.

information between member administrations. These initiatives are being pursued with the support and assistance of the Asian Development Bank.

***e. Anti-corruption approach.*** Traders feel they have no choice but to pay in order to have their documents processed and shipments cleared, and avoid future retaliation. There are numerous allegations of inappropriate conduct on the part of staff in the checkpoints and provincial government officials in terms of accepting under-declared and under-valued goods and facilitating smuggling, aggravated by the lack of headquarters management control and the involvement of provincial authorities in Customs operations. However, senior Customs managers admit very frankly that Customs officers and officers of other inspection agencies assess informal facilitation fees for normal clearance procedures, and try to build into each development activity an anti-corruption approach.

***f. Institutional strengthening.*** The LCD has prepared an organizational strategy to introduce a national administration. The first stage is the strengthening of the Department's monitoring and control of Customs offices through a program of field monitoring visits by teams led by senior departmental managers. Teams have the authority to provide direction to local staff on proper procedures and to ensure corrective action is taken. The teams are required to provide a written report of their visits to the Director General. The second stage entails implementation of a new departmental organization structure in order to increase the capacity of the Department to exercise direct managerial control of field operations and to carry out essential headquarters policy and program management functions.

### **Remaining constraints**

***The LCD does not have a comprehensive computer system.*** Customs houses do not

make use of the system and continue to maintain parallel manual records and registers, reflecting a lack of understanding of, and confidence in, the system. The declaration form is not entirely aligned to the UN Layout Key Single Administrative Document, making further development, including the exchange of data with other countries, difficult. The LCD does not have an ICT strategic plan, and therefore has no clear sense of direction and priorities for automation. Enhancements to the C-2000 system appear to be based more on expanding the technical capacities of the system and on pursuing specific initiatives without a well thought out strategy and plan, and there is little ownership over the system, apart from a small dedicated technical team that appears isolated from the rest of Customs operations. The LCD is considering implementing direct trader input procedures using a web-based system. While this may well be an appropriate direction, before proceeding the Department should first establish its ICT vision and strategy based on a careful analysis of its requirements (both functional and technical), capacities, and clearly articulated priorities.

***The post audit function is insufficiently credible.*** At the present, the unit has difficulties in obtaining declarations from the provincial offices, and only two percent of all declarations are selected for a post release review, and half of these reviews end up in the detection of an irregularity, which is very low. When an irregularity is suspected, Customs have further difficulty in obtaining additional information from the importers, who often simply ignore such requests. The unit has no power to issue re-assessment notices – which are the prerogative of provincial directors – and the only result of a re-assessment is the collection of unpaid duty, thus further eroding the credibility of the unit.

## Strategy for the way forward

The LCD needs to continue to strengthen its efforts to modernize and reform if it is to be in a position to meet WTO obligations and requirements. Even if WTO accession is not in the near future, the Department still needs to pursue an aggressive and comprehensive reform agenda to ensure the proper collection of government revenue, to facilitate trade and regional integration and to afford legitimate businesses protection from unfair competition from smuggled or fraudulently entered goods. Recognizing that considerable progress has been made to date in reform and modernization, and that donors have been and continue to actively support and assist the Customs in their reform efforts, the Department should focus on the following priority objectives:

**a. Legislation:** The Government should give a very high priority to the implementation of the new Customs Law and supporting regulations. As the new Law entails a major departure from existing policies and practices, including meeting WTO requirements, a comprehensive policy and procedures manual will need to be developed for use by Customs staff and the public. Extensive work will be required to develop the new regulations, including a detailed assessment of existing regulations, writing of new or revised regulations, and in implementation activities such as training and public information.

**b. Organization:** The Government needs to continue to develop a national Customs administration. Initial efforts to improve the control of field operations through the Monitoring and Control program and restructuring and strengthening the Customs Department headquarters organization should continue. A comprehensive human resource development plan is needed to ensure the new organization has sufficient numbers of qualified staff to direct the field operations and to carry out essential headquarters policy planning and monitoring functions. Once the headquarters

organization is in place and staffed, implementation of the national organization should occur, resulting in a unified national administration providing consistent service to facilitate trade and to ensure compliance.

**c. Strengthening human resource:** Limited attention has been paid to date to the development of the Department's human resources capacity and professionalism of staff in order to implement modern Customs practices consistently throughout the country. In order to implement successfully the national customs administration and to meet the demands to be placed on the department by WTO membership and regional commitments under the GMS and ASEAN, much greater priority will need to be given to developing the capacity of departmental human resources. A comprehensive human resource plan is required. The LCD needs to develop its internal training capacity including trainers and a training centre (both of which are being developed with the assistance of the Government of France). The centre should deliver technical and management training courses, as well as English language training (English being the official language of ASEAN). Competency based recruitment and promotion policies and clear and transparent policies for delegation of authority and accountability are required. An integrity program needs to be developed for the new national Customs administration, including elements such as internal audit, a code of conduct (discipline code), internal "checks and balances", and reasonable compensation policies for customs officials (salaries and bonuses) to discourage inappropriate behavior, and to attract and retain higher qualified staff.

**d. ICT:** Significant improvements in trade facilitation, revenue collection and internal controls in the Customs Department can only be achieved with the implementation of an automated and comprehensive Customs processing system. The C-2000 system currently in use in the Department needs to be stabilized and strengthened as a matter of

priority to improve the quality and timeliness of trade data, management reports and support to operations before any expansion takes place, as long as there is a sufficient capacity within the Department, both in terms of IT personnel and full-time customs staff assigned to the project, which is not the case at the moment. The Department therefore needs to develop a comprehensive ICT strategy, based on a careful analysis of its requirements and capacities. Decisions on the best way forward can then be made, to use the considerable work that has been put into C-2000 and turn it into a fully integrated operating system. Another, cheaper, option, should there not be sufficient resources to further develop C-2000, would be to integrate the existing computerized processes into an “off the shelf” system.

***e. Preparation of a transition strategy for implementation of the WTO Valuation Agreement:*** While Annex III, Paragraph 2 to the Valuation Agreement provides a transition period for developing countries, the use of minimum values will have to be phased out and replaced with the transaction value provisions of the ACV. The Government of Laos should develop a proposal for a transitional period for application of the valuation provisions in order to protect the revenue, given the low rate of voluntary compliance by importers, their lack of sound accounting systems and record keeping, and the limited capacity of the Department to administer transaction valuation provisions. This transition plan should provide for the gradual introduction of the provisions of the agreement, based on a careful assessment of revenue risks, the levels of capacity within the customs Department and the capacity of the trade to comply. Extensive technical assistance will be required in the planning for and implementation of the Valuation Agreement.

***f. Improved trade facilitation through streamlining clearance procedures and rationalizing the involvement of other government agencies in the clearance***

***processes:*** Building on the work carried out under the GMS Cross Border Transport Agreement, and past initiatives of the Department to streamline procedures supported by technical assistance from the UNDP, IMF, Government of France and others, a major review of existing border clearance procedures should be undertaken covering all government agencies. This initiative should aim to eliminate redundant and unnecessary procedures, integrate and streamline documentary requirements, and seek to make maximum use of ICT.

***g. Strengthening enforcement capacity in order to reduce smuggling and other illegal activities.*** While no studies have been carried out to assess the revenue loss through smuggling and other Customs fraud, all indications are that it is extensive. The Department needs to strengthen its anti-smuggling operations throughout the country, building on the successes of the inspection division’s anti-smuggling task force approach in the major provinces.<sup>10</sup> The intelligence unit needs to be expanded and provided with the training and tools needed and finally, a Customs fraud investigations function needs to be established.

#### **Donor coordination**

Following is a brief summary of the donor activities and technical assistance being provided to or planned for the LCD:

**UNDP.** Continued provision of a resident advisor for approximately four months beginning in March 2005. Areas of assistance include: preparation of a new reform project document; strengthening the C-2000 system and preparation of an ICT strategic plan; strengthening post clearance

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<sup>10</sup> Results of the anti-smuggling unit have reduced by 30 percent in 2004 (196 cases) compared to the previous year, largely, according to Departmental sources, because Customs were no longer able to hire and pay informants.

audit; and implementation of the LCD reorganization.

**JICA.** A JICA project formulation mission visited Laos in February-March 2005. While their proposals for TA are not final, the mission was advised it is considering assistance in the following areas: management of assembly factories (motorcycles); Customs transit procedures; compliance management of Duty Free Zones; and compliance management of garment factories (investment firms).

**Vietnamese Customs.** There is no formal program establishing the extent and timing of assistance but the Customs Department advised that Vietnamese Customs have offered to assist in the following areas: (i) review of the Customs Law; and (ii) reorganization (a short mission in 2005 focusing on the VN experiences with the provincial authorities).

**France.** The resident advisor responsible for both Customs and the Treasury (accounting) matters, with a major emphasis on the provision of training will be extended for another two year term in mid 2005. Areas of assistance include: (i) management courses in planning and decision making; (ii) automation training and familiarization (study tours); (iii) creation of a training center and a training program including Training of Trainers; (iv) assistance in developing an automation strategy; and (v) general policy advice.

The extent of this technical assistance also illustrates the need for a closely concerted approach to modernization strategy and issues, if only to avoid overlaps, or even conflicting advice and developments.

## **Chapter 7: Addressing Sanitary and Phytosanitary Issues to Raise Competitiveness**

Laos has a high agricultural growth potential. In its vicinity, there are 200 million people in China, Vietnam and Thailand with rapidly growing incomes and demand for products which Laos can produce. The main priorities are in the field of potential and emerging formal exports of fruits and vegetables, coffee, perhaps some other fresh products, and possibly high quality beef. The abundance of good soils and favorable climatic conditions in the highlands offer unique comparative advantage for producing temperate and off-season fruits and vegetables which are in high demand. Demand for high quality beef in neighboring countries is rapidly increasing. However, the present capacities for animal disease surveillance and quarantine of bovine animals are insufficient.

The growing concern for food safety and agricultural health has given rise to the prevalence of safety standards that has markedly affected agricultural trade. Outbreaks of food-borne diseases and food scandals have added pressure for the stricter enforcement of these sanitary and phytosanitary (SPS) requirements. In general, the capacities for managing SPS by the government and the private sector fall short of what is prudently needed for an agricultural sector which is diversifying and focusing on opening for international competition. Shortages are not merely lack of budget, skilled staff and laboratory equipment; they include legislation, regulation, databases, monitoring, evaluation, negotiating skills, public awareness of law enforcement and, last but not least, private sector capacities. SPS issues are further complicated by border problems. For several products, governance problems in border procedures contribute to the high formal and informal transaction costs that erode competitiveness. There is a risk that expanding sanitary and

phytosanitary controls would do more bad than good, especially in areas of low SPS risks. SPS capacities (facilities and staff) for managing food safety, animal health, and plant health in cross border trade are weak making it more difficult to control and manage ongoing animal diseases—Foot and Mouth Disease and Avian Flu. With increasing intra-regional trade and agricultural diversification, new plant health hazards may be brought into the country. The lack of capacities for phytosanitary management adds to uncertainties and risks for private investors.

Like other developing countries, Laos does not have the financial means, technical skills and infrastructure needed to comply with quality and safety requirements of overseas markets. In many cases, the adoption of food safety procedures and practices entail huge up-front costs that cancel out the competitive edge that developing countries would otherwise have from low labor costs, seasonality, and niche product capabilities. The inability to meet SPS requirements restricts access to markets opened up by trade liberalization. If Laos is to maintain competitiveness and benefit from new export opportunities, it will need to build up the framework and/or infrastructure necessary for adopting and enforcing safety and quality regulations. Given the government's constrained budget and limited human resources, expanding SPS capacities can only be achieved gradually and will require selectivity, and shared funding and shared implementation by the private sector.

### **Agriculture and food trade**

Agriculture contributes about 50 percent to GDP and employs 80 percent of the people. The sector grew by 2.2 percent in 2003, lower than the previous year's 4 percent, yet growth picked up again in 2004 with 3.5%.

It is largely subsistence farming—primarily rice and livestock. In 2000, 54 percent of the sectoral GDP was from crops, 36 percent from livestock and fisheries, and 10 percent from forestry.<sup>1</sup>

At present, only 6 percent of total land area is used for agriculture and pasture: 3 percent of land is cropped and another 3 percent is grassland or permanent pasture. Rice is grown on over 80 percent of the cultivated land. The other agricultural products include vegetables and fruits (pineapple, bananas, orange), sweet potato, tobacco, coffee, cassava, maize, soybean, mungbean and groundnut.

***The contribution of the agricultural sector to international trade is relatively small—accounting for 5 percent of exports and 17 percent of imports in 2002.***<sup>2</sup> The main agricultural exports include wood and wood products, forest products, coffee, and tea; the main imports include beverages and tobacco. Agricultural products with an export potential include vegetables, livestock and poultry, coffee, and wood products as well as non-timber forest products.

*Vegetables.* Vegetables are widely grown in all provinces. Main crops are cucumbers, cabbage, cauliflower, eggplant, yardlong bean, tomato, Chinese cabbage and mustard. The Boloven plateau produces vegetables and has fertile soil and good weather that allow for year-round production with relatively few inputs. Production, however, is still not sufficient for domestic demand. Production problems range across “poor seed quality, limited pest management, inadequate water resources, high local labor costs, the low technical skills of farmers, and the high costs of fertilizer, pesticides,

and seed.”<sup>3</sup> The crops are transported to the urban centers to be sold in the marketplace. Limited quantities of tomatoes and other vegetables are exported to Thailand for processing. Lao farmers have the competitive advantage of supplying fresh vegetables to Thailand during Thailand’s off-season. The Thai merchants supply seed, fertilizers and chemicals. Development of this sector requires greater effort with regard to phytosanitary procedures, pesticide management, agricultural inputs and distribution infrastructure.

*Livestock and poultry.* Laos has 1.2 million heads of cattle and 1.1 million heads of buffalo. The pig population is about 1.65 million heads (FAOSTAT 2004). Livestock is important in the smallholder farming systems of the country. Cattle and buffaloes provide assistance in rice production through the ploughing of fields, transport of rice and organic fertilizer. Pigs, poultry and goats generate household cash income. Livestock production caters mainly to domestic consumption. About 95 percent of the country’s livestock are owned by smallholders. Demanding sanitary checks encourage informal border trade.

*Coffee.* About 20,000 tons of primary processed coffee is exported each year (UNIDO 2003). Europe is the main market for coffee. Export sales are monitored by the Lao Coffee Exporters Association. The following documents are required for export: a Certificate of Quality with humidity content from the Ministry of Industry and Handicraft (MIH), a Phytosanitary Certificate from the Ministry of Agriculture and Forestry (MAF), and a Certificate of Origin from the Ministry of Commerce. Due to a lack of qualified technical staff, however, these documents are often inaccurate, especially the Certificate of Quality.

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<sup>1</sup> Lao Consulting Group. Laos SME Agribusiness Study for the Vientiane Plain. Mekong Private Sector Development Facility. August 2004

<sup>2</sup> FAO Food and Agricultural Indicators, July 2004

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<sup>3</sup> USDA FAS Grain Report LA4001

*Wood products.* Laos is estimated to have the highest ratio of forest to total area in Asia. Wood products, including lumber, are one of the main export earners. In 2001, the reported GDP contribution of the forestry sector was about 3.2 percent. The sustainability of the sector, however, is endangered by current logging practices, the cutting of fuel wood and the practice of shifting cultivation. Legislation has been enacted in recent years to control the sector.

### **Private sector involvement**

The formal private sector is small and at early stages of development—most agribusiness companies are small-scale, employing 3-5 people.<sup>4</sup> There is little production of manufactured food—less than 0.1 percent of fruit and vegetable production is processed. Processed food is mostly imported from Thailand since farm produce is either sold unprocessed in the domestic market or sold to Thailand, Vietnam, or China where value is added (processed goods are then sold at much higher prices).<sup>5</sup>

The increasing demand from large foreign markets has provided an impetus to agricultural diversification. A number of entrepreneurs are taking advantage of this market potential. They implement HACCP and traceability systems in their operations, and hire technical consultants to train and supervise farmers. One example is the export of potatoes off-season from Laos for processing in Thailand. Some companies invite foreign buyers to look at farm sites, observe operations and check out products or they send sample products to potential buyers. In certain cases where there is trust, buyers find products acceptable even without formal certifications.<sup>6</sup>

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<sup>4</sup> Lao Consulting Group

<sup>5</sup> USDA FAS Gain Report 2004.

<sup>6</sup> From interview with Dr. Sisaliao Svengsuksa, President Director General, Fonds Coopératif. He noted that organic certification is too expensive, yet buyers accept claim of organic production.

*A common problem of the agro-processing business is the reliability of supply of raw material.* Most Lao farmers are not used to commercial farming; they have difficulty supplying the agreed quantity and quality of harvest due to inadequate inputs and farming practices or lack of organization. At other times, however, farmers take advantage of price differentials and sell to another buyer. The Lao Agro-Processing Association attributed the failure of contract farming to the ‘below market’ prices offered by buyers. In other cases, the buyers fail to honor contracts leaving the farmers with unsold produce.

But there have been successful stories. The *Lao Agro Industry Factory* is a joint venture between Thai and Lao investors. The company exports canned fruits and vegetables (bamboo shoot, sugar palm nut, mango, garlic, baby corn and Chinese cabbage) to EU countries (United Kingdom, Belgium, Germany, Poland), Russia, and Vietnam. Initially, they had problems with raw material supplies. Learning from their experience they adopted a more proactive approach to management—they became more involved in the production (supplying seeds, providing technology and quality control), set minimum productivity levels (e.g. yield/unit of land area) and pay farmers higher prices. Farmers who cannot produce the minimum yield were removed as suppliers and replaced by more productive farmers.<sup>7</sup>

Another example is the *Lao Farmer Products*. The company produces jam, fruit juice, candies, banana, processed bamboo, rice, wine, liquor and beer (made of liquid from sugar palm) with organic products bought from individual farmers. The raw materials are semi-processed in the areas of origin then transported to the factory in Vientiane. Since the company is small-scale

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<sup>7</sup> Company has a registered capital of US\$300,000 and employs 350 people.

and produces according to orders, it has no problem with the supply of raw materials.<sup>8</sup>

### **SPS issues constraining market access**

Given the profile of its current agriculture exports as well as new diseases that have emerged worldwide, Laos faces, or could be facing, several SPS requirements from countries to which it exports.

***Phytosanitary certificate for coffee.*** In Laos, the issuance of phytosanitary certificates to export coffee is done upon request of the exporter (or foreign importer). The reported requirement for a phytosanitary certificate for the export of coffee requires some clarification. There may be a phytosanitary concern for coffee beans imported for sowing; fresh coffee beans have a risk of having fruit flies and coffee rust disease, as well as coffee berry borer (*Hypothenemus hampei*); but there is no such concern for dried, but unroasted coffee beans for consumption. In the US, for example, dried, unroasted coffee beans are considered as sufficiently processed and, as such, are not likely to harbor injurious pests.

Exporting countries issue certificates as a service to exporters to meet the requirements of the importing country. However, if the exporting country charges a fee for each certificate issued, it may consider it a source of income and issue certificates even when they are not required by the importing country. Also, some importers require a certificate as a basis for extending a letter of credit. These are not legitimate reasons for the issuance of phytosanitary certificates.

***Sanitary and phytosanitary risks from informal border trade.*** Besides the local trade between villages on both sides (Laos and any of the neighboring countries), there is smuggling of goods from and to destinations beyond the Southeast Asia

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<sup>8</sup> Both examples are from a study by Lao Consulting Group.

region. There is much uncontrolled and unregistered border trade so that pests and diseases in animals and agricultural products, unsafe food, harmful pesticides can very easily get into Laos. Neighboring countries along the border are exposed to the same risks from the products transited through Laos. Additionally, traditional entry/exit points also often neglect quarantine requirements for animal quarantine.

***International Standards for Phytosanitary Measures (ISPM) 15 for wood packaging.*** ISPM 15 presents the guidelines regulating wood packaging material primarily to control the spread of timber pests through the movement of timber packing and dunnage in international trade. Many countries have implemented procedures to accept ISPM compliant imports. The National Plant Protection Organization (NPPO) of the exporting country is responsible for ensuring systems are in place to meet the requirements of ISPM 15. The currently approved measures for the treatment of wood packaging materials are heat treatment and methyl bromide fumigation. In Laos, no assessment of risks and implementation of measures have been made yet.

***Avian influenza.*** On January 2004, avian flu was confirmed in Laos. The control measures used included stamping out, quarantine, movement control, active surveillance, a culling program<sup>9</sup> and regional coordination through the FAO. Accurate surveillance and diagnosis are not readily available in many Asian countries. Diagnosis is made more difficult by the similarity of the clinical symptoms to fowl cholera and acute Newcastle disease (diseases affecting poultry). Laos,

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<sup>9</sup> Laos government pledged K550 million (US\$50,700) to acquire chickens for the state farms affected by the outbreak. The Ministry of Finance suggested that farmers be compensated for 20% of poultry deaths and 30% of birds culled (EIU Country Report 2004).

Cambodia, and Indonesia do not have in-country capacity for confirmation of diagnosis of avian influenza (H5N1).<sup>10</sup>

**Foot and Mouth Disease (FMD).** Laos is one of seven Southeast Asian countries where foot and mouth disease (FMD) is endemic.<sup>11</sup> The occurrence of the disease could be attributed to Laos being a major transit corridor of livestock trade from Vietnam to Thailand, from Cambodia to Thailand (through the south of Laos), and from China to Thailand (through northwest Laos).<sup>12</sup> Certain trading practices were also considered to be a factor in the spread of FMD—traders buying infected animals for lower prices and selling these in other areas for slaughter. The ideal solution of removing (or reducing) the threat at the source is often not feasible. Quarantine measures at the borders are deemed impractical in the region given the scarce human and capital resources to run the facilities.<sup>13</sup> Moreover, the increased cost would push the traders towards another route. Also, widespread vaccination will not only deplete the meager resources of the smallholder farms but also may well be ineffective if authorities cannot control the movement of livestock.

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<sup>10</sup> ACIAR website.

<sup>11</sup> The other countries are Cambodia, Malaysia, Myanmar, the Philippines, Thailand and Vietnam. FMD is also endemic in China, another border country.

<sup>12</sup> Gleeson, L.J. 2002. "A Review of the Status of Foot and Mouth Disease in South-East Asia and Approaches to Control and Eradication" OIE's Scientific and Technical Review, Vol 21(3), pp. 455-475.

<sup>13</sup> According to information from ACIAR's website – Laos' Department of Livestock and Fisheries (DLF) had set up a four-tiered network of veterinary workers – at village, district, province and national levels – but the network is under-resourced, lacking skills and equipment. Thus, there is no detailed information available about the frequent outbreaks of diseases in buffalo, cattle, poultry and pigs.

## **Institutional and legal framework for SPS**

The *Food and Drug Administration* (FDA) Commission was established in 1991.<sup>14</sup> It is chaired by the Minister of Public Health and includes member representatives from 7 ministries. The Commission is responsible for the management and control of both imported and domestically-produced food and drugs. The Food and Drug Department (FDD), under the Ministry of Public Health, carries out all activities of the Commission.

Responsibility for food safety along the supply chain is shared by different Ministries.<sup>15</sup> The Ministry of Agriculture and Forestry (MAF) is responsible for the production activities—farm and post-harvest practices. The Ministry of Public Health, the Ministry of Industry and Handicraft and the Ministry of Commerce are the agencies that oversee the processing, importation and exportation of agriculture and food products. A food safety program has been developed with the support of all these ministries to address food safety along food chain.

The *National Codex Committee*<sup>16</sup> members are from the following ministries: Science, Technology and Environment Agency (STEA), Ministry of Commerce, Ministry of Agriculture and Forestry (MAF), Ministry of Industry and Handicraft, Ministry of Public Health (Food and Drug Department, Food

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<sup>14</sup> The information on legislations and institutions was mainly obtained from a Laos report "Country Overview on Food Safety" from the FAO/WHO Regional Conference on Food Safety for Asia and the Pacific, held in Seremban, Malaysia, 24-27 May 2004.

<sup>15</sup> The division of responsibilities may not be clear. With regard to the private sector, the Laos Food Safety report specified the role of the private sector to be "following the regulations, rules and codes or practice related to food safety."

<sup>16</sup> Laos has been a member of the Codex Alimentarius Commission since 1995 and the Codex contact person is the Director General of the Food and Drug Department (FDD) of the Ministry of Health (MOH).

and Drug Quality Control Center, and Hygiene and Prevention Department). The committee is responsible for the various food safety standards<sup>17</sup> and food safety control issues.

Specific offices under the Ministry of Agriculture and Forestry have their respective responsibilities:

- *Plant Health.* The Department of Agriculture is the National Plant Protection Organization (NPPO)<sup>18</sup> for Laos. MAF has designated the Plant Protection Center under the Department of Agriculture as the agency responsible for plant protection activity and for the collection and dissemination of information on plant protection and related border controls.
- *Animal Health.* The National Animal Health Centre under the Department of Livestock and Fisheries (MAF) is the office responsible for animal health activities in the country and related border controls.

*Standardization, Metrology, Testing and Quality (SMTQ).* The Department of Intellectual Property, Standardization and Metrology (DISM), under the STEA, is the government agency responsible for the formulation of national standards and maintenance of national metrology standards.<sup>19</sup> It acts as focal point to

coordinate the line agencies including the private sector.

*SPS Enquiry Point.* A major requirement to comply with the WTO's transparency provisions is the establishment of the enquiry point. The enquiry point is the single contact point to which enquiries regarding SPS and related issues can be addressed. It is responsible for obtaining the pertinent information from the relevant national bodies or agencies and relaying that information to the party making the inquiry. Laos has no SPS enquiry point yet, though it has been suggested to set one up within DISM.

In terms of *legislation*,

- The National Assembly enacted a National Food Law in May 2004.
- The Ministry of Public Health, the Ministry of Industry and Handicraft and the Ministry of Commerce have regulations on the importation and exportation of food, safe processing of food, bottled drinking water, food additives, inspection, and hygiene.<sup>20</sup>
- A draft of the veterinary law has been approved by the government and has subsequently been submitted to the national assembly for approval.
- The Ministry of Agriculture and Forestry (MAF) has regulations on livestock and pesticide management. Under the regulation on management and usage of pesticide (issued in 1992, amended in 1998 and 2000), the import, sale and transport and storage of pesticides are controlled through a registration scheme. There are 46 active ingredients with 33 trade names that

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<sup>17</sup> For food products for which no standards have been set, the Codex standards are applied.

<sup>18</sup> Contracting parties to the International Plant Protection Convention (IPPC) designate an office to be the contact point regarding phytosanitary regulations and requirements.

<sup>19</sup> The Decree on the Management of Standards and Quality of Products (No. 85/PM) named the Science, Technology and Environment Agency (STEA) the central agency responsible for standardization activities. Based on interview with Director Nheune Sisavad, Department of Intellectual Property, Standardization and Metrology.

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<sup>20</sup> The Laos Food Safety report, however, noted that most of these regulations require a review and a revision. Moreover, more regulations on other issues have to be drafted.

are permitted within Laos and 26 active ingredients that are banned.<sup>21</sup>

- The Department of Agriculture (in the MAF) is pushing for an existing regulation on plant quarantine to be made into a national law.

### **Monitoring and enforcement**

**Animal health.** Effective management of animal health requires knowledge of the epidemiology of the diseases and movement of animals, which requires resources and organization.

- A reporting system for disease information was established from grassroots to central level. For the 10,044 villages in the country, there are 8,220 village veterinary workers that can gather information.<sup>22</sup>
- There are 10 international animal check posts and 6 operational animal disease diagnostic laboratories that can perform simple parasitological tests. Further, the National Animal Health Center (NAHC) can perform microbiological diagnosis and testing, except toxicological testing.
- In the Avian Flu outbreak, there was little facility to gather disease information. Also, the samples were submitted to Vietnam and Thailand for analysis. Funding from FAO has helped to establish an Avian Influenza diagnostic lab for disease surveillance and monitoring.
- A livestock project involving the tagging of cattle, vaccination and issuance of certification was initiated. Out of an estimated 1.2 million heads of cattle, approximately 35% had been vaccinated and 10% tagged with a cost of 6000 Kip per head. However, the project seems to be too costly and not effective.

**Plant health.** In the negotiations for market access for agricultural commodities, Laos may have to undertake a pest risk analysis (PRA)—a scientific analysis of the risk of moving pests with traded commodities. PRA requires information and knowledge of pests endemic to the country, a detailed record of the occurrence, distribution and prevalence of plant pests within the country. A major output of a recently completed project of the New Zealand Agency for International Development (NZAID) was the installation of a National Phytosanitary Database (NPD) system, a management information system that facilitates computerization of pest records and can be used to issue phytosanitary certificates. Plant health authorities can utilize the system and initiate the creation of pest records. There are six plant quarantine border posts, though these are lacking in equipment and personnel.

**Food safety.** The capacity, both in human resources and technical capacity, of the food safety agency determines the strength of the food safety control system.

- Food quality inspection is carried out at the point of entry. The importer must declare and provide samples which may be analyzed in the laboratory. If quality does not comply with the attached certificate, entry is not allowed.
- The Hygiene and Disease Prevention Department of the Ministry of Health monitors and maintains data on certain food-borne diseases.
- The staff of the Food and Drug Department (FDD) is insufficient for the inspection and enforcement of food regulations. Moreover, the educational background of most of the staff is on pharmacy. In the capacity plan of FDD for 2004-2005, out of 135 personnel, 90 have an advanced degree in Pharmacy;

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<sup>21</sup> Lao Report in the Plant Protection Commission 2003.

<sup>22</sup> Laos Food and Feed Report 2004.

only 40 percent of the staff received specific training on food.<sup>23</sup>

- Due to their tight budget constraint, the FDD has analyzed less than 400 food samples in 2000.
- Food safety courses for producers are organized only once a year.

**Issuance of certificates.** The issuance of certificates of quality for *domestic food products* is the responsibility of the pertinent departments—Department of Industry, Department of Agriculture, Department of Livestock and Fishery. For *imported foods*, most sanitary and phytosanitary certificates from exporter countries are accepted (special attention is paid to insect pests and diseases that could be a risk to crops in the country and in order to ensure national food security). Due to the country's limited capacity to analyze food, the manufacturer's analysis is often accepted. For *food exportation*, the issuance of certificates of food analysis and quality assurance is the responsibility of the Food and Drug Department and Food and Drug Quality Control Center of the Ministry of Health (MOH). The issuance of sanitary and phytosanitary certificates<sup>24</sup> for agricultural and animal products is the responsibility of the Department of Agriculture and the Department of Livestock and Fisheries, both of the Ministry of Agriculture. The quality of food and agricultural products to be exported has to comply with the requirements of the importing countries. With regard to organic production, the government still has no system for certification. Laos does not yet have a certification body for quality assurance systems (ISO 9000, HACCP). Companies

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<sup>23</sup> Since 1999, food safety curriculum has been added to medical science university and college of health and technology.

<sup>24</sup> In an interview with a private company, it was mentioned that the phytosanitary certificate needed for the export of potatoes has to be requested 10-15 days before the export date, even though it is not based on any substantial data, tests or inspection.

usually obtained certification from Thai certifying bodies.<sup>25</sup>

**Laboratory capacity.**

- The Ministry of Health assumes responsibility for the control of processed food and water, including hygiene in food and bottled water processing plants and restaurants. The two departments involved in food safety are the *Food and Drug Department* and the *Department of Hygiene and Disease Prevention*. The *Food and Drug Department*, together with its laboratory, the *Food and Drug Quality Control Centre*, is responsible for analysis of domestic food and quality assurance of imported foods. The Food and Drug Quality Control Centre performs tests on food samples submitted by food establishments for the issuance of certification. The *Department of Hygiene and Disease Prevention* is responsible for safe food practices (in particular, markets and street vendors) and the monitoring of 18 diseases. The *National Center for Laboratory and Epidemiology* provides laboratory services and coordinates the disease surveillance.
- The laboratory of the Department of Livestock and Fishery does analyses of animal parasites and diseases and issues certificates on the sanitary condition of meat products. Fish disease diagnosis on the other hand is being done by Namxuang Aquaculture Development Center and Living Aquatic Resource Research Center.
- The Agriculture Inputs Testing laboratory of the Plant Protection Centre in Vientiane tests fertilizer and agricultural produce for heavy metals, pesticide residues and microbiology.<sup>26</sup> These tests are for

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<sup>25</sup> UNIDO report 2004.

<sup>26</sup> UNIDO report 2004.

the issuance of phytosanitary certificates for exports (mainly rice, coffee and potatoes) at six border crossings to Vietnam, Thailand and China.

- The Animal Feed laboratory (under the MAF) collects and analyzes samples from the feed mills.<sup>27</sup> However, the quality assurance system is still hampered with the limited staff, inadequate equipment and methods of analysis, and the oftentimes unavailable chemicals and reagents.
- The laboratories in Laos are not internationally accredited. Accreditation can be done by a third country party. The option of creating a National Accreditation Body (NAB) in Laos may not be appropriate or efficient given the few laboratories, the absence of certification bodies, and the unavailability of highly skilled technical staff required.<sup>28</sup>

### Potential areas for growth

*Growing market.* Laos has a high agricultural growth potential. In its vicinity there are 200 million people in China, Vietnam, and Thailand with rapidly growing incomes and demand for products which

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<sup>27</sup> Control for the quality of animal feed is based on the animal feed standard and formulation of the US National Research Council. Information from “Country Report on Food and Feed Production in Laos” from the FAO/OIE Regional Food and Feed Safety Workshop, 19-22 July 2004, Bangkok, Thailand.

<sup>28</sup> Decree of the Prime Minister No. 85 on Management of Products and Goods allows the set-up of Certification Bodies within STEA as well as the set-up of a National Accreditation Body, however, due to the limited resources of DISM in particular the lack of testing facilities and skilled technical staff, Lao is currently unable to do so. However DISM now assists some factories to prepare for third party certified ISO 9000.

Laos can produce. The abundance of good soils and favorable climatic conditions in the highlands offer unique comparative advantage for producing temperate and off-season fruits and vegetables which are in high demand. Several of these production areas have already fairly good transport links with main logistic centers in neighboring countries. There is also growing interest from foreign buyers to outsource agricultural produce from Laos for supplying food processing plants in Thailand, Vietnam, and China. The potential market for fruits and vegetables is not limited to processing plants; there is a growing demand from fresh markets and supermarkets for fresh product as well.

*Adding value.* A good business strategy is to increase value-added to agricultural products in Laos. Technology and market access can be provided by investors from neighboring countries who are already active in these fields. Some of these companies even have well-established supply chains to the top-end of the market in Europe and Japan.

*Traditional crops.* Expansion of cultivated areas in the lowlands allows farmers to earn more income by expanding cultivation of traditional crops such as rice and maize. These products have low requirements for SPS services.

*High quality beef.* Demand for high quality beef in neighboring countries is rapidly increasing. Availability of large areas of grassland in parts of Laos offers opportunities for production of high quality beef. With the use of improved breed, cold storage and meat processing facilities, Laos has good potential. The government and private sources interviewed in the USDA FAS Gain report are recommending the livestock sector for possible investments stressing the suitability of the terrain for this production and the opportunities for both backward (e.g. forage, animal and supplementary feed processing technologies) and forward (e.g. slaughter

house, meat processing) integration and the resulting multiplier effects on local economies. However, the present capacities for animal disease surveillance and quarantine of bovine animals are insufficient, though better in urban than in rural areas. Easy and reliable market access would probably also require extensive negotiations with neighboring countries on disease surveillance, quarantine, and border procedures. The cost of necessary veterinary controls and investments for developing high quality beef exports are high. A feasibility study is needed covering costs and benefits of public and private investments.

*Organic farming.* The use of chemicals in agriculture is not very common in Laos. All pesticides are imported and not easily accessible or affordable for most farmers. This would make organic farming a possible niche market for Laos. However, because most farms are dispersed and remote, it is difficult to have an organic-certified production. The farmers cannot benefit from the premium price for organic products.

### **What needs to be done?**

In general, the capacities for managing SPS by the government and the private sector fall short of what is prudently needed for realizing the growth potential in agriculture through diversification and further opening for international competition. Shortages are not merely lack of budget, skilled staff and laboratory equipment; they include better governance, legislation, regulation, databases, monitoring, evaluation, negotiating skills, and, last but not least, private sector capacities.

The needs for monitoring and control of markets of agrochemicals deserve further assessment. To date, the use of agrochemicals in Laos is limited. However, with further diversification of agriculture, use of pesticides will increase. Given the widespread use of illegal pesticides in

neighboring countries and risk of illegal import, control capacities in this area deserve assessment. Regulation, monitoring, promoting good agricultural practice and enforcement of regulations will become important elements in promoting food safety and human health at home and in preventing restrictions of exports in foreign markets.

Laos' capacities for managing food safety, animal health and plant health in cross border trade are weak. Testing facilities and trained staff are very limited. Certificates are issued without adequate databases, surveillance, testing and inspection and, to some extent, perhaps without a necessity (not a buyer requirement). As for other trade regulatory services, there are governance problems in carrying out SPS border controls. This weakness in border control makes it more difficult to control and manage ongoing animal diseases—Foot and Mouth Disease and Avian Flu.

To date, there are no urgent plant or pest hazards that require immediate attention. However, with increasing intra-regional trade and agricultural diversification, new plant health hazards may be brought into the country from Thailand, Vietnam, and China, and trading partners may require new control measures. The lack of capacities for phytosanitary management in Laos adds to uncertainties and risks for private investors.

The capacity for inspection and laboratory testing is lacking in human resources, equipment and facilities. Laboratories are in need of upgrade of equipment and supply of chemicals and reagents to perform basic methods of analysis and, more importantly, to satisfy accreditation requirements. Appropriate scientific training of personnel is necessary to be able to perform tests and analyses. A plan with priorities is needed.

Laos still has significant governance problems in border procedures. For several products, reported formal and informal transaction costs contribute a high share of total cost in the supply chain and erode

competitiveness. Sanitary and phytosanitary controls contribute to this. Therefore, there is a risk that expanding sanitary and phytosanitary controls will do more bad than good, especially in areas of low SPS risks and in situations where governance is poor.

The government of Laos is budget constrained and has limited human resources. Expanding SPS capacities can only be achieved gradually and will require selectivity and shared funding as well as shared implementation by the private sector. Selectivity has to be guided by assessments of risks, costs, and benefits. In many cases, part of the implementation and cost can be left to the private sector, while the government can concentrate on core public roles and oversight of self-control measures by the private sector. Strengthening industry associations, such as for coffee and wood products, will be an important element in promoting self-control by the private sector.

### **Priority actions**

Given the economic context and circumstances of Laos, the following areas may be considered as priorities:

- Drafting of pertinent legislations and rationalization of existing regulations
- Creation of databases (e.g. collection of pest data for plant health) and improvement and update/maintenance of existing databases
- Setting up of an emergency response system (FAO is supporting this process)
- Human resource training and technical capacity (equipment and facilities) required for the control of animal diseases
- Creating public awareness on SPS requirements, safe food production and agricultural health
- Setting up an institutional coordination and collaboration mechanism to serve SPS requirements

**Action Plan for SPS management.** There is concern in government agencies about SPS standards and a feeling that something should be done. In particular, the WTO accession process adds to the sense of urgency. However, there is also some degree of apprehension based on a perceived lack of direction on how to accomplish the WTO and SPS requirements. A number of officials have expressed the need for a comprehensive discussion of SPS management that will:

- define basic capacities required to effectively manage food safety and agricultural health in the context of the Laos economy
- discuss factors that determine priority—i.e. potential in the export market, infrastructure obstacles etc.
- discuss possible gaps, overlaps and duplication in functions and activities that are not based on international good practice.

Moreover, there is clearly a need for a more detailed assessment of the present SPS capacities to better identify needs and priorities in capacity building. For this purpose, the preparation of an action plan is recommended. Such preparation will require information gathering and assessment on the following issues:

*Institutional responsibilities and coordination.* The division of areas of responsibilities among the various ministries may require some further clarification. With regard to the issue concerning post-harvest activities<sup>29</sup> of agricultural products, the National Food Law defines food inspection as “the examination of food, raw materials, production, processing, packaging, service, storage, distribution, importation, exportation and donation of food, including the testing of the food productivity and food products commencing from the primary

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<sup>29</sup> Post-harvest activities in the fruit and vegetable sector can be broadly defined to include cleaning, sorting, grading, packing, transport and storage.

production to the processed products...” The food management and inspection authorities are then defined to be the district, provincial and central levels of the Ministry of Public Health. The Ministry of Agriculture and Forestry and its area of jurisdiction are not mentioned. On another issue, the Agriculture Inputs Testing laboratory of the Ministry of Agriculture and Forestry performs pesticide residue testing, although this belongs more appropriately under food safety control which is the responsibility of the Ministry of Public Health. One important issue for WTO accession is policy coordination and establishing the Office of the SPS Enquiry Point.

*Adequacy of the legal and regulatory framework.* One of the primary requirements to set up the SPS framework concerns the drafting of *legislations and regulations*. Priority areas include:

- Delineation of functions and responsibilities among the various Ministries
- Import restrictions to protect against human health hazards, pests and diseases
- Regulations to monitor and enforce the import, production, sale and use of pesticides and veterinary drugs.

*Databases on food-borne diseases and pest and disease databases on agricultural health issues.* Databases are fundamental in the management of food safety, animal and plant health. Pest Risk Analysis (PRA) that is usually a requirement for market access for fruits and vegetables makes use of data on pest incidence. Proper implementation of disease control strategies such as zoning requires adequate understanding of the sources of infection and disease pathways into the relevant area. Records of incidence of food borne diseases contribute to the implementation of government health policies. The importance of databases is recognized in the number of donor projects providing assistance in the establishment of databases for Laos and other countries in the

region. The sufficiency of available databases and sustainability of their maintenance is still to be assessed.

*Capacities to perform risk assessments on food safety, animal and plant health.* Import regulations and priorities for public spending need to be based on some form of risk assessment. For exports of fruits, vegetables and livestock products, approvals are usually necessary from the importing country. These are based on negotiations with and risk assessments by the importing country. For negotiation, risk assessment capability can be an important attribute.

*Capacities to do cost benefit analysis on options for public intervention on food safety, animal and plant health and to set priorities.* Considering the scarce resources and the numerous capacities necessary to manage SPS requirements, it behooves the government to do cost-benefit analysis in considering the various options available in implementing SPS activities, whether it be controlling diseases, issuing certifications, setting-up surveillance and monitoring systems. In the area of animal health, the MAF undertook an animal tagging project—cattle were vaccinated and tagged. Out of about 1.2 million heads of cattle, the officers were able to tag only 10% at a cost of 6000 Kip per animal. Apparently, there is no clear benefit. More resources in general inspection, testing, quarantine and certification should be prioritized for areas with international requirements and areas with high risk. Also, there are certain activities, specifically, the control of animal diseases, that are most efficiently carried out in cooperation with other countries in a regional approach.

*Capacities for managing health hazards, animal diseases and plant pests, including rapid alert systems.* A communication network is essential for the necessary early response to disease outbreaks. The capacities of Lao PDR for managing health hazards, animal diseases and plant pests,

including rapid alert systems, communication networks, and emergency plans are very limited.

*Technical and human resource capacities to prepare policies, to monitor food safety and agricultural health, to perform tests for inspection, and to issue of certificates.* The technical capacity for equipment and facilities (for inspection and laboratory analysis, and database maintenance) usually entails a substantial capital expense that is not readily present in developing countries. The numerous SPS activities require skills that are, in certain cases, not available in Laos, such as chemical and microbiology analysis and food technology.

*Awareness of food safety among stakeholders.* Producers and processors do not understand the need for good practices in the production and processing of food. Also, there is no participation of the private sector in discussions on standard setting.

*Work programs carried out by the various services.* The team has not been able to collect and assess actual work plans in the light of priorities and capacities. Some activities carried out may not be priorities.

*Private sector capacities.* At least 15 exporting companies have to be visited with the aim to assess their SPS capacities and more general constraints to the private sector. Certain SPS activities can be facilitated with the help of industry associations. Farmers' cooperatives can facilitate dealings with either the government or with the investors-processors.

*Capacities for tracking and tracing and quality assurance.* An increasingly important requirement for certain export markets is the implementation of quality assurance systems (such as ISO 9000 and HACCP) in the processing plants. This presents a huge difficulty for small-scale processors. Part of the UNIDO project is concerned with initiating activities to enable

the Divisions of Standards and Quality under DISM, STEA to provide certification services for the quality assurance systems. A number of export markets extend their requirements beyond HACCP to include the traceability of inputs.

## Chapter 8: Business Environment and Institutional Framework for Trade and Investment

Promoting the business or enterprise sector, and particularly private enterprise, is a prerequisite for Laos to be able to take advantage of trade opportunities. But doing business in Laos is still difficult and costly, placing domestic producers at a disadvantage—both in terms of competing with imports as well as being competitive to export.

The problem of high cost of critical services, such as transport or telecommunications, is exacerbated by a cumbersome regulatory environment, at the national level as well as at the provincial level. Adding to the magnitude of the challenge is a relatively low level of entrepreneurial experience and know-how in Laos, which is an emerging market economy trying to compete regionally with its more developed and experienced neighbors.

This chapter analyzes the business environment in Laos, with an emphasis on the legal and regulatory environment for doing business in the country. The chapter details the business regulations and procedures that private entrepreneurs need to go through in order to do business, including detailed information on the existing business start-up, registration and licensing requirements, investment, and taxation. The focus on the legal and regulatory environment is not because it is the only element of the business environment that needs to be improved, but because amending the business regulations (especially sub-laws and/or legal documents such as decrees and decisions) is arguably the “quickest” and “least-cost” way to achieve a large improvement in the business environment. Building institutional capacity, strengthening entrepreneurial skills and improving the physical infrastructure, are equally important pieces of the jigsaw puzzle to significantly improve the business

environment in Laos. But significant improvements in each of these areas will require long-term efforts—and considerably more financial resources—than those required to streamline the regulatory processes.

### Where is the private sector?

It is almost 20 years since Laos started its transition to a market-oriented economy. In this time, however, there has been limited entrepreneurial response to the greater market freedoms. This “lack of supply response” is most noticeable in sectors requiring long-term investments such as manufacturing. In the entire country with a population of 5.6 million, there are only a few hundred manufacturing businesses with more than 10 employees (Table 1). The manufacturing sector continues to be overwhelmingly dominated by small or micro scaled enterprises. The relatively small number of medium-sized enterprises suggests that there are substantial constraints to firm-sized growth from small scale to medium scale. Only 30-40 percent of total manufacturing output and value added are accounted for by medium and large sized enterprises (with more than 10 employees) with the balance being made up by micro and small sized production units and the informal non-monetized economy.<sup>1</sup>

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<sup>1</sup> A GTZ study (1996) of small and medium enterprises, found that the average number of workers per firm was 1.9 (including the owner) among a population of 2,799 businesses visited. The domination of the micro-sized firms was confirmed by the 1999 UNIDO survey of small manufacturing establishments, which recorded a total of about 21,800 small manufacturing establishments (less than 10 workers), with an average size of about 2 persons. Three quarters of these were micro-grain mills. The output of the ‘other’ approximately 5,450 micro sized manufacturing establishments was 2.5 times

Manufacturing activities are also narrowly focused in four key sub-sectors—food processing, wood and wood processing, textiles and garments, and construction materials—making the economy particularly vulnerable to a shock in one of these sub-sectors.

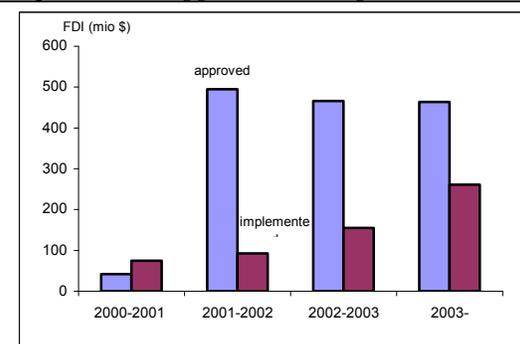
**Table 1. By far most firms are small scale**

	2000	2001
Large enterprises (more than 99 employees)	95	116
Medium-sized enterprise (10-99)	512	542
Small-scale establishment (less than 10 employees)	20,962	23,651

Source: CPI – National Statistical Center, Statistical Yearbook 2001.

The limited level of foreign investment and low numbers of domestic private firms are signs of a difficult business environment (Figure 1). The question is why the business environment in Laos is so difficult, and what specific high-leverage actions are needed to stimulate entrepreneurial activity and private investment.

**Figure 1. FDI approval and implementation**



Source: Government Presentation at Business Forum August 2004

higher than the grain mills and employed an average of 2.8 persons. This survey also showed that almost all of the establishments were operated as individual proprietorships, with only a small fraction run either under cooperative or partnership basis, and none reported on share capital basis.

## 1. Constraints to PSD: Policy and Legal Framework for Business

### Policy uncertainty

Lack of a clear and well-communicated government policy towards the business sector creates an unpredictable operating environment, undermines business confidence, and discourages investment. Entrepreneurs cannot be expected to invest in an environment where the “business ground rules” may change without warning or recourse, and in doing so, jeopardize the commercial viability and rationale of the original commercial decision to make the investment. In unpredictable/risky environments business activities are biased towards short-term activities like trade, against longer-term productive investments. This is largely the case in Laos.

In Laos, there have been statements made in some broad scope documents (such as the NGPES) confirming government’s support for business development. However, such statements are very general and not well communicated to the business sector. Policy commitments towards promoting private sector development remain vague and are typically not reflected in actions. Public-private dialogue, although improving, is very limited. At the simplest level it is difficult to get copies of business related laws, in part because the authorities have yet to compile a list of all related laws and regulations. Until very recently there was almost no consultation with the private sector in the development of legislation or administrative procedures affecting them, and effectively no transparency in the decision making processes of the government, though the situation is improving.

The combined impact of poor public-private dialogue, unclear and poorly communicated government policies, and a lack of transparency in decision making processes, creates a business environment with a high

degree of policy uncertainty. Inconsistent and opaque government policies and bureaucratic procedures continue to hamper the growth of business activity and promote vested interests. Further compounding the problem is the poor coordination of policies between the central and provincial authorities, with the effect that the practices at the provincial levels may differ from the central government explicit policy.

On the positive side, the government has taken some steps in recent years to move towards a more open and consultative policy approach with respect to the private sector. Two events in particular deserve to be highlighted. The first is the recent decision to host regular and structured Private Sector Fora, to facilitate the exchange of views and concerns between the policy-makers and business community. The first regular Forum was scheduled for February 2006.<sup>2</sup> The second event is the one-day forum that was held in mid-2005 to consult with the private sector on the outline of the sixth 5-year National Socio-economic Development Plan (2006-10) currently under preparation. This event represents a tremendous leap forward in the government's efforts to dialogue with the private sector. Remarks from local investors during this consultation are summarized in Box 1.

### **Legal framework for Business**

Much of the legislation governing business activities was enacted in the early mid-1990s soon after the start of Laos' transition to a market oriented economy, when the concept

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<sup>2</sup> MPDF is acting as the Secretariat for the Fora and has already started setting working groups and gathering initial list of issues from businesses in Vientiane Capital and the first working group meetings are expected to take place from mid July, an Inter-ministerial Team is being set up by the Government. In terms of geographical coverage, this year the focus will be on Vientiane Capital with 1-2 meetings of tourism working group in Luang Prabang. GTZ is planning to support some dialogue at provincial level

### **Box 1. What are private investors saying?**

#### *Comments from local investors*

On Government: (i) More transparency in the Government's procedures is required to operate in an appropriate way. (ii) Better-trained Government officials to deal with private sector issues. (iii) Domestic market is too small to attract investments. GoL's policies should concentrate in promoting export-oriented industries (iv) Long periods to set up a business (or to complete any kind of transaction with the Government) (v) Lack of coordination among different agencies.

On the Financial System (i) Banks are not lending following commercial criteria (suggestions that loans are given on political grounds) hence the number of non-performing loans in the system. (ii) Very expensive rates.

On the legal system (i) Laws are not being enforced consistently. Enforcement of existing laws, rather than creation of new ones, is the priority. (ii) Labour regulation too strict, difficult to dismiss staff. (iii) Corruption of officials in charge of law enforcement.

#### *Comments from Foreign Investors*

(i) Lao accounting system not standardized: two sets of books have to be kept for foreign companies. (ii) Fulfilling a company's tax duties takes up to 6 months per year. Highly incompetent GoL officials. Corruption on tax collection. (iii) Many potential foreign investors discouraged by the experience of current investors. (iv) Most of the companies are still paying 35% profit tax (while the GoL announced long time ago a reduction in this %) (v) Lack of training, low qualification of the Lao people is below the average worker in China or Vietnam. Vocational schools have to be created: some factories are undertaking this task privately for their own employees. (vi) Financial system: most of the components of the banking sector are unable to provide the private sector with lending on a commercial basis. (vii). Garment industry is being neglected by the GoL even though 26% of the export revenues come from this sector.

of a market economy was still not well understood by policy makers or legal drafters. Since then, capacity constraints in the central government and the slow, top-heavy law making process in Laos, have meant that only a few of these key laws have been updated to meet the needs of a modern market economy.

The laws are strongly “control-oriented”, i.e., designed to “control” business activities, rather than to facilitate them. There are inconsistencies and overlaps among the laws. The wording of laws is often vague, leaving too much room for interpretation and uncertainty. For example, the 1994 Business Law, instead of clearly stipulating which Ministries an entrepreneur needs to obtain authorization from, and the application procedures involved in setting-up a business, it vaguely states that: (Article 12):

“Persons having the intention to create an enterprise shall present an application for the creation and registration of such enterprise to the commercial sector. Application procedures for the creation and registration of enterprise will be separately determined by the relevant sectors.”

This vagueness gives officials considerable discretionary authority, and creates opportunity for corruption. It also places the entrepreneur in a vulnerable position of having to “do-the-rounds” of several ministries and agencies to obtain approvals and being in the “ask-grant” position. In many areas each Ministry/agency inserts its own clearance/authorization steps into the regulatory processes the entrepreneurs have to satisfy, which adds both to the time delays and documentary requirements entrepreneurs need to meet<sup>3</sup>. The combined

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<sup>3</sup> Take the case of an importer in Laos. As an importer of goods the entrepreneur is responsible for the self-assessment of the duty and tax liabilities on all goods imported, her/his authorized agent must prepare all necessary

effect of these outdated and relatively poorly crafted laws, the extensive regulatory requirements, and limited capacity of agencies, is a huge bureaucratic burden on firms in business which stifles business activity. It is therefore unsurprising, that in the global context, *Laos is consistently in the lowest decile across all of the World Bank’s 2005 Doing Business Indicators.*

The key laws relevant for business activities in Laos (in addition to the laws on taxation and international trade) are:

**The Business Law, 1994.** The 1994 Business Law is a basic company act that covers the establishment and operation of firms of all ownership types. It covers four types of enterprises: private, state owned, collective, and joint venture. The Business Law further defines two legal forms of enterprises: sole trader enterprise and companies. In general the law is fairly board-brush with vague provisions, although in some aspects it is very specific and thus rigid (e.g. specifying the amount minimum paid in capital requirement). A new “Enterprise Law”, that was recently passed by the National Assembly (9 November 2005) will replace the 1994 Business Law. The new law has been crafted with the input of international and regional experts and is expected to be a substantial improvement over the current Business Law. It has also been prepared through a relatively consultative approach including consultation with the business sector.

**The Industrial Processes Law (Factories Law), 1999.** According to the assessment of an ADB financed commercial lawyer working for the government of Laos on the revision of laws, the Industrial Processes Law is a particularly archaic and problematic law for businesses. The

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documents for presentation to customs. The list of documents required include: (i) customs declaration (ii) a cargo control or transport document (iii) a carrier advice note (iv) invoice and (v) relevant permits.

Industrial Processes Law requires manufacturing businesses to get approval/permission for all minor operating changes in their manufacturing production. It is also unclear how the Industrial Processes Law should be implemented because the implementing guidelines to support this law, which is already several years old, have yet to be issued.

**Labor Law, 1999.** This law provides protection of worker rights: for example, it clearly sets out the responsibilities of the employer and processes to be followed in dismissing a worker.

**The Land Law, 2003.** The amended Land Law of 2003 has expanded the nature and lease term of land use rights for individuals and firms, which has effectively made land lease rights a fairly close proxy to private freehold ownership, within prescribed parameters. For example, the Land Law (2003) allows the lessee to transfer the land use right, to give the right to another person or to dispose of the right to by sale, offer or exchange (article 57). But the Law also sets limits on the nature of this right, depending on the party involved. Foreign invested firms can lease land for up to 50 years for an agreed purpose. But if the firms' plans change (or their business involves sub-leasing) the term for which they in turn can lease out their land is determined on the basis of the feature, size and conditions of the activities, but in any case can not exceed three years. From a business perspective, especially for foreign invested firms, the land market still imposes many authorization/ approval steps, and leads to significant discretionary power of officials. For example, these firms need to first get State approval before they can use their fixed assets on its land as collateral (article 66) with local banks.

**Law on the Promotion of Foreign Investment, 2004.** The current Foreign Investment Law was recently passed in October 2004 and replaced its predecessor that dated 1994. In the assessment of FIAS,

this "new" law is not up to the same standard as the Investment Law now in force in Cambodia and (soon to be passed) in Vietnam, let alone international best practices. FIAS notes, that while there has been some progress in the most recent legislation over previous versions<sup>4</sup>, the new Law still falls short in fundamental areas including:

- (i) Investment Licenses: A less than transparent licensing approach based on loosely defined criteria which are to be spelt out in more detail in sub-laws and decrees. Significantly, this licensing rather than registration approach leaves far too much discretion with the Government officials with not enough certainty for the investors. Investors can often deal with risk but hate uncertainty;
- (ii) Investment Sectors: A reliance on a poorly defined "positive list" rather than adopting a "negative list" approach

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<sup>4</sup> Examples of where there has been some progress in the most recent legislation over previous versions include: (i) Land Rights and Uses: the new Foreign Investment Law version is clearer and explicit (Article 12.4) on land rights and uses than the previous Implementing Decree (Article 23.2 and Article 25) (ii) Intellectual Property Rights: a clearer and more explicit (Article 12.7) recognition of protection in the new Law; (iii) Length of Investment Term for Foreign Investment: extended to a maximum of 50 years (Article 11) in new Law from 15 years (Article 17.1) in the old Implementing Decree; and (iv) More timely screening: within the limitations of the screening approach for foreign investment applications, the new law (Article 20) requires a more rapid (Article 26 of old Law) response in terms of the number of days to respond to applications.

On the question of the Decentralization of Approvals, both the old Law (Article 28) and Article 4.1(a) of the 27 Feb, 2003 "Decision" do provide for the possibility of a role for the provincial authorities in approving promoted investment activities; this option is decided on a case by case basis by the Committee for Investment Management, Foreign Cooperation and Domestic Investment (CIC).

which would provide a more logical structure for defining the activities in which various categories of investors can invest; and

- (iii) Dispute Resolution: procedures are too general — however, the implementing decree does provide for recourse to international arbitration.

**The (revised) Law on the Promotion of Domestic Investment, 2004.** In contrast to the international trend of having a single piece of investment legislation for both domestic and foreign firms, thereby placing them on a level legal footing, Laos has maintained two separate regimes. The (revised) Law on the Promotion of Domestic Investment was passed in October 2004, at the same time as the foreign investment law, and replaces the previous domestic investment law of 1994. Many of FIAS' criticisms of the foreign investment law also apply to the domestic investment law, such as the less than transparent licensing approach based on loosely defined criteria. (This said, the Implementing Decree No. 300/PM which was approved by the Prime Minister's Office in October 2005 does provide some more details.)

**SME Decree, 2004.** The Decree on the Promotion and Development of Small and Medium Sized Enterprises<sup>5</sup> was passed in April, 2004. This Decree, sponsored by the Ministry of Industry and Handicraft (MIH), defines directions and policies and establishes an SME Promotion and Development Fund. The Decree, albeit brief, is very comprehensive in the scope of activities to promote SMEs, covering access to finance, training of entrepreneurs, setting-up new regulatory and administration

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<sup>5</sup> Small enterprise is defined as those having an average number of employees not exceeding 19 persons or total assets not exceeding 250 million kip, or an annual turnover not exceeding 400 million kip. Medium sized enterprises are those having an average number of employees not exceeding 99 persons or total assets not exceeding 1,200 million kip, or an annual turnover not exceeding 1,000 million kip.

environment, etc. The challenge will be to actually make this Decree operational and especially to finance the host of activities it proposes. The sources of funds for the SME Promotion and Development Fund are the national budget, international grants or loans, donations and service fees. This fund can be used to cover administrative and staff costs (including bonuses and training) of the Fund, financial support for SMEs and promotional activities.

**Decree No. 15 on Trade Competition (February 2004, effective in August 2004).** Prime Minister Decree No. 15 on trade competition provides key principles to regulate anti-competitive practices and to promote fair competition. The business environment in Laos is open to entry and competition by all entities. While there are about 150 state owned enterprises, including some large joint ventures, they operate in competitive sectors, with the exception of some of the utilities. In general, SOEs do not have preferential access to resources (such as commercial credit). Therefore, crowding out results more from the small size of the market and competitive pressures rather than from regulatory favoritism. Public sector entities are not required to purchase goods only from state firms.

**The Enterprise Law, 2005.** This new law which will eventually replace the 1994 Business Law was crafted with the input of international and regional experts and prepared through a relatively consultative approach including consultation with the business sector. Like the old Business Law, it covers the establishment and operation of firms of all ownership types. It stipulates and defines four types of enterprises: private; state owned; joint-venture (between government and domestic or foreign investors), and partnership. Moreover, it also defines three legal forms of enterprise: sole proprietorship, partnership, and companies. Once implemented, the new law will be an improvement over the Business Law as it reduces ambiguities of procedures and shortens the timeframe of business

registration approval. This is achieved by reducing the amount of documentation required and doing away with stringent conditions such as minimum capital requirements.

### Regulations and Procedures to Start a Business

It takes longer in Laos than any where else in the world, except Haiti, to start up a business (WB Doing Business Report). In order to formally establish a business in Laos entrepreneurs are required to go through a multiplicity of regulatory processes; obtain several licenses/certificates and meet heavy documentary requirements. This is a long, time-consuming, and in parts highly opaque process (the Law on Business is particularly vague on the sector/business license requirements). It provides room for extensive official discretion and encourages firms to remain informal. The process places extra costs on business set-up in Laos, especially in terms of the time of managers and government officials. The challenges of launching a business in Laos are shown below through four measures: procedures required to establish a business, the associated time and costs, and the minimum capital requirement. Entrepreneurs can expect to go through **9** steps to launch a business, take over **198** days on average, at a cost equal to **18.5 percent** of gross national income (GNI) per capita. (Note that there may have been some reductions in the time to work through all of these processes since the government has set time limits for approval of investment projects.) Entrepreneurs must deposit at least **28.5 percent** of GNI per capita in a bank to obtain a business registration number, compared with the regional average of **100.5 percent** of GNI and OECD average of **44.1 percent** of GNI (Table 2).

**Table 2. Doing Business indicators**

Indicator	Laos	Regional Average	OECD Average
Number of procedures	9	8	6
Time (days)	198	51	25
Cost (% of income per capita)	18.5	48.3	8.0
Min. capital (% of income per capita)	28.5	100.5	44.1

Note: In Laos, there are 9 key administrative procedures to complete - starting with obtaining application forms – followed by applying for a business license, investment license, enterprise registration certificate, tax licenses, asset registration, depositing capital registration money into a bank account and making a business sign, obtaining a company seal, and registering workers.

Source: Doing Business, 2004

Contrary to current international practices, Laos continues to require the submission of a feasibility study/business plan for all businesses. In the Lao context, given the low capacity of the bureaucracy, it makes even less sense for bureaucrats to assess business plans. The heavy regulatory burden encourages enterprise “informality”, rather than growth. Many businesses do not bother to apply for enterprise registration because it is such a long process. Instead they pay a monthly fee to the district authorities, and a monthly lump-sum amount to the tax collectors as “profit-tax”. Such businesses do not have a Tax License because they do not have the business registration, a necessary prerequisite. Thus in the cases of some types of businesses at least, such as small restaurants, there is little incentive to formally register, and no penalty for not being registered.

The start-up procedures cover the period from when the entrepreneur decides to start a business to the stage where (s)he has fulfilled the necessary requirements to legally open for business. A firm in Laos requires at least *four* separate licenses/certificates before it can start operations:



**Sectoral or (business) approval.** A sectoral or business approval or license is required by Article 16 of 1994 Business Law. This provision is currently still a concern as the new Enterprise Law has not yet been fully implemented.

The approval specifies exactly what type of business the applicant can carry out. In an effort to facilitate new firm entry, most transition economies have moved from a licensing regime to a system based on a simple registration process, where all business activities are allowed unless explicitly prohibited. In contrast, Laos is still effectively operating a licensing regime, even though all firms must also receive a certificate of registration. Obtaining a “license” to operate is the first key step in legally setting up a business, and a necessary prerequisite for obtaining a business registration. Under a licensing regime the would-be entrepreneur prepares a business plan or feasibility study<sup>6</sup> (together with several other documentary requirements), which is then reviewed by officials either in the relevant sector or line ministry/department or the investment

<sup>6</sup> This requirement is in the yearly plan.

agency, depending on the sector of activities and/or the ownership of the proposed firm.

*Domestic businesses* under the 1994 Business Law (No. 03/NA) are required to apply directly to the relevant sector agency/other concerned ministries to obtain a “business” license.<sup>7</sup> The documentary requirements vary according to the specific regulations of the sector concerned, but at minimum include the (i) business plan (feasibility study), and (ii) professional certificates of owner and future staff of the business. According to the Law on Business, the “relevant” sector agencies and concerned government bodies have 60 days in order to review the business application and provide their comments to the Ministry of Commerce.<sup>8</sup>

Once the new Enterprise Law is fully implemented, sectoral or business approvals/licenses will be required only for businesses to be set up in sectors that are contained in a controlled list, where a “controlled” sector is defined as one that is highly sensitive with respect to national security, social order, culture and tradition and environment. The exact content of the controlled list is yet to be specified. The approval specifies exactly what type of business the applicant can carry out. Under the new Enterprise Law, it will be possible

<sup>7</sup> The wording in the Business Law is very vague as to which agencies need to be involved. Article 16 states “persons having the intention to create an enterprise shall present an application for the creation and registration of such enterprise to the commercial sector. Application procedures for the creation and registration of enterprise will be separately determined by the relevant sectors”.

<sup>8</sup> Article 16 of the Business Law specifies that all relevant sectors and agencies review a business application for the establishment of a business and provide their comments to the Ministry of Commerce within 60 days. The Ministry of Commerce has tried to shorten this period with the issuance of MoC instruction No. 750 August 6, 1996, which states that response, should be provided in 30 days.

to register businesses directly at the relevant trade authority (ministerial, provincial or district authority depending on the size of the planned business). Trade officials will respond within 10 business days if the sector is not contained in the controlled list. If, on the other hand, a business is listed in the controlled list, the relevant sectors/agencies' approval is needed. The latter are required to respond back to the trade authority within 10 business days, except where special assessment is needed, e.g. in cases where there are environmental concerns.

In case an application is rejected, the agency should give reasons in writing. However, the documentary requirements may vary according to the specific regulations of the sector concerned.

**Investment License.** The recently amended Law on the Promotion of Domestic Investment, October 2004 (Article 12) requires persons or juristic persons who want to invest in any economic/social sector that relates to procurement's rights and activities in investment sectors as stated in Article 9 shall duly fill an application form made by the Committee for Planning and Investment (CPI) together with preparing a copy of the family register book, resume, feasibility study or business plan, and JV agreement (in the case of a joint venture). After that, these documents have to be submitted to the Department for the Promotion and Management of Domestic and Foreign Investment (DDFI) under the CPI for its consideration. Apart from the aforementioned sectors, the application should be submitted to the Internal Trade Department or Provincial Trade Offices under the Ministry of Commerce. After receiving the required documents, DDFI will respond to a subscriber within 30 working days for activities related to procurement's rights. For other activities, the feedback shall not be given later than 20 working days. For activities relating to trading sectors, the Internal Trade Department or Provincial Trade Offices will respond within 20 working days. Local investors that submit the application to DDFI if all

conditions are met will be granted the investment license, business registration, and tax registration altogether by the DDFI. For local investors who submit the application to the Internal Trade Department and comply with all conditions business registration and tax registration will be granted by the Trade Department. While an implementing decree for a one-stop shop has been drafted, it has not been agreed to by government or passed by the National Assembly.

*Foreign investors* apply for foreign investment licenses through the DDFI, thus removing the need for foreigners to apply directly to the various sectoral ministries. Foreigners submit an application to investment authorities at the central or provincial level with copies of passport and resume of the foreign investor; feasibility study or business plan; background information on the investor, or JV agreement (if applicable). DDFI then coordinates with all relevant agencies and responds in writing to the foreigner investor within 15-45 working days, depending on area of activities and whether a concession is requested. Foreign investors who qualify will obtain a foreign investment license from the DDFI. Within 90 days of receiving this investment license the business must operate in accordance with the feasibility study or business plan, if not the investment license may be revoked.<sup>9</sup>

Under the recently amended Foreign Investment Law the DDFI can also organize and provide the foreign investor with (i) an Investment License (ii) a Business Registration Certificate and (iii) a Tax Registration Certificate at the same time, in a one-stop-shop approach.

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<sup>9</sup> A 90 day period is extremely short by international practices. Indeed most consider 12 months too inflexible, especially where construction or land acquisition is involved.

**Business Registration Certificate.**<sup>10</sup> Once entrepreneurs have obtained their sectoral and investment license, they apply for a Business Registration Certificate to the Internal Trade Department, Ministry of Commerce (whether this is submitted to the central, provincial level or district level depends on the nature and scale of business<sup>11</sup>). To be registered, domestic investors and enterprises in commerce, for example, need to submit the following documentation to either central or provincial level authorities as appropriate: (i) Application form from the Ministry of Commerce, (ii) Curriculum Vitae, (iii) Asset statement, (iv) Criminal record clearance No. 3, copy of an ID card, 3 photos of

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<sup>10</sup> Notification on Procedure for Business Registration in Laos. Announcements No.0530/MOC, dated 10 May 2002 & No.0538/MOC, dated 13 May 2002. Ministry of Commerce, Domestic Trade Department (Business Registration Division) hereby notifies the procedures for Business Registration and documents required for Enterprises.

<sup>11</sup> The **Ministry of Commerce (Internal Trade Department)** handles the registration of (i) investment whose registered capital is more than or equal to \$200,000. (ii) Enterprises engaged in import of vehicles, gas and export of wood products. (iii) State-owned enterprises and state-owned joint venture enterprises. The **Trade Offices** in the **Provincial, Capital and special zone level** handle the registration of (i) investors whose registered capital is less than \$200,000. (ii) Enterprises regulated by or that have dealings with other main sectors such as: agriculture, industry and services. (iii) Commercial enterprises engaged in export-import outside the administration of the Ministry of Commerce. At the **district level** small business enterprises which operate outside the Ministry and Provincial jurisdiction should register with the district offices; these are: (i) Branches (ii) Small shops. (iii) Others. Source: Notification on Procedure for Business Registration in Laos. Announcements No.0530/MOC, dated 10 May 2002 & No.0538/MOC, dated 13 May 2002. Ministry of Commerce, Internal Trade Department (Business Registration Division) hereby notifies the procedures for Business Registration and documents required for Enterprises.

passport sized; (v) Regulation confirmed by commerce authority, and (vi) Business feasibility study. If all documents are complete as required, the registration process should be completed in 24 hours.<sup>12</sup> However, once the new Enterprise Law will have been fully implemented, less documentation will be required.

**Tax registration.** After entrepreneurs have obtained their business registration, the “registration of revenues shall be made with the [Tax] Department” (Article 18 of the Law of Business) and the firm will be issued a tax registration certificate. Foreign investment companies must obtain this registration within 90 days of receipt of the Foreign Investment License<sup>13</sup>.

**Other Licenses and Permits.** In addition to the four above-mentioned licenses/certificates, firms are required to obtain some additional permits or fulfill other certain regulatory processes. The number of these “additional” permits required depends to some extent on the nature and size of the proposed business. The following list is by no means exhaustive.

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<sup>12</sup> To be registered: **Domestic investors and enterprises in sectors other than commerce** need to submit the following documentation to either central or provincial level authorities as appropriate (i) License from the concerned sector (ii) Registration form (iii) Curriculum Vitae (CV) (iv) Asset statement (v) Criminal record clearance No 3, copy of ID card, 3 photos. Whereas **Foreign Investors** must submit the following documentation to either central or provincial level authorities (i) Investment License from the CPI (formerly FIMC) (ii) Registration forms (iii) Copy of passport. (iv) 3 photos (v) Letter of authority from the manager of company. (Note: Foreign investor can now get this registration as part of the package when applying for their Investment license). See Minister of Finance’s additional announcement No. 0341/MF, dated 21/02/2002 for fees involved.

<sup>13</sup> Under the Foreign Investment Law October 2004, the DPDF will obtain this tax registration as part of the overall licensing package service they provide.

- *Company seal* – all firms need to file an application with the Ministry of Public Security – Police Department for a company seal.
- *Company sign* (required by Articles 19 of the Law on Business).
- *Registration of workers*. (Social Security Decrees 207, Dec.1999, Article 48 Labor Law 1999)<sup>14</sup>.
- *Document registration*. FDI companies must also register its legal documents and pay document registration fees.
- *Additional sector specific licenses*: for example, garment exporters claim they need six licenses and permits before they can start operations.
- *Registration of accounting books* “Before utilization the accounting books shall be registered with numbering, sealed and signed by the competent tax authority. (Article 61 of Tax Law)
- *Certification of the “The bills of payment receipt”*<sup>15</sup> (effectively a firm’s invoice book) needs to be checked, certified and

sealed by the related tax officials before its utilization. (Article 62 of the Tax Law).

- *Asset registration*. A newly registered business is required to declare and register its physical assets with officials of the Department of Housing and Lands and the Ministry of Finance. The declaration of assets is minutely detailed, including both movable and non-movable assets of a business. MOF appraises the value of the assets based on the predetermined standardized values, and a fee of 0.01 percent of the total value is assessed on the business. According to the MOF, the time to complete the procedure ranges from 2 days to 7 days, depending on the availability of government personnel to appraise the value of the assets and assess the fee to the complexity of some of the more tangible assets owned by the businesses.

In addition to these above-mentioned processes, entrepreneurs who want to set up manufacturing factories, involving the acquisition of land, construction of a factory, and the importation of capital goods (equipment), will need to go through considerably more procedures, which can be expected to add at least 6-12 months to the processing time.

#### *Construction Permit & Utilities:*

- A permit is required for all new construction. The approval process is time-consuming, and requires either a large MCTPC or an inter-departmental committee to consider and approve the construction plans. Utilities are inadequate, especially in the areas designated as Special Economic Zones (SEZs). The process for seeking approval and connection of utilities is costly and time-consuming, taking, for example, up to 10-12 months in Savannakhet’s two SEZs.

<sup>14</sup> Art. 48 of the Labor Law 1999 states that each labor unit in the socio-economic sectors should establish a social security fund... and workers and employer shall contribute to the social security fund in accordance with regulations adopted by the Government. Employee registration is covered in Social Security Decree 207, December 1999.

<sup>15</sup> Article 62 of the Tax Law requires those who deal in such business as production, trade and services, or have an independent job-occupation and pay the profit tax on the system of accounting holding as stated in Article 41 of the present law as well as providing the sales of goods and services, shall issue the bills of payment receipt to the buyers or clients served. The bill of payment receipt shall consist of the following contents: i) Name and location of the shop selling goods, commodities or providing services; ii) Name and address of the buyer/of clients receiving goods or services; List of items sold or services provided; Price of goods without turnover tax or services charges divided on each separate rate; iii) Amount of the calculated turnover tax divided on each separate rate; Total price of goods or services including the turnover tax.

*Factory License:*

- Entrepreneurs must submit an application for approval to the Ministry of Industry and Handicraft (central, provincial or district level) along with details of the factory layouts, master list of equipment, electricity plan, and drainage and waste water systems. The more complex the manufacturing process, the longer it will take to obtain a Factory License. The approval speed varies between provinces.

### **Trade and Tax Regulations and Procedures to Operate a Business**

The regulatory burden does not just go away when a firm finally satisfies all the necessary requirements to start-up a business. Indeed meeting bureaucratic requirements is a part of firm's daily life in Laos. There are many repetitive regulatory requirements a "standard" firm must meet doing the course of a year. Some of these are quarterly, semi-annual, or annual requirements. If a firm is dynamic, that is, it grows, expands its scope of activities or product range, opens new branches, increases its capital or asset stock, or incurs any other "changes", this firm would be required to meet several additional regulatory requirements<sup>16</sup>.

**Tax requirements.** Feedback from entrepreneurs suggests that their interaction with the tax officials is the most problematic of all bureaucratic process. Tax-related issues were among the main concerns raised by entrepreneurs during the recent

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<sup>16</sup> For example, to expand existing business activities (e.g. additional factories, production lines, or branch offices), the entrepreneur must submit a new business plan and financial forecast to the MOC and MOF for approval and pay the additional license fees to the concerned departments. From the interviews with the entrepreneurs, it is unclear how long the process takes, but estimates range from 2 weeks in Savannakhet to several months in Vientiane Capital and Udomxay.

government consultation on the 5-Year Socio-Economic Development Plan; in particular they noted:

- Fulfilling a company's tax duties takes up to 6 months per year:
- Government officials are highly incompetent and tax collectors are particularly corrupt
- Most of the companies are still paying 35 percent profit tax, despite the fact that the government announced a reduction in this rate a long time ago.

The tax system of Laos consists of direct tax (profit tax, minimum profit tax, income tax, fees etc) and indirect tax (turnover tax and excise tax)<sup>17</sup>. Most businesses pay a monthly lump-sum for taxes, as well as the annual tax in quarterly installments (Article 48 of the Tax Law "those who pay the profit tax

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<sup>17</sup> Indirect taxes: (i) **Turnover tax** is collected from imports, sales of goods and general services. (ii) **Excise tax** is imposed on some products imported or manufactured by domestic producers for sale inside the country, considered luxury consumer goods such as cosmetics, alcohol, soft drinks, etc. Direct taxes: (i) **Profit tax** includes business profit tax and profit tax from self employed activities. It is paid annually based on the total profit or income obtained within the year (ii) **Income tax** includes salary, wages, interest from loans, rental incomes, income on dividends, royalties, income from movable and immovable property, (iii) **Minimum profit tax** is a "minimum duty" of anyone who operates a business in Laos (domestic and foreign) whose income falls below the threshold for payment of normal income tax., **Fees/charges** are those collected from the issuance of the tax registration license, road tax, river transport fees, border entry and exit fees, etc. Source: Presentation by Mr. Daovala Phommala, Assistant to Director General, Ministry of Finance Laos in Tokyo, October, 2004. The Tax Department in Laos consists of a Head Quarters, 18 Provincial Tax Offices and a number of District Tax Units in each province and at the village level a grass roots tax collection administration. The Province Tax offices administer the large and medium sized taxpayers and the district offices administer the small tax payers, and villagers – the very small.

according to the extended or ordinary accounting system shall pay, the annual profit tax (each phase shall include three months) based on the profit of the previous year or the estimated profit of the fiscal accounting year). On an annual basis, firms need to (i) submit a financial report to the relevant authorities, to be audited by the State Audit Authority or an independent audit company established in Laos<sup>18</sup>; (ii) pay Minimum Tax, annually based on the annual business income or the total annual income of the preceding year (at the rate stated in Article No. 55 of the Tax Law); and (iii) facilitate an audit by tax department.<sup>19</sup>

The tax system involves a relatively complicated web of advance payments and refunds, which seems to be more designed towards generating over-payments than making it easy for firms to meet their tax obligations. For example, importers, or producers who operate sales or services inside the country and have paid the initial tax (at customs checkpoints) shall have the right to get the deduction of initially paid turnover tax from a monthly tax amount due to payment. If the amount of the initial tax paid exceeds the monthly tax volume, the difference shall be transferred to the next month deduction until its completion. Those who are able to obtain the initial tax deduction, shall have the tax registration with the tax authority and hold a legal accounting system as well as providing a full set of tax payment certificates, such as import documents on tax declaration (D10), tax-payment receipts and invoices stating a certain turnover tax amount. If firms do not *perfectly* meet all the complex documentary requirements they will not be able to obtain the refund for the excess tax paid.

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<sup>18</sup> Article 7.2 Law on Domestic Investment 2004.

<sup>19</sup> The audit shall be made at least once a year, but if it is considered as necessary, the audit can be made earlier. Article 75 of the Tax Law requires the tax agency to give 10 days warning, in writing, of a tax inspection “to let them prepare all necessary accounting documents and select an accounting consultant to assist in the explanations during the audit.”

Firms complain that the approach used to impose taxes is arbitrary and that unfair practices are used to determine the amount of the different taxes. The tax amount paid is reportedly more of a result of the negotiation between the firm and the tax officials. Firms also report that as a standard practice, tax officials do not accept the profit figures in the business's accounts and negotiations take place to determine the final payments. In these negotiations the entrepreneur is in a vulnerable position because if he does not accept the “negotiated amount” he risks non-renewal of his license. Domestic businesses complain about the penalties regularly imposed at the end of the year by tax authorities, claiming that either no concrete reasons are given or they are groundless. Again, negotiations will take place and the firm finally has to pay a fee, officially or unofficially.

Further complicating the businessman's frustration with the tax system is the fact that apparently the Lao Accounting System is not compatible with the Lao Tax System. Both systems produce different profit figures, because deductions that are allowed under the accounting systems are not accepted in the tax systems.<sup>20</sup> Foreign firms in particular complain that because the Lao accounting system not standardized they have to keep two sets of books.

Firms also report that in addition to the national taxes, other taxes and duties are being imposed by the village, district and provincial levels. For example, the village reportedly has a production tax. The legal bases of these additional taxes are unclear.

**Trade procedures.** Firms that trade internationally need to submit an indicative plan of imports and export volumes to trade authorities (provincial trade offices) on an annual basis. For example, at the beginning of each year garment exporters have to

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<sup>20</sup> For example, interest paid for loans from shareholders is a deductible cost in the Accounting system but not in the Tax system.

estimate the volume and the kinds of fabrics they intended to import and the volume of garments for exports. If they later exceed this volume because of more orders than expected, it reportedly takes at least 14 days to get the required approval for an increase in quota.

Beyond these specific requirements, the Business Law provides opportunity for considerable government intervention, especially with respect to businesses wishing to operate in the following sectors: “food, medicines, petroleum, water supply, telecommunications, wood and wood products, mining and minerals, chemical substances, alcohol and cigarettes, which are subject to “close control by the State” (Article 13 of the Business Law and Prime Minister Decree on Export-Import Management, no 205/PM, dated 11 October 2001).

***The export of goods from Laos requires a series of relatively time-consuming procedures.*** The process includes steps such as the conclusion of an export contract, the securing of export permission, customs clearance and shipment, and the collection of payments. The following provides an outline of the export procedures, using a Letter of Credit (probably the most typical case).

*Key procedures for exports using the L/C method to export garments and textiles*<sup>21</sup>.

- *Official confirmation that items are not on the restricted export list.* Firstly, entrepreneurs need a “recommendation from an authority assigned” to determine whether the export items (listed on the L/C of the importer) are included on the list of products restricted from export under the government’s export-import

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<sup>21</sup> Source: Website of the Export Promotion Division of the Lao National Chamber of Commerce and Industry.

notice. Assuming that they are not, next the exporter needs to:

- *Obtain Export Permission.* The exporter needs export permission for every export transaction he makes from the provincial trade offices. On the application form the exporter must include exporters name, the port of lading, settlement method, and period of validity, as well as specifications of the export items.
- *Export Inspection of designated export items prior to shipment.* Export inspection is not required for all commodities but pertains only to those items designated by the government, e.g. textiles and garments.
- *Customs Clearance.* The exporter must deposit the export commodities in a bonded area before submitting documents to the head of the customs house for clearance. The customs clearance house inspects export commodities against invoices and export permits. If all is found to be in order, the customs house issues an export declaration for customs clearance (Box 2 gives the example of garments).

***The importation of goods is also a time-consuming process.***<sup>22</sup> The procedures range across the conclusion of import contracts<sup>23</sup>, the securing of import permissions, customs

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<sup>22</sup> Source: Website of the Export Promotion Division of the Lao National Chamber of Commerce and Industry.

<http://www.lncci.laotel.com>

<sup>23</sup> An import contract is included when an offer based on a written agreement or a contract between a Lao trading agent and a foreign supplier is received, or an offer issued overseas from a foreign exporter is accepted, administered according to the Foreign Exchange Regulations, the Custom Law and with special reference to the Export & Import Regulations issued by the Ministry of Commerce. All items can be freely imported unless they are specifically controlled or prohibited goods.

clearance and payments for imports. Imported goods legally enter into Laos when shipments have arrived at the port of entry, estimated duties have been paid, and delivery of the goods has been approved by the customs house concerned. The key regulatory steps are as follows:

- *Obtain an import license* from the provincial trade offices where the importer is situated. (The Ministry of Commerce delegates its authority to issue license to the provincial trade offices). An import license remains valid for, in principle, three months. Payment for imports, as well as customs clearance of imported goods, should be completed within the term of the import permission. (See Chapter 2 on Trade Policy).
- *Establish the Letter of Credit (L/C) exactly in accordance with the importing permit.* The party receiving import permission must establish an L/C through a foreign exchange bank within the effective period. When arranging the L/C, the same information as noted on the import authorization form must be used. The amount of the L/C should not exceed the authorized amount, and it must be expressed in the same currency specified in the import authorization form.
- *Customs Clearance.* The importer unloads the imported freight and places it in a bonded area house. The customs clearance report can only be prepared by a consignee (importer). Upon receipt of the import, the customs house inspector will verify that the contents of the imported merchandise correspond with that described in the import authorization form and confirm that the documentation is in order. The tariff on the merchandise is then calculated and levied, and an import approval is presented to the person reporting the import. This person may remove the imported merchandise from the

bonded area. After doing so, the import procedures are complete.

**Box 2. Exporting Garments from Vientiane.**

Garment exporters from Vientiane Capital complain that the numerous rules and regulations associated with the export of garments from Laos hinder their efficient business operations. There are currently 59 garment exporters in the capital. These exporters are particularly critical of the *export inspections and clearance progress*. According to garment exporters, the practice is that representatives from the Department of Customs and a representative of Economic Police need to be presented to inspect, monitor and count the loading of a truck with cartons for export. Only 15 policemen are available in Vientiane Capital for this process and difficulties arise because of the lack of officials available. Moreover, as the police are not motorized, the exporter needs to “pick-up” the official. When the checking/loading process is complete the truck is sealed by the Economic Police and transported to the border. At the border – 20 km away, the seal is reopened and the shipment is re-checked by the customs and sealed again. Then the shipment crosses the border. At the other side the seal is broken again and checked by the Thai customs officials. *So over a distance of about 20 kilometers an export shipment has been checked and sealed three times by different officials.*

In practice the complexity and time that firms need to spend to satisfy the import procedures depends, to some extent, on the products being imported. For example a domestic factory owner located in the Vientiane Capital requiring one shipment of imported chemicals each month for the manufacturing of his finished goods for exports: At the beginning of each year he provides an estimate of the amount of import volume to the Ministry of Commerce. The procedure for the approval of monthly imports then takes him two months to obtain, and requires him to apply for approval at three ministries (i) Ministry of Defense (ii) Ministry of Health and (iii) Ministry of Communication Transport Post and Construction (MCTPC).

## Capacity and Institutional Constraints

*Capacity constraints are numerous, especially at the provincial level.* The practical experience of firms does not always align with the specifications and time-lines set out in the legislation. How long it takes to complete the regulatory processes required to set up a firm will depend greatly on the implementation effort by the provincial authorities.

Laos is a highly decentralized country. This is particularly true for all authorizations and official interactions involving the private sector. Provincial governments, rather than the central authorities, are responsible for processing/authorizing firm registrations and investment licenses; for firm-level inspections; for allocating land-use rights and a private firm's access to other resources. Except for some very large or politically sensitive business ventures, the various authorizations an entrepreneur needs to do business are provided at the provincial level or below.

The capacity, attitude, and workload of the officials concerned varies by agency and provincial location and significantly influences the time and "hassle-factor" involved for entrepreneurs going through these processes. The provinces located on key trade routes tend to be more "business-savvy" and supportive. The officials in the less well connected provinces often lack a clear understanding of private sector activities and often, despite good intentions, tend to be obstructionist rather than supportive to entrepreneurs. But the regulatory procedures in the country's capital, Vientiane, were found to be the most burdensome and time-consuming, due to a rigid and hierarchical approach taken by capital city bureaucrats.

Provincial differences can be illustrated through the example of obtaining a Business/Sector license (one of the many steps required to step up a business). In

each of the six provinces reviewed<sup>24</sup> a separate Business License application is required by each ministerial department, which involves a very time consuming process for the entrepreneur (to obtain the applications, complete and file each application at the different departments). But the application submission requirement varies from submitting an individual application at the concerned provincial offices in Champassak, Khammouane, Luang Prabang, Udomxay and Vientiane capital, to submitting all applications together at any one department in Savannakhet province, where the department will in turn distribute the applications and coordinate the approval process. Champassak, Luang Prabang, and Savannakhet do not impose any extra administrative processes before approving the licenses. But in Udomxay an inspection of the business site is required. Vientiane capital requires in-person interviews with several departments, often over many rounds before the licenses are approved. In Khammouane an inspection of existing land (if a new business already owns the land rights) for agricultural activities is required. Overall, the procedure was found to be the most streamlined and efficient in Savannakhet, followed by Champassak and Luang Prabang. While in Khammouane, Udomxay, and Vientiane capital, the procedure seemed lengthy and time consuming with many redundant parts (Table 3).

Provincial capacity and attitude is the key factor determining the length of time and ease of dealing with this procedure. In a pro-business province, the government combines the irrelevant or small processes to expedite the completion of a procedure. Whereas in other provinces, the procedure took much longer than the requirements stipulated in the legislation, either (i) because extra administrative processes are added to a procedure for "control" or "rent

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<sup>24</sup> Champassak, Khammouane, Luang Prabang, Udomxay, Savannakhet, and Vientiane capital.

seeking” purposes, making it more cumbersome and time-consuming, or (ii) there is a lack of understanding of the need to expedite the business start up and operational procedures in order to facilitate the growth of businesses and the private sector.

**Table 3. Reports of exporting firms highlighting provincial differences in the handling of exporting procedures**

Province	Exporters’ experience in seeking approval for exports
Champassak	<ul style="list-style-type: none"> <li>• Export of coffee is handled with much less administrative procedures, no quantity check, a Certificate of Origin can be issued in Pakse, and only 13 approval stamps are needed.</li> <li>• Export of wood products are inspected twice, in Pakse and then again at the border. In all 24 approval stamps are needed.</li> </ul>
Khammouane	<ul style="list-style-type: none"> <li>• A wood furniture exporter has to obtain 19 stamps before a shipment can cross the Mekong River to Thailand.</li> </ul>
Udomxay	<ul style="list-style-type: none"> <li>• An exporter of agricultural products (maize, job’s tears) recalled each shipment being inspected in Udomxay and again at the border, and had to obtain at least 19 approval stamps before the shipment leaves Laos.</li> </ul>
Vientiane capital	<ul style="list-style-type: none"> <li>• An exporter of parquet floor and wood furniture had to obtain 27 approval stamps from the various departments before a shipment can cross the Friendship Bridge to Thailand.</li> </ul>
Savannakhet	<ul style="list-style-type: none"> <li>• As far as can be determined, all exporters are subjected to only one inspection in the city (a distance of 2 km from the Provincial Administration to the ferries), and 8 stamps are needed.</li> </ul>

Source: interviews with entrepreneurs

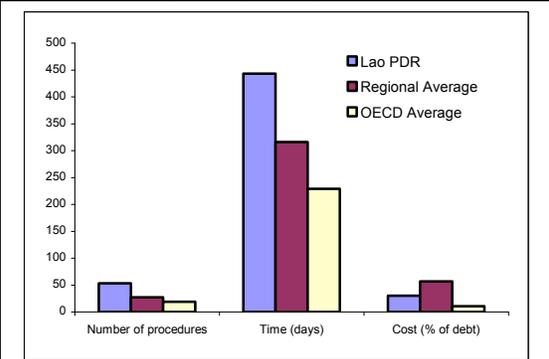
**Institutional Constraints.** As is normal for an economy in transition from a centrally planned system to a market oriented economy, many of the institutions needed to underpin a market economy have not yet been established or are very new and require strengthening. For example, Laos now has a reasonably comprehensive set of business laws, albeit of mixed quality, but it lacks the institutional capacity to effectively enforce these laws.

There is little effective recourse to the Court system in Laos, or other formal alternatives to resolve disputes between businesses, or to enforce contracts. It will necessarily take

considerable time to build this institutional capacity, as it involves the training of commercial lawyers, etc. Nevertheless, Laos has made this process much more complicated than need to be, and certainly far too complicated given the capacity constraints in the country, by inserting numerous procedures.

The 2004 Doing Business study assessed the ease or difficulty of enforcing a simple contract, counting the number of procedures from the moment the plaintiff files a lawsuit until actual payment. It found that in Laos, this involved 53 procedures and took 443 days compared to the regional average of 27 procedures and 316 days (which is still high by international standards). And the cost of enforcing the contract, (court and attorney fees) is equivalent to 30 percent of the value of the debt (Figure 2).

**Figure 2. Enforcing contracts—where does Laos stand regionally and globally**



Source: Doing Business 2004

Similarly, the process of registering property is more complicated and time-consuming than in most other countries (Table 4). The Doing Business Report looked at the ease with which businesses can secure rights to property, by comparing the number of procedures necessary to transfer a property title from the seller to the buyer. In the case of Laos, this process was found to involve 9 procedures and take 135 days, compared to 4 procedures and 51 days average for the East Asia region. Again Laos is making itself relatively less competitive by inserting additional procedures, which in a country of

low capacity significantly add to the time it takes to meet these requirements and to the frustration of businesses.

**Table 4. Registering property**

Indicator	Laos	Regional average	OECD average
Number of procedures	9	4	4
Time (days)	135	51	34
Cost (% of property value)	1.1	4.3	4.9

Source: Doing Business 2004

In several other areas important to business development and product diversification, the required institutions are not yet in existence in Laos. For example, the institutions necessary to ensure and certify that necessary quality and standards are met both for domestic consumption but especially for exporting purposes are lacking in several product areas where Laos could potentially be highly competitive, such as the export of fresh meat products and traditional plant medicines. Laos could have a comparative advantage in exporting meat products to its rapidly growing markets, especially from the southern, cattle raising regions of Laos. But at present its meat exports are only accepted in a couple of limited markets, as they lack the required quality and hygiene certification.

## 2. Constraints to PSD: Costs of Doing Business

### Infrastructure for Business

The principal constraints on production for exports are transportation costs and lack of information on export markets and prices. Infrastructure, especially the road and bridge transport links to the markets are underdeveloped. And transporting goods to markets is relatively expensive. Because of the high cost and unsuitable roads most goods shipped out of Laos are shipped unbundled in trucks (not containers) and are loaded into containers, usually in Thailand (see Chapter 5 on Logistics). Only a few of

the bridges in the country can take the weight of a truck carrying 20ft containers (Table 5). Indicative information collected from freight forwarding companies shows that Laos is effectively more expensive to transport from than the comparative countries, although the costs for Laos have been brought down following the recent transit agreement between Thailand and Laos (see Chapter 5).

**Table 5. Comparative transportation costs for a 20ft container, door to door, for general commercial cargo**

In US\$	Bangkok Thailand	Manila, Philipp.	Hamburg Germany	Osaka Japan	L.A USA
From:					
Vientiane Laos	935	1635	2625	1635	4135
Beijing, China	666	746	1737	506	2241
Hai Phong, Vietnam	350 - 450	450	1550- 2000	700	2,900 - 4,000

Source: These estimated costs are based on quotations from freight forwarding companies at the site of origin, in late May/early June 2003.

While it may not be surprising that transportation costs from Laos are not competitive given its rugged terrain, landlocked status, and dependence on shipping through ports in third countries, one would expect Laos to be more competitive with respect to other costs of doing business. Based on a limited comparison of labor, electricity, telephone and office rental costs in several East Asian countries, Laos does appear to have a slight cost advantage in these areas. In general it has cheaper labor costs, and about average for electricity and telecommunication costs (Table 6). However, these costs advantages do not seem sufficient to outweigh the other disadvantages, especially the regulatory burden and difficulty of dealing with government agencies and processes.

**Table 6. Comparative cost of Doing Business in Laos, 2002**

Operating Costs	Vientiane Laos	Hanoi Vietnam	HCMC Vietnam	Jakarta Indonesia	Bangkok Thailand	Beijing China	Manila Philippines	KL Malaysia	Singapore
Monthly salary for engineers	200-300	264.5	241.4	205	296	206	237	710	1282
Monthly wages for workers	50-70 (a)	97.5	117.5	108	163	120.5	150	208	462
Monthly salary for middle managers	200	528.5	592.5	540	671	386.5	506	1518	2339
Office rent (USD/m <sup>2</sup> /month)	15-20	21	21	17	10.13	37	7.49	16.29	45.77
Telephone cost (3 minute call to Japan in \$)	5.40	5.61	5.61	3.76	2.07	2.9	1.2	1.42	1
Electricity cost (Cent/Kwh)	4	6	6	4	4	4	3.5	5	7

Source. Lao estimates – World Bank Office Vientiane. Other countries – JETRO compiled from information gathered from Japanese Chamber of Commerce, Local Governments

### 3. Constraints to PSD: Access and Cost of Key Inputs for Business.

#### Access and Cost of Financing

Business access to formal debt and capital financing and financial services is very limited in Laos as a result of a highly underdeveloped financial services sector, including a weak banking system<sup>25</sup>, and absence of an equity/capital market. At present the financial sector in Laos comprises a few commercial banks (state-owned banks, private domestic banks, joint-venture banks, and foreign bank's branches), one agricultural promotion bank, micro-finance institutions, and one joint-venture insurance company. Non-bank financial institutions, such as leasing companies, do not exist. The size and reach of financial markets is very limited and there are no capital markets other than a primary market for treasury and central bank paper.

Interest rate spreads are very high and private sector credit (as a ratio to GDP) is very low, because the level of monetization of the economy is low and the legal framework for secured lending remains weak. The payment and clearance system,

<sup>25</sup> The credit provided to the economy is less than 15% of GDP compared with an average for the ASEAN countries that exceeds 100 percent. Eighty percent of the SMEs do not take out loans.

and credit reporting systems, are highly underdeveloped, and transactions remain heavily cash-based. A very small proportion of the population has access to formal financial services, and SMEs have limited access to finance. The legal and regulatory framework is improving but is not yet conducive to the provision of adequate financial services. Microfinance is still in its infancy.

To assess the private sector's access to financial services, the Doing Business Report looks at a number of indicators, from the sharing of credit information made available by public and/or private credit registries and the legal protection of creditor rights. It is more expensive to create collateral in Laos (Table 7); the collateral and bankruptcy laws are much less likely to facilitate lending, with the combined effect of making access to financial services in Laos comparatively more difficult.

#### Labor Issues: Skill and Regulation

The combined effect of a relatively less educated labor force (not much more than 1/3 of the adult population are literate), a limited tradition of entrepreneurship and the prolonged war years, when Laos was effectively isolated, have taken its toll on the labor skills and productivity in Laos.

**Table 7. Access to financial services—Laos compared to its neighbors**

	East Asia & Pacific regional average	Cambodia	Thailand	Vietnam	Laos
Cost to create collateral (% of income per capita)	2	0	1.1	2	3.8
Legal Rights Index[1]	5	4	5	4	2
Credit Inform. Index[2]	1	0	5	3	0
Public Credit Registry coverage (borrowers per 1,000 adults)	33	0	0	8	..
Private Bureau coverage (borrowers per 1,000 adults)	67	0	150	0	0

1. Legal Rights Index measures the degree to which collateral and bankruptcy laws facilitate lending.

2. Credit Information Index measures rules affecting the scope, access, and quality of credit information.

Source: Doing Business 2004

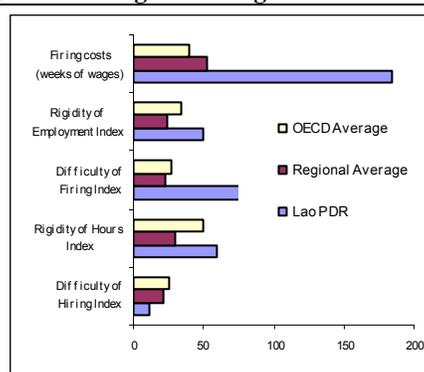
Increases in labor productivity will be important in raising the competitiveness of the Lao manufacturing sector. Similarly, concerted efforts to “train” and “expose” Laos would-be entrepreneurs to business practices and markets in other countries will be important in stimulating Laos’ entrepreneurial capacity.

From a labor regulations perspective, the labor market is relatively un-restricted in Laos albeit with some rigidity (see Box 3 and Figure 3). The state does not allocate individuals to jobs. Salaries diverge across the private and public sectors. The Labor Law (1999) provides reasonable protection for employees, but less flexibility for the employer, and thus creates some rigidity in the labor market. Article 25, for example, stipulates that a worker may work a maximum of eight hours per day, and 48 hours per week. The Law also builds in additional state approval steps in many procedures rather than allowing these to be governed by the employment contracts. For example, if an employer wishes to terminate the contract of a worker for misconduct after repeated warnings, the employer must first notify the labor administration in the respective jurisdiction at least five days in advance, and then wait a further 15 days for their response, before the contract can be terminated.

**Box 3. Hiring and Firing Workers**

The difficulties that employers in Laos face in hiring and firing workers are shown below. Three indices measure how difficult it is to hire a new worker, how rigid the regulations are on working hours, and how difficult it is to dismiss a redundant worker. Conditions covered by the indices include: availability of part-time and fixed-term contracts, working time requirements, minimum wage laws, and minimum conditions of employment. Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The overall Rigidity of Employment Index is an average of the three indices. For Laos, the overall index is **50**, compared with the regional average of **24.4** and OECD average of **34.4**. Firing costs are calculated on the basis of the number of weeks worth of salary in severance, notification and penalties that must be paid to dismiss a worker.

**Figure 3. Hiring and firing indicators**



Source: Doing Business, 2004

## **Land**

Land in Laos is under the ownership of the national community as prescribed in Article 17 of the Constitution of 1992 (amended in 2003). The State is charged with the management of land in a central and uniform manner throughout the country, and with the allocation of land to individuals, families and economic organizations for use, lease or concession. The provincial governments exercise these rights on behalf of the state. They grant land rights for a pre-determined purpose in exchange for payment of an annual tax, and allow the purchase and transfer of rights between individuals for both personal and business reasons.

In practice across provinces, allocation of land rights and tax rates are discretionary on the part of the authorities. Although the revised Land Law allows for longer periods, in practice, the range of land rights and payment method vary from as little as 5 years in Vientiane Capital to perpetuity in Udomxay, while the other provinces grant 50 years, and in all provinces advance payment of tax is required. For some businesses, the short term land rights create business uncertainty, potential risk, and are not attractive to larger businesses.

The advance payment of annual land tax is an impediment to a start up business with limited capital and cash flow. The time to complete the land registration also varies between provinces, ranging from over a year for acquiring new land rights from the authorities of Vientiane Capital to 2 days for transferring land rights between two individuals in Savannakhet; it takes longer if more than one person holds the rights to a particular land.

The amended Land Law of 2003, has expanded the nature and lease term of the land use rights for individuals and firms, which has effectively made land lease rights a fairly close proxy to private freehold ownership, within prescribed parameters.

For example, the Land Law (2003) gives the lessee the right to transfer the land use right/to give the right to use and dispose of the land/ to another person by sale, offer, or exchange (article 57). But the Law also sets limits on the nature of this right, depending on the party involved.

Under the 2003 Law, foreign invested firms can lease land for up to 50 years for an agreed purpose. But if the firms' plans change (or their business involves sub-leasing) the term for which they in turn can lease out their land is determined on the basis of the feature, size and conditions of the activities, but in any case can not exceed three years. From a business perspective, especially for foreign invested firms, engaging with the land market still involves many authorization/approval steps, and leads to significant discretionary power of officials. For example, an FDI firm needs to first get State approval before it can use its fixed assets on its land as collateral (article 66) with local banks.

## **4. Recommendations to Facilitate PSD in Laos**

Businesses trying to become established or to operate in Laos are being smothered by a huge regulatory burden. The laws pertaining to ongoing business activity in Laos involve relatively long-winded procedures; various ministries and provincial governments typically have additional procedures through sub-law legal documents (Decrees, Circulars, etc). The combined effect is an enormous regulatory and documentary burden for firms to face, that absorbs much management time, and reduces competitiveness. These regulatory requirements also create room for substantial official discretion—giving too much arbitrary power to the civil servants—and thus create excessive scope for corruption.

The regulatory requirements placed on businesses in Laos are simply too high. They are too high compared to those faced

by firms in Vietnam, Thailand, and other regional neighbors with whom Lao enterprises are trying to compete. They are too high compared to the technical capacity of the civil servants in Laos, especially at the provincial level, who lack the capability to serve the private sector—for example to critically review business plans. They are too high for the capacity of the local entrepreneur, who already faces competitive handicaps in terms of poor infrastructure and less entrepreneurial experience. And finally they are way too high for a country whose main potential source of growth out of lesser developed economy status is through facilitating rapid private sector development.

The recommendations of this paper focus on the legal and regulatory environment not because they are the only element of the business environment that needs to be improved, but because amending the business regulations, especially sub-law legal documents such as decrees and decisions, is arguably the “quickest” and “least-cost” way to achieve a large improvement in the business environment. Building institutional capacity, strengthening entrepreneurial skills and improving the physical infrastructure, are equally important pieces of the jigsaw puzzle to significantly improve the business environment in Laos. But significant improvements in each of these areas will require long-term efforts, and considerably more financial resources, than those required to streamline the regulatory processes.

Key regulatory reforms that should be instituted as a priority include:

1. Substantially simplify the business start-up process:

a. Move away from a business licensing to a “proper<sup>26</sup>” registration system (for

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<sup>26</sup> By “proper” we mean an approach where a registration system replaces a business licensing system – as is the trend globally, for all but very sensitive sectors. However, in the Lao case, while they have adopted – or rather added “business registration” to the process, they have not removed the “licensing requirements”, thus undermining the whole purpose of moving to a

almost all sectors). The current amendment of the Business Law provides the perfect opportunity for this (in the drafting of the new Enterprise Law). At minimum remove the review of business plan requirement for most sectors.

b. In the few sectors where licensing is still absolutely necessary, implement without further delay the provision of the new Investment Laws that provide for a one-stop-shop service to obtain the necessary licenses, and especially limit the time allowed within this for the sectoral ministry to review a business plan.

c. Either remove the need for firms to obtain a company seal or allow private suppliers to make seals. This would remove the monopoly of the Ministry of Public Security and the extensive delays that are incurred as a result.

2. Repeal the Industrial Processes Law, or at minimum review the implementing decree.

3. Revamp the tax system and administration, minimizing the opportunity for negotiation between firms and tax officials and simplifying the reporting requirements for entrepreneurs to meet their tax obligations, and effectively implement the “promised” tax rates.

A joint ADB/WB Investment Climate Assessment is currently being undertaken for Laos which will yield further insights.

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registration system to facilitate firms’ entry in all but a few specified restricted sectors.

## Chapter 9: Raising Export Competitiveness: A Vision from Within

The government of Laos is seeking to boost exports, increase foreign exchange earnings, generate sustainable employment opportunities and improve standards of living. The government, in partnership with international donors, has undertaken a number of measures to gain market access and to increase its competitiveness in the global market economy. The goal is for exports to grow quickly and significantly in the coming years.

The effort to help boost exports comes at a time of rapid change in the global economy. The apparel sector will undergo radical change as the former MFA quota regime ended in January 2005 as part of integration into WTO trade agreements. China's continued growth is altering trade patterns globally with major implications and opportunities for South East Asia. Neighboring countries, such as Thailand and Vietnam, have been highly successful in a number of export industries and tourism. Laos may be able to exploit opportunities offered by these neighboring countries to take advantage of their existing trade networks, infrastructure and experience.

Across the key industry clusters in Laos, there is keen interest on the part of local entrepreneurs and exporters in learning about international markets, taking advantage of new trading opportunities and cooperating with the government to help build exports. There is also great potential for narrowing the gap in export growth rates with China, Vietnam, and Thailand in coming years. In an effort to support the government and key industry clusters in the commercial sector to raise the competitiveness of exports, this initiative sought to:

1. Focus and align public sector and commercial leaders around the most important strategic initiatives by

verifying and further detailing the opportunities and recommended actions to raise the export competitiveness of key sectors.

2. Design action matrices for 3 key export sectors (tourism, light manufacturing, and agriculture). The action matrices outline the practical initiatives that public sector, commercial leaders, and international donors can undertake to boost exports in each industry
3. Test the feasibility and willingness of the government and the commercial sector leaders to implement practical strategies for raising the competitiveness of Laos.

In doing this, the initiative complemented work being done under the International Trade Centre's National Export Strategy Design project with the Ministry of Commerce.

### Defining competitiveness

Competitiveness is not to be confused with natural resource abundance, cheap labor or continued devaluation of the currency. Competitiveness based on cheap labor is not a formula for boosting prosperity in the long-run, especially when relative productivity is taken into account versus neighboring countries, some of which also have relatively cheap labor on a productivity-adjusted basis.

Nor should competitiveness be confused with export growth rates or foreign exchange generation based on mineral wealth or hydroelectric power. While these will be important generators of government revenues, they will not create large numbers of investment and innovation driven jobs. Unless the revenues generated from these activities are invested in human capacity and

in facilitating (but not subsidizing) the emergence of competitive industry clusters, the benefits may not reach the average person.

Competitiveness can be defined as sustainable increases in productivity resulting in improved incomes for the average citizen. Competitiveness can also be defined as the ability of Lao products and services to meet the test of the market place without protection or subsidies in ways that boost the average income of people in Laos.

The government has articulated a goal of 7 percent growth with equity in GDP/capital per annum on a sustainable basis. The key question underlying this goal is how this growth will be achieved and what should be the priority strategies and actions for public and commercial sector leaders in Laos in achieving this goal?

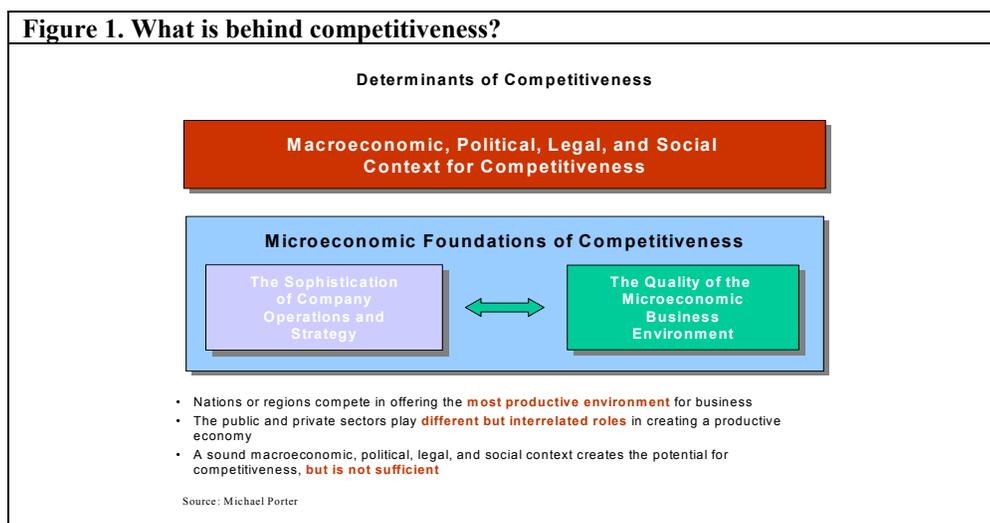
The competitiveness framework used in this study for analyzing Laos' growth prospects is Michael Porter's determinants of competitiveness and the Competitiveness Diamond. His model provides a useful framework for organizing the many determinants of a country's competitiveness and economic growth potential (Figure 1).

The model illustrates how a country's potential for competitiveness, and long-run economic growth is created by a sound macroeconomic, political, legal and social context, and a continuous drive to improve the microeconomic environment, foster the sophistication of local companies, and increase local competition.

The model also illustrates how Laos' future economic growth track will be determined by its ability to support:

1. Sector-specific growth, driven by local companies that are successful in raising the sophistication of their operations and strategies and increasing their competitiveness
2. Improvements in the business environment and release of cross-cutting, binding constraints to growth.

This study focuses specifically on industry cluster-specific growth and the underlying microeconomic determinants of competitiveness for each sector. To understand the current state of Laos' competitiveness in agriculture, light manufacturing and tourism, this study uses the Competitiveness Diamond, often referred to as the Porter Diamond (Figure 2).



The economic theory of the Competitiveness Diamond has been validated by numerous analytical and case studies and is now used by industries and governments worldwide to assess industry cluster competitiveness and to develop strategies for improving competitiveness. It is structured around four pillars:

1. Factor (input) conditions: skilled labor, infrastructure, etc.
2. Demand conditions: size and type of accessible demand
3. Related / supporting industries: presence of supplier and supporting industries
4. Context for firm strategy and rivalry: conditions for conducting business.

Within each sector and across the economy, these four pillars interact to form a foundation for building a competitive economy. For developing economies like Laos, building a competitive industry cluster starts with understanding the demand for products and services in key markets and then organizing and investing in the factor inputs (supply) to best meet the needs of the market. Only by accessing and understanding the specific needs of the market can the commercial sector in Laos utilize its resources in the most efficient way that create the most value for the producer and the customer. As a more in-depth understanding of the market is developed and the supply is upgraded accordingly, the industry cluster must then concentrate on upgrading its suppliers and supporting

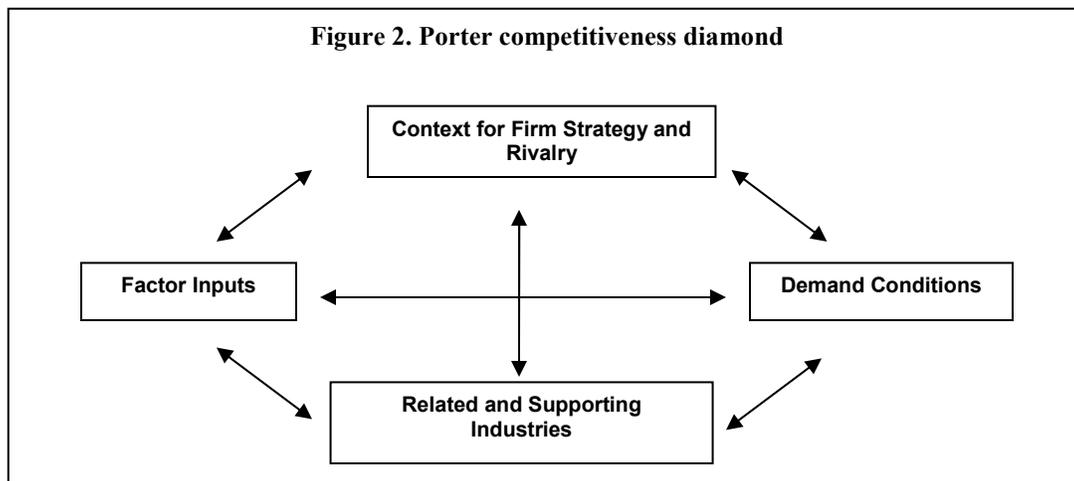
industries and work with the government to improve its business environment.

### Why is competitiveness important for Laos and its key sectors?

*Raising competitiveness is one of the most critical challenges and one of the most important goals facing Laos today.* There are several reasons for this. First, Laos still falls behind other neighboring countries in terms of export performance (Figure 3) and would need to catch up. Second, the signing of trade agreements with ASEAN and the US and the eventual accession to the WTO will result in the lowering of tariff barriers and the need to improve productivity. At the same time, these agreements have created new opportunities for market access that are still relatively untapped. These, in turn, create potential investment opportunities.

Third, the 80 percent of the people who still depend on farming, and especially those who rely on subsistence farming, have begun to migrate to other activities and the government will need to ensure that there is adequate employment to avoid social problems. Fourth, the goal of reducing poverty requires achieving high rates of growth, especially in export-driven industries.

Finally, the rapid pace of globalization and technological change threatens to bypass



Laos and relegate its producers to relatively low rungs on the value chain unless actions can be taken to adapt to change an adopt emerging technologies of which e-commerce transactions is but one visible example.

**Figure 3. Lao export performance has been relatively poor compared to neighboring countries**



**The base for current competitiveness is unsustainable.** The current competitiveness of Lao exports has been based on natural resource abundance and cheap labor. However, this is not a source of sustainable competitive advantage. Price pressure on raw agriculture and other raw material products will continue to exert itself. Although the world economy has been experiencing an upward trend in commodity prices, over the last 30 years the real prices of most commodities have gone down. Competing on the basis of cheap labor may allow Laos to enter certain areas of light manufacturing but will not be a long-run formula for building prosperity, especially when labor costs are adjusted for relative productivity and compared with Indonesia, China, Cambodia and eventually Myanmar.

To some extent, competitiveness has been based on trade preferences in apparel in the EU market, and this is also not a sustainable strategy. Formal apparel quotas ended in January 2005. Continued restrictions on certain countries like China may offer

temporary opportunities, but in the long-run this will not be a sustainable source of competitive advantage.

The presence of subsoil assets for mining and hydroelectric power will also generate economic activity and government revenues. All of these factors are “inherited” or “received” factors. Many resource-dependent countries have not achieved high levels of prosperity and have experienced the “natural resource curse”. The government of Laos will be receiving increased revenues and rents from hydroelectric power and mining concessions. Unless these are invested well, they could end up not having as broad an impact on poverty alleviation as they might otherwise have.

**The future sustainable competitiveness of Laos will come first from improving the productivity of its people through education, training, and capacity building.**

There is an urgent need to invest in more language training, computer training and basic business skills. Apart from this, it will be necessary to invest in more specific areas such as marketing training, design and industry specific schools such as tourism and hospitality. (Note that Seco/ITC is expecting to have a strong capacity building component in the next phase of its ongoing export development project. Training would be divided into sector-specific training for businesses that are already exporting and general export oriented training for potential exporters)

**...and from creating a business environment that facilitates the emergence of entrepreneurs and competitive clusters.**

Competitiveness will require building the capacity to understand international consumer and market trends and then to translate this knowledge and insight into higher value products and services. Competitiveness will come from well-considered investments in infrastructure that generate industry dynamism.

***Productivity can be strategic in nature.***

Competitiveness is determined by the productivity (value per unit of input) with which an economy uses its human, capital, and natural resources. Productivity depends on the value, uniqueness, and quality of a product in addition to the efficiency with which it is produced. Productivity can be strategic as well as operational in nature. For example, by choosing to grow and export high value agarwood instead of exporting raw logs of other varieties, Laos can greatly increase its export values<sup>1</sup>. By choosing to focus on high income tourists already living in the region, the tourism industry could increase its off-season business and thereby amortize its investment more effectively while creating more stable year-round jobs. By choosing the appropriate commercial development model for an export-oriented industrial park, the country could accelerate its entry into light manufacturing industries by attracting a critical mass of investors to set up satellite plants.

***Productivity is also operational in nature.***

By investing in infrastructure and abundant energy resources, Laos can improve the economic feasibility of many industries which can now import inputs, manufacture outputs and export the results. However, much remains to be done. Perhaps the most important priority for improving operational productivity is to invest in human resources beyond literacy and numeracy to include basic business skills such as English and other foreign languages, computer skills, accounting and entrepreneurship. After human resources, a focus on improving access to finance and the building of a competitive financial sector could do much to improve productivity by mobilizing and allocating resources efficiently. Creating abundant access to bandwidth at lower cost can also help improve the business environment (see Chapter 8). The large majority of businesses interviewed for this

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<sup>1</sup> This example is outlined further in the agriculture section of this study

study indicated that there are still major impediments in the business environment. Releasing these constraints is critical to the competitiveness of Lao entrepreneurs in regional and international markets.

Although good strategic decisions enhance competitiveness, competitiveness is *not* about picking winners and losers. It is about improving the business environment that allows many entrepreneurs and many companies to make good strategic decisions and implement them efficiently in a variety of industries. It is not so much about where firms compete but how they compete in those industries.

The productivity of local industries is critical to competitiveness even if attracting key foreign investors can contribute to export competitiveness. This requires building the capacity to learn about customers, understand markets, innovate, improve quality, invest in human resources, cooperating with the supply chain and working constructively with private sector leadership and government to solve problems and address constraints in the business environment.

**Methodology and approach to this analysis: a vision from within**

The quantitative information available on Laos is still relatively scarce. As such, the information included in this study was not simply based on desktop research and interviews, but also interactive workshops with entrepreneurs and public sector leaders from each sector. The team worked directly with business leaders, industry associations and government officials to understand the competitiveness of agriculture, light manufacturing and tourism and design strategic action matrices for each. The action matrices outline the practical initiatives that private sector and public sector leaders can take to boost exports in each industry. The focus of this effort was on *implementation*. The key to successful implementation of the initiatives outlined

below will be to engage the local and regional industry and governmental leadership in constructive ways that can have a tangible impact in the short to medium term while improving the business environment for achieving these results. There are a number of implementation constraints that were apparent in this study and must be considered when undertaking future initiatives to support the commercial sector in Laos:

1. The commercial sector is small and time-constrained, making convening key commercial leaders and facilitating a constructive public-private dialogue very difficult.
2. Understanding of the international markets and competition is very low among the public and commercial sector.
3. Channels for information dissemination, both formal and informal, are either non-existent or very weak.
4. There is a mindset that financial resources must precede actions.

## **1. Competitiveness Assessment of Tourism**

### **Profile and importance of tourism**

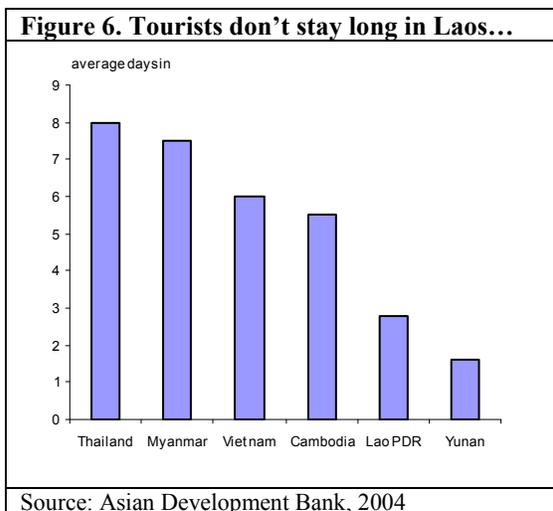
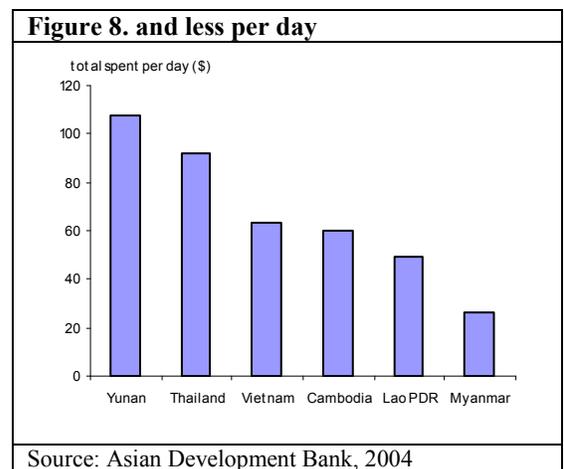
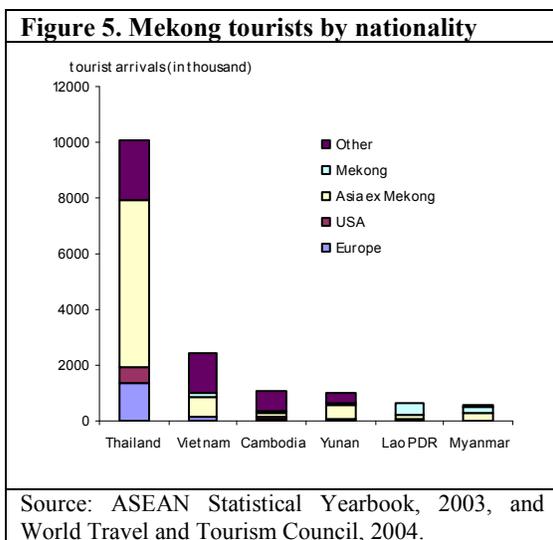
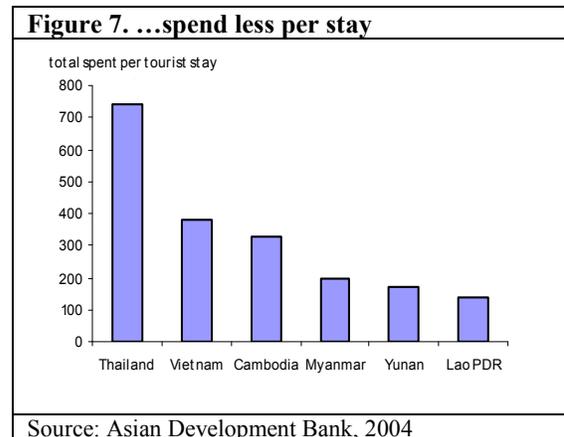
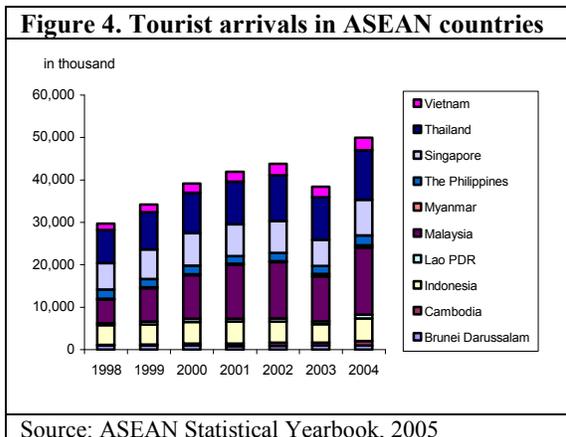
*Tourism is a significant and growing industry worldwide and has been a key lever for local and regional economic development.* Globally, the tourism industry is estimated to represent \$4.4 trillion, or 10 percent of the world's GDP. The industry supplies over 230 million jobs and over \$800 billion in tax revenues internationally. Tourism is a major generator of foreign exchange revenues and facilitates regional and international trade and investment linkages.

*For Laos, tourism is a critical industry for driving economic development.* Tourism currently generates over \$120 million in revenues. The industry employs 3.4 percent of total employment, represents over 4 percent of total GDP, 23 percent of export revenue and is projected to grow by nearly

12 percent in the coming years. In addition, capital investment in tourism projects is projected to double over the next ten years.

*However, tourism in Laos is still largely concentrated in a few locations in the country,* namely Luang Prabang, Vientiane, and, to a lesser extent, Champasak. Among the international tourists, these “point” locations are not considered to be destinations in themselves, but side trips as a part of a regional tour. As a result international tourists spend less than 3 days in Laos—the lowest in the Mekong Region (Figure 4). In addition, Laos is attracting a very different mix of tourists compared to its neighbors. In 2003 Thailand attracted 1.3 million Europeans while Laos attracted under 100,000 (Figure 5). Over 65 percent of arrivals are from the Mekong region and can be attributed to regional cross-border day trippers. Reflecting the regional mix of tourist arrivals, tourists that come to Laos spend on average less than any other country in the region except Myanmar; they also spend less per day and stay less than in other countries of the region (Figures 6-8). Knowledge of Laos as a country is limited; this is both an advantage and disadvantage for the tourism sector. Laos is still “undiscovered” and still carries a premium of mystique, but lack of awareness in the market is constraining growth. At a recent tour operator conference in Malaysia, a Malaysian tour operator asked if Vientiane was in Myanmar.

*The tourism industry has the potential to grow from \$120 million to \$500 million per year in the coming 5-7 years, but care must be taken for it to be socially and environmentally sustainable.* Industry experts in Laos had estimated that current foreign exchange revenue is \$120 million and that 100,000 international tourists will arrive in 2005—already, in the first four months of 2005 over 380,000 tourists have come to Laos. The country is increasingly on the map for international tourists and becoming known as one of the last untouched places in Asia.



***Tourism is important to the government's regional economic development objectives.*** In some regions tourism production is the major driver of economic activity. Therefore, the tourism industry has a major role to play in improving rural incomes and in poverty alleviation in rural areas. This is especially true in Luang Prabang which used to be a relatively poor province but which has become more prosperous in the last 15 years. Tourism also has the potential to play a key role in increasing economic opportunities for the southern provinces of Attapeu and Sekong. To this end the MOC/ITC Tourism Sectoral Strategy is explicitly focusing on building backward linkages from the tourism industry to the rural areas. An action plan will be proposed in this regard.

With special emphasis on community and eco-tourism from tour operators and international donors, the industry is becoming an increasingly important source of rural income and poverty alleviation. The potential doubling of the industry revenues would have a tremendous impact on people in this sector. Even a modest impact on the productivity and incomes of the people who rely on this industry would be quite significant.

*Tourism also has important spillover effects in terms of creating a Lao national “brand” in global markets and developing a favorable international image for the country. It also has spillover effects in promoting rural tourism and handicrafts, encouraging so-called “exports on the spot”.*

#### **International and regional market trends**

The tourism industry, defined broadly to include all travel, lodging, restaurants and supporting services, already represents 10 percent of GDP. While there are many significant trends taking place simultaneously, the following are a few of the “mega-trends” that will affect Laos tourism.

The first is the aging of the population in wealthy countries which means an increasing supply of tourists who have more time, disposable income but evolving needs including concerns for safety, comfort, beauty and cultural stimulation (over the rigorous water sports and beaches that represented the goals of more youthful tourists).

Another trend is the movement away from mass tourism to many “micro-segments” that are appealed to increasingly through very specific and targeted means of communication. These niche segments catering to affinity groups such as soft adventure tourism, cultural tourism, ecotourism or health tourism are allowing destinations and tourism companies to

customize high-value experiences to the exact motivations of the segments.

Innovations in communications technology are allowing tourists to conduct primary research on a destination prior to arranging and arriving. The increased availability of information on destinations on the internet is changing the standard and manner for attracting international tourists. In addition to using international tour operators, tourists are increasingly planning their own visits. International tour operators cannot be relied on to be the primary gateway for international tourists. Clear, concise information portals and ecommerce capabilities are now a necessity for attracting international tourists. The last tourist feedback report conducted by the National Tourism Authority (NTA) highlighted the high cost of traveling to Laos and the difficulty in finding information about Laos prior to arriving.

Within the Mekong, nearly all international tourists coming to Laos are part of a regional tour that takes them to surrounding destinations as well. Growth in the medium to high-income brackets of Asian economies is fueling growth in travel and tourism within Asia. Huge growth in Chinese tourists is expected, but it is unclear whether these tourists will bring value to Laos. In fact among many tour operators, there is concern that the Chinese market may be high volume, but with limited value.

#### **Competitive position of tourism**

The team applied a number of diagnostic tools. Most of these tools were applied in workshops with tourism representatives. Some 50 representatives came to the workshop in Luang Prabang and about 25 representatives were present at the workshop in Vientiane. The team applied a series of diagnostic tools including SWOT Analysis, GAP Analysis, Value Chain Analysis, Market Trend Analysis and Diamond Analysis. Below are the results obtained from the workshops with the contribution of

the private sector and government officials present.

Overall, the Lao tourism industry is currently positioned as a relatively low-cost “add-on” destination where tourists come mainly during a relatively short high season, spend little and stay only 2-3 days. There is great potential to triple or quadruple tourism industry revenues without having to triple or quadruple the volume of tourists arriving in Laos by four principal strategies to be described below. The industry has traditionally lacked good information on markets and effective market development skills. As a result it does not control its own destiny and is dependent on others. Government policy has rightly stressed conservation and preservation, even routing a major highway around the historical town of Luang Prabang but the industry now needs to focus on improving its strategic position.

#### ***SWOT analysis:***

Tourism industry ***strengths*** include great natural beauty, world heritage sites, beautiful architecture, a navigable river for boat tourism, relatively low costs, unique ethnic cultures which have maintained traditional dress and customs and traditional music and dancing. The country is also well known in France. The natural hospitality of the people is an asset.

Industry ***weaknesses*** include the lack of bilingual and multilingual staff with training in the service industry, a short “high season,” an unfavorable image for the “low season” as being hot and rainy, relative isolation, limited air transport, low capacity to market internationally, lack of access to finance for small businesses, very short stays by tourists as an “add-on” and relatively low expenditure per day by tourists.

There are major ***opportunities*** that could propel the growth of this sector in the future. Global tourism is growing quickly and tour operators and tourists are looking for “new”

destinations. The growing prosperity of the ASEAN countries and India and China provide additional target markets that are not put off by the heat or occasional rain of the “low season.” Thai Airways has offered to provide its international offices as distribution channels for NTA promotional literature and to help convene the relevant target groups (whom they know quite well) to meet with promoters of Lao tourism during their visits to places like Japan, China or Australia. Since Laos is relatively unknown abroad, there is the opportunity to shape and manage the image of the country as a tourist destination. The relatively low volumes of tourists during the off-season is itself an opportunity to market the destination during those months which also correspond to summer vacations in northern countries.

However, ***threats*** to the industry include downward impacts on tourist volumes that have happened in the past and could happen again related to terrorism, SARS or other global problems. If tourism growth is not managed, it could have adverse environmental and social impacts and this in turn can negatively affect the perception of Lao tourism abroad. Already there are signs that increased tourism to Luang Prabang is having a negative impact on the local citizens. As one established tour operator mentioned, “our people are losing their hospitality and are now focused simply on how to earn more money.”

#### ***GAP analysis:***

At the national level, Lao tourism leaders identified Vietnam, Cambodia and Thailand as relatively successful countries in the region. They also identified a number of things it takes to be successful in tourism including knowledge of market, good strategic focus, human capacity, access to finance, transportation ease of access and quality of government policy (Figure 9). The Luang Prabang leadership identified comparative destinations Siem Reap, Chiang Mai, Bali, Ha Long Bay, and southern

China. The recent emphasis placed on preservation of architecture and culture in Luang Prabang was reflected in the key success factors that the participants highlighted, specifically architectural preservation and cultural performances.

The industry representatives identified significant gaps between the Lao industry and counterparts in these other countries. The participants in Vientiane ranked Laos relatively low versus other countries in knowledge of market, human capacity, access to finance, transport accessibility and quality of government policy. The Luang Prabang leadership perceived the gap between Luang Prabang and comparative destinations to be much smaller, but still highlighted a gap in marketing and ability to deliver high quality services.

**Tourism cluster and value chain analysis:**

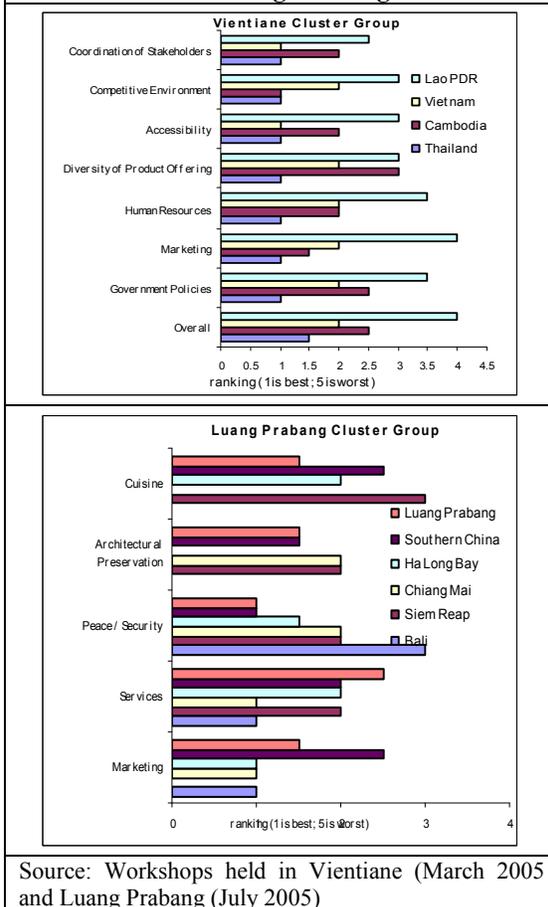
The tourism industry value chain analysis revealed a surprisingly large number of industry participants who form the tourism cluster. The tourism cluster includes: air transportation, immigration and customs department, hotels, guest houses, home-stay hosts, restaurants, boat operators, taxis, “tuk-tuk” drivers, motorcycle rentals, bicycle rental shops, museums, temples, national parks, artisans, retail shops, food suppliers, communications providers including Internet cafes and mobile phone providers, education and training providers (secondary schools and universities), foreign investors, infrastructure and conservation donors, travel agents, tour operators, tour guides, translators, the local and international media (including producers of documentaries), artisan villages, the National Tourism Authority, provincial and local governments, the Ministry of Culture and other government departments and ministries (Figure 10).

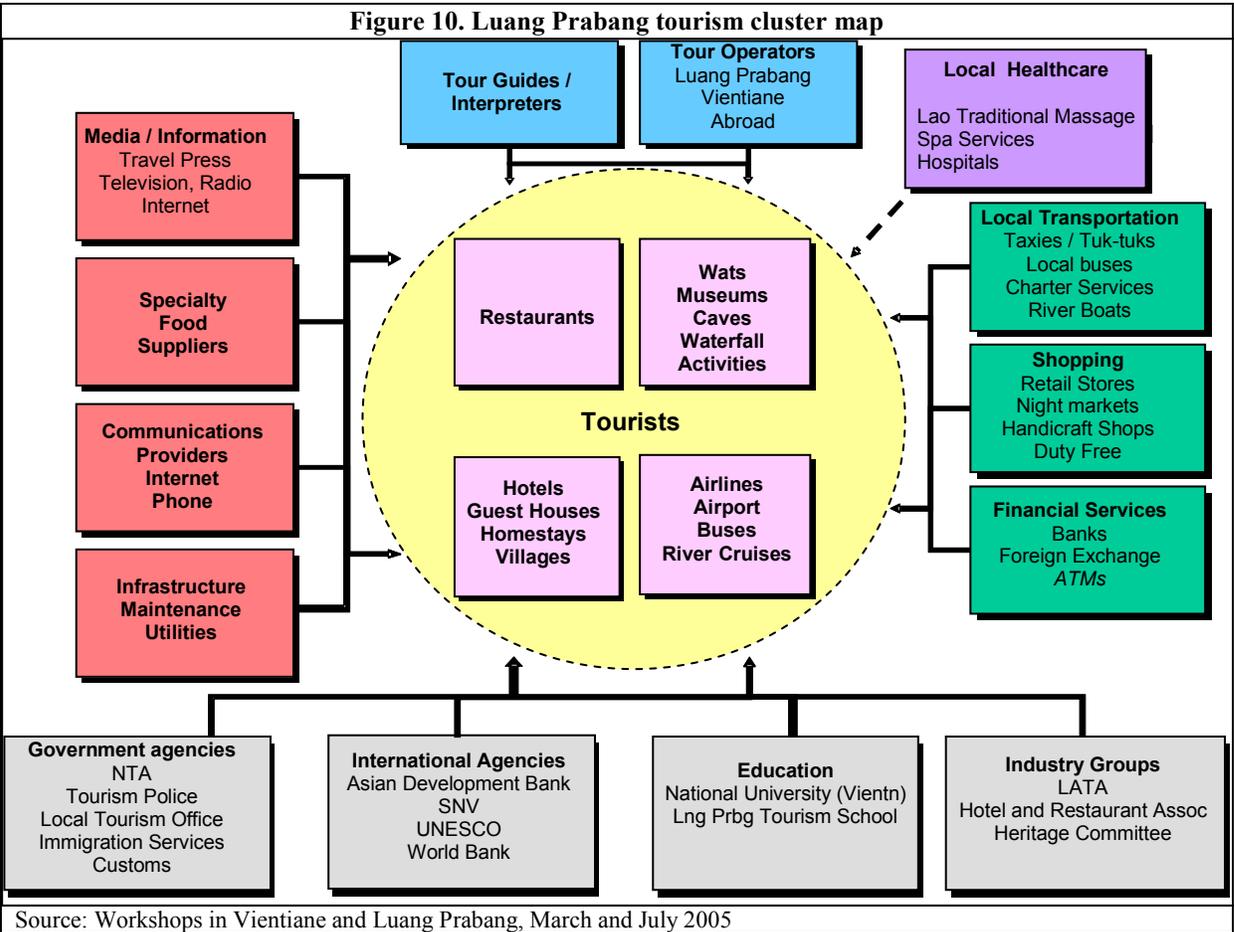
In both Vientiane and Luang Prabang, there was strong consensus that the tourism industry cluster must be better coordinated and must cooperate to develop the industry further. In Luang Prabang, leadership representatives ranked the cooperation of the cluster at about average, clearly highlighting a need for better communication and cooperation among key stakeholders across the industry cluster.

**Communication and coordination across the cluster is deficient.**

The most formalized channels of communication and coordination are between the tour operators, the hotels, and the national and regional tourism administration. Aside from the National Tourism Administration and the newly formed Tourism Marketing Board, there are no mechanisms or organizations that facilitate cross-cluster coordination and planning. Among the National and Regional Tourism Administrations, increased

**Figure 9. Gap analysis for the tourism sector in Vientiane and Luang Prabang**





planning and coordination is essential. There is a significant amount of interest among donors to assist tourism at the national and regional level, but to date there is limited coordination among the government interfaces. This has become apparent in recent tourism trainings and workshops when the trainings are designed for a high level audience, but because managers are so busy with managing their business in addition to the various initiatives, they do not attend, or simply send junior staff. Regional tourism offices within the government are still mainly focused on regulation and licensing of the tourism businesses; more emphasis needs to be placed on supporting the businesses with information dissemination and coordination.

*Despite the focus on regulation and licensing among the government tourism bodies, there are no certifications and standards for hotels or restaurants.* There is a perceived need among the cluster stakeholders, and some discussion on setting up a system through the newly formed LATA, but still no central body that regulates the key service providers in the industry. Given the fact that Laos is still developing its reputation among international tourists, setting up self-regulating systems for the industry cluster, by the industry cluster, is critical for establishing Laos as a high-value, unique destination in Asia.

***The value chain for tourists visiting Laos can be further developed as a cluster of additional products and services emerge to meet the needs of various segments of the market.*** Already there is a sophisticated network of camera and digital photography shops that has emerged to serve the needs of tourists. In addition, cooperation among the tour operators and rural villages are leading to product development in homestays and agricultural tourism. As new segments of the market are attracted to Laos, new sources of revenue and new products and services can be offered. Given the increasing interdependence of the destinations in the Mekong region, fostering regional partnerships will be critical for attracting tourists to Laos. The opening of Luang Prabang airport to international airlines is already starting to yield benefits with Thai Air offering to promote Laos for free on international flights and at international offices, and Bangkok Air partnering with a number of tour operators and offering special packages.

The new tourism marketing and promotion board includes 6 representatives from the private sector and 5 from the government—it may be well positioned to play a coordinating role in the larger cluster.

***Porter Diamond:***

***Diamond analysis has revealed very weak current competitiveness for the Lao tourism industry.*** Few Lao tourism firms are linked directly to sophisticated and demanding consumers and only a handful of very sophisticated hotel firms are located in the country. The Pansea Group, now affiliated with Orient Express, has set up a high end hotel in Luang Prabang (Mick Jagger was one of the more famous customers), following on the success of a World Bank/IFC resort on the outskirts of town. Another even more exclusive firm associated with \$1,000/night fees is said to be interested in locating a hotel in the area. This emerging discrimination in targeting high income consumers bodes well for the

future, especially considering that current best estimates place the daily international tourist expenditure at only \$60/day. However, to date most of the tourism industry is still dependent on international tour operators and other marketing information providers to communicate with international tourists. Even the most successful tour operators struggle with connecting to international tourists. One major operator noted the continued travel warnings from embassies as a big issue that is still affecting demand. The isolated incidents that occurred in 2003 have not been repeated, yet the embassies are not cooperating in removing travel warnings maintaining the perception that Laos is a dangerous place to travel.

The tourists who come to Laos can provide a rich source of feedback on how to upgrade facilities and services. To date there is very little evidence that tourism companies are proactively seeking feedback from tourists and changing the way they provide services.

***Strategies for tourism industry firms are relatively unsophisticated.*** As a result many tour operators compete mainly on price with similar tourism packages for their competitors. Tour operators also compete on their ability to get and maintain strategic alliances with tour operators abroad who send them clients. While there is now a program to assist hotels and others to create websites, there is no ability to book directly from abroad with hotels via the Internet. As a result, the tourism industry is still reliant on tour operators to facilitate international tourists. Yet similar technology weaknesses are evident in the marketing of the tour operators. Of the 60 tour operators in Laos, only 20 have brochures for tour operating partners and customers and less than 10 have operating websites. Given the wide variety of tourism segments, there could be much greater sophistication and diversification for tourism companies. Similarly, most retail shops offer a similar variety of tourist goods.

***The tourism cluster has emerged but is still relatively weak.***

While there are many groups of stakeholders, these have not yet come together effectively to forge a common vision, agree upon a joint strategy and implement strategic initiatives to enhance the competitiveness of the industry. For example, there is no coordinated strategy to bring tourists to the country in the off-season. Yet this would be one of the surest ways to enhance growth, improve profitability and provide for more constant and sustainable employment without overcrowding natural or cultural sites. The financial sector is a very weak participant in the cluster as most family and small businesses have very limited access to finance to add capacity.

The pro-tourism perspective from the government has been successful at supporting the growth of the industry, but many constraints still remain including:

- Visa requirements are a significant barrier to attracting tourists, visa on arrival is a good step and the visa exemption for ASEAN countries will be important to attracting more visitors, but more can be done to make it easier on tourists coming to Laos
- Documentation for organizing a conference or meeting in Laos is still significant. For instance, letters of invitation are required for attendants from different departments in the government. This imposes a significant cost to the organizers and deters organizations from conducting conferences in Laos
- Lao Airlines only has 4 planes, all are very old, 2 of which are ATRs seating 70 people and two others only seat 17. This limited and outdated fleet heavily constrains scheduling issues. Breakdown of one aircraft can alter the schedule for multiple days. Charters do exist, but there are not many options.

***Basic factor conditions for tourism are good but advanced factors are weak.*** Laos has excellent natural beauty, wonderful

architecture, proximity to high-volume tourist destinations in neighboring countries and a relatively good climate. Warm hospitality and authentic, welcoming culture are characteristics that tourists cite as a distinguishing factor between Laos and its competitors. Local labor is cheap but not well trained in languages or service. The availability, skills, knowledge, and service delivery of tour guides is still very weak. Transport logistics are poor but improving with the safety and capacity of the national airline being a weakness. There is no good tourism or hospitality training institute, although the Department of Tourism and Hotel Management (under the Social Sciences Faculty) at the university in Vientiane is starting a program on this. There is a small institute in Luang Prabang, but both graduating students and local businesses agree that it is currently not providing the skills needed by the industry. The University of Souphanouyong is considering introducing an international management program which will include tourism and hospitality management. Capable higher level management is very scarce, and typically imported. The National University of Laos as well as three other private colleges offer a Bachelor's degree in management and marketing. There are, however, no masters programs in tourism in Laos, for higher level training most Lao students go to Thailand, Vietnam, China, Japan, Australia and sometimes Europe if they can afford it. Top hotels must send their employees to affiliated hotels in the region for training.

**Business environment constraints**

Numerous issues in the business environment are holding back the development of the tourism industry. While the tourism industry has still registered strong growth under the currently constrained environment, there are a number of issues that need urgent resolution in order for the industry to continue to grow in the right ways:

- *Implementation of the Law on Foreign Investment (the law was passed in Oct. 2004 and one year later in Oct. 2005 the Law on Tourism followed):*
  - Foreign partners are critical to upgrading service infrastructure, expanding capacity, and raising the level of service delivery
  - According to one tour operator, numerous foreign investors are waiting in the wings for this decree to be signed. One high-end hotel group is planning the construction of a hotel in Luang Prabang with projected pricing at \$500 - \$1000 per room per night
- *Adoption of open skies policy for international airlines:* Restriction on open skies is a significant barrier to expansion of the tourism industry to other regions and income levels. Lao Airlines has a fleet of 4 planes, of which only two can seat 70 people (ATR 72) and the other 2 are much smaller. The entire fleet is old, and when one plane breaks down, the national flight scheduling must be altered spontaneously. The result is that tour operators and international tourists cannot rely on intra-country bookings with Lao Airlines in advance. Tourists arriving from outside the region are not willing to take the risk of altering travel plans. With the opening of Luang Prabang to international flights, more tourists may choose just to fly directly in and out of Luang Prabang without visiting the rest of the country.
- *Easing of border crossing time and procedures at Vietnamese border:* It can take 2-3 hours to cross the border into Vietnam for a tour group. The constraint is on the Vietnam side, not the Laos side. Nearly all tour operators mentioned the ease and friendliness with which the Laos officials dealt with tourists. Facilitating a reciprocal response from Vietnam would assist the Laos tour operators engage in regional tours
- *Facilitation of money transfer:* Money transfer through local banks is costly and can take a significant amount of time.

### **Strategy for repositioning the Lao tourism industry<sup>2</sup>**

***Significant investment is occurring in building the supply of the Lao tourism industry; however, the industry is not clear on what types of tourists it wants to attract and how to effectively promote to those audiences.*** Limited information is available in Laos on tourist needs and preferences by motive of travel. This information is critical for guiding the industry in setting a targeted strategy. International expertise could be useful in helping the industry segment the global tourism markets by motive of travel, identify the most attractive niche markets appropriate to Lao offerings, prepare appropriate marketing efforts and thereby increase the number of tourists arriving, the average spending per day and the length of stay. Other important steps to attracting the right tourists include: improving the ability of Lao tour operators to proactively target attractive clients, improving the language, communication skills and professionalism of tour guides and other service providers and providing upgraded certification.

The strategy workshop moderated with the industry cluster resulted in the validation of the current vision statement, the identification of key strategies, the elaboration of strategic action initiatives and the fleshing out of initial targets.

***The strategy needs to fit to government's vision of social harmony and environmental preservation.*** The values that motivate the government are preserving social harmony, conserving the environment and developing tourism in such a way as to have a maximum impact on poverty

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<sup>2</sup> In this context, the Cabinet Meeting adopted the National Strategy for Tourism Development in December 2005.

alleviation and broad distribution of income including to rural areas and ethnic minorities.

*The strategy for Laos should be to tap into the high-value, longer-stay, seasonally balanced tourism, while still promoting low-cost tourism that has a positive spillover on the poor.* This would require working with the international press, improving the local offerings, learning about market niches abroad and improving and diversifying local package offerings.

*Laos could achieve a tripling or quadrupling of revenues without adverse social and environmental impacts simply by getting people who do come to Laos to spend more, stay longer, and visit the country on the off-season.* Laos should avoid the expansion of large volume during the high season as this will decrease the attractiveness of the experience for the tourist (with adverse consequences for word-of-mouth promotion) while having adverse social and environmental consequences.

Key strategies to do this were identified and discussed in detail among industry participants. These strategies include branding Lao tourism, increasing off-season arrivals, targeting higher income tourists with unique offerings, and promoting Laos as a destination in its own right. Other strategies to support this include facilitating access to finance, engaging in private-public dialogue and improving human resources capacity.

→ **Increasing off-season tourism:** Some 20 specific strategic initiatives were identified that can improve counter-seasonal tourism (Box 1). Laos has a unique heritage in music and dance. An annual music and dance festival coinciding with the graduation period of the music and dance schools in June could be marketed abroad. Honeymoon tourism could be marketed in June when some countries traditionally have

#### **Box 1. Ways to extend the tourist season**

Extending the tourist season beyond the high season can improve year-round employment prospects, increase foreign exchange, improve capacity utilization for hotels and restaurants and increase tax revenues without having an overcrowding effect during the high season. As a result, this is one key strategy recommended by the team. Below are specific ways to do this:

1. Promote annual traditional song/dance festivals at the end of the school year (June)
2. Market boat racing festival to international tourists (September)
3. Promote caravan tourism to World Heritage Triangle sites
4. Attract tourists to annual bamboo rocket festival
5. Develop a package geared to “summer vacation” tourists in the EU, USA, and Japan
6. Develop annual food festival, chef competition and cooking classes
7. Improve trip planning services, maps and guide services for backpackers
8. Hold annual handicraft competition among provinces
9. Market Laos as honeymoon destination after weddings (June)
10. Develop agro-tourism with visits to rice farms, fishing communities, etc
11. Develop golf tourism and golf tournaments
12. Work with publishers of tour guide books to change off-season image
13. Promote boating and rafting trips
14. Revive the festivals on the monthly calendar
15. Target high-income regional tourists from Singapore, Thailand, Malaysia, etc. who are not at all put off by the heat and occasional rain of the low season
16. Target expatriate communities in regional capitals in neighboring countries for weekend get-aways
17. Use the low volume of the off-season as an attractive feature to market to high-income tourists who value privacy, solitude and natural beauty
19. Market Laos as an offering to cruise tourists docking in Asia
20. Offer personal development thematic packages: Buddhist philosophy, architecture lessons, massage classes, silk weaving, cooking classes
21. Identify and attract micro-segments such as bird watchers

marriage ceremonies. A summer vacation package could be marketed to Lao people who have moved to other countries. The boat racing festival in September could also be promoted. The most promising strategic initiative is to market Lao tourist destinations to affluent consumers in the ASEAN region who are not at all put off by the heat or occasional rain because they already live with these conditions. For example, Luang Prabang is cooler than Singapore in the off-season. The beneficial impacts of counter-seasonal tourism are: increased incomes, more stable incomes, more stable employment, the ability to amortize investment more rapidly (and thus attract more investment in the first place), increased tax revenues and decreased dependency on external factors affecting high season tourist volumes.

- **Creating a national brand image for Lao tourism:** Branding Lao tourism involves both the development of a country brand and company brands and will further involve choices regarding specific packages marketed to specific segments. It is beyond the scope of this effort to create such a national brand image but, the current theme, “Jewel of the Mekong” may have the desired impact. Other themes could include:
  - “Destination Lao”
  - “Peaceful Lao”
  - “Laos: Nature Conserved, Culture Preserved”

It should be noted, however, that considerable promotion costs will be associated with such a strategy (cf. Malaysia’s “Truly Asia” campaign) and it needs to be ensured that once the attention of the potential visitor has been caught, the tourism industry has sufficient financing and know-how to maintain this interest.

Once the tourism cluster agrees on the appropriate brand image (possibly with some advice from international branding experts), a low-cost and high-impact publicity campaign can be mounted that involves engagement with tour book writers, contacts with leading documentary film makers, promotional literature and dissemination of the message throughout the cluster. An international public relations and publicity expert can help to create, advise and manage such a campaign. Numerous tour operators expressed a willingness to share the cost of a marketing and public relations expert to orchestrate a cohesive and convincing marketing and public relations campaign.

- **Developing tourism destinations outside of Luang Prabang, Vientiane, and Champassak:** Both the southern and northern provinces have tourism potential in adventure tourism, eco-tourism, and agro-tourism. These areas are currently underdeveloped, so attracting tourists could have a significant impact on rural populations. In the south specifically, there is high potential for safari tourism. Abundant wildlife and untouched natural beauty, if organized carefully, could attract high income tourists. There is little knowledge of building and managing safari tourism in Laos, so an initial step is to sponsor a number of study tours to centers of excellence in safari tourism and bring an international expert to assess the potential and create a plan of action for development of safari tourism in Laos.
- **Assisting with marketing skills, targeting of market segments and developing diversified offerings:** Creating company brands will require informed choices regarding target markets, positioning, packaging and distribution channels. This can be facilitated by participation in

international trade fairs and through using international consultants knowledgeable on branding. Firm-level assistance is needed to help companies improve their marketing skills, target attractive niches and develop trip itineraries and packages appropriate to the micro-needs of each target segment. If done appropriately, this will increase the daily tourism spending while diversifying the tourism base for the country.

Enhancing the general market knowledge on Laos tourism will be essential in supporting tourism marketing. The annual statistical report currently underway at the NTA is a good start, and can be further developed to include detailed information about specific customer segments (by both motivation of travel and origin country) attracted to Laos, in partnership with WTTC and WTO. A survey of international travel agents on the current image of Laos would be useful in assessing the current international perception of Laos. The end result is to identify attractive segments and develop appropriate itinerary and package tours targeted to those segments.

- **Improving quality by building human capacity:** A national training institute for hospitality and tourism should be created with international guidance with a national center in Vientiane and an ongoing training program in Luang Prabang (the Swiss who are among the best in the industry<sup>3</sup>, are reported to be discussing support in this area). Key skills needed in the industry include: hospitality management, tourism marketing, customer service, tour guide training, language training, reception,

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<sup>3</sup> Top international hospitality schools include: Les Roches (Switzerland), IHTTI (Switzerland), Le Bouveret (Switzerland), Brig (Switzerland), Cornell University (USA), Boston University (USA), Cesar Ritz (USA).

office management, guest house management, catering, etc. In addition, there is a need to assist the new tourism faculty at the National University to develop an appropriate curriculum for training future managers in the tourism industry

- **Improving and facilitating access to finance:** Small and family businesses do not have access to finance to improve and expand their facilities. The tourism industry can collectively approach the banking industry to design new financial products appropriate to industry needs and to identify ways to encourage credit to the sector.
- **Attracting appropriate foreign investment:** There is also potential co-investment from joint venture interest with foreign partners who could also provide technology, market access and other key inputs. The government should take as a point of departure this tourism strategy outline in its efforts to promote that kind of investment which results in the targeting of high-income segments, the diversification of offerings, the expansion of business in the off-season and the improvement in human capacity through internal employee training programs.
- **Establishing a public-private dialogue:** Public-private dialogue can bring to government attention obstacles to implementing this strategy and will help mobilize private sector and entrepreneurial energies and investment to implement the Laos strategy and achieve government growth targets. The IFC, through the MPDF is supporting a tourism business forum as part of the larger Lao Business Forum initiative. This has the potential to facilitate a constructive public-private dialogue. It is very new, so care will need to be taken to ensure buy-in from key tourism representatives and early successes to prove effectiveness in

resolving key business environment issues and building credibility.

- **Strengthening associations within the tourism cluster:** There is very little coordination and joint planning and investment from the various stakeholders in the tourism cluster, both at the provincial and national levels. The Association of Travel Agents, the Hotel, and Restaurant Association and a potential tour guide association are critical players in coordinating the cluster and implementing joint initiatives such as establishing certification committees for hotels, restaurants, and guest houses aligned with ASEAN standards.

Improving regional coordination of tourism bodies at the provincial and national level is critical to Laos tourism. Currently there is no joint planning across regional offices and limited sharing of information of tourist information centers. The Lao Tourism Marketing and Promotion Board has the potential to play the necessary coordinating role, but care will need to be taken to make sure the Board has a broad representation of the various provincial and functional stakeholders of the cluster as illustrated in the cluster map.

- **Establishing Luang Prabang tourism cluster working group:** As evidenced by the tourism cluster map above, Luang Prabang tourism has advanced enough to need a coordinating body that facilitates joint planning across the various members of the cluster. A cluster working group will assist the Luang Prabang tourism industry in developing strategies specific to the region.

**Quantifiable targets:** The implementation of this strategy can result in a four-fold increase in tourism value added over the next 5-7 years from \$120 million per year to

\$500 million per year. To achieve this, it would be helpful if the donor community could provide the requisite expertise in the various areas mentioned above by fielding a tourism industry expert, providing technical assistance and funding for a tourism and hospitality training institute, providing short term technical assistance in marketing and by helping to convene, guide and enable the tourism cluster to implement the above strategies. A center for design, such as that being developed under the National Export Strategy project, could also help to develop new and unique handicrafts, silk products, wood products and cotton products for sale to tourists and these designs could benefit artisan villages that would help them supplement their existing traditional products with other high-value products.

**Implementing mechanisms:** The strategy can be implemented in an uncoordinated fashion by the existing tourism associations or in a coordinated fashion. In a coordinated way, this could be implemented by assembling representatives of the tourism industry that include the various existing associations and government agencies. This should be done under the overall umbrella of the Lao National Tourism Authority (NTA) with a strong supporting role of the Lao Association of Travel Agents and hoteliers association. The industry is cooperating already under the Lao Tourism Marketing and Promotion Board and the Ecotourism Working Group.

## 2. Light Manufacturing

### Profile and importance of light manufacturing in the economy

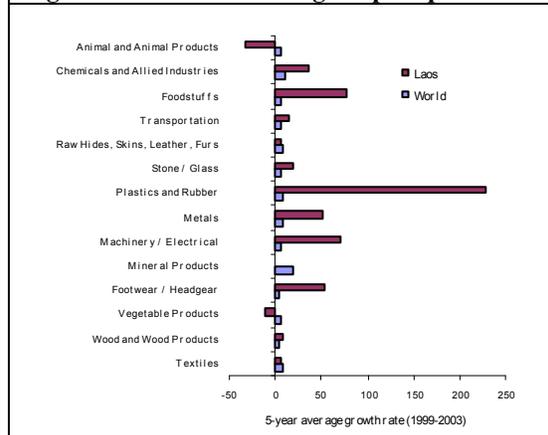
The manufacturing sector in Laos achieved strong growth over the past ten years, registering over 9 percent growth from 1998 to 2002. In 1998 industry represented under 22 percent of the national GDP, but now represents nearly 25 percent. Within the industrial sector light manufacturing,

including garments, wood products, and assembly of electronic and mechanical parts are the main export segments, with textiles and wood products dominating, representing 85 percent of total tracked goods exports.

*There are a number of high growth segments in light manufacturing that are starting to establish themselves with a significant presence.* The high growth, high potential export segments include rubber, which grew at over 200 percent annually over the past 5 years, machinery and electrical parts (71 percent), and production of footwear and headgear (54 percent)—Figures 11-12. Individually, all three segments still do not make up more than 2 percent of Lao exports, but the significant 5-year growth trajectory indicates that they have a strong future. In the rubber industry, there is much foreign interest in addition to domestic investment. Thai Rubber Latex Corp (TRLIC) is investing \$490,000 in developing rubber plantations in Vientiane and Borikhamxay province, with the intention to export rubber for processing in Thailand. Significant interest in rubber plantations has also surfaced from Vietnam and China. Rubber is exported mainly to China (Figure 12).

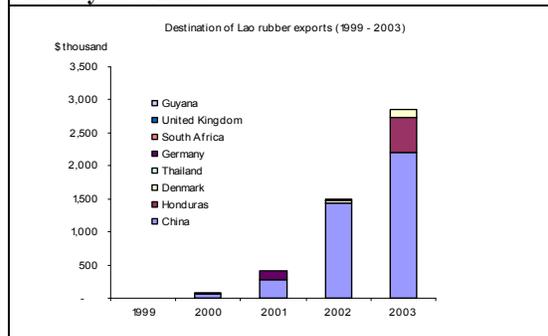
*World markets for Laos’s key exports are generally growing fast.* World markets in textiles and wood products grew consistently from 1999 to 2003. Total world exports in textiles were over \$400 billion in 2003 and grew 7.2 percent annually since 1999. World export markets in wood processing lagged in both size (\$243 billion in 2003) and growth (4.8 percent since 1999). One group of promising light manufacturing activities for Laos appears to be machinery and electrical equipment, representing over \$2 trillion in world trade and growing at over 7 percent annually; rubber, a \$70 billion world market registering 7.4 percent growth; and foodstuffs, a \$212 billion market growing at 6.7 percent.

**Figure 11. Sectors with high export potential**



Source: UNCOMTRADE

**Figure 12. Rubber exports are growing and go mainly to China**



Source: UNCOMTRADE

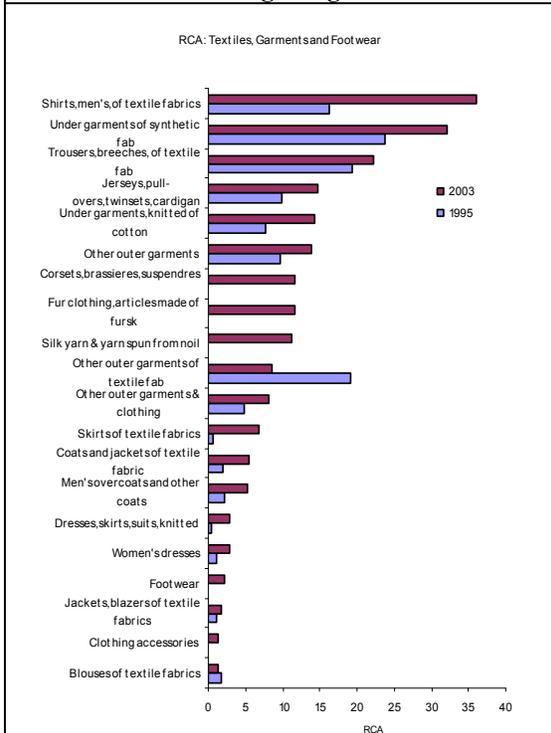
### Textiles and garments

At its peak, the garment industry employed an estimated 30,000 people. Current estimates are between 22,000 and 25,000 employed. As of the end of 2004, there were a total of 57 firms, of which an estimated 70 percent have foreign ownership. Lao investors in garment companies are mostly subcontractors that take on spillover contracts with very tight margins. There are a few Asian investors from Singapore, Taiwan and Malaysia who have recently invested in the garments sector, but these investors still appear to be using the Lao location for access to EU preferences, of which Laos companies are still only filling \$60 million of the \$150 million equivalent quota cap. These foreign investors already bring a pool of customers,

the technology, skilled labor and sources of raw materials.

Laos's comparative advantage in garments varies by category (Figure 13). The Revealed Comparative Advantage (RCA) index shows that between 1999 and 2003 Laos has gained competitiveness in products such as men's shirts, synthetic and cotton undergarments, trousers, jerseys, and silk products.

**Figure 13. Revealed Comparative Advantage in textiles and clothing categories**



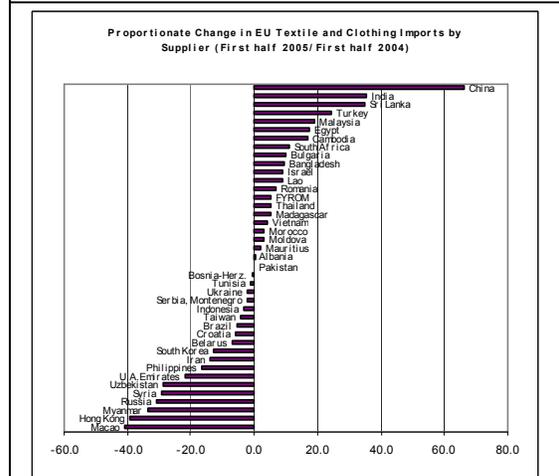
Note: RCA index greater than one indicates that the country has a comparative advantage in the product—the greater the RCA the greater the comparative advantage.

Source: UNCOMTRADE

*The textiles and garments sector seems to be experiencing pressure from the expiration of the MFA.* Textiles and garments are the most uncertain markets for

Laos at this point. World markets are still adjusting to the expiration of the MFA. While it is too soon to assess the impact of the MFA phase-out, initial data from imports into the EU market show that overall Laos has been able to maintain a positive growth in exports (Figure 14). But apparel manufacturers in Savannakhet noted that two of the five producers in their area had closed down. Apparel manufacturers in Vientiane reported continued severe price pressure from buyers. As China is again subject to quotas for certain apparel products—both in the US and the EU, this may offer Laos an immediate opportunity to fill excess demand and raise orders through 2008. However, a constraining business environment makes it difficult for entrepreneurs to take advantage of short-term opportunities. The garment sector in Laos still faces many constraints compared to other neighboring countries, as evidenced by the gap analysis (Table 1). The largest constraints are availability of management staff; education level and skill of workers; productivity; and access to raw materials.

**Figure 14. Initial response to the MFA phase out in the EU market**



Source: Paul Brenton

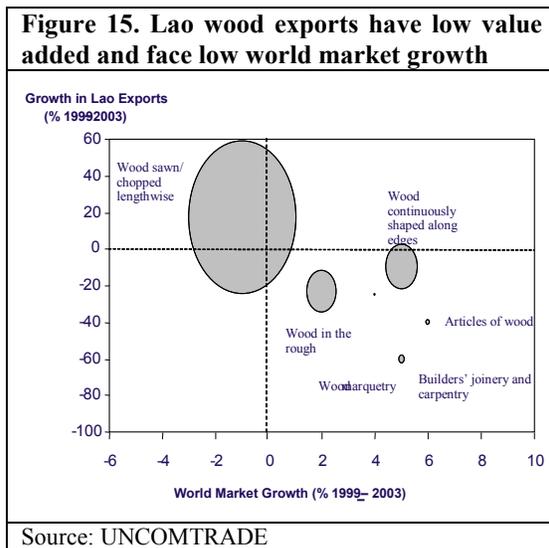
**Table 1. Gap analysis for the garment industry**

	Laos	Cambodia	Bangladesh	China	Vietnam
<b>Labor and Management</b>					
Availability of production workers	1	1	1	1	1
Availability of management staff	5	4	3-4	3	4
Recruitment of expatriate management staff	1	1	1	NA	3
Education level	5	4-5	5	4	NA
Skills	5	4-5	4-5	3	3
Training facilities in house	4	2-5	5	3	NA
Vocational training schools	4	4	5	3	NA
Productivity	4-5	4-5	4-5	2	NA
Absenteeism	4-5	2-3	3	2	NA
Work ethic	3-4	2	3	2	NA
Diligence / dexterity	2	2	3	2	3
Overtime pay (% of regular pay)	200%	150%	200%	150%	NA
National holidays pay (% of regular pay)	200%	200%	200%	200%	NA
<b>Access to Raw Materials</b>					
Access to fibers					
Cotton	5	5	5	1	2
Wool	5	5	5	3	4
Silk	5	5	5	1	4
Polyester staple	5	5	4-5	1	5
Polyester filament	5	5	5	1	5
Polyester micro	5	5	5	1	5
Acrylic	5	5	5	1	5
Nylon/polyamide	5	5	5	3-4	5
Bast	5	5	1	5	5
Local yarn suppliers	5	5	4	1	5
Local fabric suppliers	5	4-5	3-4	1	4-5
Cut panel printing	5	4-5	3	1	4
Embroidery	5	4-5	3	1	4
Garment wet processing	5	4-5	3	1	3-4
Threads, interlining, buttons, zippers	5	5	3	1	4
<b>Performance</b>					
Productivity	5	4-5	4-5	2	3
Quality	3-4	2	3-4	2-3	NA
Production flexibility	4	4	2-4	2-4	NA
Small Runs	3	4-5	3-5	2-4	3-4
Technology (CAD CAM)	4	3	3	2-3	NA
Computerized planning and control	4	3	3-4	3	NA
Code of conduct compliance	4	2	2-3	3	4
Lead-times: placement to delivery					
Woven garments	90	90 - 120	90 - 120	40 - 60	60 - 90
Cut & sew knit garments	90	90 - 120	60 - 80	50 - 60	60 - 120

Source: "Cambodia's Garment Industry: Meeting the Challenges of the Post-Quota Environment, September 2004, Asian Development Bank; Compiled for Laos by: "Lao's Textile and Clothing Analysis," March 2005, ITC  
Based on Formal and Informal surveys and interviews with members of the industry across the region  
Scale: 1 = Excellent, 2 = Good, 3 = Average, 4 = less than average, 5 = Weak or Poor

## Wood and wood products

*The wood and wood products sector is a major contributor to exports and income and holds significant potential.* The majority of wood exports are still direct from sawmills with very little value added activity occurring in Laos (Figure 15). There are a few furniture producers that are exporting to international buyers, and wood flooring is seen by producers as a segment with high potential. Implementing strategies for stimulating downstream production will transition Laos' activity into high growth and higher value segments (see below a value chain assessment for furniture). World markets are triggering high growth rates in processed wood products such as paper and paperboard (16 percent), toilet and facial tissue paper (15 percent), fiberboard (29 percent), and paper trays/dishes (11 percent). These products are largely driven by growth in urban populations. With significant growth expected to continue in China and India, Laos could be well-placed to enter into the Asian paper market.



### The case of the furniture value chain

With a forest cover of 47 percent of total land, Laos is highly endowed with timber resources. Wood processing and wood-

related exports are one of the major export items—it employs an estimated 22,000 people and accounts for over a third of the country's exports. Nevertheless, the sector is still underdeveloped. The bulk of exports are basic sawn and planked wood, without much value addition going into products such as furniture. The share of furniture in wood exports has generally been less than 3 percent, while that of sawn wood is about 75 percent.

Figure 16 below illustrates the value chain of a java chair, typically used as garden furniture, made from teak wood, purchased as ungraded or mixed class of wood. The producer is situated in the province of Khammuane. The integrated value chain analysis shows that the end-price of the chair, FOB Bangkok, is \$9.46, with the three highest value-added components being the raw material, at 51 percent, followed by overhead, at 29 percent, and charges for export administration, at 6 percent. Discussions with various processors of the value chain highlight problems that are constraining the road to high value added export-driven furniture processing.

*Uncertain raw material supply.* One of the most often mentioned issues that the secondary processors raise is the difficult access to raw material supply, which introduces uncertainties in the production process, most notably the inability to plan customer orders over long periods of time. The primary cause of this difficult access is the distribution of wood by the government, who owns forest resources and logging operations through outsourced suppliers. Introduced over the last year, the distribution of logs takes place through a mixed system of allocation of a portion of wood quota directly to wood processing companies, and auctioning another portion of wood quota through a 'sealed bid' bidding process, both under the authority and discretion of provincial forestry authorities.

**Figure 16. Furniture Value Chain, Java Chair, Laos**

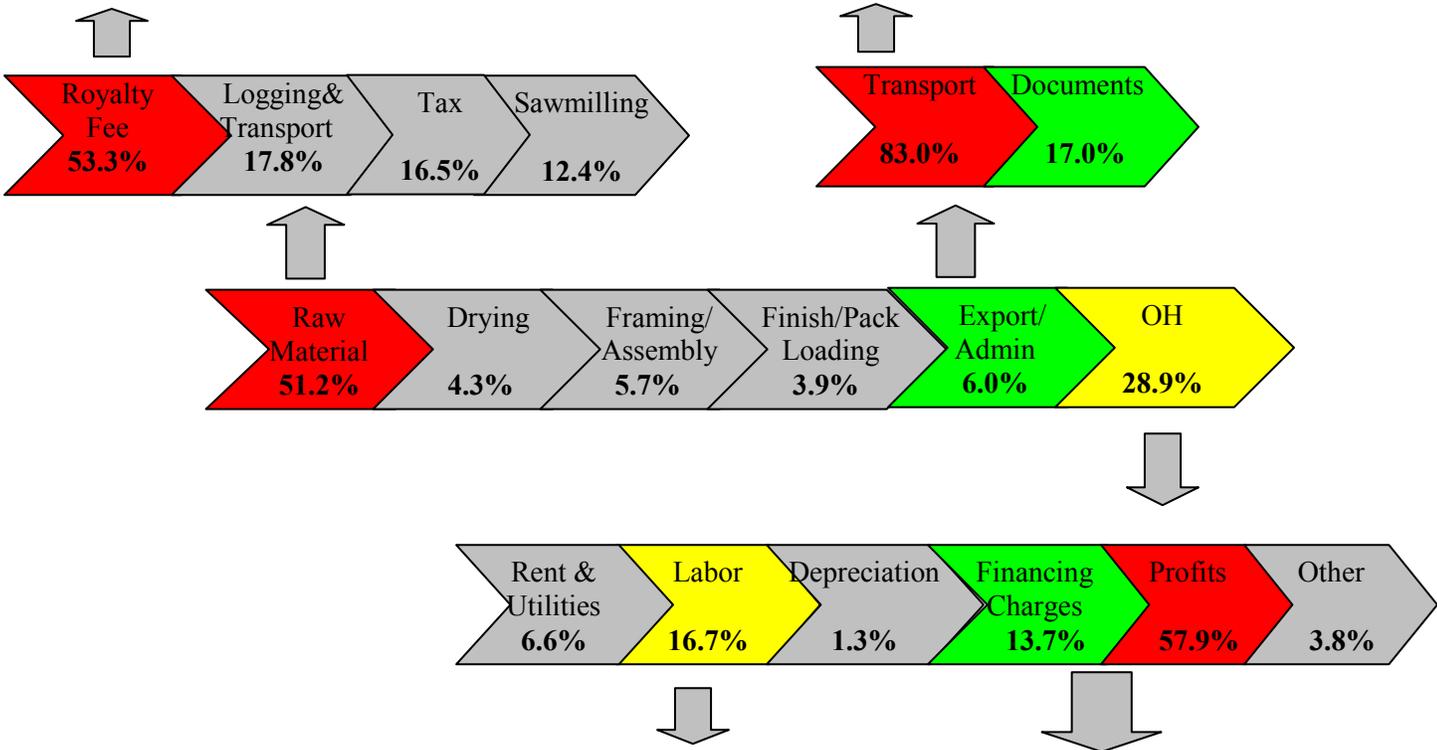
A newly introduced log auctioning system is pricing out small and medium size processors in favor of financially powerful larger firms, mainly sawmills, which effectively buy the bulk of available logs and thus deprive smaller players of predictable and steady supply of logs.

Log payments upfront strain the cash flow of small and medium size enterprises.

No transparency as to the allocation of logs on the part of government, which makes it impossible to plan over the longer term and keep steady pricing policies with customers

Collection of 25 signatures or stamps over an average period of 12 days is needed to clear the goods for export.

Rent seeking behavior of government officials is rampant, as reflected in the share of unofficial charges exceeding the official charges for administering exports.



Maintaining expatriate staff is indispensable for proper operations due to the lack of skilled and trained local labor.

Margins over and above cost of goods sold cannot be more than 15 - 20% in order to stay competitive in international markets; margins (and cash flows) are squeezed by upfront financing of timber purchases.

Source: Global Development Solutions, LLC™

While the strategic orientation of the authorities to allocating timber resources according to market-based principles is correct, the current system does not support the higher-value added furniture producers, especially given the nascent stage of the furniture industry. The small and medium size high-value added producers are disadvantaged in comparison with financially powerful lower-value added producers like sawmills or outright timber traders. Interviews in the field suggest that purchasing wood from sawmills or trading companies is next to impossible, since they have secure international markets for their produce where they can achieve a much higher price than in the local markets. Direct quota allocation is also proving difficult for furniture makers—in the allocations in the Khammuane province, only 14 percent of quota had been allocated to furniture makers as of May 2005 (Fig 17).

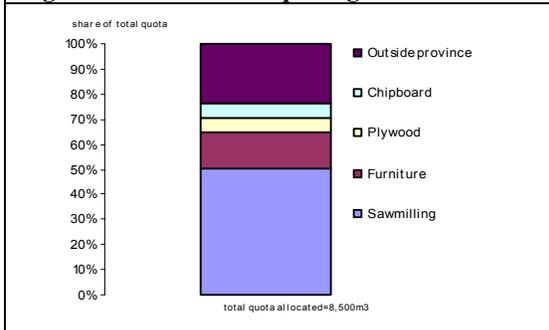
Importantly, a realignment of the current quota allocation can help. First, as far as the non-competitive direct allocation is concerned, furniture makers could be given a larger share of timber. Second, a better balance needs to be achieved as to the quantities sold in a competitive process versus direct allocation at preset log prices—allocating a larger share of stable, directly-allocated timber at prices that have historical precedence from previous years' quota prices would go a long way toward decreasing the uncertainty of timber supplies and thus enable furniture makers to produce more efficiently.

**High overheads reduce profit margins.**

Another issue identified by the value chain analysis is high overheads, generally driven by the *high cost of finance*. The current payment mechanism for timber is such that all payment must be made within a week of acquiring the timber. For a furniture company that needs 2,500 m<sup>3</sup> of timber per year, in the unlikely event that it has been allocated a direct quota, and depending on the type and grade of timber needed, the company would need to pay between \$250,000-\$1,000,000. In the event the company chooses to compete in the bidding process, this price range will most probably be higher. One way to address this constraint is to split the auctioning quantities into smaller volumes, to have multiple auctions, and to allow phased payment.

In addition to the financing charges, *expatriate labor costs* dominate overhead costs (at 35 percent of pre-profit cost) associated with operating a furniture company in Laos. However, at present it is very difficult to find a local Lao company that exports high-value added furniture without relying on the expertise and design skills of international experts. It is therefore of utmost importance that training and skills develop, as well as transfer of know-how be facilitated to help accelerate the indigenization of the sector. At the same time, local capacity needs to be built in the form of educational institutions that would support the private sector through the provision of a trained labor force (*Note, these considerations are acknowledged in the NES and will be included in the Wood Strategy Action Plan*). Currently, in the case of Khammuane and Champasak provinces for example, there exist only two classes with 20 students each within vocational training colleges that provide training for wood processing. The placement of these students could not be traced directly with the schools, but judging from the interviews in the field, it appears that more graduates from these schools work within government departments than they do in the private sector.

**Figure 17. Most of the quota goes to sawmills**



Source: Interviews GDS, LLC<sup>tm</sup>

**Expensive and time-consuming export clearing process.** Export administration is the third highest value (cost) adding component (6 percent). There are two key features of the export administration process. **First, unofficial payments exceed payments for official charges.** Every step of the export clearance process requires unofficial handouts to be issued to government officials. On average, a company pays \$100-150 per export shipment (Table 2). For a small to medium size company that ships between 30 containers of end product per year, this amounts to approximately \$3,000-4,500 per year.

**Second, it takes approximately 12 days to complete all the paper work necessary to export.** This entails significant resources on the part of the exporting companies who must allocate staff for export clearance procedures. Usually this process requires involvement of a number of people, including significant management involvement to oversee the documentation process. Going through the entire export clearing procedures for wood processing companies takes an average of 12 days to complete and 25 stamps and signatures are required to clear a shipment through the Lao border (Table 3). By any standard, this is a major distortion that hinders the competitiveness of the sector. Not unlike most globally traded goods, the furniture market is extremely customer driven, and time to delivery is just as important as price competitiveness for attracting and retaining customers. In contrast, it takes only 30 to 31 days to clear, ship, and deliver the same goods from Bangkok to Rotterdam. Thus almost 30 percent of time-to-delivery to end customer is lost to in-country export administration. If Laos is going to have any meaningful exports of wooden value-added products, this export procedure red-tape must be greatly reduced.

**Table 2. Sample running cost for export administration/documentation of wood products**

Expense	Kip (000)	Share in total
1. Customs Department Form	30	
2. Commerce Department Form	40	
3. Industry Department Form	30	
4. Agriculture Department Form	50	
5. Advance Profit Tax	171	
6. Property Tax	155	
7. Agriculture & Forestry Tax	22	
8. Mekong Ferry Fee	234	
9. Overtime Fee 1 Border Section	156	
<b>Total Official Payments</b>	<b>888,</b>	<b>45.5%</b>
<b>Unofficial Payments:</b>		
a) 4 Government Departments	200	
b) Paper work/export clearance handouts:	20	
	40	
(each amount represents a different transaction in which a bribe was required to facilitate that one transaction).	10	
	25	
	50	
	84	
	30	
	60	
	20	
	20	
	88	
	40	
	26	
	200	
	150	
<b>Total Unofficial Payments</b>	<b>1,063</b>	<b>54.5%</b>
<b>Total Running Cost of Export Clearance</b>	<b>1,951 (\$195)</b>	

Source: Interviews, Global Development Solutions, LLC

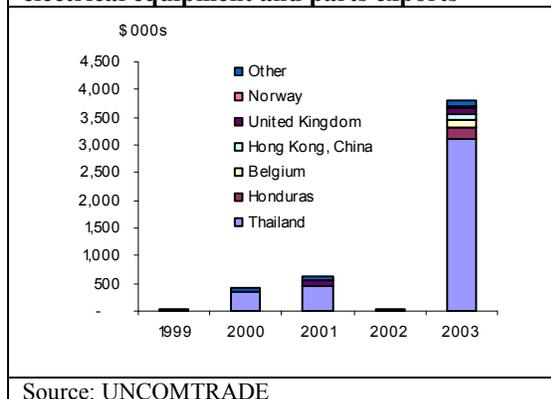
### Other light manufacturing

**There is an emerging mechanical and electrical equipment and parts industry in Laos.** According to the Ministry of Commerce, there are over 20 motorcycle assembly factories currently operating in Laos. Hyundai assembles and exports motorcycles to Niger and Uganda. The parts are imported, but the frame is from Laos. The mechanical parts are assembled in Laos and then shipped to Thailand, Vietnam, or China (Figure 18). This is a short-run, high growth segment since it takes advantage of low labor costs and very little investment is needed. It also shows that Laos is starting to take advantage of the production sharing

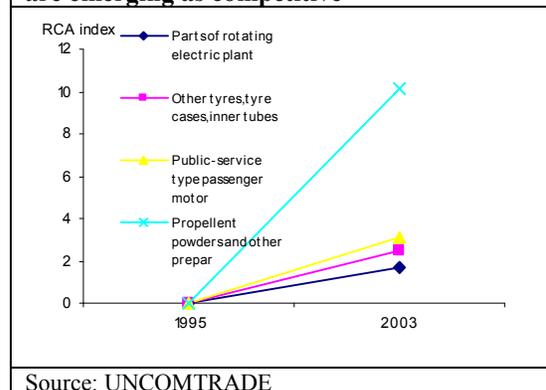
<b>Table 3. Export clearing procedures for wood products</b>	
Day 1	*Collect and fill forms (6 sets) from each department: <ul style="list-style-type: none"> <li>○ Ministry of Finance, Customs and Tax Department;</li> <li>○ Ministry of Commerce, Commerce Department;</li> <li>○ Ministry of Industry, Industry Department</li> <li>○ Ministry of Agriculture, Agriculture Department</li> </ul>
Day 2	*Apply at each office for inspectors to be sent to inspect goods prior to shipment: <ul style="list-style-type: none"> <li>○ MOF, Customs and Tax Department Inspector;</li> <li>○ MOC, Commerce Department Inspector;</li> <li>○ MOI, Industry Department Inspector;</li> <li>○ MOAF, Forestry and Agriculture Department Inspector</li> </ul> *Inspectors assigned within 1-2 days at best *Goods inspected and signed by the 4 officers
Day 3	*Stamp the MOI Inspector's signed form with Chief of Industry Department *Go to the bank to confirm that payment for exports has been received, as a measure to "protect" exporters *Stamp the MOC Inspector's signed form with Chief of Commerce Department *Reconcile Log List and Stamp the MOAF Inspector's signed form with Chief of Department
Day 5	*Confirm the goods are Industrial Goods (with MOI officer) *Apply for Export Permit with Chief of Forestry Section, MOAF (3-5 days)
Day 9	*With the Export Permit, go to MOF and Customs: <ul style="list-style-type: none"> <li>○ Tax Section, MOF: pay for advance income tax, cash or check</li> <li>○ Property Section, MOF: reconcile log list with data of property section</li> <li>○ Customs Section, MOF: obtain Customs Declaration</li> <li>○ Border Checkpoint, Export Section of MOAF: sign Export Permit (5-50 km from exporter's facilities, depending on location)</li> <li>○ Ministry of Communication and Transportation: obtain permit for truck to leave country</li> <li>○ Customs Section, MOF: ask for officer to be assigned to seal truck</li> </ul>
Day 11	*Border checkpoint, Immigration Section: Invite officially assigned officer to seal truck *Officially assigned officer seals truck at exporter's facilities *Truck heads to export point. *Obtain 4 signatures from each representative at export point (MOI, MOC, MOF, MOAF, and head of customs on duty at export point *Obtain Certificate of Origin from MOC, signed and stamped, including with MOAF
Day 12	*Goods ready for loading at Thai border

Source: Interviews, Global Development Solutions, LLC

**Figure 18. Destination and size of Lao electrical equipment and parts exports**



**Figure 19. New light manufacturing sectors are emerging as competitive**



networks of the Asia region. These have been growing in importance in recent years as a source of export.

World export markets for electronic parts and equipment are consistently growing at above 7 percent annually. While overall growth is solid, but not exceptional, there are a number of product segments that are registering above 10 percent growth. High growth segments include: integrated circuits (averaging 15 percent growth over the past five years), electronic micro-assembly (21 percent), transmission apparatus (18 percent), headphones and earphones (11 percent), and color video monitors (39 percent). Some of these segments require highly skilled labor and advanced technology and so may require significant investment in Laos, but segments such as integrated circuits and transmission apparatus may provide short-term opportunities for growth.

### Competitive position of light manufacturing industries

#### *SWOT analysis:*

Laos's *strengths* in light manufacturing include low labor costs, disciplined labor, good labor-management relations, low electricity costs, and bilateral preferential trade agreements. In addition, segments in light manufacturing are

starting to align themselves to Laos's raw materials supply such as rubber and metal. Industry leaders that participated in the DTIS workshops perceive the current government support and subsidies as a significant strength, signaling a misinformed and short-sighted view on the underlying determinants of the competitiveness of their businesses.

*Weaknesses* in light manufacturing include lack of market and trade information, shortages in labor supply (especially skilled labor), lack of raw materials for garments and furniture, poor infrastructure and high transport costs, restrictive labor laws, lack of technical and design skills, weak knowledge and skills in marketing, high communication costs and poor infrastructure, and ability to manage peaks and valleys in demand and meet increasingly tight deadlines (Table 4)

*Opportunities* for development of the sector are viewed to be the new trade agreements (AFTA, NTR, EU), rising income in neighboring countries and the emergence of a consumption driven upper and middle class, improved infrastructure, and capitalizing on communication technology innovations to connect Laos to key markets. Reinstatement of quotas on China to the US for a few garments may present a short-term opportunity to attract investment and create jobs.

**Table 4. Infrastructure and Market Access**

	Laos	Cambodia	Bangladesh	China	Pakistan	Sri Lanka
Roads	5	5	5	3	1-4	2-4
Rail	NA	5	4	3	4	
Airports	5	4-5	3-4	2-3	2-4	1-3
Shipping ports	NA	5	5	2-3	3	2
Container terminals	5	4	4	2	4	2-3
Customs systems	5	4-5	5	3	4	3
Power shortage	3	5	5	3	3-4	3
Power supply breakdown	3	5	5	4	4	2
Cost of electricity	2-3	4	3	3	3-4	3
Grid (\$US/kwhr)	0.07	0.15	0.065	0.047 - 0.08	0.065 - 0.075	
Internet	4	2-5	3-4	1-3	3-4	3
Telecommunications	4	2-4	3-4	1-3	2-3	2-3

Source: ITC, 2005, Lao Textiles and Clothing Sector Analysis

**Threats** to the sector are numerous. Laos is already behind in international standards, and the latter keep increasing. Elimination of the MFA agreement is underscored with the larger threat of China, and soon Vietnam, as an efficient, low cost manufacturing powerhouse.

**Porter Competitiveness Diamond:**

Exporters need to understand the **demand conditions** in their export markets. With such small local market, it is essential for light manufacturing companies to be well connected to buyers and end consumers in regional and international markets. As the majority of companies are sourcing downstream companies in the region or covering overflow production, there is minimal interaction with key markets. Understanding of the current needs and trends in key markets is very weak. China, Vietnam, and Thailand all represent large, growing markets. In addition, normalized trade relations with the US offer the opportunity for proactive Lao entrepreneurs to profitably penetrate the US market. To date there are very few entrepreneurs with even a plan of how to enter the US market due to lack of information, but those that have been successful have used the diaspora to make initial contacts and gather information.

**Factor inputs** need to increase in quality—cheap is not enough. Low cost labor is available, but getting scarce in some industries due to high competition for cheap labor. Skilled labor is very limited and higher level supervision / management is typically imported. Garments and wood products both require unique skill sets in order to participate in high-value segments of the market. There are no training centers for employees of larger industrial firms in both garments and wood products and only 5–6 smaller training centers for training small scale family producers. To date all training has been conducted by international donors course by course, but this is not sufficient to train a substantial labor pool. It should be emphasized

that Vietnam, Cambodia, and the Philippines all have industry-wide garment training centers.

In scale-driven industries, especially in garments, there are significant capacity constraints to growth and attracting major foreign investors. In the past six months a number of major US retailers including Walmart and Sears have visited Laos, but decided that it did not have the needed capacity to justify significant investment. Laos imports nearly 100 percent of raw materials for the garments sector. In addition, there is currently only one factory in Laos that is able to comply with US garment standards and certifications, and it is a Taiwanese firm.

For wood processing, the majority of raw material is still sourced from natural forests, not from sustainable plantations. The natural forest resources are quickly depleting, but plantations are growing. For now, there appears to be enough raw material and production capacity to keep up with demand; however, the availability of skilled labor and craftsmen is extremely low. There are training centers, but according to wood processing managers, the curriculum is not aligned with needs of the industry.

Even for smaller scale silk weavers, human resource is a key constraint. With basic education so low, there is a need to invest a lot of resources in quality control; in addition, many of the weaving companies have set up in-house training programs. There is also a significant need for marketing and business management skills in silk and handicraft industry.

The local **context for competitiveness and rivalry** needs to leave enough flexibility to producers and be more market based. Laos once enjoyed a 10-12 percent margin advantage in garments over other countries in the region, but recent passage and enforcement of labor laws has reduced this to just a 5 percent advantage, as the minimum wage rose and the enforcement of company contributions to social welfare became more stringent. This, compounded with an

increase in the electricity cost by 10-15 percent, resulted in an overall upward pressure on operating costs. Coupled with a significant downward pressure on prices in most segments, margins of many Lao companies are being severely squeezed.

Given the many business environment constraints in Laos, success in light manufacturing is still largely determined by networking and a company's ability to navigate the various delays to doing business. The textiles and garments industry cluster is well-organized under an industry organization that effectively advocates with the government on key issues. Other industry clusters such as wood processing and mechanical parts assembly have no such dialogue mechanism or are just starting the process. In most cases, advantages for Lao companies are still based on protection from international competition or government subsidies, neither of which can be relied upon in the medium and long term. Sustained innovation across light manufacturing is significantly lacking. Companies are relying on cheap factor costs and established marketing channels, or are simply importing highly mobile technology and skills that can quickly be removed as protections and subsidies disappear.

A more extensive network of *related and supporting industries* needs to be put in place. All light manufacturing activities in Laos have very shallow industry cluster structures. Apart from wood processing, nearly all raw materials are imported at a high cost and questionable quality. Support services for producers and assemblers are weak. Exporters struggle to find appropriate financial services that meet the needs of their business such as lines of credit and long-term loans, business services are almost non-existent, and business associations, with the exception of textile exporters, are uncoordinated or non-existent. There is no institutionalized training for skilled labor—cluster-wide training sessions are short-term and sporadic, mostly based on donor timelines, so companies are forced to expend significant cost

to conduct in-house training. Transportation and distribution services are significantly lacking. The cost of owning and maintaining trucking fleets is prohibitively high for most companies, and leasing is not available.

### **Business environment constraints**

The business environment is a significant constraint to growth and investment in light manufacturing. Similar to tourism, business leaders in light manufacturing are eagerly awaiting the passage of the foreign investment decree. Channels for market and regulatory information collection and dissemination are nearly non-existent. Rigid labor laws were cited by the Garment Exporters Association as a competitive risk for manufacturers in Laos. Under the law there is a limit to 1 hour of overtime per day, competing countries average 2-4 hours per day. In addition, producers cannot employ workers after 10 pm, which means that manufacturers are not able to run 2 full shifts. Currently the laws are not enforced, but if they are, they will significantly impact the competitiveness of manufacturing companies operating in Laos.

Significant progress has been made on improving customs and the various processes for importing and exporting commercial goods. The time for clearing customs is estimated to be just 1 day for textile and wood products. Yet much remains to be done in synchronizing and harmonizing customs with other regulations. There is a contradiction between customs laws and the recent SME promotion decree. Under the customs law, all imported materials must be monitored and tracked by customs while in country and then at point of export, but this makes it very difficult and costly for larger Laos companies to transfer materials to SMEs for subcontracting, as is promoted in the recent SME promotion decree. Also, the government-operated warehouses at customs have caused some concern among industry leaders in their efficiency and cost.

## Strategic opportunities

- ⇒ **Strengthening marketing linkages will be critical** to light manufacturing businesses continuing to adapt to the changing market dynamics. Currently there are five full-time commercial attachés working under the Ministry of Foreign Affairs in Vietnam, Thailand, China, France and Russia. There is limited communication and coordination between the Lao National Chamber of Commerce and Industry (LNCCI) and these foreign representatives, even though these representatives could be a source of market linkages for Lao exporters. The industry cluster should make full use of these attachés in providing on-the-ground links to potential clients and for feeding back market information. In 2003 Russia only accounted for 0.1 percent of total registered exports from Laos, so there may be an opportunity to re-evaluate the key export markets where the LNCCI and the government are best positioned to assist industry growth.
- ⇒ **Realigning Lao garments industry around its expertise as well as cheap labor will require a more focused understanding of market and customer needs.** Currently, the market economics are on a downward trend and profitability will continue to deteriorate. There is already evidence of business closures and entrepreneurs transitioning into other industries. Investment should be cautious and focused on:
- Improved technology use in garments sector in anticipation that wages will begin to increase
  - Target niche opportunities to raise export values to the US and grow exports in Europe
  - Position Laos as the most efficient destination for spillover business from Thailand and Vietnam

- ⇒ **The planned Special Economic Zone (SEZ) offers good prospects for attracting light manufacturing, but this needs to be confirmed with surveys.** Given the construction of the new bridge at Savannakhet and the focus on the East-West Corridor connecting Myanmar-Thailand-Laos-Vietnam, the SEZ has good potential for success according to the JICA study completed in 2001. It is important to confirm the demand assumptions of the SEZ by conducting more in-depth surveys of manufacturers in Thailand, Vietnam, and others to confirm the “demand side” feasibility and the conditions under which firms would transfer operations or add capacity in Laos. After confirming this, it is necessary to expedite progress on the SEZ using international best practice and strategic partners who can provide financing, engineering, management expertise and—most importantly—the ability to attract a critical mass of tenants. If these steps are taken, the SEZ might generate 20,000 jobs in its first five years of operations. However, workforce development and training are constraints to effective implementation.

Commissioning a comprehensive survey of Thai industries to identify companies willing to create satellite plants for light manufacturing in Laos, and the conditions required for them to do so, would be an important first step in investigating this opportunity. Unlike the JICA study, this survey should include site visits to companies in Thailand.<sup>4</sup>

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<sup>4</sup> The JICA study used faxed surveys to companies in Thailand and Vietnam. The response rate was relatively low. Only a handful of companies indicated existing plans to establish operations in Laos although many others indicated interest in the SEZ.

⇒ **Improving customer knowledge and market contacts as well as design capabilities are two urgent priorities for boosting wood product and handicraft exports.** Much can be done to assist current and potential producers and exporters. It is important to build market research capacity, participate in international trade shows (conditional upon companies actually being ready to participate in such an event, practically as well as in terms of company strategy), develop e-commerce capability and link up with importers in foreign markets who are willing to pay attractive prices.<sup>5</sup> Design capabilities in Laos are still very weak. Design skill will raise the value of exports. Master craftsmen and women earn up to three times as much as normal craftspeople. Creating a Lao center of design and innovation would build human resource capacity and continue to spur product innovation. Value-added manufacturing in wood exports is clearly an important opportunity to fully capture the value of unique wood in Laos. It may be unrealistic to expect sawmills themselves to forward integrate into furniture production but there are a number of entrepreneurs already interested. One Swedish entrepreneur with expertise in furniture had at one point made export agreements with the Swedish firm IKEA.

⇒ **Promotion and certification of Lao silk products can increase value.** For the silk industry, a few of the successful silk weavers have developed a successful cottage industry model of bringing income generating activities to the rural areas. One silk business based in Vientiane works with village cooperatives covering over 300 families. Promotion of urban-rural industry

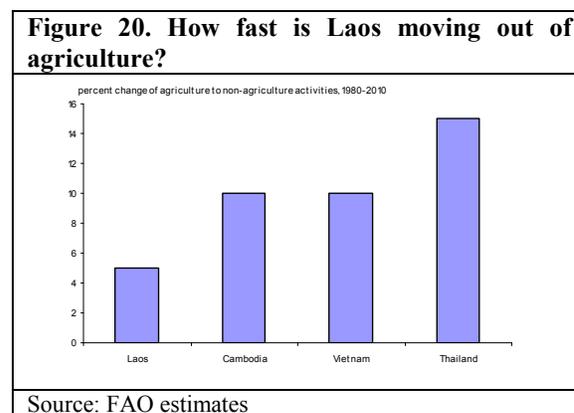
<sup>5</sup> For example, the non-profit group “Ten Thousand Villages” is an importer of handicrafts that passes on “fair prices” directly to artisans in developing countries such as “fair trade certified” coffee passes on higher prices to coffee farmers.

connections could accelerate the option of this model across the silk industry and in other similar handicraft and agro-industries (medicinal plants and herbs, coffee). A certification process and labels for high-value Lao Silk is much needed and already planned by Japanese donors. A JICA initiative building the Chao Lao brand for the Japanese market has already been successful in increasing the value of Lao silk abroad.

### 3. Agriculture

#### Profile and importance of agriculture

Agriculture remains the main source of income and livelihood for the people of Laos. The sector accounts for 50 percent of GDP, down from 52 percent in 1998, with rice representing 75 percent of all agricultural production. Other main crops include maize, coffee, sugarcane, tobacco, and peanuts. Laos is transitioning from an agricultural based economy much slower than its neighbors (Figure 20). Of the total population in Laos, 76 percent still dwell in the rural areas and an estimated 80 percent of the labor force are farmers.

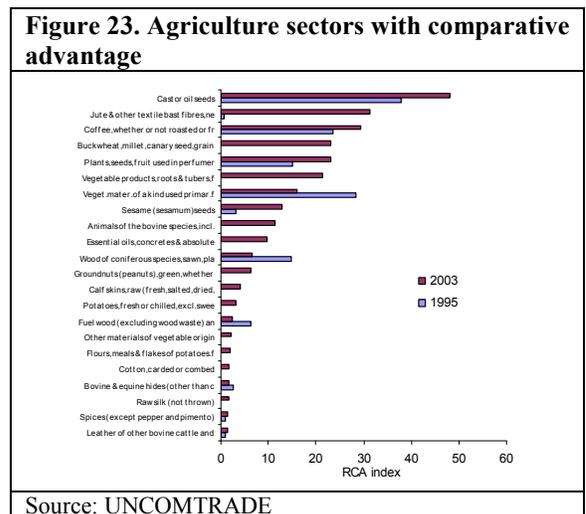
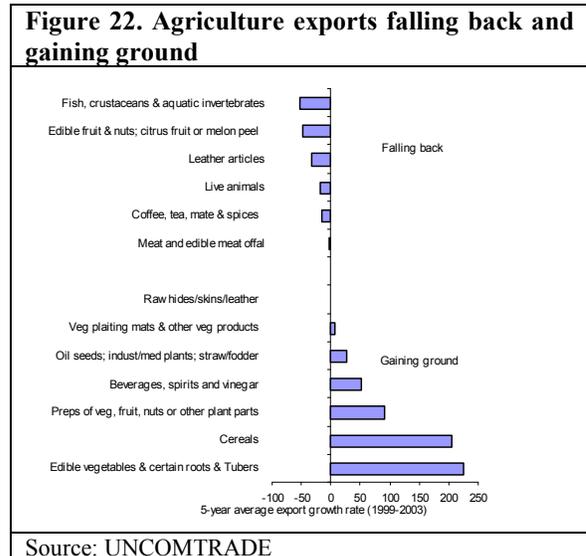
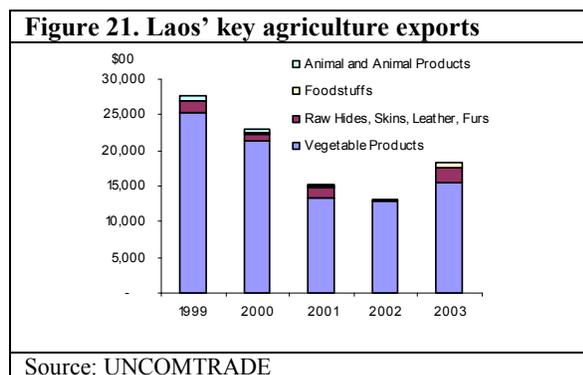


**Coffee is currently the main agriculture export commodity.** Despite its importance in the domestic economy, agriculture only represented 6.1 percent of total Laos exports in 2003, of which coffee dominates (Figure 21). Coffee alone accounted for nearly 80 percent of

agricultural exports, \$12.5 million, with cereals the next highest value at \$1.4 million and hides, skins and leather totaling \$1.4 million as well. There are some smaller segments that are achieving high growth rates in agricultural exports including: edible vegetables/roots/tubers (226 percent average growth since 1999), cereals (106 percent), and vegetables/fruits/nuts (91 percent)—Figure 22. Illustrating the volatility of commodity markets and the uncertainty of crop yield, coffee exports declined 15 percent over the five-year period. Since 2003 Lao coffee has made a rebound, but future exports are still subject to external shocks that Lao farmers and the agricultural industry overall are not yet able to successfully mitigate.

Laos has gained comparative advantage in several agriculture products, including castor oil, jute fibers, coffee, wheat, and seeds used in perfumes (Figure 23). A successful example is agar wood (Box 2).

There is a significant amount of informal trade in agriculture across the Mekong region. This is especially the case for livestock, which can and do leave by mass on foot into Thailand. In addition non-wood forest products (NWFP)—including medicinal herbs, fiber products, resin and edible products—are harvested in the forests and then traded into southern China and sold at local markets. No definite number is known for the value of NWFP exported from Laos, but estimates are up to 2.5 percent of exports, of which the majority are medicinal plants headed for China.



### International and regional market trends

Reflecting the low value-added and their largely domestic nature, agricultural export markets are relatively small in comparison to light manufacturing and tourism trade. World fruit and vegetable exports in 2003 totaled \$190 billion and registered 5.8 percent growth during 1999-2003. High growth vegetable products from 1998 to 2003 included: green tea (23 percent) tropical fruits (pineapple, mangosteen, guavas, papayas ranging from 13-20 percent growth), fruit juices, coconut oil (25 percent), and soya bean (20 percent).

### **Box 2. High-value cultivation: Eagle wood**

One example of the ability of Laos to reposition itself in the global economy is the example of Eagle Wood, also known as “Agar Wood” or by its scientific name “*ecolera*”.

The team visited a plantation of agar wood and also interviewed the Managing Director of Lao Agar International Development Company, Ltd., who was based for many years in Saudi Arabia and knows the market there quite well. The end-product is used for burning as incense in Asia but especially prized in Saudi Arabia and the Arab world. As an essential oil, it is also used as perfume or cologne with a woody scent. The oil and the wood are given as gifts in the Middle East. One 11.62 gram bottle can be sold for \$100. Treated wood appropriate for the market goes for between \$200 and \$2000 per kilogram and can easily average \$800 per kilogram. In both oil and treated wood, this is a very high value product.

The tree itself only produces the desired black resin if it is damaged by natural disasters or insects, but the response can be induced by drilling holes in the tree and injecting a substance that causes this response. This is often done after five years of growth, after the tree has reached a certain size and maturity. Thereafter, it takes only a few months to produce the resin that can be used in essential oil. Alternatively, the tree can be aged for many more years (10-15 years) to produce the wood that is highly prized for its incense smell when burned. The tree is felled and the valuable dark part of the wood is separated from the white part of the wood which is not usable.

One hectare can yield 800 trees, of which 700 can normally be used when treated appropriately by injection. Minimum prices for trees are \$150 (although others allege that the price should more properly be estimated at \$500). Even at the lower price, each hectare would produce over \$100,000 when brought to harvest in 5-6 years. After processing, this value goes up and each tree is said to be able to produce between \$200 and \$1,000 worth of final product. When wrapped as a gift in an attractive bottle and wood box, the final product can be sold for over \$2,000.

Supply is said to be diminishing in Cambodia, Thailand and Vietnam but is still quite good in Laos and Myanmar. The team found evidence of new planting of eagle wood at more than one site. Agarwood also provides an alternative crop to highland people who have in the past grown opium.

The plantation of 3,200 hectares, the entrepreneur was investing in eagle wood expansion while also growing coffee under the tree canopies, harvesting eucalyptus, processing eucalyptus charcoal for export, raising cattle which grazes on the grass among the trees, developing fish ponds and investing in rural tourism.

Animal and animal exports followed closely behind fruits and vegetables at \$139 billion and 5.7 percent annual growth. High growth segments included: swine meat (17 percent), salmon (18 percent), and natural honey (20 percent).

***Agriculture exports to Thailand have grown, but those to China remain low.*** Rising incomes and urban migration in Southeast Asia are both positive market trends for Lao agriculture. Vegetable and foodstuff exports from Laos to Thailand grew notably; from 1999 to 2003, foodstuffs registered 628 percent annual growth and vegetable products grew 69 percent year on year. Surprisingly there was very little growth in exports to China. With recent partnerships between Laos and China, Laos agricultural exports destined for China should grow significantly—while other ASEAN countries also have preferential access to the Chinese agriculture market as part of the Early Harvest Agreement of the ASEAN-China free trade area, Laos can export niche products to China (e.g., medicinal herbs and products) and can target the Southern part of China.

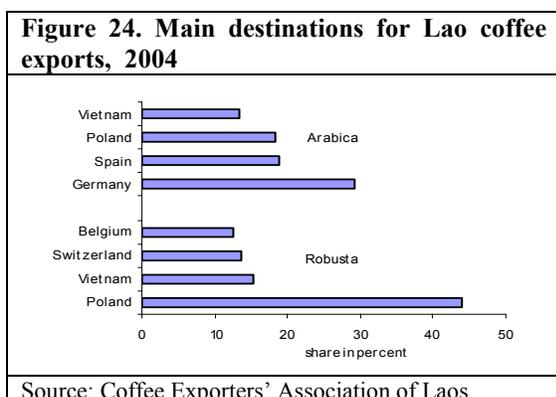
Notable market trends in agriculture include a growing demand for organic products in international markets, rising standards for agriculture produce and livestock, rising efficiency of international distribution networks, and rising levels of income in Asia that is likely to shift the consumption needs of a large portion of the market.

### **The case of coffee**

Coffee is a growing export product for Laos. While there is some coffee grown in the Northern Provinces, nearly all of the primary coffee production takes place in the southern region, particularly Champassak where over 80 percent of the coffee is produced. Total production in 2004 is estimated at about 35,000 hectares and 23,000 tons—of which 70 percent is Robusta, 20 percent is Arabica, and the remaining 10 percent is Catimor. Production is

gradually shifting towards Arabica and Catimor which command a much higher market price. For poor rural farmers whose primary source of income and livelihood is not coffee, Robusta continues to offer a viable choice. The market structure for coffee is an inverted pyramid with a large number of smallholding farmers, very few medium size farmers (<10 hectares), and a single large coffee plantation (210 hectares). There is a budding cooperative movement which began in 2004 with 500 smallholding farmers.

Exports of coffee amount to \$153 million (2003), or 7 percent of agriculture commodities exports. Over 80 percent of coffee exports go to Europe, and the rest to Asia. Vietnam is an important destination of Robusta exports, mainly because of close ties between Lao coffee companies and Vietnamese traders (Figure 24).



Lao coffee faces key competitors within the Mekong Region. Vietnam is the largest producer—accounting for 45 percent of all coffee production in Asia and over 10 percent of world production. In this context, Laos is a small player and its production represents less than half a percent of world coffee. The yield per hectare in Laos is lower than most of its neighboring countries but is adequate enough to attract farmers into this sector (Table 5).

A unique feature of Lao coffee farming is the fact most smallholding farmers practice organic farming—not necessarily by choice but because they cannot afford fertilizers. In many areas

where coffee is grown, infrastructure and access to transportation is poor.

**Table 5. Greater Mekong coffee comparison**

	Laos	Thailand	Vietnam	Myanmar
Production area	37576	66400	500000	5000
Yield (kg/ha)	681	1193	2500	458
Production volume (tons)	23000	86400	700000	1830

Source: Compiled by Global Development Solutions, LLC.

From the perspective of Lao coffee farmers' competitiveness, the inability to use agrochemicals by small farmers undermines yield rates but creates the possibility to exploit the organic niche market. With the market for coffee increasingly more competitive and consumers more quality conscious, premium prices are being paid for organic coffee. Although most Lao coffee farmers produce organic coffee, they have not been able to take advantage of it because of several constraints:

- *Weak extension services.* Farmers have poor on-farm technical skills and poor post-harvesting handling, all contributing to low yield, poor quality control, poor product quality, and limited volume of marketable product—further efficiency gains in on-farm and post harvest handling techniques can go a long way towards improving the income generating potential of rural coffee farmers;
- *Lack of marketing infrastructure.* Currently there is little marketing, from both within the country to improve awareness among the farming community and to develop a “coffee culture” within Laos, as well as outside the country to draw the attention of key buyers in the international coffee market on the potential of Lao organic coffee;
- *No “country branding” associated with Lao coffee;*

- *Weak capacity of the Coffee Growers' Association.* This would allow the Association to promote organic coffee, both within the country and to foreign consumers.
- *Absence of quality and grading standards.* Laos lacks certified liquoring specialists to help categorize coffee and respond to demands from international buyers seeking distinct and complex flavors, aroma, acidity, and character. Standards and certification will greatly improve value.

### **Competitive position of Lao agriculture**

#### ***SWOT analysis:***

Agricultural *strengths* in Laos include abundant and fertile land, preserved, naturally organic farms, cheap electricity and good access to irrigation in many areas, wide access to cheap labor, and limited, but well-trained government staff.

*Weaknesses* in industry clusters in the agriculture sector are high cost of production and distribution, weak extension services, poor availability and dissemination of market information, lack of technical know-how, lack of institutional support and research on modern processing and packaging techniques, limited supply of skilled labor, poor warehousing and distribution infrastructure, lack of cold chain infrastructure, no regulation or certification for export products, lack of export financing, no breeding of seedlings by segment, capacity of production, limited use of organic fertilizers, landlocked country with limited and expensive air-freight.

*Opportunities* include the lowering of trade barriers in ASEAN, large populations with rising incomes in neighboring countries, increasing infrastructure connecting Laos with its neighbors, the rising awareness and concern for organic produce, and the still unknown brand of Laos for export commodities such as coffee.

*Threats* continue to be posed by external shocks, ability to mitigate the risk of natural disasters inclement weather, and rising agricultural productivity in neighboring countries.

#### ***Porter competitiveness diamond:***

*Demand conditions.* Laos farmers are extremely isolated, both physically and informationally, from end markets. As a result, there is limited understanding of markets outside of Laos and this is reflected in basic pricing and the quality of processing, packaging and distribution of current agricultural goods. According to the Ministry of Agriculture, which is currently engaged in a project to raise the awareness of the value of organic products, many farmers simply do not see the market for these goods yet, so they are not willing to make the investment to go organic.

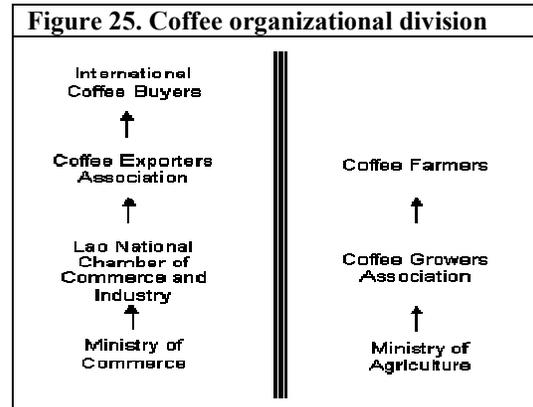
*Factor conditions.* Abundant land with access to irrigation and an appropriate climate makes Laos a natural candidate for high-value agricultural exports. However, knowledge and skills in modern farming techniques are severely lacking. Physical infrastructure is weak: many roads are either unpaved or worse, unpassable, and irrigation systems need expansion and upgrading. Processing techniques are very rough and current handling, processing and packaging occur at warehouses many kilometers away from the point of harvest. As a result, Lao farmers and exporters typically get a very low value for their products and further processing and packaging is needed in the country of destination.

Access to appropriate financing is a major issue for many exporters. Interest rates for agricultural loans range from 22-28 percent and require a faster payback period than is possible with most commercial agriculture investments. For commercial entrepreneurs that are seeking to building businesses in new areas of agricultural exports, these high rates are not aligned with the risk profiles and return timelines that they are facing in new investments.

**Context for strategy and rivalry.** Given that much of Lao agriculture is still informal and largely domestic, the sector is fragmented and unorganized. Ability to compete in this sector is driven by access to physical and financial resources and market linkages to regional and international markets. Given the limited formal commercial sector participation outside coffee, it is unclear whether the regulatory environment is significantly constraining to competition.

**Related and supporting industries.** The supporting knowledge institutions and services that are essential for sustained agricultural competitiveness over time are virtually non-existent in Laos. There is no cold chain distribution and warehousing services, even in the major urban areas. There is no official count, but estimates total less than 5 cold trucks available for use in the country. Warehousing and packaging facilities are equally lacking. NAFRI is the main agricultural research institution, but its mandate is broad and according to local experts it does not have the capacity to effectively deliver desperately needed knowledge and technology to key agricultural segments. Insect and pest management is a big problem, but there is very little knowledge of the organic and chemical solutions.

The coffee industry is the only segment that has an organizational structure for coordinating industry-wide decisions and activities (Figure 25). Yet even with the coffee cluster, communication, flow of information and activities are not occurring efficiently between the farming community, directly supported by the Ministry of Agriculture, and the exporters association, directly supported by the Ministry of Commerce. Numerous leading coffee exporters stressed the urgency of better coordination between the two groups in developing and implementing standards, educating the industry on best practice in farming and processing, and coordinating the supply-chain to better handle large orders.



**Business environment constraints**

As highlighted above in the Diamond Analysis, there are a number of key issues in the business environment that need resolution for supporting further growth in agricultural exports. Regulations and standards are cited by both public and commercial sector representatives as a critical issue. Regulations and standards on farming of organic products are already drafted and in the process of being reviewed and passed; however, there is very little awareness of this among the agricultural sector. Exporters of coffee are individually seeking out compliance to international standards, but there are no services available in Laos for this. It should be noted that the issue of standardization is of critical importance also for other sectors, so awareness raising and action in this respect should become a priority.

Distribution and warehousing infrastructure, especially cold chain services are another urgent priority. High-value agricultural products require modern packing and transportation that preserves the freshness of the product. Currently these services are not available in Laos.

In a country as fertile as Laos, surrounded by growing markets, it is surprising that there is not a higher level commercial investment occurring than currently. Farmers appear to be facing more than just supply-side and infrastructure constraints in expanding their farming activities.

This indicates that there may be regulatory constraints in private property or farm management that are hindering commercial scale-up of the sector.

### Strategic opportunities

Examples already exist of Lao entrepreneurs marketing high-value agricultural exports to international markets in coffee and organic rice. There have also been recent small-scale successes in expanding pork production for the domestic market, exporting selected horticulture products, selling non-wood forest products (e.g., herbal medicine) and establishing rubber plantations for export. The investments being made in road infrastructure will create not just transport corridors but economic development corridors as well. Agriculture is still the major provider of livelihoods in Laos and agro-exports can help reduce poverty. To do this, it will be necessary to improve village-market linkages, ensure fair price discovery, develop agricultural credit, implement export standards and grades and encourage value-added processing of natural resources.

Specific strategies that can be developed or initiatives implemented include:

- **Upgrade agricultural practices and develop standards for agricultural exports.** Initiatives here could be patterned on recent initiatives implemented in Thailand with the eventual goal of adopting HACCP and ISO standards. Also essential is the establishment of an organic certification body.
- **Upgrade capabilities and capacity of STEA.** STEA plays a critical role in both informing, facilitating and monitoring agricultural standardization and modernization. It is currently not able to support the industry to the extent needed in linking with international science and

technology regulatory bodies and regulating agricultural standards.

- **Review agriculture incentive structure for commercial farming.** As mentioned above, there is a need to assess the current state of farm growth and the constraints on farmers to growth into larger scale commercial farming. Once the constraints are clear, the government, with assistance from international experts, should design a strategy for facilitating transition of subsistence farming to commercial farming.
- **Provincial production zones and distribution centers.** Establishing production zones for cultivation and processing in each province that have incentives and infrastructure for commercial agriculture that meets international standards would allow regional farmers to share the costs of key infrastructure needs. This alone would not solve the infrastructure constraints, but may be one part of a near-term solution, which would also have to include improvements in the legal framework supporting contracting.
- **Market access to regional and international markets.** Laos farmers and exporters need assistance in market identification and market linkages to help them make better decisions and increase exports. Setting up provincial market information centers would improve market and pricing information. These centers could also play a role in developing farmer-to-market strategies. This could be closely tied to the design of regional production zones.
- **Farmer processing training.** Increased access to information and markets will not be enough. Local farmers and first stage processors need training in:

- Complying with international export standards
- Quality control and order size management
- Managing buyer relationships
- Warehousing, storage, packaging, and distribution
- Training of trainers in specific crop segments

This training could be facilitated through one of the above centers mentioned. Alternatively, an overall provincial agricultural extension services center could be an efficient way of delivering all of the above services to the provinces.

- **Investment in road and irrigation infrastructure.** Invest in rural road infrastructure from high potential agricultural regions is essential in ensuring that farmers can get their produce to market in a timely fashion. Irrigation, while adequate in regions, can be expanded according to commercial and public sector leaders.
- **Seedling investment.** Technical assistance is needed in breeding seedlings optimal for cultivation in Laos and then supplying seedlings to rural farmers along with training on modern farming techniques
- **Appropriate technology identification and investment.** Facilitate the transfer, investment, and adoption of appropriate technologies to increase the productivity for rural farmers. Set up a long-term agriculture investment fund designed for investment projects with long return period or start-up funds.
- **Agriculture financial services**  
Assess the availability and appropriateness of current financial services available to industry clusters in the agriculture sector such as

- Insurance services for external shocks and natural disasters
- Orders used as collateral
- Village funds and microfinance

- **Annual sector publication to increase the availability of information for investors.** Publish investor oriented agriculture information to inform potential investors and producers (e.g., what products are being produced, where, how much, at what price?)
- **Support the formalization and growth of the coffee sector.**
  - Boost Arabica production with financial assistance, technical expertise, and raising awareness of the benefits. Currently there is very little production and limited knowledge of how to cultivate and process so volumes are limited.
  - Institutionalize standards certification for coffee exports. The quality delivered to international coffee buyers is currently sporadic and needs to be carefully managed as a few bad shipments could tarnish the country's image.
  - Establish a coffee marketing media and information channel, broadcasting price discovery and information dissemination via radio and other means to assist the farmers in capturing full value for their product.
  - Deliver coffee training and extension services to support farmers in capturing additional value through initial coffee processing at the farm level.
  - Establish Coffee Cluster Working Group that bridges the divide between the exporters/Ministry of Commerce and the coffee farmers/Ministry of Agriculture.

#### 4. Conclusion and cross-cutting recommendations

The analysis in this chapter—especially the identification of constraints, opportunities, and challenges to the main export sectors—is derived from feedback from cluster leaders during the extensive workshops undertaken for this DTIS. In this respect, the chapter reflects the vision from within the Lao private sector itself. The ITC has recently developed a National Export Strategy for Laos—which provides comprehensive and in-depth recommendations to boost exports in Laos. This chapter seeks to complement the ITC study by focusing on practical issues raised within the context of the DTIS workshop.

Key overall messages include:

1. Laos has the potential to meet or exceed the growth rates of neighboring countries Vietnam and Thailand over the next ten years.
2. However, large scale increases in Laos' exports will not be immediate or automatic from signing trade agreements or entering the WTO; proactive efforts must be undertaken to achieve this export potential.
3. There is potentially high interest in international markets for a number of Lao export products and tourism offerings—modest examples of export competitiveness are already emerging in coffee, silk, wood and cultural and eco-tourism.
4. Laos is relatively unknown abroad and this provides an opportunity for building a “Laos” national brand for specific high-value industries.
5. While some Lao export champions already exist, very little in the past has prepared the average Lao entrepreneur to understand the needs of international markets and respond with world-class offerings; therefore human capacity

building in marketing and management is an urgent priority.

6. To date there has been much focus on the “supply side” of tourism development and industry development; however understanding the “demand side” is an urgent priority as this can help guide investment priorities at both business and government levels.
7. It would be helpful to form industry cluster working groups that can better understand their current positioning in world markets, develop a clear vision and design and implement strategic initiatives.
8. Implementation of concrete initiatives can boost export competitiveness; examples include improving market linkages, e-commerce, product innovation, branding, workforce development, supply chain management and others.
9. The Special Economic Zone (SEZ) planned for Savannakhet promises particularly to create jobs in manufacturing; progress should be accelerated with strategic partners who can provide financing, management and ability to attract tenants.
10. Workshop participants revealed a high level of receptivity to further active participation in understanding their current position and working together to implement strategic change.

On the basis of intensive work in these industry clusters, there are several general recommendations that would apply across the board.

**Industry cluster strategies.** Many commercial industries in Laos are still in the early stages of development in positioning themselves to compete in international markets. The Laos industries need to develop a vision, goals and strategy for building export competitiveness. Working together in close communication and cooperation, these leaders can then implement

strategies that focus on quick wins as well as building long-term competitiveness.

***Market research and understanding of international markets.*** Understanding international markets is critical for building export competitiveness. International marketing capacity in Laos is currently very low across all industries. The industries individually as well as the government overall, with donor support, should invest in building capacity among young professionals in Laos in market research. Sending at least 30 Lao professionals abroad for training in market analysis and international marketing would create a critical mass of talent for understanding and taking advantage of global market opportunities. At the industry level, supporting the dissemination of industry information can help strengthen the ability of industry associations to provide useful information and services to their members.

***Branding of Laos and its high-value products and services.*** High quality products from Laos are currently undervalued on the international market due to limited recognition of the origin and uniqueness of the products. Building brand value in these high-value areas is critical for positioning Laos to compete in international markets. Overall, the Lao “brand” could be built around themes such as “peaceful people, creative culture”. Within specific industries, branding opportunities are apparent in Tourism, Silk, Coffee, Wood Products, and organic foods. This would include the development of a “Laos” brand, mark of origin, and assistance to firms on trademarking.<sup>6</sup>

***Industry-government coordination.*** All four workshops expressed a desire from both industry and government representatives for increased coordination between businesses and the government in achieving increased export competitiveness. It is understood that neither group alone will be able to implement the necessary steps to raising exports—it will take a joint effort with both sectors working towards the same vision. The government should support the formation of “industry working groups” that would be charged with improving the measurable performance of export competitiveness in their industries.

***Improving financial services.*** Lao business participants were nearly universal in their agreement that they do not have access to finance, that finance is too costly and that this represents a major barrier to expansion. For most business people, this was the most serious constraint in the business environment.

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<sup>6</sup> It should be kept in mind, however, that a brand should only be introduced once consistent quality and availability of the product can be assured; funds should primarily be allocated to strengthening the capacity of a sector and only later towards marketing. The tourism and silk industries are probably the ones that are most prepared for the launch of a marketing strategy.

## Chapter 10: What's in it For the Poor?

There are 1.8 million poor in Laos; most live in rural areas spread all over the country. They wonder how economic reforms and trade openness is going to reach them. What's in it for them? If the past is any indication, the reforms of the New Economic Mechanism have been remarkably successful: GDP grew rapidly, poverty incidence fell by about a quarter in a decade, and inequality increased only slightly and is still lower than in most countries. The government is now embarking on a new reform agenda, including implementation of regional agreements that would lower tariffs and accession to the WTO. It is also promoting an export-led growth strategy. This is not only a challenging task in and of itself, but the link to the poor is neither direct nor obvious. What can the poor sell or export? How can they reach foreign markets? This paper (i) assesses the impact of trade measures on the poor and (ii) provides some practical experience from other countries on making the poor reach out to export opportunities.

### 1. Impact of Trade Measures on the Poor

#### Profile and trends of poverty

*About a third of the Lao population is poor, although inequality is low* (Table 1). Laos contains many ethnic groups that are located in remote rural regions and are cut off from economic opportunities in the towns both by language and cultural barriers and by poor transport and communications. The remote northern part of the country, in which the proportion of the population in rural areas is highest, is much poorer than the relatively more urbanized central provinces (Table 2). Although poverty incidence is generally higher in rural areas than in urban areas, it is higher in the urban areas in the north than in rural areas in general. Vientiane capital has the lowest poverty incidence.

**Table 1. Poverty and inequality**

	Headcount poverty rate %	Poverty gap %	Poverty severity %	Gini coeffi- cient %
<b>Laos:</b>				
1992/93	46.0	11.2	3.9	30.5
1997/98	39.1	10.3	3.9	34.9
2002/03	33.5	8.0	2.8	32.6
<b>Rural:</b>				
1992/93	51.8	12.9	4.6	29.0
1997/98	42.5	11.4	4.4	32.1
2002/03	37.6	9.2	3.2	30.3
<b>Urban:</b>				
1992/93	26.5	5.5	1.6	30.9
1997/98	22.1	4.9	1.7	39.7
2002/03	19.7	4.1	1.3	34.8

Source: Richter et al., World Bank, 2005.

*The growth resulting from the government's reform program has led to a reduction in poverty, and only a slight increase in inequality.* In order to promote development and reduce poverty, the government adopted in the mid 1980s the New Economic Mechanism (NEM), a program for the transition from a centrally planned economy to a market economy. GDP growth during the reform period has been rapid. It averaged 7 percent per year between 1992 and 1997, slowed to 4.5 percent between 1996/97 and 1997/98 because of the financial crisis in Thailand—the most important single market for Lao exports—and then recovered to just under the 7 percent rate that had been achieved in the early 2000s.

The rapid growth of the 1990s substantially benefited most poor people. Inequality increased between 1992/93 and 1997/98 but was partially reversed in the next five years (see Table 1 above). The headcount ratio fell from about 46 percent in 1992/93 to about 33 percent in 2002/03. Over the same period, the poverty gap fell from 11 percent to 8 percent and the severity of poverty fell

**Table 2. Poverty incidence by region**

Province	LECSI 1992/93	LECS2 1997/98	LECS3 2002/03	Change 92/93 to 97/98	Change 97/98 to 02/03
<b>Northern Region</b>	<b>58.4</b>	<b>52.5</b>	<b>37.3</b>	<b>-5.9</b>	<b>-15.2</b>
Oudomxay	51.1	73.2	44.9	22.1	-28.4
Luangnamtha	60.3	57.5	23.0	-2.8	-34.6
Huaphanh	78.4	74.6	50.9	-3.8	-23.7
Phongsaly	68.7	64.2	50.8	-4.5	-13.4
Luangprabang	62.7	49.4	38.6	-13.3	-10.8
Xayabury	30.1	21.2	24.7	-8.9	3.5
Bokeo	63.5	37.4	20.9	-26.1	-16.5
<b>Central Region</b>	<b>39.5</b>	<b>34.9</b>	<b>34.8</b>	<b>-4.6</b>	<b>-0.1</b>
Bolikhamxay	10.6	25.8	32.9	15.2	7.1
Khammuane	43.7	41.6	33.7	-2.1	-7.9
Vientiane Province	28.1	24.3	18.4	-3.8	-5.9
Savannakhet	45.7	37.1	41.7	-8.6	4.6
Xiengkhuang	57.3	34.9	41.8	-22.4	6.9
Xaysomboun SR	55.0	-	29.7	-	-
<b>Southern Region</b>	<b>45.9</b>	<b>38.4</b>	<b>32.4</b>	<b>-7.5</b>	<b>-6.0</b>
Salavane	36.7	39.6	54.2	2.9	14.6
Champassak	43.6	35.6	17.5	-8.0	-18.1
Sekong	65.9	45.7	41.6	-20.2	-4.1
Attapeu	72.2	45.3	43.6	26.9	-1.7
<b>Vientiane Capital</b>	<b>24.4</b>	<b>12.2</b>	<b>16.4</b>	<b>-12.2</b>	<b>4.2</b>
<b>Laos</b>	<b>45.0</b>	<b>38.6</b>	<b>32.9</b>	<b>-6.4</b>	<b>-5.7</b>

Source: World Bank estimates based on LECS data.

from 4 percent to 3 percent.<sup>1</sup> Poverty fell most rapidly in Vientiane capital.

*Social indicators have improved across the board during the reform period.* Between 1995 and 2000, life expectancy at birth increased from 51 years to 59 years, the mortality rate for children under 5 years fell from 170 to 107 per 1,000 live births. The maternal mortality rate per 100,000 live births fell from 560 in 1995 to 530 in 2000.

<sup>1</sup> The headcount ratio is the proportion of the population below the poverty line. The poverty gap is the product of the 'expenditure gap' and the headcount ratio, where the expenditure gap is the average, for all poor people, of the proportionate shortfall of their expenditures below the poverty line. The severity of poverty is the headcount ratio multiplied by the mean, for all poor people, of the squared proportionate shortfall of their expenditures below the poverty line.

However, communicable diseases such as malaria, dysentery, cholera, dengue fever, intestinal parasites, tuberculosis, acute respiratory infections and measles are still common. The proportion of the population with access to safe drinking water increased from 15 percent in 1995 to 50 percent in 2000 (I-PRSP). In October 2000, Laos was declared to be free of polio and 95 percent of villages were covered by basic vaccinations under the government immunization program.

Education attainment is low but improving. Less than 30 percent of all adults went beyond primary school, and one quarter never attended school in 2002/03. School attendance is highest in urban areas—Vientiane capital, along the Thai border, in lowlands, and in non-priority districts—and very low along the Chinese-Myanmar border where just two in five adults ever attended school compared to 19 in 20 adults in the capital. School attendance of adults

has improved over the second half of the past decade—it increased from 49 percent in 1997/98 to 59 percent in 2002/03 in priority districts. This is a remarkable progress as it reflects exclusively improvement in school attendance among young cohorts joining the adult population.

***There are large differences among provinces in social indicators.*** For example, in Vientiane capital about 90 percent of both girls and boys between ages 6 and 14 are enrolled in primary schools, whereas in the northern region the corresponding enrolment rate for boys is between 45 and 50 percent, while that for girls is below 40 percent (2002/03). Life expectancy at birth ranges from 57 years in the northern region to 63 years in Vientiane capital and the prevalence of malaria varies from 7 cases per thousand people in Vientiane capital to 82 per thousand in the southern provinces.

#### **Government strategy**

***The government's reforms aim at further integration into the regional and global economy.*** The government has shown its intention to consolidate the process of opening the economy to international trade and investment by applying to join the World Trade Organization (WTO) in 1997. Besides the liberalization of merchandise trade and investment, this will involve the opening up of service sectors to international competition and the introduction of laws to protect intellectual property rights, to modernize the customs service and to make the treatment of import and export standards and quarantine procedures compatible with WTO norms.

To try to ensure that the benefits of these and other planned reforms flow through to the poorest groups, the government has set out a National Growth and Poverty Eradication Strategy (NGPES). The Committee for Planning and Investment (CPI) is responsible for coordinating the preparation and implementation of both the

NGPES and the National Socio-Economic Development Plan (NSEDP). The last NSEDP finished at the end of 2005 and the CPI is preparing the sixth plan for the period 2006–10, which is currently being reviewed by the National Assembly. The NGPES refers to trade policy and lists the tariff reductions scheduled under AFTA as part of the government's package of policies for eradicating mass poverty. At present, however, the most important components of the NGPES are those that provide for increased spending on health, education, and infrastructure, on policies aimed at directly helping the poor and at reducing the barriers that separate the most isolated provinces from the rest of the country.

To target increased spending at the poorest groups, the NGPES used data from the household expenditure surveys to identify 47 very poor districts that will receive top priority in the allocation of public investment. The next poorest districts have been assigned to a 2<sup>nd</sup> priority group and the remainder are classified as 'non-priority'.

The government recognizes the importance of agricultural development to poverty reduction: poverty incidence is higher in rural areas than in urban areas and most rural households are involved in agriculture. The main ways of promoting agricultural development proposed in the NGPES are public spending on extension services, improved road and river transport, rural electrification and irrigation.

Reducing the physical barriers separating people in remote areas from the urban centers in which growth is likely to be concentrated will make an important contribution to poverty alleviation. In Laos, residential districts are categorized into three groups—1<sup>st</sup> priority, 2<sup>nd</sup> priority and non-priority—according to their general levels of living standards and need for development. The government is keen on improving road access in the first and second priority districts.

## Impact of AFTA and EHP

Trade policy reform can affect welfare in two ways: ‘dynamic effects’ through GDP growth—these effects operate through changed incentives to accumulate physical and human capital and changes in the rate of growth of total factor productivity—and ‘static effects’ due to changes in relative prices, with aggregate real income unchanged.

### *Implementing all AFTA and EHP concessions by 2009 can lift an additional 80,000 people out of poverty.*

Table 3 shows the simulation results of the impact of this trade liberalization on poverty.<sup>2</sup> If the benefits of trade liberalization are allocated neutrally (column 1), poverty would decline by 0.9 percentage points, from 32.7 percent in the base case to 31.8 percent. When the benefits are biased towards the rich, the result is almost the same, meaning that the bias is negligible. When account is taken both of the growth effects and of the relative prices effects of trade and associated reforms (columns 2 and 4), the reduction in the headcount rate ranges from 0.9 percentage points to 1.5 percentage points. However the effects on the poverty gap, the income gap and the severity of poverty are smaller.

### Impact of road improvement on poverty

Access to roads, and hence to markets, is key for poverty reduction. If the poor do not have road access, they will not be able to

<sup>2</sup> It is important to emphasize that the results of these estimations do *not* take account of ongoing growth between 2005 and 2009 and are therefore *not* estimates of the changes in poverty between 2005 and 2009. Rather, they are estimates of how the simulated trade reform, by itself and in the absence of any other source of growth, would reduce poverty. Even in the absence of further trade reform, annual growth is likely to continue at the rates of between 5 percent and 7 percent that have occurred in the recent past. The AFTA and EHP tariff reductions are assumed to be provided on an MFN basis.

**Table 3. Estimated changes in poverty and inequality due to AFTA and EHP implementation** (reducing average tariffs from 11.3 percent to 3.9 percent over 4 years)

	Neutral	Neutral + price changes	Bias	Bias + price changes
(% points)	(1)	(2)	(3)	(4)
Headcount	-0.9	-1.5	-0.8	-1.4
Income gap	-0.3	-0.6	-0.3	-0.6
Poverty gap	-0.3	-0.5	-0.3	-0.5
Poverty severity	-0.1	-0.2	-0.1	-0.2
Gini	0.0	-0.3	0.0	-0.3

Note: Columns 1 and 3 are obtained by ignoring the relative price changes. Columns 2 and 4 take also relative price changes into consideration. In all cases, it is assumed that aggregate real spending rises by 1.2 percent, based on Weerasinghe’s estimate of the effect on GDP growth of trade liberalization. The differences among the three simulations arise from the ways in which this total increase is shared among individuals—equi-proportional increases for all in cases 1 and 2, and increases that are biased towards the rich in cases 3 and 4.

Source: World Bank calculations based on LECS III data.

purchase goods at the lowest price possible, nor would they be able to sell their products, let alone export. The potential benefits of trade liberalization and access to international markets will pass them by.

In Laos, poverty and lack of road access are strongly correlated. There are 2,262 households living in the first priority districts, of which 962 rural households are poor (Figure 1). About 43 percent of rural poor people have no access to road in either dry or rainy season, and 17 percent of them have access to roads only in the dry season (Figure 2).

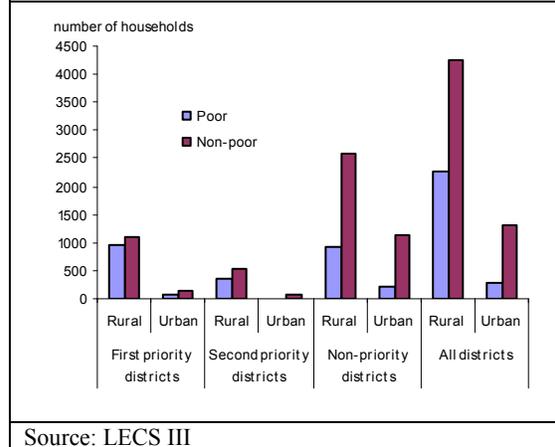
Progress in road development has been remarkable during the last five years. In the case of national roads, the total length of the network has only been increased by 3 percent, but great progress has been made in upgrading these roads from gravel and earth to paved roads (Figure 3). In the case of other roads (provincial, municipality, district, rural, village and special roads), there have been large increases in the total length of the network for all surface types. Remote villages have been connected to the

main network by building new earth and gravel roads and existing roads have been upgraded from earth to gravel and from gravel roads to paved roads.

Improved road access is also apparent from the LECS data. These surveys imply that in 1997/98, 59 percent of rural households lived in villages with no road access in the wet season, but that this proportion had fallen to 48 percent by 2002/03. This improvement was entirely due to the provision of wet season road access to villages that already had dry season access; the proportion of rural households in villages with no access in either season was roughly unchanged at 31 percent.

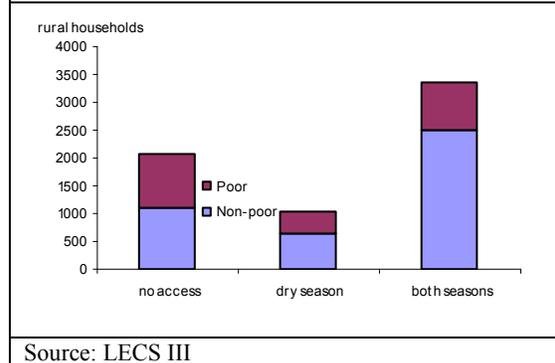
*If all-weather road access is provided to all, as many as 182,000 people will be lifted out of poverty—that is nearly 5 percent of the poor.* Simulation results show that the impact of road building on national poverty depends on whether the roads are built in 1<sup>st</sup> priority, 2<sup>nd</sup> priority or non-priority districts (Table 4). Among the three categories of priority districts, providing roads in first priority districts has the largest and also the best targeted impact on poverty and inequality reduction. If first priority districts were given full access to all-weather roads, 3.3 percent of the population would escape poverty. Providing all-weather road access in all rural districts that lack such access would raise total expenditure by 6.3 percent and reduce the national headcount ratio by 6.4 percentage points.

**Figure 1. Household distribution in priority districts**



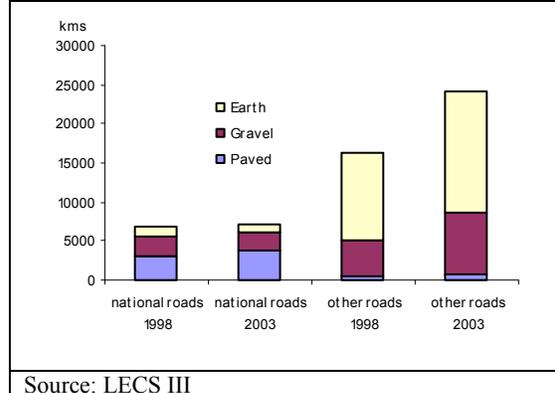
Source: LECS III

**Figure 2. Many rural households do not have access to roads**



Source: LECS III

**Figure 3. Progress in road improvement**



Source: LECS III

**Table 4. Simulation results for impact of roads accessibility on poverty. 1<sup>st</sup> and 2<sup>nd</sup> priority districts**

<b>Location included in simulation:</b>	<b>1<sup>st</sup> priority</b>	<b>2<sup>nd</sup> priority</b>	<b>Non-priority</b>	<b>Rural</b>	<b>Urban</b>	<b>All</b>
	(1)	(2)	(3)	(4)	(5)	(6)
Increase in expenditure (%)	9.3	10.0	4.7	8.4	0.4	6.4
Fall in headcount (% points)	11.4	6.8	4.0	7.9	0.5	6.5
Fall in poverty gap (% points)	3.6	2.8	1.1	2.5	0.1	2.1
Fall in severity of poverty (% points)	1.5	1.2	0.4	1.0	0.0	0.8
Fall in Gini (% points)	1.0	0.4	0.5	0.6	0.1	0.9
Increase in total expenditure (%)	2.2	1.1	3.1	6.3	0.1	6.4
Fall in national headcount (% points)	3.3	0.8	2.1	6.4	0.1	6.5

Note: Simulations of the impact of road improvement on the poor are done by first calculating the changes in real expenditure per capita for each person due to providing all-weather roads in particular areas (urban/rural) and regions with choice of districts—based on Warr’s results (regressing per capita spending on household and village characteristics). We ignore relative price changes and assume that expenditure is unchanged in regions in which road access is not improved. Using the resulting estimates of how changes in road access affect expenditure of each household, we then estimate the changes in the various poverty measures and the Gini coefficient. We run simulations that differ according to the priority of the districts in which road access is provided:

1. All people in first priority districts who do not already have all-weather road access are provided with it.
2. All people in second priority districts who do not already have all-weather road access are provided with it.
3. All people in non-priority districts who do not already have all-weather road access are provided with it.
4. All people in rural areas who do not already have all-weather road access are provided with it.
5. All people in urban areas who do not already have all-weather road access are provided with it.
6. All people in Laos who do not already have all-weather road access are provided with it.

Source: LECS III.

### **The role of remittances**

Migration—or temporary movement of people—is a key trade area that can play an important role in reducing poverty in developing countries. Remittances to developing countries have grown steadily over the past 30 years, and currently amount to about \$100 billion a year. For many developing economies, remittances constitute the single largest source of foreign exchange, exceeding export revenues, foreign direct investment, and other private capital inflows. Remittances have proven remarkably resilient in the face of economic downturns. They can help improve a country’s development prospects, maintain macroeconomic stability, mitigate the impact of adverse shocks, and reduce poverty. Remittances allow families to maintain or increase expenditure on basic consumption, housing, education, and small-business formation.

*The most important destination for international migration from Laos is Thailand.* Until very recently, it has been

illegal for Lao people to migrate to Thailand. Lao people face strict regulations on migration to other countries. Moreover, most Lao workers in Thailand are breaking Thai laws that require migrants from Laos and other foreign countries to pay registration fees and obtain work permits. Removing Lao prohibitions on migration and trying to persuade the Thai government to ease the cost to migration appears to be one of the cheapest ways of raising the standard of living of the poor and the middle class given slow growth in the domestic labor market. Around 80 percent of the people who still depend on farming, and especially those who rely on subsistence farming, have begun to migrate to other activities and the government will need to ensure that the private sector can grow quickly enough to generate adequate employment to avoid social problems.

Data on Lao migrant workers in Thailand is available from the Thai authorities as a result of the registration of migrant workers. Between September 2002 and February 2003, 59,358 Lao migrant workers in

Thailand registered for 6-month permits in Thailand. Of the total, 43 percent were males and 57 were females. More recent Thai data for July 2004 show that there are 181,614 registered Lao migrants in Thailand, of which 45 percent are male and 55 percent are female.

In 2002-03, the fee charged by the Thai authorities for registration for a migrant worker for one year was Baht 4,450, or about \$100. There was therefore a considerable incentive for migrants not to register. The Thai Ministry of Labor estimates that there may be an additional 80,000 unregistered Lao workers in Thailand. UNDP estimates suggest that the true figure may be even higher and that remittances from Thailand alone amount to at least \$100 million per year.

***Strict Lao laws regarding migration are increasing the number of illegal migrants.***

Many of the migrants who are legally registered in the host country (and all those who are not) are in breach of Lao laws, which require a Lao citizen working in a foreign country to satisfy all the following criteria:

- Hold a valid Lao passport.
- Have an exit visa to leave Laos.
- Have a visa and work permit from the host country.
- Not take a job in any of the occupations specified in the Decree of the Prime Minister (Group 2, section 2, 2002).

The banned occupations cover all of those in which employment would be most readily available for Lao migrants (and particularly female migrants) from poor families, including house maid, maid in hotel, cleaner, restaurant service worker, supermarket worker, parking lot attendant, road sweeper, other unskilled worker. The effect of these regulations is to make it illegal, from the perspective of Lao law, for most poor people to migrate to other

countries, even if they are not breaking the laws of the host countries.<sup>3</sup>

***Most internal and international migrants are in the middle socio-economic group.***

Migrants account for 6.5 percent of the total population—international migrants make up 5.2 percent of the population and internal migrants make up 1.2 percent. The proportion of migrants in each socio-economic group rises with income (Figure 4,5).<sup>4</sup> This pattern is found for both internal and international migrants. This is because migration is an investment that cannot be undertaken without the initial outlay of resources. In addition, many host countries are less reluctant to accept skilled workers than unskilled ones.

***Remittances are important for the middle income group and should not be ignored.***

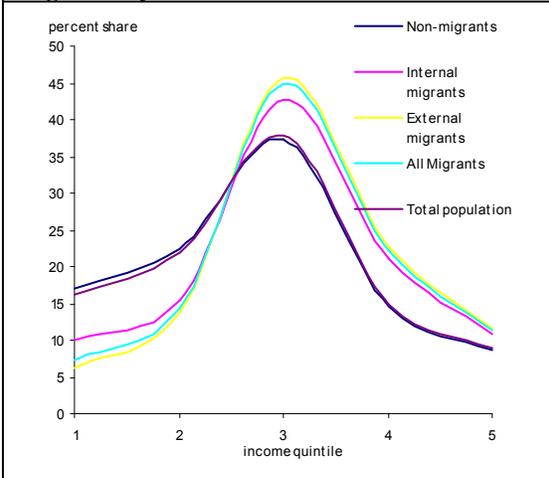
Facilitating migration is an important way of reducing poverty, but families above the poverty line may nevertheless gain more from remittances than those below the poverty line. Existing restrictions on international migration should be replaced by policies to regularize the status of international migrants and minimize the potential dangers of international migration, such as migrant abuse (Figure 6).

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<sup>3</sup> Recently, MOF has allowed Lao workers in Thailand to have an exit visa for 1 year; moreover, the Lao embassy is now allowed to renew visas for Lao workers.

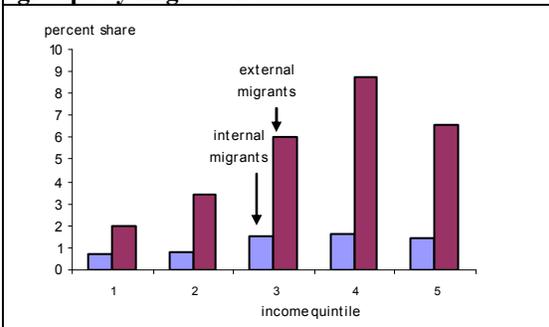
<sup>4</sup> Data on internal and international migration are also available from the National Migration Survey (NSC, 2003). This survey is not representative of the whole country, since it covered only three provinces—Savannakhet, Khammuane and Champassak. Since these are the three provinces that send the most migrants to Thailand, the survey presumably overstates the propensity for Lao people to migrate.

**Figure 4. Distribution of migrants and non-migrants by socio-economic status**



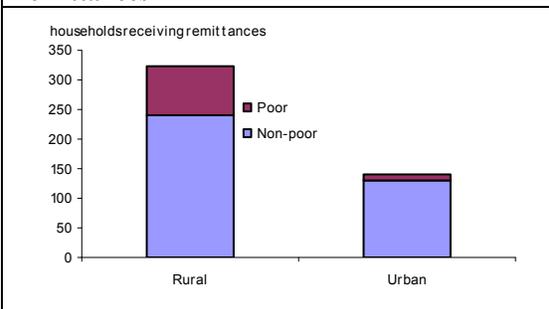
Source: Labor Migration Survey, National Statistical Center, Vientiane. The sample covered all people, 0 years and up.

**Figure 5. Distribution of socio-economic groups by migration status**



Source: Labor Migration Survey, National Statistical Center, Vientiane. The sample covered all people, 0 years and up.

**Figure 6. Non-poor are the main recipients of remittances**



Note: Includes internal and external remittances.  
Source: LECS III

## 2. Competitive Strategies for Grassroots Handicraft Export Development

A frequent question about an export-oriented growth strategy is how does it benefit the poor, especially those living in rural or remote areas with little education and access to transport or markets. The development of the handicraft industry presents an option—though still a partial one—to link people at the grassroots level and with traditional knowledge with international markets. There are several examples of countries that have succeeded in raising the incomes of these people by promoting the ethnic products they can produce. Handicraft production is one way to diversify and increase income in rural areas, especially for disadvantaged people such as women and ethnic minority groups.

The government of Laos is aware of the importance of creating an environment that is suitable for village craft micro-enterprises, such as hand-woven textiles, wooden crafts, basket weaving, paper mills, organic foods, jewelry, etc. In order to ensure sustainable development in poor and remote areas, with ethnic minorities, the National Growth and Poverty Eradication Strategy suggests that the government should implement policies that encourage natural resource preservation, keep traditional techniques, use domestic materials, and promote trade and industrialization.

The handicraft industry is mainly informal, so there is no accurate data on employment or income. A 2003 UNIDO study estimates the equivalent of 30-40,000 full time workers employed in this sector, of which 15-20,000 people work full time, while 100,000 work part time or as a complementary activity. The number of enterprises in the handicraft sector was estimated at 21,558 in 2000 growing from 10,826 in 1995. Out of the estimated output value of \$30-40 million, half was hand-woven textiles.

Most of the potential to develop traditional handicrafts would come through exports, as domestic demand for the domestic market is very limited. But the handicraft industry cannot as yet meet the demands of the world's commercial buyers in terms of both quality and quantity. Laos must find its own products which no other country can produce or replicate, and suitable markets which appreciate the uniqueness of these products. It is possible to foster a handicraft industry from the grassroots level to meet the needs of the world market trends if the government encourages micro and small enterprises to take initiatives. This section looks at two handicraft sectors—hand-woven textiles and woodcraft products—and provides recommendations on what can be done to increase the quality, visibility, and exports of these products. This section was prepared by a former buyer to a Japanese-equivalent of Walmart. It therefore offers practical suggestions.

***Traditional Lao textiles have significant market potential.*** Hand-woven textiles in Laos not only reflect the strong tradition of weaving, but are also unique among the world's textiles. Women have practiced weaving since ancient times across the country by using naturally dyed cotton and silk yarns. Hand-woven textiles include silk and cotton and are used for various purposes such as clothes, home use, and souvenirs. Patterns in Lao textiles have cultural and religious significance. Traditional methods such as “Chok” and “Mat Mi” have been passed on from generation to generation. Although Lao women have traditionally worn woven silk skirts, this custom has been fading (it remains the case that women are obliged to wear traditional costumes in formal working places, however.) Lao textiles, silk and cotton, are very popular among tourists. The market could be expanded if they are able to improve product marketing. Expensive silk clothes are appropriate for high-end niche markets, but not for ordinary consumers. Small accessories such as bags and scarves, as well as decorative textiles have a broader appeal,

and have the potential to become a high-volume export commodity. Clothing made from traditional Lao textiles can target various ranges of consumers regardless of gender, age, and nationality.

***Lao woodcraft products are not yet recognized in international markets.*** The wood processing industry accounts for about 30 percent of total manufacturing output, and employs about 22,000 people (UNIDO 2003). Compared to the hand-woven textile sector, the woodcraft sector does not have an established image as a Lao craft in the international market and thus, the sector needs to establish a strong identity. In addition, while the hand-woven textile sector has many skilled artisans in villages, the woodcraft sector lacks the necessary amount of skilled artisans who can produce sellable woodcraft in the international market in terms of quality and design.

***Although there are many institutions supporting the handicraft sector development, they need to coordinate and work through an integrated framework to increase effectiveness and maximize the capacities of existing programs.*** There are several institutions dedicated to support the handicraft sector. These include:

***(1) The Ministry of Industry and Handicraft (MIH).*** The MIH initiated the National Five Year Plan (2001-2005) for the handicraft sector to support artisans, villagers and private sector investment. The MIH considers hand-woven textiles and woodcrafts to be priority.

***(2) The Lao Trade Promotion Center.*** This center is under the Ministry of Commerce and promotes export activities including maintaining a web site for Lao companies producing handicrafts, wood products, and as well as providing technical assistances to artisans that are participating in international trade fairs.

***(3) The Lao Handicraft Group (LHG).*** The LHG was established in 1998 by the National Chamber of Commerce and Industry to promote Lao handicrafts as an association for various kinds of handicraft

artisans. It had 106 member companies as of 2005 and collaborates with the Lao Trade Promotion Center and the Department of Handicraft, Ministry of Industry and Handicraft.

**(4) The Lao Women's Union.** The Union was founded in 1955 to increase women's political awareness and in 1992 initiated the Women's Development Program to empower women in villages. It assists the traditional Lao textiles sector and provides technical assistance to artisans in the sector and has been supported by many international organizations such as UNICEF, UNIFEM, SIDA and JVC.<sup>5</sup> The Union managed the Lao Cotton Company, has created a museum and has a retail store in Vientiane capital.

Multilateral donors such as UNESCAP and UNIDO provide technical assistances to develop export markets for small and medium sized enterprises (SMEs) in the handicraft sector. Bilateral donors such as GTZ and JICA have programs to support capacity development for handicraft enterprises. NGOs are also actively engaging in the handicraft sector and carrying out development activities.

The government should provide clear strategies and guidelines for the future prospects of the handicraft industry, and ensure a well coordinated effort among the various institutions supporting the handicraft sector.

**Exports of handicrafts are limited and dominated by a few companies.** The Lao Handicraft Group (LHG) identified existing handicraft exporters and the amount of exports as of 2002. Although many new exporters have been established since 2002, primary exporters such as Phaeng Mai Gallery and Thonglahasinh are still leading

5 UNICEF (United Nations Children's Fund). UNIFEM (United Nations Development Fund for Women). SIDA (Swedish International Development Agency). JVC (Japan International Volunteer Centre).

companies in the export market. The amount of exports remains limited and an appropriate policy is needed to increase the total amount of exports (Table 5).

**Table 5. Existing Handicraft Exporters**

Company Name	Number of Workers	Exports (2002)	
		Products	Amount (US\$)
<b>Textiles sector</b>			
Thida Handicraft	15	Silk fabrics and scarves	4,000
Nikone Handicraft	47	Silk scarves, cushion covers	64,925
Phaeng Mai Gallery	35	Silk fabrics and scarves	50,000
Lao Cotton Co.	85	Scarves and shirts	5,000
Thonglahasinh	200	Cotton fabrics	72,882
Cama crafts	75	Scarves	37,989
Lao Textiles (Carol Cassidy)	55	Silk fabrics	9,298
Ethnic Handicrafts	42	Silk fabrics	36,000
Sub Total			280,094
<b>Woodcraft sector</b>			
SMP	50	Wood accessories	20,000
Phai Exclusive	25	Bamboo products	9,288
Sub Total			29,288
Total			309,382

Source: The Lao Handicraft Group, 2003, "Report on the Lao Handicraft Industry"

### Constraints in the Handicraft Sector

**Limited interest of international buyers in Lao handicrafts.** Despite government and supporting agencies' efforts to help artisans to export handicrafts, foreign demand for Lao handicrafts remains low. Foreign buyers do not have sufficient information about Lao handicrafts. Moreover, since they are able to purchase handicrafts made in neighboring countries such as Vietnam and Thailand, they are not interested in buying handicrafts from Laos. They are also constrained by limited capacity of Laos to produce in large quantities.

**Lack of information and marketing skills.** Artisans lack of information about foreign

markets. As a result, the handicraft products they produce do not meet consumer needs and market trends. Direct business contact with foreign buyers is extremely limited. Handicrafts made by village artisans usually go through a conventional supply chain that includes middlemen; artisans rarely have direct links with foreign buyers, who may be able to give artisans feedback over their products. There is also a lack of designers and craft persons who are aware of the handicraft's competitive market. Information on consumers' preferences is also not available in Lao villages.

***Lack of skills and entrepreneurship among artisans.*** The shortage of skilled labor to produce quality handicrafts for the export market is a critical disadvantage in the handicraft sector. The lack of business skills, such as management skills, also hinders competitiveness. Due to the lack of information and direct contact with foreign buyers, artisans are not aware of the importance of entrepreneurship. They lack the necessary incentives to improve product design and quality. Further, a shortage of successful examples in the domestic market has failed to inspire competition among Lao artisans.

***High transportation costs and insufficient volume of raw material.*** Since Laos is a landlocked country, transportation costs are considerably high, which hinders price competitiveness among other countries. Moreover, the insufficient infrastructure in rural areas increases cost of transportation and raw materials. For the hand-woven textile sector, the domestic production of both silk yarn and cotton yarn is not sufficient, and therefore, artisans have to import them mainly from Thailand. This does not only increase costs but also hurts the image of Lao textiles.

### **Competitive strategies in handicrafts**

There are numerous practical strategies to expand handicraft exports, overcome inherent constraints, and make it more

competitive in the international market. There are synergies among these strategies, suggesting a multi-tiered approach to the problem is necessary.

### **Building business linkages with Fair Trade Organizations:**

A strong linkage with the fair trade organizations provides artisans various embedded services including product design development and market feedback (Box 1). The level of the capacity of artisans in Laos, however, is still far too low to be able to deal with commercial buyers whose goal is to maximize their profits. As a first step, a business linkage with fair trade organizations whose mission is to help artisans and promote fair trade is strongly recommended.

#### **Box 1. Fair Trade Organizations**

More than 270 organizations in 60 countries are members of the International Federation for Alternative Trade (IFAT), a global network of Fair Trade Organizations (FTOs), established in 1989. IFAT defines fair trade as "a global network of producers, traders, marketers, advocates and consumers focused on building equitable trading relationships between consumers and the world's most economically disadvantaged artisans and farmers." Members include producer associations, marketing organizations (import and export), retailers, and national and regional fair trade networks dedicated to the fair trade movement. About 65 percent of members are located in the South, meaning Asia excluding Japan, the Middle East, Africa and South America while the remainder is located in North America, the Pacific Rim (Australia, New Zealand and Japan) and Europe. Fair trade organizations assist producers by providing guidance such as pricing, marketing, quality control, and exporting.

Source: [www.ifat.org](http://www.ifat.org)

***The fair trade movement*** is growing in the world. According to the 2003 Report on Fair Trade Trends, total sales in the US, Canada, and the Pacific Rim reached \$250 million in 2002 (IFAT, 2003). The total sales for the fair trade industry in North America and the Pacific Rim jumped 44 percent and 23 percent, respectively, during 2002 compared to the previous year (Table

6). Certified fair trade coffee accounted for the highest proportion of sales and registered the highest growth rate among other fair trade products, increasing from 6.8 million lbs. in 2001 to 10.6 million lbs. in 2002. Following certified fair trade coffee, other handicrafts accounted for 24.5 percent or \$13.8 million while jewelry accounted for 11.5 percent or \$6.5 million.

**Table 6. Total Sales of Fair Trade Industry: North America and Pacific Rim in 2001 and 2002**

	2001 (\$ million)	2002 (\$ million)	% change
<b>North America</b>			
FTF & IFAT members	48.2	56.2	16.6
TransFair USA	85.6	131	53
TransFair Canada	5.4	9.1	68.5
Total	139.2	196.3	41
Less FTF member coffee sales (29%)	14	16.3	
Total (excludes double counting)	125.2	180	43.8
<b>Pacific Rim</b>			
IFAT members	9.9	11.3	13.9
TransFair Japan	47.8	59.6	24.7
Total	57.1	70.1	22
Less Japanese IFAT member coffee sales (5.25%)	0.23	0.28	
Total	57.5	70.6	22.9
Grand Total	182.7	250.6	37.2

Source: IFAT (2003). "Report on Fair Trade Trends in US, Canada & the Pacific Rim."

**"The Fair Trade Company" in Japan** is another such organization. Established in 1995, it is a leading fair trade organization in Japan buying many of its handicrafts from organizations registered in IFAT, such as Thanapara Sallows Development Society in Bangladesh, Ockeden International in Pakistan, and Kumbeshwar Technical

School in Nepal. Products purchased through IFAT members are subject to compliance with IFAT's fair trade criteria and are subject to quality control. The Fair Trade Company imports products from 250 partner producers in twenty counties.

Sales have increased since 1995 and reached about \$6 million in 2003, an increase of 10 percent from 2002. Their sales channels include catalogues (29 percent), a directly owned store in Tokyo (9.3 percent) and wholesale (37 percent).<sup>6</sup> Clothing accounted for the highest share of sales at 38 percent followed by handicrafts. Among the 20 producing countries, 38 percent of products are from India followed by Bangladesh (22 percent) while 73 percent of all products are from Asia. The Fair Trade Company has not yet entered into contracts with Laos, but has shown interest in buying Lao handicrafts.

Joining the IFAT provides opportunities to utilize a wide range of networks including finding new buyers that are able to not only purchase handicrafts but also give technical assistance such as product design and marketing skill development. Also, strong business linkages with fair trade organizations leads to cultural preservation and environmental protection while at the same time providing artisans opportunities to achieve higher income. Laos has only one organization, Phontong/ Camacrafts Handicrafts Cooperatives, which registered for IFAT while Bangladesh has 14 organizations. In the past, Aid to Artisans US, an IFAT members funded by the Rockefeller Foundation, provided technical assistance to Laos. They conducted a 10-day workshop on natural dyes in 2002 and a 15-day workshop on product development in the United States in 2003 for 20 handicraft micro-enterprises.

<sup>6</sup> The Fair Trade Company (2005). [www.peopletree.co.jp](http://www.peopletree.co.jp)

**Engaging in e-commerce:**

The internet is one of the best ways to connect grassroots artisans with the outside world. Artisans can periodically update their products on the internet while they are in their countries. Buyers can search for products that they want through the internet and contact the artisans directly through e-mail. Artisans are able to reduce transportation costs because they do not have to send samples each time they approach a new buyer. Also, they can introduce new products in a timely manner as soon as they create new samples by updating their web catalogues. For this to work, apart from English language, artisans need to get trained in computer skills (or organize themselves to hire computer services).

***CatGen and online shopping.*** CatGen, an e-commerce NGO in the United States, is helping artisans in developing countries by providing software that enables artisans to create and maintain their own websites. CatGen occasionally provides technical training for artisans in order to familiarize them with computers. The software to create web catalogues is user-friendly and manageable for beginners. Artisans are able to create their own web catalogues after receiving only a few hours of training. After creating a web catalogue, artisans are even able to sell their products online. In this way, they save costs and maintain direct contacts to buyers all over the world. Examples can be seen at [www.modishandicrafts.com](http://www.modishandicrafts.com) and also [www.nayocrafts.com](http://www.nayocrafts.com).

***Selling products through eBay.*** CatGen assisted in establishing the Enterprise Support for Empowering Women and Artisans (ESEWA) in Nepal in 2002 (<http://www.esewanepal.com>) aiming at capacity building for small and micro level producers through technology. ESEWA helps provide handicraft producers access to global markets by using the internet as well as by conducting training related to e-commerce, product development, and

marketing. ESEWA helps market its partners' handicraft products through initiating web catalogues and listing products on eBay, a top e-commerce site in the United States. ESEWA lists products which are in Nepal while customers in the United States bid through eBay. Sales reached over \$6,000 through eBay. A spillover effect of this way of selling handicraft is increased awareness of buyers about Lao products.

E-commerce saves time and cost because it is accessible worldwide and does not need to consider inventory risks. Handicraft producers that have a partnership with ESEWA are responsible for making sure how much inventory they have, and ESEWA collects the products as soon as they receive notice that the products were sold through eBay. ESEWA then bundles commodities together to minimize shipping costs.

One of the most popular items that ESEWA sold through eBay was the art of Thangka paintings representing Buddhist Gods, a very traditional art in Nepal. Artists usually spend months and sometimes years to create a Thangka painting. Collectors in the United States are not parsimonious in order to get those rare items. The average price of Thangka is about \$150 and it is more than the amount that an artisan earns in a month.

While selling handicrafts online is very convenient and creates an environment where it is easy to find buyers in the international market, there are some requirements to engage in e-commerce, such as establishing a payment system, inventory control, and shipping methods. One concern in using eBay is the nature of the bidding system over a certain period of time. The system appeals to collectors and bargain seekers.

**Empowering existing Lao-owned domestic stores:**

There are some privately owned companies that engage in the handicraft retail business.

The Mekong Private Sector Development Facility (MPDF) conducted a comparative study to determine which Grassroots Business Organizations (GBOs) trigger potential private sector development in Laos, Cambodia, and Vietnam.<sup>7</sup>

Although the study shows that Laos did not have a conducive environment for GBOs, the MPDF identified some GBOs in the handicraft sector in Laos, such as Phaeng Mai Gallery and Taideng Lao (Tables 7 and 8). These organizations are privately funded and owned by Lao citizens. It is very important to empower existing domestic stores and nurture them as “the best practices” in the handicraft sector in Laos. Artisans in Laos need to have role models in order to learn and become competitive in the market.

#### **Boosting domestic demand:**

Though domestic demand is limited, establishing a “flagship store” in Vientiane Capital will stimulate the domestic market not only for tourists but also fashion-conscious Laotians. Currently, those fashion-conscious Laos prefer buying Thai products to Lao products. Creating a fashionable trend within Laos is necessary. Existing domestic stores including Phaeng Mai Gallery and Taideng Laos mainly target on tourists. The new “flagship store” should target on the Lao middleclasses. Bangladesh provides a good example of a country that succeeded in boosting domestic demand for handicraft (Box 2).

#### **Targeting niche markets:**

Targeting niche markets where customers do not mind paying higher prices and

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7 Grassroots Business Organizations (GBOs) are “Organizations or programs (whether independent or part of a larger organization and regardless of structure or legal status, though always formal) that seek to provide employment opportunities, training and income generation activities to underprivileged segments of society through the sale of products or services.” MPDF (2004).

appreciate the artisans’ works is one of the best ways to promote Lao handicrafts. Making business linkages with a commercially oriented niche market such as the ABC Market is more demanding and hard to establish considering the current level of capacity in the Lao handicraft sector. Therefore, establishing a business linkage with a socially oriented niche market is suggested as a first step towards increasing international linkages.

#### **Box 2. Aarong in Bangladesh**

Bangladesh serves as a successful example that has attracted domestic consumers and raised awareness of the importance in preserving the handicraft culture. Aarong, established in 1978, is a marketing department of Bangladesh’s largest domestic NGO, BRAC (Bangladesh Rural Advancement Committee), and deals with more than 30,000 artisans, of which 85 percent were women in 2002.<sup>1</sup> They sell various kinds of Bangladeshi handicrafts including silk and cotton textiles/clothing, leather items, clay and brass products, straw, as well as jute and bamboo products.

They have eight domestic stores, five of which are located in Dhaka. The stores attract not only tourists but also middle-class Bangladeshi. As of 2002, the most popular items for Bangladeshi were Panjabi and Salowakamis (traditional costumes) with hand-made embroideries. Panjabi from Aarong is well-known by other Bangladeshi and wearing the Aarong’s Panjabi gives Bangladeshi a sense of special self-esteem and pride. Fashion-sensitive young people save money in purchasing Panjabi and Salowakamis in Aarong.

Establishing a firm status as a trend shop in Dhaka, Aarong successfully engaged in exporting handicrafts to international markets, including the US, Europe and Japan. The brand name recognized by Bangladeshi people became a guarantee for international buyers. As of 2002, Aarong was exporting Nokshi Kantha, a traditional quilted embroidery in Bangladesh, which was revived by BRAC, to many international buyers including Takashimaya, one of the largest department stores in Japan. The department store, targeting a niche market, sold Nokshi Kantha at a price that was about ten times the domestic price. Targeting domestic consumers as well as foreign tourists and residences is necessary in order to establish the domestic demand. This model can serve as an example for ways in which a domestic retail sector in Lao can aid in overseas expansion.

**Table 7. Phaeng Mai Gallery**

Industry	Handicrafts
Organizational Type	Private Sector Company
Social Objectives	Provide employees with dignity and job opportunities through employment and training.
Business Operations	Phaeng Mai Gallery has a strong retail outlet in Vientiane and also sells to export markets in Japan and the U.S. The business sources its silk fibers from independent Lao farmers, has one factory and a training center that trained approximately 36 weavers last year.
Size	Employs 125 staff of which 105 are weavers.
Management Team	Strong family-run business with significant management experience. The same management team has been operating the company since its inception in the early 1990s.
Financial Status	Profitable.
Rationale	The company is looking to expand its operations and penetrate more export markets. To do this, they require additional capital, expansion advice and greater design capacity. Already sustainable and with large number of beneficiaries, Phaeng Mai has the potential to achieve good development impact, providing jobs and training for weavers and a market for silk producers. Phaeng Mai sees its biggest challenges as capital availability, the small local market (hence the need to be good at exporting) and price/competitiveness. Phaeng Mai has had exposure to business consultants previously, taking marketing and management advice as well as training. It is positive about receiving additional business services. Part of an initial hub-wide focus on handicrafts to gain sectoral analysis and product standardization capabilities early in SGBI life.
Potential Intervention	Provide export promotion assistance and operation expansion advice through consulting services. Also, potentially, investment capital to support growth.

Source: MPDF (2004). "Strengthening Grassroots Business Initiative: East Asia Hub Review."

**Table 8. Taideng Lao**

Industry	Handicraft
Organizational Type	Private Sector Firm
Social Objectives	Employs a significant number of beneficiaries in production of silk goods
Business Operations	Production and sale of silk accessories and scarves. Also specific training in natural dye and silk protection. Exports to Thailand and Japan.
Size	100 employees
Management Team	Well established, opened in 1994/95, has a strong management team.
Financial Status	Unclear. Survey report suggests revenues consistently around \$96 thousand revenues over past several years, with small \$2 thousand profit. Status as a private sector firm may be open to question, since it explains the consistency of revenues as arising from use of a revolving fund.
Rationale	Taideng Lao employs a significant number of 100 staff and is mature. The organization is looking to improve the quality of its products and its production capacity, and to grow its markets.
Potential Intervention	Technical Assistance with production Management consulting growth strategy Export marketing Cost reduction

Source: MPDF (2004). "Strengthening Grassroots Business Initiative: East Asia Hub Review."

**Novica.** Established in 1999 in association with National Geographic, Novica sells handicrafts from more than 1,700 artisans all over the world through the internet. Novica sells more than 8,500 products online and sends the products to customers all over the world. Aiming at promoting the handicraft products of talented artisans, Novica has successfully increased revenues. Novica has 11 local offices in El Salvador, Brazil, Ghana, India, Indonesia, Mexico, Morocco, Peru, Thailand, Venezuela and Zimbabwe. Artisans all over the world are interviewed by Novica's local staff, and photos of their work are placed on the Novica website. When customers purchase handicrafts through the Novica's online shopping site, the local staff collects those handicrafts and delivers them directly to the customers. Having a direct linkage between artisans and customers, Novica can eliminate inventory risks as well as cut costs. Novica attracts customers because it sells products which customers cannot find anywhere else. Although they are not selling any products from Laos, having a business linkage with these companies targeting niche markets would greatly contribute to the development of the Lao handicraft industry.

***Textile Museum in Washington, D.C.***<sup>8</sup>: Selling products through a museum could work as a means of establishing an international reputation. The Textile Museum in Washington, DC is hosting a series of exhibitions featuring textiles from all over the world, and they have a store inside of the museum. Currently they sell products from about 100 different countries including products from Laos. Their customers, typically aged between the mid-30s to seniors, pay special attention to the contexts behind products such as how and by whom those products are made. The most popular products are books about textiles of the world, and sales of these books amount to 50 percent of total sales. Popular products include items like woven

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<sup>8</sup> Based on interviews with the Textile Museum (2005).

baskets, shawls, scarves, and jewelry. The average spending per customer is \$39 to 50 per transaction. Average annual sales are about \$300,000 with about 30,000 visitors. The shop manager started to buy Lao handicrafts in 1992 through personal connections with one of the curators in the museum. The store is quite small, but gives grassroots organizations opportunities to start selling their handicrafts to a new market. The store manager says that Lao textiles are special and have competitive advantages in terms of their quality and design among other textiles. Lao hand woven silk textiles with natural dyes have the potential to attract consumers in the international market. The manager buys products depending on customers' demand by looking at upcoming exhibitions. Through her personal connections, she picks and buys products for exhibitions. She is interested in expanding purchases of Lao textiles.

#### **Participating in international competitions:**

Participating in international competitions increases the identity and image of Lao traditional handicrafts in the international market. It also stimulates artisans' incentives.

Each year, Asian Handicraft Promotion & Development Association (AHPADA) in cooperation with UNESCO awards the "Seal of Excellence" for handicrafts which demonstrate excellent quality on highly selective standards in the ASEAN region. Since 2002, six handicrafts from Laos received awards, including clothes from Thonglahashinh (2002), 100 percent silk hand-woven wall-hanging from Lao Textiles, paper weaving products from Vangvieng Posa Handicraft (2002), hand-woven cushion cover from Paula Jones at Mulberries (2003), and scarves and shawls from Phaeng Mai Gallery (2004).

Receiving awards contributes to raising the brand image of handicrafts and guarantees the quality of the products. It also increases

interest among consumers in domestic stores and international markets. The handicraft sector can appeal the cultural heritage in Laos. Lao handicrafts are unique and not comparable with mass-produced products. Increasing awareness of the cultural richness and uniqueness of Lao handicrafts will add more value.

**Understanding buyers' needs:**

Most importantly, artisans have to understand what buyers are looking for. They should not produce handicrafts because of artisans' preferences but instead must look for buyers' needs and tastes. Sales do not grow without making an effort to grasp consumers' needs. If buyers cannot sell products to consumers, their inventories remain in stores, which makes it difficult for buyers to purchase new stocks. On the other hand, if buyers can increase sales and can have a higher rate of inventory turnover, orders to artisans grow. Artisans should create a dialogue with consumers in order to receive feedback over their products. This will lead to a long-term relationship which mutually benefits both buyers and artisans.

***The importance of new products.*** In a retailing business, new products sell the most. In an accessory department in Ito-Yokado, the largest super-store chain in Japan, new products which arrive in a store in the previous week account for less than 20 percent of total stock, but account for about 80 percent of total sales. Newly arrived products attract customers' attention, especially if the customers frequently visit the store. Timely introduction of new products is critical for a retailing business. Because handicraft products are not essential commodities such as food or clothes, customers buy handicraft products if they find "something new" compared to those things they already possess.

***Quality and pricing.*** In order to become competitive in the international market, artisans should acknowledge the importance of quality. Customers are finicky and pay attention to the details of products. Artisans

must not compromise the quality of handicrafts. They have to pursue the best possible quality in order to compete with mass-produced products and attract customers. Customers do not accept handicrafts that have lower quality simply because they are made by poor villagers in developing countries. A high level of quality is necessary in order to enter the international market.

While it is important to attract buyers by providing handicrafts of high quality, it is also critical to offer competitive prices. Buyers make the final decision by looking at the balance between the quality and price of the handicraft. Cheap price and low quality does not satisfy customers. Products should come with high quality and appropriate pricing.

***Introducing items in a "coordinated" manner.*** The method of presenting product lines is also very important. In order to attract customers' attention, introducing items in coordinated sets is desirable. For example, instead of introducing a single color for an item, introducing multiple color models of same item, or suggesting a set of accessories such as a bag, scarf, pendant, and earrings in the same product line catches customers' attentions and is essential to remain competitive. In purchasing a new item, customers tend to think whether the new item is a suitable match to their own possessions, depending on an item. They may not buy all items in the coordinated set; however, suggesting items in a coordinated way enables each product to look better and to attract more attention.

However, this does not mean that producing as many varieties as possible is a good method to increase sales. The number of items that buyers can display in their retailing stores is limited. Buyers always consider how they are going to create a display to appeal to customers because appropriate spacing for displayed products is very important due to limited space. Therefore, suggesting coordinated items is

essential to appeal to customers in the international market, but needs to be done thoughtfully.

***The best way to meet buyers is at trade shows.*** Buyers are always looking for producers who can produce unique, creative, and new handicrafts which they are not able to find anywhere else. The best way to meet them is still through trade shows although communication methods have changed through the expansion of the internet. Buyers go to trade shows to discover new products as well as to gain ideas over market trend. While the internet allows buyers to find new producers through websites, most buyers still want to meet producers or suppliers and see the products in person to ensure a successful deal. Getting to know buyers' needs and obtaining buyers' contact information are one of the most important tasks for producers.

***Be aggressive in order to learn buyers' needs.*** In order to increase sales, artisans should be aggressive in learning buyers' needs and the current trend in the international market. Although there are many explanations for the lack of information or lack of direct contact to buyers, artisans should actively pursue market trends such as learning from such secondary sources as tourists. Artisans can also get information about customers' needs and market trends from simple means such as fashion magazines. The internet makes research for market trends a lot easier. Through the internet, artisans can see what competitors are selling and what kind of products are popular in the international market.

## **Recommendations**

The handicraft sector shows considerable potential exports that would benefit the poor and minorities in Laos. Until now, the Lao handicraft industry has existed in isolation from world markets, and has fallen behind the handicraft industries of neighboring countries. However, the unique character of

the Lao handicraft industry indicates its ability to gain access to world markets while at the same time increasing living standards among the nation's impoverished regions through increased production and exports. In order to create an economic environment that is conducive to growth, the Lao government must initiate policies that target both the domestic and international sectors in order to ensure growth in the handicraft sector.

***Promote artisans' initiatives.*** Most importantly, the government should provide a framework which inspires artisans to take initiatives towards the export market. The bottom line is that the successful development of the handicraft sector does not happen without stimulating the business interests of the artisans.

***Provide a constructive environment for grassroots business organizations in the handicraft sector.*** The study by MPDF showed that the environment of Laos' GBOs suffered from a lack of infrastructure and supporting institutions and a limited domestic market compared to Cambodia and Vietnam, countries which went through the same screening process (Table 9).

A constructive environment requires the establishment of proper regulations and frameworks. The SME sector in Laos lacks appropriate regulations, and the legal framework is underdeveloped. Although the government drafted a New Prime Ministerial Decree on SME Development Support in 2004, the government has not yet enacted appropriate laws to promote SMEs. A lack of supporting infrastructure and the low capacity of supporting institutions are also problems and need to be addressed.

***Supply chain management.*** Analyzing value and supply chain structures will lead to more cost-effective and efficient production of handicrafts. In order to make Lao handicrafts attractive, Laos should provide buyers attractive products and prices. Understanding the supply chain

helps to eliminate middlemen or distributors that benefit from inefficient chains. The ideal way for artisans to sell handicrafts is a direct linkage with buyers by skipping some links in the supply chain. This is also a global trend in the manufacturing sector.

***Identify handicraft clusters in villages and promote handicraft development in the context of rural development.*** Although the Central Government allocates financial support for provincial governments such as Vientiane capital, Bolikhamxay, Khammuane, and Savannakhet provinces to promote the handicraft sector, the programs lack strategic policies. Identifying handicraft clusters in villages should be done in order to maximize artisans' capacity and promote the sector in the international market.

Using a social marketing message that signifies the development of the handicraft sector as a means of cultural preservation is a good advantage in competing with other sectors. Also, the social mission of economic growth will be achieved under the implementation of a decentralization policy that increases local ownership and involvement in projects.

***Necessary domestic policies.*** Stimulating the domestic market is essential to ensure the vitality of the handicraft industry. A collapse of this industry would not only be a blow to the Lao economy, but a blow to the rich cultural tradition of Lao handicrafts. Domestically, the Lao government must take steps to:

- establish the infrastructure necessary for producers to gain information on world market trends
- establish direct linkages between producers and buyers in order to communicate on their needs
- empower domestic stores to become more responsive to market indicators, such as demand and supply
- increase domestic demand by making products competitive with regional competitors.

For all these steps, the use of the internet is an essential tool. Effective use of the internet will put producers in contact with their target market, allow producers to learn the specific wants and desires of consumers, and obtain information on market trends easily.

***Policies to penetrate international market.*** The government can facilitate several channels through which artisans can export their products.

- actively pursue the assistance of Fair Trade Organizations in order to provide the domestic handicraft industry with international exposure. This will allow previously inaccessible customers exposure to Lao goods. Because of the respectability of such organizations, this will assist Lao handicrafts in establishing an international reputation for quality and unique goods.
- promote e-commerce programs to raise the profile of Lao goods and allow producers to reach international consumers. Utilization of the internet would also reduce costs by cutting middlemen out of the supply chain, and these profits would be absorbed by the rural micro-enterprise workers.
- actively target global niche markets. Because Lao products are unique, the Lao government has an opportunity to use its image to create demand for a product that only it can supply. Further, developing a strong niche market would also help the government preserve its rich heritage of handicrafts through sales to wealthy international buyers.
- encourage participation in international competitions to raise international awareness about Lao products. The Lao government should use this venue as a means of establishing and raising the profile of domestic handicrafts. Participation in these competitions would also ring the producers closer to buyers and consumers, allowing them to have greater access to vital information over market trends. This would not only establish the Lao handicraft industry,

but also ensure its prestige among the great textile cultures of the world.

**Table 9. Summary for the comparison of GBOs market in Laos, Cambodia and Vietnam.**

	<b>Cambodia</b>	<b>Laos</b>	<b>Vietnam</b>
Relative Size of Market	Large	Small	Medium (large with inclusion of Cooperatives)
Industry Segments	All	Agriculture Handicraft	Agriculture Handicraft Services (Disabled)
Organizational Type	All Legal Structures	Private Sector Association	Cooperatives Social Mission NGOs
NGO Environment	Large, relatively free to pursue business activities	Small, restricted activities, require local partner	Medium, unable to pursue business activities with scale
Legal Environment	Relatively open and supportive of GBO development	Restrictive, unclear and undeveloped with respect to business activities	Improving with respect to formalization of laws governing business development Still restrictive with respect to NGO income generating activities
Government Oversight	Minimal	Active, restrictive	Active provincial governments overseeing most activities
Other Structure	Limited formal structures involved in grassroots business development	Strong Mass Organizations involved in most grassroots development	Complex interaction between the government, the Communist Party, Mass Organizations and Business Activities which are all involved at some level in most grassroots business activities
SGBI Opportunity*	High across most sectors	Low with some opportunities to support private sector handicraft organizations and GBO start-up	Medium across Handicraft, Agriculture and Services in the Handicapped population. High with respect to cooperative development.

\*“Strengthening Grassroots Business Initiative (SGBI): An international IFC initiative to provide business/technical advice and “patient” investment to Grassroots Business Organizations globally.” MPDF (2004). Source: MPDF (2004). “Strengthening Grassroots Business Initiative: East Asia Hub Review.

## **Chapter 11: A Practical and Collaborative Approach: The Process for Undertaking the Laos IF**

When the Laos DTIS started with the preliminary mission, government officials from the Ministry of Commerce provided the World Bank with clear feedback that this was not the approach they were seeking for the IF. They wanted a practical approach (given that they already have many reports on trade and industrial performance) and a focus on export competitiveness. As a result, the task manager and the whole approach were changed accordingly. The DTIS put much emphasis on participatory workshops: 8 workshops on export competitiveness were organized—in Vientiane, Savannakhet, and Luang Prabang. The approach and results of these workshops are summarized below.

The draft DTIS report was shared at every step with donors and government, and a complete draft was distributed to all stakeholders in October 2005. Their comments are already incorporated in this version. But more importantly, it became clear that for the IF to succeed, the emphasis should be on the Action Matrix—not only on building a coherent and actionable matrix, but also on ensuring government ownership and donors buying in early on, and on thinking through the implementation hurdles that needed to be overcome to make the action matrix happen.

As a result, an Action Matrix workshop was organized in February 2006, with all stakeholders—government officials, private sector, and donors—attending and attempting at reaching consensus on what they would like to see in the matrix. In addition, awareness raising workshops were undertaken in several provinces to engage them in this process. The preparation and results of the workshops are summarized below.

### **1. Description and Assessment of the Industry Cluster Workshops**

Three industry competitiveness experts worked with the Government of Laos, commercial sector leaders and the World Bank over a six month period to assess the competitiveness of key export industry clusters and develop practical recommendations for boosting export performance. The team moderated eight half-day workshops in Vientiane, Savannakhet, and Luang Prabang on competitiveness in agriculture, light manufacturing and tourism. The experts also met individually with approximately 75 entrepreneurs, exporters and government officials to discuss current constraints for export and potential strategies for growth.

### **Methodology and Activities**

This effort worked directly with business leaders, industry associations and government officials to assist them in understanding the competitiveness of their industry clusters and designing strategic action plans for agriculture, light manufacturing, and tourism in Laos<sup>1</sup>. The strategic action plans outline the practical steps that private sector and public sector leaders can take to boost exports in each industry. The focus of this effort was on developing tangible recommendations for action at the sector level.

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<sup>1</sup> Within the agriculture and light manufacturing sectors, specific industry clusters included: coffee, horticulture, rice farming, livestock, wood and forestry products, agarwood, food processing and distribution, textiles and apparel, silk products, handicrafts, and automotive parts assembly

### **Stage 1: Benchmarking Competitiveness of Laos and Export Sectors**

Prior to visiting Laos, the international experts assembled information and analysis relevant to the country and specific sectors including studies conducted previously by the World Bank, UN Agencies, the Asian Development Bank, ASEAN and bilateral donor agencies. The team also reviewed global and regional industry trends relevant to Laotian exports.

### **Stage 2: Competitiveness Assessment Workshops with Commercial and Public Sector Leaders**

Two highly qualified experts with experience in export competitiveness relevant to Laos then traveled to the country to make a series of intensive presentations on export competitiveness and discuss key constraints to and opportunities for growth.

In preparation for the competitiveness assessment workshops, the Government of Laos, with the guidance of the team, assembled commercial sector leadership maps and convened the key actors and decision-makers in each of the sectors including:

- A. Industry leaders in 3 sectors representing multiple industry clusters
- B. Regional economic leadership in the capital and two secondary cities
- C. Government of Laos leaders
- D. Academic economic leadership

On the basis of the national and industry cluster benchmarking, the international experts developed compelling presentations on the current competitiveness of Laos that indicated current export competitiveness, highlighted opportunities currently available to boost such exports, provided relevant examples on boosting competitiveness from other countries in industries relevant to Laos and provided some initial indications of ways to boost exports.

Each presentation was tailored to the different industry groups and audiences. For

example, the presentation to the tourism cluster not only benchmarked the current performance of the industry (using dollars per day per tourist and Laos market share of global and regional tourism) but provided many examples of how tourism revenues have been increased in countries where the team has worked such as Thailand, Mongolia, Sri Lanka and the Caribbean. Specific strategies were presented as examples along with diagnostic tools focused the industry leadership on increasing value for their businesses and for the country. Similarly, presentations to industry leaders in wood products included examples from countries where the team has worked on increasing value-added wood exports such as Croatia. Presentations to government leaders included examples of public policy initiatives that have improved the national platform for competitiveness in other countries.

The objective of the initial competitiveness presentation is to make an impact on the mindsets of those present by providing compelling examples of practical ways to boost export revenues that are based on the real experiences of industry clusters in other countries. The outline for the presentation was as follows:

1. Economic and Social Goals of the Government of Laos
2. Definition of Export Competitiveness
3. How Export Competitiveness Is Built
  - a. Macro Economic Platform
  - b. Micro Economic Platform and Business Environment
  - c. Quality of Business Strategy and Operations (with examples)
    - i. Improving Understanding of International Markets
    - ii. Innovation in Products and Services (Mongolian Tourism)
    - iii. Design (Croatian Wood Products)
    - iv. Supply Chain Management (Sri Lankan Ceramics)
    - v. Workforce Development (Tourism Schools)

- vi. Policy Initiatives (Thai “Good Agriculture Practices”)
- vii. Branding (Ceylon Sapphires, Vietnamese Ceramics)
- 4. Examples from Other Countries
  - a. Wood Products: Boosting Value-Added
    - i. Case of Croatia: Furniture
  - b. Coffee: High value added sector
    - i. Mistakes: Vietnam; Colombian Coffee Federation
    - ii. Successes: “BanCafe”
  - c. Tourism
    - i. How to Attract High Income Tourist Segments
  - d. Horticulture
    - i. Improving Value Added in Cut Flower Exports (Colombia)
  - e. Other
    - i. Apparel and Light Industry
    - ii. Information Technology
    - iii. Financial Sector
- 5. Discussing Relevance of These Approaches to Laos
- 6. Develop Initial Industry Cluster Strategies and Prioritize Key Actions for achieving Export Goals

The team used a highly interactive and participative methodology for engaging leadership groups so that the concepts presented and strategies identified are both understood and supported by local leaders (see Appendix for methodologies used). The workshops engaged the leaders in a highly interactive and participative manner working with and through native Lao-speaking professionals who are fluent in English and who have been exposed previously in their education to economic, public policy and business and industry strategy concepts.

While in Laos, the team also met with government officials to review plans for boosting exports, existing strategies and budget priorities designed to remove impediments to exports, to boost trade facilitation (infrastructure and customs),

promote foreign investment and improve workforce skills and productivity.

### **Stage 3: Design of Industry Cluster Export Strategies and Action Plans**

On the basis of the initial benchmarking, and the first interactive workshops in Laos and meeting with regional industry experts, the team proceeded to map out a practical strategy for “jump-starting” exports for the three sectors.

The team then returned to Laos to present the findings to the Laotian government leaders, industry cluster leaders, and the World Bank and other donors in an effort to encourage rapid implementation of the strategies developed.

Attendance was requested from all participants during the first set of workshops as well as any additional leaders of the key companies in each industry, industry associations, relevant university departments, and the Chamber of Commerce and Government of Laos.

In preparation for the second set of workshops, a consultant was mobilized prior to the mission to gather information needed in the second set of workshops and begin to discuss the key strategic opportunities for each industry cluster. The consultant held approximately 20 meetings with industry and government leaders to verify the initial findings and begin to discuss potential industry cluster strategies.

### ***Review and develop specific strategic opportunities at the industry cluster level.***

These strategies will build directly off the assessments and opportunities developed in the first mission. For example, the initial strategic opportunities for the tourism cluster that were further developed in the second mission included:

- a. Enhance Market Knowledge in Laos Tourism Industry
- b. Invest in Human Resource Development
- c. Improve Quality of Lao Tourism Experience

- d. Strengthen associations within the tourism cluster, including the Association of Travel Agents, the Hotel and Restaurant Association and a potential tour guide association
- e. Improve regional coordination of tourism bodies at the provincial level. This would include regional tourist information centers and guidebooks and annual meetings of provincial tourism officials
- f. Establish Luang Prabang tourism cluster working group to coordinate and develop strategy specific to the region

In the second set of workshops, the consultants presented practical examples of how other industry clusters have pursued similar opportunities. The consultants then worked with the leaders to design specific action plans for the most important opportunities.

A typical strategic agenda for a cluster prioritizes the high value opportunities and constraints for the cluster. Depending on the market economics, competitive position, and business environment for a given cluster, these strategies can represent different broader drivers of profitability and competitiveness:

- Production processes and productivity
- Supply-chain structure and management
- Development of key related and supporting industries
- Access to profitable markets and Route-to-market strategies
- Administrative barriers to operation and growth
- Infrastructure
- Human resources (technical and management)
- Access to financing
- Marketing and demand-side strategies

Some examples of actual cluster strategic initiatives facilitated by the consultant in previous projects include:

- Improvement in travel logistics for tourists (air travel, taxis, visas, signage, etc.)
- Development of E-commerce capability by hoteliers and tour operators
- Investment in first eco-tourism lodge
- Market survey and client satisfaction initiatives for Mongolian tourism
- Branding “Ceylon Sapphires”
- Investing in laboratory testing equipment to certify sapphires
- Negotiation of 10% energy price discount through joint procurement
- Improvement in materials and kiln technology to save on ceramics input costs
- Certifying product characteristics and standards for Sri Lankan latex rubber
- Innovating in gourmet coffee production and exports
- Adding product and service features to ornamental flower exports
- Foreign investment attraction efforts to “fill out” the apparel cluster in key related and supporting industries
- Fostering greater responsiveness and customize curriculum in technical training schools and management institutes

## **2. Action Matrix and Awareness Raising Workshops**

### **The Action Matrix Workshop**

The Action Matrix workshop held in Vientiane was modeled on the IF Simulation held in Addis Ababa in September 2005. Unlike the simulation in Ethiopia, rather than creating an artificial environment with a “generic” draft Action Matrix, the workshop in Vientiane was based on the actual Lao draft DTIS report, and asked participants not to role play, but to assume their real responsibilities and consider the actual issues facing Laos in its drive toward an improved trade performance. As a

consequence, the workshop in Vientiane was less a simulation, but more accurately, a first step in working toward a national consensus of Lao IF priorities and the creation of an “implementable” Action Matrix.

The objectives for the workshop to be held in Vientiane were to encourage government, private sector and development partners to work to reach the full potential of IF implementation, including:

- Further developing the Action Matrix phase by better utilizing the resources, knowledge, and experiences of other IF countries and the Lao DTIS
- Helping IF stakeholders explore and understand implementation expectations and realities
- Fostering commitment of government, private sector and IF donor organizations and agencies to implementation planning
- Building a core team in Laos for IF implementation

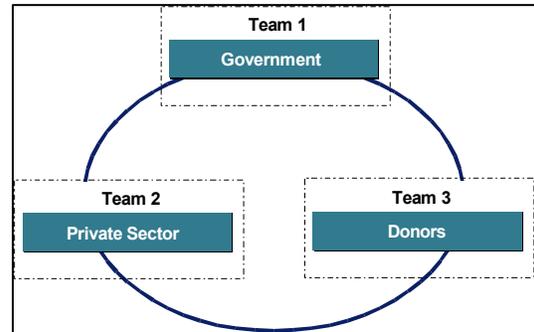
The concept for the Vientiane workshop was to have a simulation exercise that would encourage participants to consider the various issues identified in the Lao DTIS report and seek to prioritize them. During the workshop, three moves or action phases required participants to identify priorities for Laos and address a variety of implementation challenges and opportunities.

In the first move, stakeholders were divided into three teams, consisting of government, private sector, and donor representatives. These teams, representing the three major Lao stakeholder groups were asked to separately identify three major priorities from the draft Action Matrix for Laos. During this move, participants were asked to respond to relevant questions including:

- What are high-priority, feasible Lao trade development concerns?
- What actions best address these priorities?

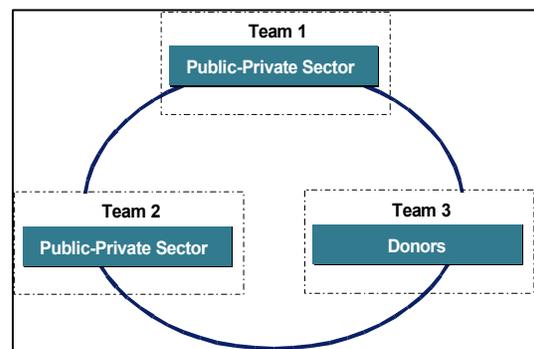
- Which three actions will Lao take first and why?

At the end of the first move, each group was asked to present their priorities in plenary session to all workshop participants.



During the second move, the composition of the three teams was altered so that private sector and government representatives formed Lao public/private partnerships. These combined Public/Private teams were instructed to work to reach a consensus on Action Matrix priorities and to move to develop project implementation plans.

During this move, donors worked to refine their priorities for Laos, but were also asked to visit with each of the other two teams in order to comment on identified priorities and implementation plans. Results of the move were subsequently reported out in plenary session.



Move three, which took place on the second day of the workshop, was similar to the second move, except for the fact that each team was asked to develop more detailed implementation plans for a specific priority that had been identified the previous day. In order to focus on two priorities that had been

identified earlier, one team was asked to focus on trade facilitation issues and the other, to focus on the development of implementation plans related to the tourism sector. Teams were asked to provide details on:

- Project objective and technical description
- The specific roles or actions of the stakeholders,
- The identity of (a) champion(s) and the primary implementing entity
- Estimated cost, duration, and possible funding options (use of Window II funding)
- The keys to implementation success and how to overcome identified barriers

As in the second move, donors visited with the teams and offered their comments on the implementation plans that had been developed. The results of the final move were also reported in plenary session, after which the workshop facilitators offered their commentary on the outcome of the proceedings.

**Workshop Results.** The process of prioritizing the draft Action Matrix was difficult and time consuming. Despite the fact that the draft had been prepared to guide discussions and to focus deliberations along five thematic lines, the observations by participants were wide ranging. Ultimately, a general consensus emerged to identify the three top priorities as follows:

1. The need to promote and develop small and medium enterprises.
2. Trade facilitation.
3. Capacity building for Ministries dealing with policy support, particularly MOC.

### **The Provincial Workshops: Luang Prabang and Pakse**

The workshops held in the provinces of Luang Prabang and Champassak provinces were designed somewhat differently. Given

the more limited exposure of participants to the IF process, one of the primary objectives of these two workshops was to increase awareness of the IF process. Thus, the opening presentation focused on an overview of the IF and the various phases that constitute the entire process. However, as in the capital, the findings of the DTIS were also presented. The third presentation was a more detailed discussion of the draft Action Matrix, along with a summary of the prioritization that had been carried out by the Vientiane workshop.

With the main emphasis for the regional workshops being placed on awareness raising, they were designed as introductory sessions to the IF. During the first part of the workshop, DTIS results were presented, the draft action matrix was discussed and the prioritization as proposed by the Vientiane workshop was summarized.

It became clear during the course of the workshop that priorities identified by representatives of the regions are not entirely different from those identified in the capital, though prioritization of sectors reflects more the economic structures of the regions. Discussion focused on the need to support those sectors that had already been identified as promising, in particular tourism and agriculture. The impression emerged that the private sector is very much relying on government to make those improvements, being hardly prepared to take initiatives themselves. Another issue that was raised by participants throughout was the lack of working capital and non-existence of micro-finance schemes raised.

## Appendix

### *Participatory Industry Diagnostic Tools/Exercises*

<b>Diagnostic Tool/Exercise</b>	<b>Description</b>	<b>Facilitation Approach</b>
Porter Competitiveness Diamond	Assesses industry cluster competitiveness along four components: factor inputs, demand conditions, context for strategy and rivalry, and related and supporting industries	Participants posed probing questions about their industry specific to each component to test the competitiveness of the industry and business environment
GAP Analysis	Compares industry with key competitors along industry specific factors of success. Reveals strengths and weaknesses, focuses industry on critical success factors, forces leaders to think about what competitors are doing better than they are. <i>Note: answers are based on perception by industry leaders and should be verified with international expertise</i>	Participants first choose 3-4 direct competitor industries / countries and then choose 8-10 factors that determine success and rank their performance versus their competitors on each factor
SWOT Analysis	Highlights industry cluster strengths, weaknesses, opportunities for growth and near-term and long-term threats to profitability and performance	Participants collectively discuss the four categories and characterize the current state of the industry
Market Trend Analysis	Highlights current trends in demand for domestic, regional and international markets. Tests trends from international industry experts with local demand conditions	Participants outline key market trends that they have observed in their industry and brainstorm how these trends will affect their business
Cluster Analysis	Assesses the robustness of the cluster by highlighting gaps in core products and services and weaknesses in linkages to related and supporting institutions and industries. Also shows the participants the many different players critical to the success of the industry outside of just producers, processors, and exporters	Participants asked to list the players in their industry and then probed to think of supporting industries, academic and governance institutions. Finally asked to assess the linkages and effectiveness of communication among players

### *Study Questions in Preparation for Laos simulation*

#### **Questions to be addressed throughout the IF process**

- How can the government of Laos build and maintain sufficient commitment to the IF process within government? How can it improve the inter-ministerial process which is crucial for the success of the IF? Are there ways to improve ownership of the IF process among Lao stakeholders? How can senior government officials be encouraged to become champions for the IF?
- How can the role of the IF focal point be strengthened? How can the IF focal point be empowered to carry out its role of overseeing the IF process among disparate stakeholders both inside and outside of government?
- How can the Lao government institute regular, consistent, and meaningful consultations with its private sector?

- How can the Lao government reach out to the international private sector to further its trade-related objectives? How can the Lao government respond to issues that are critical to the concerns of traders and investors?
- How can the government of Laos work to develop priorities that are consistent with the expectations of bilateral donors and donor agencies operating in Laos?
- How can the Lao government encourage integration of the IF process into the ongoing national development strategy envisioned in the PRSP process?

**Questions to be addressed during the development of the Action Matrix.**

- Among the constraints identified in the DTIS, what are Laos' most pressing needs? Given that there is a limited amount of resources available from the donor community, how will the money be most effectively spent?
- The DTIS addresses a number of broad issues relevant to Laos's greater participation in the international trading system. How should these interventions be sequenced among these competing interests? Which interventions can be accomplished in the short, medium, and long-term? Can interventions be characterized as having greater or lesser impact?
- Are the identified constraints issues which can be addressed through regulatory or legislative changes by the Lao government or through collaboration with other Lao stakeholders—primarily the private sector?
- Are the identified priorities matters that require technical or other assistance from the donor community? If yes, what type of assistance (and over what period) would be most effective in resolving these constraints?
- Are there interventions that have cross-cutting benefits and therefore constitute more efficient methods of addressing Laos' trade performance?

**Questions to be addressed related to implementing the IF**

- What can the Lao government do to encourage a collaborative relationship with the donor community and to ensure that all parts of government are engaged with donors in discussions about IF implementation?
- How can Action Matrix recommendations be made more specific and targeted to allow for more efficient translation into project designs?
- How can IF findings and Action Matrix priorities be integrated rapidly into Laos' PRSP in order to mainstream trade into national development strategies and improve broad donor support?
- How can the Lao government ensure that national priorities are better aligned with the implementation activities of bilateral donors and agencies?
- How can the process of project development be accelerated? What resources are available to assist with project design, which includes development of technical descriptions, estimated costs, project timelines, and possible funding options?
- How can IF Window II funding lead to more rapid implementation of specific priorities and lessen competition among stakeholders for limited resources?
- How might an empowered Lao IF focal point assist more actively with implementation initiatives? Can it assist donors by providing templates and sample project Terms of Reference to advance the process of implementation?
- How can government work cooperatively with its private sector to build capacity related to trade policy formulation and implementation of trade-related initiatives?
- How can the international business community be encouraged to participate in the implementation of IF recommendations? Can the international business community be called upon to contribute its views and other resources to Laos' development priorities?

**Related questions to be addressed by the donor community**

- How can donors work most effectively with Lao stakeholders to advance the IF process
- What can donors in Laos do to improve donor coordination?
- How can donors encourage a collaborative inter-ministerial process within the Lao government? Similarly, how can donors assure that other Lao stakeholders are engaged in IF-related discussions?
- How can the donor community identify a donor champion who will serve to animate the IF process in Laos?
- How can the donor community catalyze the appropriate and effective use of Window II funding to advance Laos's IF implementation activities?
- What activities are donors willing to undertake?