FOREIGN DIRECT INVESTMENT: IMPLICATION FOR ECONOMIC DEVELOPMENT IN LAO PDR

Miss Chintana Khouangvichit

A Thesis Submitted in Partial Fulfillment of the Requirements

for the Degree of Master of Arts Program in Southeast Asian Studies

(Interdisciplinary Program)

Graduate School

Chulalongkorn University

Academic Year 2011

การลงทุนโดยตรงจากต่างประเทศ: นัยยะต่อการพัฒนาเศรษฐกิจของ สปป. ลาว

นางสาวจินตนา ควงวิจิตร

วิทยานิพนธ์นี้เป็นส่วนหนึ่งของการศึกษาตามหลักสูตรปริญญาศิลปศาสตรมหาบัณฑิต
สาขาวิชาเอเชียตะวันออกเฉียงใต้ศึกษา (สหสาขาวิชา)
บัณฑิตวิทยาลัย จุฬาลงกรณ์มหาวิทยาลัย
ปีการศึกษา 2554

Thesis Title	FOREIGN DIRECT INVESTMENT: IMPLICATION FOR ECONOMIC DEVELOPMENT IN LAO PDR
By	Miss Chintana Khouangvichit
Field of Study	Southeast Asian Studies
Thesis Advisor	Associate Professor Withaya Sucharithanarugse, Ph.D.
Thesis Co-advisor	Associate Professor Lae Dilokvidhyarat

Accepted by the Graduate School, Chulalongkorn University in Partial Fulfillment of the Requirements for the Master's Degree

……………………………………………….. Dean of the Graduate School
(Associate Professor Pornpote Piumsomboon, Ph.D.)

THESIS COMMITTEE

……………………………………………….. Chairman
(Assistant Professor Theera Nuchpiam, Ph.D.)

……………………………………….……. Thesis Advisor
(Associate Professor Withaya Sucharithanarugse, Ph.D.)

……………………………………….……. Thesis Co-advisor
(Associate Professor Lae Dilokvidhyarat)

……………………………………………….. External Examiner
(Chuwit Mitrchob, Ph.D.)

จินตนา ควงวิจิตร : การลงทุนโดยตรงจากต่างประเทศ: นัยยะต่อการพัฒนาเศรษฐกิจของสปป.ลาว. (FOREIGN DIRECT INVESTMENT: IMPLICATION FOR ECONOMIC DEVELOPMENT IN LAO PDR) อ. ที่ปรึกษาวิทยานิพนธ์หลัก: รศ.ดร. วิทยา สุจริตธนารักษ์. อ. ที่ปรึกษาวิทยานิพนธ์ร่วม: รศ. แล ดิลกวิทยรัตน์, 98 หน้า.

ในการพัฒนาเศรษฐกิจของประเทศกำลังพัฒนา ส่วนใหญ่ต่างพึ่งพิงการค้าการลงทุนจากต่างประเทศในรูปแบบใดแบบหนึ่ง การลงทุนโดยตรงจากต่างประเทศมีความสำคัญไม่น้อยสำหรับประเทศที่กำลังเปลี่ยนผ่านทางเศรษฐกิจ ดังกรณีของสาธารณรัฐประชาธิปไตยประชาชนลาว (สปป.ลาว) การศึกษาชิ้นนี้มุ่งเน้นที่จะทำความเข้าใจบทบาทของการลงทุนโดยตรงจากต่างประเทศต่อการพัฒนาเศรษฐกิจของสปป.ลาว โดยให้ความสนใจทางด้านทรัพยากรธรรมชาติ ตลอดจนมุ่งเน้นศึกษาสถานการณ์ของการลงทุนโดยตรงจากต่างประเทศในสปป.ลาวตั้งแต่ปี 1988 การศึกษาพบว่า ตั้งแต่ปี 1988 สปป.ลาว ได้เสนอโอกาสในการลงทุนให้กับนักลงทุนต่างชาติ และได้กำหนดนโยบายต่างๆ เพื่อดึงดูดนักลงทุนต่างชาติให้เข้ามาลงทุนในประเทศ โดยมีการแก้ไขกฎหมายที่ว่าด้วยการลงทุนจากต่างประเทศแล้วถึงสามครั้ง ตั้งแต่ช่วงกลางปี 2000 การลงทุนโดยตรงจากต่างประเทศในสปป.ลาวมีสถานการณ์ที่ดีขึ้นอย่างชัดเจน การทำเหมืองแร่และการผลิตไฟฟ้าพลังน้ำเป็นอุตสาหกรรมที่มีการลงทุนจากต่างประเทศเป็นส่วนมาก และยังคงเป็นภาคอุตสาหกรรมที่ได้รับความสนใจจากนักลงทุนต่างชาติอยู่เสมอ การลงทุนโดยตรงจากต่างประเทศได้รับการคาดหวังว่าจะนำผลประโยชน์มาสู่ประเทศเจ้าบ้าน การศึกษายังได้พบว่า การลงทุนจากต่างประเทศทำให้เกิดผลกระทบที่ดีต่อเศรษฐกิจในรูปการเจริญเติบโตทางเศรษฐกิจที่สูงขึ้น การเพิ่มรายได้ภาครัฐและการขยายตัวของการส่งออก ตั้งแต่ปี 2006 ถึง 2010 ผลิตภัณฑ์มวลรวมในประเทศ (GDP) โดยเฉลี่ยของ สปป.ลาว สูงถึงร้อยละ 7.9 และในปี 2011 สูงถึงร้อยละ 8.4 การส่งออกเพิ่มขึ้นอย่างมากในช่วงระยะทศวรรษเนื่องมาจากการส่งออกแร่ธาตุและพลังงานไฟฟ้า อย่างไรก็ตาม นอกจากผลดีแล้ว ผลกระทบด้านลบต่อการใช้ทรัพยากรธรรมชาติจำนวนมากได้สร้างปัญหาทางด้านสิ่งแวดล้อมด้วย

สาขาวิชา เอเชียตะวันออกเฉียงใต้ศึกษา ลายมือชื่อนิสิต ....

ปีการศึกษา: 2011 ลายมือชื่ออ.ที่ปรึกษาวิทยานิพนธ์หลัก ....

ลายมือชื่ออ.ที่ปรึกษาวิทยานิพนธ์ร่วม ....

5387647120: MAJOR SOUTHEAST ASIAN STUDIES

KEYWORDS: FOREIGN DIRECT INVESTMENT/ ECONOMIC DEVELOPMENT/ NATURAL RESOURCES/LAO PDR

CHINTANA KHOUANGVICHIT: FOREIGN DIRECT INVESTMENT: IMPLICATION FOR ECONOMIC DEVELOPMENT IN LAO PDR. ADVISOR: ASSOC. PROF. WITHAYA SCHARITHANARUGES, Ph.D., CO-ADVISOR: ASSOC. PROF. LAE DILOKVIDHYARAT, 98pp.

Most developing countries rely on some form of trade and foreign investment for Foreign Direct Investment (FDI) has considerable significance for transitional economy countries like Lao PDR as well their economic development. This study is aimed at understanding of role of FDI in economic development in Lao PDR through focusing on resource sector and also this study examined the FDI situation in Lao PDR since 1988. The study found that, since 1988, Lao PDR offers investment opportunities for foreign companies and has adopted a number of policies to attract foreign direct investment into the country. Law on foreign investment was revised three times. FDI in the Lao People's Democratic Republic has improved clearly since around mid-2000. Mining and electricity generation sectors account for much of FDI, and are likely to remain the most active sector for foreign investment. FDI are expected to bring benefit to host country. The study also found that FDI has positive impact on economy in the form of higher economic growth, an increase in revenues, and export performance. From 2006 to 2010, average GDP growth rate in Lao PDR was 7.9% and in 2011, it was 8.4%. Export increased significantly over the decade due to the increase of export in mining and electricity. However, aside from benefit, resource sectors have a negative impact in term of environmental problem.

Field of study: Southeast Asian Studies	Student's signature…………………………….
Academic Year: 2011	Advisor's signature…………………………….
	Co-advisor's signature………………..…….

ACKNOWLEDGEMENTS

Foremost, I would like to express my sincere gratitude to my advisor Assoc. Prof. Withaya Sucharithanarugse and my co-advisor Assoc. Prof. Lae Dilokvidhayarat for the continuous support of my MA study, for their patience, motivation, enthusiasm, and immense knowledge. Their guidance helped me in all the time of research and writing of this thesis. Besides my advisors, I would like to thank the rest of my thesis committee: Dr. Theera Nuchpiam and Dr. Chuwit Mitchop for their encouragement, and insightful comments.

My thanks go also to Dr. Sunait Chutintaranond, Director of Southeast Asian Studies Center, all lectures, and staffs at the Southeast Asian Studies program especially Khun Panya and khun Doungkamol for their helping and encouragement throughout my study. I am deeply gratitude to Rockefeller Foundation for providing me scholarship throughout my MA study.

I would also extend my thanks to all my classmates and to those who have direct and indirectly helped me in completing my thesis successfully. Finally, I am thankful to my family for their support.

CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
BOL	Bank of Lao PDR
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GMS	Greater Mekong Sub-region
GOL	Government of Lao PDR
IMF	International Monetary Fund
IPP	Independent Power Pants
LDCs	Least Developing Countries
LPRP	Lao People's Revolution Party
MPI	Ministry of Planning and Investment
NGO	Non Profit Organization
NEM	New Economic Mechanism
NT2	Nam Thuen 2
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
SOEs	State Owned Enterprise
UN	United Nation

UNDP	United Nation Development Programme
WB	World Bank
WTO	World Trade Organization
$	United States dollar(s)

CHAPTER I

INTRODUCTION

1.1 Rationale

It is widely recognized that Foreign Direct Investment (FDI) produces economic benefits to the recipient countries by providing capital, foreign exchange, technology, competition and by enhancing access to foreign markets (World Bank, 1999; UNCTAD, 1991). The decline of grants and other official aids flows into developing countries in the recent time has meant that private capital, particularly in the form of FDI, has become a major source of external finance for these countries. At the same time, analysis and evidence suggest that developing countries' need for external finance has greatly increased (UNCTAD, 2001). Therefore, most developing countries rely on FDI for their economic development in some way or another. Thus, FDI has considerable significance for their economic development and peoples' livelihood.

Lao PDR is no exception. Lao PDR opened its country in late 1980's for economic development. Then, Lao government introduced the Foreign Investments Promotion and Management Law in 1988 in order to attract FDI. This is the first law since establishing the republic. It shows that FDI was the most important issue for Lao PDR then as well as today because Lao PDR lacked of capitals, technologies, and human resources, etc. However, the situation has not changed very much today. Lao PDR cannot develop its economy without FDI. Also, in 1996, at the 6^{th} Congress of the Lao People's Revolutionary Party (LPRP), there established a national target that country would graduate from Least Developed Countries (LDCs) status by the year 2020. Especially since then, FDI has become the most important factor for their economic development.

Therefore, one of the most important issues for the government is to establish favorable policies to foreign investors.

Today many foreign companies are looking at Lao PDR as a next country to invest because Lao PDR can be a hub of the mainland Southeast Asia in the future and will be linked with China, Myanmar, Vietnam, Thailand and Cambodia. Also, labor cost in Lao PDR is still lower than neighboring countries so some companies who already invested in China, Vietnam and Thailand are interested in shifting some of their factories into Lao PDR. However, population of the country is only 6.2 million, and as such there already is a problem of labor shortage in that sector. In some years, the number of the labor and the manufacturing sector itself may hit the peak.

On the other hand, there is much comparative advantage in resource sector. There are more than 570 mineral deposits sites identified, including gold, copper, zinc and lead (World Bank, 2004). In addition, Laos is also traditionally known as a high potential hydropower producer, about 26,000 MW (excluding mainstream Mekong), only 9% of its capacity being used in 2004 (Pholsena and Phonekeo, 2004). After entering 2000's, especially since 2002, FDI has flowed into Lao PDR rapidly especially in resource sectors (Kyophilavong, 2008). Recently, Lao PDR is ranked as one of the resources-rich countries in Asia. It is not an exaggeration to say that the resource sector is a leading sector in recent economic growth in Lao PDR and it is making a significant impact on economy as a whole.

Of course, depending on resource sector creates problems such as appropriation and compensation of land, ecological destruction, etc. Also, there is a voice that even though development in resource sector makes a big impact on economic growth, but it doesn't have much impact on income of the people. Nevertheless, LPRP established a policy, at the 9th Congress in March 2011, to depend on the resource sector for its economic development because of comparative advantage in the sector (LPRP, 2011). Therefore, whether good or bad, it can be said that the key for economic development in

Lao PDR is FDI in resource sector. Because of these reasons, considering economic development in Lao PDR, it is worth to study on FDI, especially on resource sector.

1.2 Objectives

The main objectives of this study are:

- To analyze the law and policy on FDI
- To investigate the influence of FDI upon Lao PDR economic development
- To identify actual situation of FDI and major trend in FDI in Lao PDR

1.3. Scope of the study and Conceptual Framework

This study is aimed at understanding of role of FDI in economic development in Lao PDR through focusing on resource sector. However, understanding only recent FDI situation is not enough to figure out whole picture of FDI and economic development. Therefore, first of all, even though the scope of the study shall be mainly on 2000s, I would study economic history and development policy of the government since 1975. This can be basic background and introduction of the main argument. Second, I would study FDI policy of the government and investment environment through analyzing FDI Law (1988, 1994, 2004, and 2009). Comparing 4 laws, the study will be able to show the change of the policy of the government toward FDI and investment environment during 20 years. Third, I would identify actual situation of FDI and major trend in FDI in Lao PDR by using primary data of the government. Last, will investigate the contribution of FDI in resource sectors mainly in economic growth, export performance, and government revenue.

Here this study would not apply any definite theory or mathematical methods or quantitative findings. What I am doing is the way of Area Studies. In other words, my research is based on descriptive analysis. As mentioned, FDI has positive influence on economic development of developing countries, but the impact, investment environment, government policy are different among countries and each country has its own character. UNCTAD World Investment Reviews suggests that FDI has a positive impact on growth but that it varies from country to country (UNCTAD, 2003). So that in order to understand Lao specific characteristic in terms of FDI and its economic development, this study will take a descriptive analysis method, which is based on the policy, statistics, law, and other related resources of Lao PDR

Also, despite the benefit that can derive from FDI, it should be noted that it can also bring about some negative impact. For instance, activities of foreign firm could displace local firms that cannot cope with the competition, thus could lead to reduce the growth of the local firms. Alfaro (2003) examined the effect of FDI on growth in the primary, manufacturing, and services sectors by using cross-country data. The author attempts to explain that not all forms of foreign investment seem to be beneficial to host country. His paper finds that FDI flows into different sector have different effects. Alfaro concluded that FDI inflows in the manufacturing sector tend to have positive effect, whereas FDI inflows in primary sector a negative one. As for Lao PDR, since FDI in resource sector has been increasing, Alfaro's argument can be applied so that I would bring negative factors of FDI into my scope as well.

4. Hypothesis

World Bank, UNCTAD, or other literatures pointed out the positive influence of FDI to economic development. Many analysis and evidence suggest that since most of developing countries don't have strong internal finance, they need external finance to develop its economy (UNCTAD, 2001). It goes without saying that FDI produces economic benefits to the recipient countries by providing capital, foreign exchange, technology, competition and by enhancing access to foreign markets. As a consequence, the performance of FDI affects the performance of a country's economic development.

In order to attract FDI into the country, it is needless to say that the recipient country has to prepare favorable environment for foreign companies. FDI can stimulate economic development if the appropriate laws are adopted. And the restrictions and incentives provided for by law and by legal reforms affect the performance of FDI.

As for Lao PDR, since late 1990's, many foreign companies have been investing in Lao PDR and the number of the companies investing in Laos and registered capitals are increasing especially in resource sector. As mentioned earlier, Lao PDR is ranked as one of the resources-rich countries in Asia. However, there still are problems such as infrastructures, investment environment, labor shortage, law, and cost of transportation. Therefore, the government has to adapt investment environment to changing economic and social situation. Also, after 2015, Lao PDR will face a challenge of competition with other ASEAN countries because of economic integration. Establishing attractive investment environment for foreign companies is a key to benefit from FDI.

Based on above arguments, three main hypothesises are set in this study as following

- First, Lao government offer FDI incentives in competing situation in order to attract more foreign direct investment since opening up the country.
- Second, since economic growth and increase of FDI has occurred concomitantly, large amount of FDI has favorable effect on economic growth, government revenue, and export performance.
- Third, based on second argument, if economic growth and increase of FDI is correlated, share of resource sector in GDP and export is also increasing, which eventually influence on economic growth.

1.5 Methodology

The mixed methodology, using both primary data and secondary data, will be adopted in the study. In the case of secondary data, the data will be gathered through published studies, articles from different related journals and studies, and other literary works. I will make a content analysis of the collected documentary and verbal material. The selection of data for inclusion in the thesis will be based on its representative character for the subject area or areas it covers. Informal interview will be used in the study. The interview will be conducted in Ministry of Planning and Investment with Lao authorities who have responsibility on investment in Lao PDR.

1.6 Significance/usefulness of research

- This study provides a better understanding of current situation of FDI in Lao PDR including newest information obtained in Ministry of Planning and Investment crucial for investors who wish to invest in Lao PDR.
- This study shows correlation between FDI and economic development in Lao PDR.
- The study provides trend and pattern of FDI history and policies of the Lao government.

1. 7 Literature review and previous studies

1.7.1 Definitions of Foreign Direct Investment (FDI)

The concept of Foreign Direct Investment (FDI) has undergone several changes overtime, and the available definitions are not uniform. According to UNCTAD (2006), adopted the idea from OECD and IMF, FDI is defined as an investment involving a long-term relationship and reflecting a lasting interest and controlled by a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investor. The lasting interest implies the existence of long-term relationship between direct investor and direct investment enterprise and significant degree of influence on management of the enterprise (OECD, 1996).

In addition, OECD (1996) recommended that a direct investment enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise (unless it can be proven that the 10 per cent ownership does not allow the investor an effective voice in the management) or owns less than 10 per cent of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management. An effective voice in management only implies that direct investors are able to influence the management of an enterprise and does not imply that they have absolute control by the foreign investors.

In case of Lao PDR, according to the Investment Law, Foreign Investment means the importation of capital, which includes assets, technology and expertise, into the Lao People's Democratic Republic by foreign investors for business purpose.

Foreign investor means a foreign individual or legal entities, or aliens or expatriate residing in the Lao PDR who take part in joint venture or co-operation with foreign business.[1]

1.7.2 Determinant of FDI

To explain the difference in the FDI performance among countries, it is necessary to understand how foreign investors choose their investment location. According to UNCTAD (1998), there are several factors that influence FDI position in host countries. Host country determinants of FDI consist of host country policy framework, business facilitation, and economic determinants.

[1] See more Law on Promotion of Foreign Investment 2004, article 2

Duning's (1988) Eclectic theory provides a flexible and popular framework where it is argued that FDI is determined by three sets known as OLI paradigm. The first of the advantage is the owner advantages including technology, know-how in production, marketing or management, a registered framework. These advantages allow firms to compete with the other firms in the markets. Second, location advantages which includes natural recourses, domestic market potential, labour, political stability and government policies. These advantages become the most important issues when Multinational Corporations (MNCs) make the decision to invest in other countries. Third, internationalization advantages, FDI usually goes to the countries where it is possible to combine the ownership advantages (O) with the location specific advantages of host countries (L) through internationalization advantages of foreign investment (I).

1.7.3 Type of FDI

There is various kind or category which can be used to classify the type of FDI. It can be classified from the host country's perspective, from the foreign investor's perspective, from the intention of the investing firms, from the mode of entry of firms and so on. For this study I mainly discuss on the mode of entry by foreign firm.

1). Greenfield investment: investment that creates a new asset or facility, either as a wholly owned subsidiary or as a controlling equity stake in a joint venture (JV) with a local or foreign firm. The local firm may be privately or state owned. Greenfield investments are the primary target of a host nation's promotional efforts because they create new production capacity and jobs, transfer technology and know-how, and can lead to linkages to the global marketplace.

2). Cross-border Merger & Acquisition (M&A): Acquisition involves a foreign firm acquiring a controlling stake in a local firm. According to UNCTAD, FDI through M&A does not generate employment when it enters a country. It may lead to lay-offs, although in the case of a firm which would have gone bankrupt if it has not been acquired, it can also maintain employment. Greenfield FDI, by contrast, necessarily creates new employment at entry.

1.7.4 Impact of FDI and Economic development

The relationship between FDI and economic growth has motivated a voluminous empirical literature focusing on both developed and developing countries.

The impact of FDI on host economies can be broken down into direct and indirect benefit. Direct benefits relate to the macroeconomic impact of FDI on the local economy such as capital flows, employment creation, and technology transfers. Indirect benefits take place via linkages between the foreign affiliate and local firms for instance, FDI contribution to economic development through growing competitiveness of local firms in the world markets (OECD, 1998).

Caves (1971) proposed that foreign companies may introduce new know-how by demonstrating new technologies and training workers who later take employment in local firms; either break down monopolies and stimulate competition and efficiency or create a more monopolistic industry structure, depending on the strength and responses of the local firms; transfer techniques for inventory and quality control and standardization to their local suppliers and distribution channels; and force local firms to increase their managerial efforts, or to adopt some of the marketing techniques used by foreign firms, either on the local market or internationally.

Many empirical works studied the impact of FDI on economic growth. Most of them showed that FDI was able to stimulate economic growth through the technology transfer and spillover effect. Borensztein, Gregorio, and Lee (1998) test the effect of FDI on economic growth in a framework of cross-country regressions utilizing data on FDI flows from industrial countries to 69 developing countries, the results suggest that FDI is in fact an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment. Moreover, they find that there is a strong complementary effect between FDI and human capital, that is, the contribution of FDI to economic growth is enhanced by its interaction with the level of human capital in the host country.

Kojima (1978), representative from Japanese school of thought, proposes his theories based on the research of Japanese firm. He pointed out that FDI flows bring the improvement in the structure of the industries and transfer of comparative advantage between both home and host country.

Durham (2004) sees FDI as an important vehicle for transfer of technology, contributing more to economic growth than domestic investment. FDI raises national welfare by increasing the volume and efficiency of investment through improved competitiveness, technological diffusion, accelerated spillover effects and the accumulation human capital.

1.7.5 Impact of FDI in specific sector

As mentioned above, FDI can increase the host country's growth via technology spillover. Foreign firms typically make significant investments in research and development (R&D) as a consequence they tend to have superior technology. Thus, FDI gives host countries especially developing countries cheap access to new technologies and skills thereby enhancing local technological capabilities and their ability to compete on world markets (Dupasquier and Osakwe, 2005).

Sjoholm (1999) support this point by suggested that through technology transfer to their affiliates and technological spillovers to unaffiliated firms in host economy, transnational corporations (TNCs) can speed up development of new intermediate product varieties, raise the quality of the product, facilitate international collaboration on R&D, and introduce new forms of human capital. De Mello (1999) studied the impact of FDI on capital accumulation and total factor productivity growth in the recipient economy by using time series and panel data. The study found that the flow of FDI to developing countries contributes to growth through two mechanisms; increasing total investment in the host country and increasing productivity through technology and management spillover.

In case of impact of FDI on employment and wage, FDI help generate employment and income in the host economy. More investments bring about more production of goods and services which would lead to a higher demand for labour. Lipsey (2002) points out that foreign firm might effect wages in host countries where they operate due to mostly foreign firms offer higher wages than those paid by domestic firms.

UNCTAD (2003) reviewed investment policy that found the evidence of benefits of FDI in term of employment generation, wages, and linkages with local firm, increases in technology incentive exports, range of new products and services. However, UNCTAD suggested that FDI has a positive impact on growth but that it varies from country to country (ADB, 2006).

FDI also plays a role in host country's export performance. Theoretically, FDI promotes exports of the host countries may derive from the additional capital, technology, and managerial know how the foreign firms bring with them, along with access to global, regional markets (UNCTAD, 2002). Zhang (2006) puts forward in his study of FDI and China's export performance that one of FDI's major potential growth-contribution is to promote host countries' exports. Zhang (2006) further suggests that FDI helps exports by investing capital in the exploitation of the host country's comparative advantage. In the case of China, foreign firms invest their capital in utilizing and improving the country's low-cost labour. However, the actual effects of FDI on host country's exports depend on the type of investment as well as on the specific host country initial economic condition (Lipsey, 2004).

Despite the benefit that can derive from FDI, it should be noted that it can also bring about some negative impact. For instance, activities of foreign firm could displace local firms that cannot cope with the competition, thus could lead to reduce the growth of the local firms. Reis (2001) formulated a model that investigates the effects of FDI on economic growth when investment returns may be repatriated. She states that after the opening up to FDI, domestic firms will be replaced by foreign firm in the R&D sector. This may decrease domestic welfare due to the transfer of capital returns to foreign firms.

Alfaro (2003) examined the effect of FDI on growth in the primary, manufacturing, and services sectors by using cross-country data. The author attempts to explain that not all forms of foreign investment seem to be beneficial to host country. His paper finds that FDI flows into different sector have different effects. Alfaro concluded that FDI inflows in the manufacturing sector tend to have positive effect, whereas FDI inflows in primary sector a negative one.

Bashir (1999), and Carkovic and Levine (2002), showed that there was no impact from FDI to economic growth in seventy-two sample countries, some of which were Asia economies, such as India, Indonesia, Malaysia, the Philippines, and Thailand. Some empirical studies noted that FDI seemed to boost growth only in economies that had appropriate initial conditions, including high levels of human capital, financial sector development and policies that promoted international trade.

Bende et al. (2001) study the impact of FDI through spillover effects on economic growth of the ASEAN-5 for the period 1970-1996. They find that FDI accelerates economic growth either directly or through spillover effects. They show that the impact of FDI on economic growth is positively signed and significant for Indonesia, Malaysia, and Philippines, while they identify a negative relationship for Singapore and Thailand

Kotrajaras, Tubtimtong and Wiboonchutikula (2011) study on how FDI affects economic growth of the host economies in East Asian economies, they divided sample countries into three country groups. The results from pooled regression and fixed effect model in high-income and middle-income countries were quite similar. FDI has positive relationship with economic growth for high-income and middle-income countries but not for low-income countries.

Fortanier (2007) analyzes the differences in the growth consequences of FDI from various countries of origin, using a dataset on bilateral investment stocks of six major outward investor countries in 71 host countries for the period 1989-2002, found that the growth consequences of FDI differ by country of origin, and that these country of origin effects also vary depending on the host country characteristics.

Kose (2006) shares the same result as Fortanier, the impact of FDI to economic growth depends on a host economy's economic foundation. Countries meeting appropriate conditions such as enough level of financial market development, institution development, better governance, and appropriate macro policies tend to reap better growth and stability benefits, or "collateral benefits", from FDI.

Blomstrom and Kokko (1998), Kose (2006) conclude that the extent of these effects for a host economy depends mainly on the size of the received FDI, transfer of the technology, number of employed people, the extent to which the foreign firms' affiliates procure goods and service inputs locally, and the proportion of reinvested profits (Cox, 1994). Different host economies prioritize differently qualitative and quantitative aspects of employment in foreign firms, depending on their local conditions.

1.7.6 Role of Government policy toward FDI

As mentioned earlier, the relationship between FDI and economic growth has been a topical issue for several decades. Policymakers in countries both developed and developing are engaged in creating all kinds of incentives to attract FDI, because it is assumed to positively affect on their countries' economic development.

Meyer (2001) states that FDI can facilitate economic development only if the appropriate laws are adopted and the restrictions and incentives provided for by law (and by legal reforms) affect the performance of FDI. Consequently, the performance of FDI affects the performance of a country's economic development. UNCTAD (2000) also has suggested in the previous study that the government plays a major role in economic development by providing a business environment that enables sound investment through government policies

Banga (2003) explain that government policies influencing the inflow of FDI can be broadly categorized into three types. First, overall economic policy that increases location advantages for FDI by improving the economic fundamentals of the host country; second, national FDI policy that reduces the transaction costs of foreign firms entering the economy; and third, international FDI policy that deals with agreements of foreign investments. The national FDI policy works at the domestic level and regulates entry and exit of FDI along with creation of incentives and restrictions on operations of foreign firms in different sectors of the economy.

Piritta Sorsa (2003) points out that although most countries offered a large numbers of incentives to attract FDI, experience from other countries shows that such plans often have limited impact on new investment, reduce transparency of the business climate, and lead to higher taxes for other taxpayers. Tax incentives or free trade zones are used by some countries to attract investors, despite mixed evidence about their impact on FDI flows and the potentially high costs compared to the benefits.

Dunning (2002) points out that for FDI from more advanced industrialized countries, government policies along with transparency in governance and supportive infrastructure has become more important. However, FDI emerging from larger developing countries still seek traditional economic determinants, e.g., market size and income levels, skills, political and macroeconomic stability, etc. Teowkul, Alsua, and Mujtaba (2009) study on factors that influence the investment in Lao PDR finds that the most influential factor toward investment is the legal practices factor in which the government of Lao PDR issues laws.

Although, there are positive relations between policies advocating FDI inflows and states of prosperity in some countries, there are considerable controversies as to the effects of FDI on countries with a developing economy (Hauser, 1986). The effects of

FDI would be favorable if developing economies could rely on a successful FDI policy approach, since sound policies are guides to successful applications. It is one of the purposes of this study to find out an appropriate FDI policy approach.

Banga (2003) shared his view in his empirical study, he pointed out that lower tariff rates attract FDI inflows. However, fiscal incentives offered by the host governments are found to be less significant as compared to removal of restrictions in attracting FDI inflows. Banga also states that FDI may flow into a country not only because the host country provides certain investment incentives but also because these incentives when compared to the incentives provided by other competing host countries appear to be more attractive.

However, studying policy alternatives is about identifying which policies work best under the particular conditions of developing economies. The similar policies cannot be expected to have similar results in different environments.

1.7.7 Previous studies from Lao perspective

There are some previous studies on Lao economic development and FDI. They can be classified into 2 groups. First, many previous studies focus on economic development in Laos in terms of transitional economy. Ljunggren (1993), Otani Pham (1996), Than and Tan (1997), and Bourdet (2000), as main examples, can be classified into this first group. Their common framework is that Lao PDR shifts its economy from centrally-planned economy to market-oriented economy. Therefore, their main view point is transition and they don’t take FDI as a main topic of their studies.

Second, there are some studies focusing on FDI such as Freeman (2001), Suzuki (2007), Kyophilvong (2009), Freeman (2001) summarize the FDI trend in Lao PDR by aggregating the data from 1988 to 1999 so that we can see short history of FDI in Lao PDR but we will not be able to see current situation, Suzuki (2007) is taking different approach. He not only summarizes FDI data in Lao PDR but also he is suggesting a policy for attraction of FDI called “Sub-Regionally Complementary Industrialization for the Lao PDR.” He sees advantage and disadvantage of Lao PDR in FDI and proposes that Lao PDR takes advantage of industrial clusters in neighboring countries for its industrial development so that they should attract foreign companies which are already doing their business in the region (Suzuki, 2007). Therefore, Suzuki focuses his attention on policy suggestion and industrial development.

On the other hand, Kyophilavong (2009) is one of few studies focusing on FDI in mining sector in Lao PDR. He summarizes the situation of FDI in mining sector during 2000’s up until 2008. He not only aggregates the statistics, but also explaining about the process of investment procedure for mining sector. We are able to understand current situation of FDI in mining sector in Lao PDR from his study. However, since his scope is set mainly from 200 to 2008, he was not able to take newest information and government policy. Also, his studies focus on mining sector so that we cannot know about electric sector, which also is a leading sector in FDI.

1.8 Structure of the thesis

The thesis is composed of 5 chapters. Chapter 1 is an introduction which explains the background of the study including objective, scope, methodology and significance. In chapter 2, summarize historical background of economic development and policy in Lao PDR since 1975, which is an introduction to understand current situation. In chapter 3, I would study on current FDI situation in Laos PDR in general. In chapter 4, I would study on FDI by focusing deeply on resource sector, and investigate correlation between economic development and FDI, particularly in growth, government revenues, and export performance. In Chapter 5, will be conclusion and discussion part.

CHAPTER II

ECONOMIC POLICY IN LAO PDR

2.1 Brief description of Lao PDR

Lao People's Democratic Republic (Lao PDR) is one–party state under Lao People's Revolutionary Party (LPRP) and it is still socialist country. Lao PDR is the landlocked country with total population of 6.4 million. The country has borders with Cambodia to the South, China to the North, Myanmar to the Northwest, Thailand to the West, and Vietnam to the east. The total work force in all country are approximately 3 million, of whom of 75% work in agriculture sector and only 6% and 19% work in industrial sector and service respectively.

Lao PDR is classified by the United Nation (UN) as a Least Developed Country (LDC). [2] However, from 2006 to 2010, average economic growth rate was 7.9%. Comparing to other countries in the region, economic growth in Lao PDR is high. Today, many foreign companies see Lao PDR as a next destination to invest and they are actually coming into Lao PDR.

However, it takes more than nearly 30 years to reach this point. Lao PDR was in devastated situation both physically and economically after establishing country because of approximately 30 years of civil war and influences of Vietnam War. Also, centrally planned economy did not function very well and production was not recovered as expected. It took more than 10 years to open up the country for FDI.

[2] According to UNDP (2010/2011), Global Human Development Index (HDR), in term of development index (HDI) Laos was rank as 107^{th} of out 134 countries cover in the report.

In this section, before entering main argument of FDI and economic development in Lao PDR, I would discuss history of economic development and development policy of the government. This is a background for the argument which I would develop in Chapter 3 and 4.

2.2 Early stage of Development, 1975-1991

2.2.1 1975-1979: Recovery from civil war and state building under socialism

After civil war between the Pathet Lao and the Vientiane[3], which began in the mid 1950s, on December 2nd, 1975, Lao People's Democratic Republic was established. Immediately upon winning power throughout the country in December 1975 the LPRP proclaimed 2 strategic goals for country; defending the country and building socialism. At the 3rd plenum of 2nd Central Committee in October 1975, the LPRP confirmed that "they would reach Socialism directly not through the stage of Capitalism."

To guide the nation's "advance toward socialism," the Party Central Committee laid out its fundamental guidelines in a Resolution announced in May 1976. The Resolution called for the carrying out, simultaneously, of three revolutions or so-called "three fundamental political objective" [4] : the revolution in production relations, scientific and technical revolution, which is described as the 'keystone' of the whole program, while the third, the ideological and cultural revolution, is to be 'a step ahead' of the others (Fox, 1986).

Even if the establishment Lao PDR indicated victory for socialism, the situation in the whole country still faced many problems, the economy of the country was divided into two different systems: the liberated economy and the state monopoly economy. In the big city like Vientiane, controlled by rightist group, most of industries were run by private companies. While in the former Pathet Laos' area, means of production belonged

[3] Pathet Lao- Communist movement or Revolutionary group, Vientiane group- the rightist group
[4] These were identical with the revolutions called for in Vietnam by Le Duan.

to state. Therefore, the government began to transform the country to socialist way by lunching the centralized economic system. The government nationalized the production process and trade. Most private companies were taken over by state; transportation and retailing were either nationalized or tightly controlled. Basic products and subsidized foods items were sold in the state shops (Stuart-Fox, 1997).The government also prevented the move of commercial goods between provinces.

Throughout 1977 and 1978, the LPRP maintained policies aimed at consolidating political power and bringing about rapid socialist transformation of Lao society. Early in 1978, an interim three year plan (1978-1980) was announced designed to prepare the way for first five years plan in 1981 and its principal goal was self-reliant economy. The plan emphasized on the increase of production in agriculture, forestry, and livestock breeding, with the development of related processing industries and improvement in transportation, communication, and repair facilities (Staurt-Fox, 2000).

Agriculture was identified to be the tools to achieve the plan and to be the basis of economic development of Lao PDR at that time (Kaysone, 1987). Therefore, small private agriculture production was transformed to a collectivization system. In the 1978, the strategies of transformation into agricultural cooperatives were introduced throughout the country based on the socialist ideology that only the cooperativization of rural production could bring about the revolution in relations of production (Staurt-Fox, 2000). The government strongly believed that the agriculture cooperative would be the important measure to increase agricultural productivity. By the end of 1978, about 1600 cooperatives had been set up over the country. (Staurt-Fox, 1982)

2.2.2 Introducing New Economic Mechanism

Unfortunately, the cooperatives did not work well for raising the production. Conversely, it decreased the amount of production because peasants acted repulsively due to lack of proper preparation and poor organization. As a consequence, economic situation at that time was worse than before 1975.

The failure of economic performance throughout the country led the Lao government to rethink about economic strategy for whole economy. They realized that their strategy of nationalization and collectivization were failure and they could not recover their economy through socialism. At that time in late 1970's, former Soviet Union, China and Vietnam also started their reform process. Therefore, Lao PDR realized the importance of markets as the engine of economic growth. They began to replace centrally planned economy with market-oriented economy very gradually (Bourdet, 2000).

By the end of 1979, a bold decision was taken to revert to limited use of capitalist methods in order to restore the economic health of the country. In November that year, the Seventh Resolution, passed at 7th plenary session of the 2nd Central Committee by the ruling LPRP marked the start of the country's shift toward a market-oriented economy. The resolution affirmed the government's commitment to utilizing a market economy, as the necessary path to economic development. A change in economic policy was necessary (Stuat-Fox, 1996). At the plenum, Kayosne Phomvihane, who was a general secretary of the party, said that there were 5 economic sectors in Lao PDR such as sate economy, collective economy, state capitalism, individual economy, and private economy. Kaysone said that state and collective economy played a central role in 5 economic sectors but he also said that they would use all the sectors in order to expand production. It means that even though LPRP confirmed in 1975 that they would proceed to Socialism not through the stage of Capitalism, they changed their Socialist aim by introducing "market principles".

Since 1979, LPRP implemented economic reform little by little such as raising the price of agricultural products of state procurement by 300 to 500%, abolishment of substitution, raising salary of government officials, lifting of the ban on preventing trade between provinces etc. In 1980, LPRP gave some autonomy to some state-owned companies and they did trial for introducing contract agreement in supplying materials. Since state supply everything to the company, I think that this trial was a big change in Lao PDR. Also, in 1983, LPRP gave autonomy to strategic companies such as beer, coffee, electricity, timber, and so on. Moreover, they raised salary of government officials three times from 1980 to 1983 and they decreased allowance in kind from more than ten to eight and then to five little by little (Kaysone, 1984).

In response to the LPRP's principle of market-economy, the First Five-Year Plan (1981-85) was announced to be a guide line for economic development on January 1981. The objective of the plan included self-sufficiency in food production, defined as the equivalent of 350 kilograms of paddy rice and other foodstuffs per capita per year, and the collectivization of agriculture. The plan also focused on developing industrial activity, increasing trade with Thailand, improving the shattered rural infrastructure, and increasing export revenues, etc. Those were tentative steps toward a market-oriented economy.

However, growth during the plan period was slower than anticipated, and the government decided to take bolder steps toward reform. In order to accelerate economic reform, they started reform state organizations and institutions. For example, they merged committee for price, committee for salary, and committee for external trade under committee for state planning. It means that they can manage their economy under sole committee. Also, they allocated some deputy ministers who have expertise and those with western education to the ministries, especially to economy related ministries e.g., committee for state planning (Stuart-Fox, 1986).

By 1986, to open the economy more toward a market system, in November that year, LPRP held its 4th Congress and decided to implement a policy called "New

Economic Mechanism (NEM)" or "Chintanakan mai"[5]. Kaysone addressed to the Congress.[6]

> *In all economic activities, we must know how to apply objective laws and take into account socio-economic efficiency. At the present time, our country is still at the first stage of the transition period. Hence the system of economic laws now being applied to our country is very complicated. It includes not only specific laws of socialism but also the laws of commodity production. Reality indicates that if we only apply the specific economic laws of socialism alone and defy the general laws pertaining to commodity production, or vice versa, we will make serious mistakes in our economic undertaking during this transition period. (Lao PDR, 1989)*

The essential points of the policy is as follows; (1) price liberalization (2) agricultural liberalization and abolishment of state monopoly of trade (3) reform of state-owned enterprises (4) reform of taxation (5) trade liberalization (6) unification of exchange rates (7) differentiation between state bank and commercial bank (8) development of legal system and (9) invitation of foreign investment.

Consequently, a massive legislative effort has taken place in Laos since 1986, the aim of which is to create a legal environment that will attract private investors, both domestic and foreign companies. In mid-1988, a law on foreign investment was adopted and promulgated, together with decrees on interest rate policy, credit and exchange rate policies. These deregulation and liberalization policies have opened up virtually all economic activities to the private sector, which I would explain in detail in Chapter 3.

---

[5] "Chintanakan Mai" mean new thinking

[6] Kaysone addressed on the topic "some lesson that we have learnt in the last 10 years after our independent"

2.2.3 Promulgation of constitution

Even though LPRP introduced some principles of market economy in 1979 and it gained momentum in 1986, there was no constitution in Lao PDR after establishing country in 1975. It means that even though the government introduced laws, there was no constitutional and basic foundation for a legal framework. This situation may affect the decision of foreign investor to invest in Lao PDR. Without the protection of a legal umbrella, prospective business entrepreneurs and individuals, especially foreign investors, would not invest in Lao PDR. Therefore, it is needed a legal system foundation to attract foreign investment (Ivarsson, 1995).

A constitution was approved by Supreme People's Assembly in August 1991. The Constitution formalized the establishment of market-oriented economy, explicitly permitted private enterprise and foreign investment, and defined many important principles of the country. For example, article 13, 14 and 16 stipulates, which are the key for market-economy as following;

Article 13

> *The economy system of the Lao People's Democratic Republic is a multi-sectoral economy having as objectives the expansion of production and increase of goods circulation, and the transform glean of the subsistence economy into a commodities economy in order to develop the national economic base and improve the material and spiritual living of the multi-ethnic people (National Assembly 2000: 185).*

Article 14

> *The state protects and promotes all forms of state, collective and individual ownership, as well as the private ownership of both domestic investors and foreigners who invest in the Lao People's Democratic Republic.The state encourages all economic sectors to complete and cooperate with one another in expanding their production and business activities. All economic sectors are equal before the law (National Assembly 2000: 185).*

Article 16

> *Economic management is carried out according to the mechanism of the market with the adjustment by the State, and is implemented by the principle of the centralized, unified management of branches at central level in combination with a reasonable delegation of the responsibility to local authorities.*

These economic definition and terms stipulated in constitution would be guarantees for investors. And other legislative development took place in Lao PDR during the 1990s, aiming at creating a good legal environment for investors. Table 2.1 shows economic related laws approved by Supreme People's Assembly from 1986 until implementation of the constitution.

Table 2.1 Laws and regulations established after 1986

Date	**Name of Laws and regulations**
1987.6.26	Decision No.30 of Council of Ministers on National Price Policy
1987.6.26	Decision No.32 of Council of Ministers on Commodity and Money
1987.10.19	Order No.33 of Council of Ministers on Monopolistic Management of the Export-Import of the State
1988.3.12	Decision No.15 of Council of Ministers on Building a System of Commercial Economy from Central to Local and Grassroots
1988.3.12	Decision No.16 of Council of Ministers on Individual and Private Economic Sectors
1988.3.12	Decision No.17 of Council of Ministers on Joint Venture Enterprises between State and Private
1988.7.25	Implementation of Law on Promotion and Management of Foreign Investment
1989.11.23	Law on People’s Court of Lao People’s Democratic Republic
1989.12.15	Decision No.97 of Council of Ministers on Amendment of New Salary System of Civil Servant
1990.3.13	Transformation of Unit of Stated Owned-Enterprises to other Forms of Ownership
1990.6.27	Law on Right of Ownership
1990.6.27	Law on Commitment of Contract
1990.11.29	Code of Civil Procedure
1990.11.29	Law on Insurance
1990.11.29	Law on Business Accounting
1991.6.26	Decision No.14 of Council of Ministers on Minimum Profit Tax
1991.8.15	Implementation of Constitution

Source: Ministry of Finance (1993)

2.3 Setting New National Goal for 2020

After promulgation of the first constitution in 1991, the FDI regimes of the Lao PDR have gone through several changes. To further answer the needs of foreign and domestic investors alike, the Lao government implemented in August a new set of economic laws relating to property ownership, contracts, and inheritance, banking, and court fees. By the end of 1993, the legislative effort had resulted in the adoption of: the Property Law which protected private ownership, and the Business Law, Bankruptcy Law and Surety Law which promoted private business transactions. Amendments were made to the Foreign Investment Law in March 1994.

Many scholars said that, in most cases the Lao legislation fulfills an acceptable standard in terms of reliability. However, in some instances the new laws leave openings for administrative actions contrary to the intentions of the legislator. This undermines the reliability of the legislation by weakening the rule of law and thus delaying the creation of a market economy in Lao PDR (Radetzki, 1994).

Since Lao PDR basically achieved a goal to restore a country from the war, thus, the government started to think of a new national goal. Therefore, in 1993, at the 6th plenum the Lao government set a goal that they would graduate from the status of Least Developed Countries step by step through poverty reduction (Lao National Academy of Social Science, 2010). In 1996 at the 6th Congress, they set a clear goal period that they would graduate from LDCs by the year 2020. Since then, this is the most important goal for Lao PDR and economic development is a key for accomplishing that goal. It also means that FDI becomes more important than before. Lao PDR needs FDI for economic development and poverty reduction. Since then, Lao PDR has been trying to attract FDI into resource and energy sector intensively.

At the 7th Party Congress in 2001, in order to prepare the nation for graduation from the Least Developed Country (LDC) status by 2020, the party defined industrialization and modernization of the country as a gradual process moving from relying heavily on the agricultural sector to a more diversified economy with higher productivity and more advanced technology. The orientation of industrial development was to give priority to developing the energy and mining. More investment will be encouraged into exploiting mines such as coal, metals, precious stones and others. This trend continued at 9th congress of the party.

At the 9th congress, they released 7th National Socio-Economic Development Plan (2011-2015). According to the plan, the government is now focusing on the GDP growth to increase by 8% per year till 2015. To achieve the goal, the total investment demands at least 32% of GDP or US$15,875 billion, of which the private investment will stand at 22% of GDP or equivalent to 65% of overall investment, 10% of state investment, 20% of ODA, and 15% of credit release of banks. Thus, in 2009, the government improved the law on investment promotion to facilitate the investment and socio-economic development and they also opened the one-stop service for domestic and foreign investment promotion.

2.4 Concluding Remarks

In 1975, Lao Peoples' Democratic Republic was established and the LPRP took a path of socialism through nationalizing most of the economic sectors and establishing agricultural cooperatives around the country. However, socialist way of economic development did not work and they were required to change their economic strategy in 1979. At the 7th plenum of 2nd Central Committee, they introduced some of discipline of market economy and started reforming their economy. In 1986, at the 4th Congress of the Party, they decided to implement a policy called "New Economic Mechanism (NEM)." Then, their economy was on progress and they were in hurry to establish legal environment to attract FDI. During late 1980s, many related laws were enacted and in 1991, at last, the first constitution of the country was established. This was a momentum for not only Lao PDR but also for investors that there was a legal basis for investment in Lao PDR. Also, this was a momentum for the country to be restored from the war.

After accomplishing a goal of restoration, the party set a new goal for the country. It was a graduation from LDCs and certain duration, which is 2020, was set at 6th congress in 1996. Since then, Lao PDR has given priority to resource and energy sector for economic development and rushed to develop its economy through the sector.

Along with these policies from 1975 to present, their economic development preceded accordingly. It means that their economy as devastated and their economic development were in difficult condition from 1975 to 1991. Then, from late 1990s, which is a period of setting new national goal and giving priority to resource and energy sector, Lao economy has been developing at the rate between 6.5 to 8 % by attracting FDI into the sector. This is what I would analyze in the detail following chapter.

CHAPTER III

FOREIGN DIRECT INVESTMENT AND LAW TOWARD FOREIGN INVESTMENT IN LAO PDR

3.1 Introduction

Recently, more and more countries, especially developing countries as well as Lao PDR, have become aware of FDI's potential benefits and have made considerable efforts to attract FDI by creating special investment zones and export processing zones, providing tax holidays, allowing duty-free imports of capital goods, production materials and equipment and by introducing fast-track approval procedures for FDI and so on. Host countries believe that there is a good relationship between FDI competition policy, law, and development. FDI competition policy can improve those laws and FDI growth.

Chapter 2 explains the change in economic policy in Lao PDR since 1975 to present. After 1975, they took a path for socialism but it did not work well for economic recovery from the war. It did not take long to change its course. In late 1970s, they introduced some of market economy principles and started reform and it had a momentum at 4th congress in 1986 for economic reform. The, FDI became one of the most important factors for economic development in the country. After 1986, many related laws were introduced and law on FDI was one of the most important at that time. During 1990s, FDI had much more meaning to the country because at 6th congress in 1996, the party set a new national goal for graduating from LDCs in 2020. Then, the government tried to attract FDI into energy and resource sector for economic development.

As we can see above, FDI has been one of the most important factors for economic development in Lao PDR and its meaning has become much more important than before along with the change of economic policy of the party and government.

Here this Chapter will deal with history of FDI in the country. First, I would explain about the change in laws on FDI. It is vital to examine the policy orientation that influences the flow of FDI, because foreign investment decisions are usually based on locational benefits as well as on host country policy and law that offer.

Second, along with establishment of better environment for FDI, how much and what sector was FDI actually introduced? These are the questions I would try to answer in this chapter.

3. 2 Law on Foreign Direct Investment

After 11 years of central-planned policies, the Government of the Lao PDR introduced a program of structural reform so-called New Economic Mechanism (NEM) in 1986 to help the country move towards a more market-oriented economy. From the late 1980s to the mid-1990s, under NEM, trade was liberalized, price controls were lifted, many state-owned industries were privatized or commercialized, and a comparatively open Foreign Investment Law was passed in 1988.

As stated above, law on FDI was first established in 1988. Since then, there have been 3 amendments, i.e. 1994, 2004 and 2010. Comparing among 4 laws, would be able to show the change of government intention for FDI during 20 years.

3.2.1 Law on Management and Promotion of Foreign Investment of 1988

The Foreign Investment Code of 1988 was aimed to expand economic and technological cooperation with foreign investors and to boost ailing state enterprises.

According to the 1988 Code, the code authorized three forms of investment: (1) business by contract, (2) joint ventures with a 30% minimum foreign share, and (3) 100% wholly foreign enterprises. The sector indicated in the law as most favorable for foreign investment included agriculture, forestry, industry, transportation, communications, services, and tourist (Otani, and Chi Do Pham, 1996).

The Code also provided guarantees that capital and other assets of foreign investors would not be nationalized or requisitioned by administrative procedure, and guarantees that profits from such investment could be freely repatriated, and reinvested earnings would be exempt from taxes (Saignasith, 1997). Tax rates on profits varied with minimum of 20-50% set for areas where the government was eager to attract capital.

However, at this point, I would like to mention that even though the party and government acknowledged that they needed FDI for economic development, they still had some kind of mixed attitude toward FDI. The investment law which was introduced in 1988 was called “Promotion and Management of Foreign Investment.” A word “Management” indicates that the Party and the government still had an intention to control FDI. Or I should say that they still placed their importance much more on management than promotion. This is confirmed by omitting the word “Management” from the law in 2004, when FDI was more important than 1988, which I will explain later.

3.2.2 Amendment of the Law on Foreign Investment in 1994

An effort to create a legal framework for foreign investment in order to accelerate FDI and to compete at least with neighboring countries, the law on Promotion and Management of Foreign Investment in Lao PDR was revised in 1994. The new law was consolidated with the principal element of the Investment Promotion Code of 1988, such as liberal, generally friendly to foreign investors, and free from state interference (IMF, 2000).

However, there was a change in the form of foreign investment. In 1988 law, there were three types of the form such as (1) business by contract, (2) joint ventures with a 30% minimum foreign share, and (3) 100% wholly foreign enterprises, as stated above. In 1994 revised law, two types of investment were allowed; Joint-venture, and 100% wholly-owned by foreign enterprise. It means that "business by contract" was omitted from the law. This form of investment has both advantage and disadvantage. Lao PDR can learn from the foreign partners about technology and management skills with restraining foreign capitals. For example, in the strategic sector like communication, form of business contract is better for Lao PDR in order to absorb technology and know-how with protecting flow of information. On the other hand, as for foreign companies, form of business contract can be a limitation for investment. From this perspective, elimination of business contract can be understood as an indication of the intention of the party and government for promotion of FDI.

For Tax incentive, the Law offers profits to be taxed at flat 20% rate compared with the 15%-50% tax rates provided in the 1988 code. As a result, a profit tax is lower than those for domestically owned businesses, which is taxed at 35 % (Otani and Chi Do Pham, 1996). Expatriate of foreign worker should pay incomes tax rate of 10% of their income. Materials and equipment imported for production input and capital goods are reduced to 1%.

However, Freeman (2001) points out that the law, which contains just only 31 articles, lacks supporting implementing regulations, and elements of it are not compatible with various other laws. Implementing regulation was established in 2001 so that there was no implementation regulation for seven years, and there are still bureaucratic impediments in the application process and a lack of transparency in the regulatory framework. This is doubt that if Lao government really has intention to attract FDI. In such environment, foreign companies may face a problem during the period, which regulation is changed every time. Also, according to the Law, foreign investors permitted to invest in all sectors however, in practice hydropower, forestry, mining, finance, construction, and many aspects of timber exploitation are effectively closed to most foreigners because it is the explicitly ruled out as relevant sectors in the Mining, Electricity Laws, and Domestic Investment Law.

Moreover, the approval process, which is responsibility of Foreign Investment Management Committee (FIMC), has been centralized; therefore, it takes longer time to carry forward the procedure. In addition, investors are subject to a substantial amount of uncertainty regarding the array of licenses; permits required for various activities (IMF, 2001).

3.2.4 Amendment of the Law on Foreign Investment in 2004

In 2004, 2nd amendment was approved by the National Assembly. Since 1996, FDI has been much more important than before because the party set a goal for graduating from LDCs in 2020. Therefore, they need to revise the law on FDI in order to attract foreign companies into the country. First of all, they changed the name of the law from “Law on the Promotion and Management of Foreign Investment” to “Law on the Promotion of Foreign Investment.” Omitting the word “Management” can be understood their intention of strong management, which they had in 1988, needs to be dropped. Lao PDR joined Association of South East Asian Nations (ASEAN) in 1997 and more integrated into regional and world economy so that I think they tried to manage an image of socialist country by omitting the word “Management” from the law.

Second significance of the law is that the aim of revision is to attract FDI more into the country so that new law provides more incentives to foreign companies. For example, in the form of investment, they bring back business contract, which they eliminated from 1994 law. Also, they extend expiry date of investment licenses from 20 years to 50 years for joint venture, and from 15 years to 50 years for 100% foreign invested companies. Besides two incentives, there are many new factors to attract FDI but I would explain in later section. Basically, this revision of the law in 2004 was evaluated favourably. Also, not like 1994, they introduced implementation regulation in 2005. This quick response of the government indicates their intention of attracting FDI at that time.

3.2.5 Amendment of the Law on Foreign Investment in 2010

In 2009, the new investment law was approved, which the Law on the Promotion of Domestic Investment and the Law on the Promotion of Foreign Investment were merged to become the Law on Investment Promotion. The merger is aimed to abolish lengthy approval procedures for general investment activities, and creates a level playing field for both domestic and foreign investors by harmonizing business entry procedures and investment incentives (MPI, 2010).

However, the 3rd revision of the law on FDI was carried out; government's aim is different from last two times. Lao PDR has been on the process toward joining into World Trade Organization (WTO), therefore, they have to ensure equality of treatment between domestic company and foreign company. Because of this reason, some of the change in the law provides fewer incentives for foreign companies, and vice versa.

For example, as for profit tax, according to 1994 law, rate is 20% for foreign companies and 35% for domestic companies. However, in accordance with equality between the two, they integrated 2 rates of profit tax into 28%. It increased 8% for foreign companies and 7% decrease for domestic companies. It means that even though this kind of revision can be worse investment environment, they have to do it because of WTO requirement. Therefore, amendment in 2010 was not only for improving investment environment, but to step forwards achieving compliance with WTO Valuation Agreement, and will make Lao PDR more attractive to FDI. The detail of difference among four laws will be analyzed in next section.

3.3 Comparison of Four Laws on Foreign Direct Investment

This section would pick up some important factors, which affect FDI, for comparison among 4 laws on FDI in Lao PDR as following.

(1) Rate of Capital

According to the law in 1988, 1994, 2004, they accept a 100% foreign owned enterprise. On the other hand, as for joint ventures, the laws stipulated minimum rate of foreign capitals at 30%. In addition, every form of foreign investment enterprises (except representative office) shall have a registered capital of at least US$100,000. This is a measure that Lao PDR lack capital. In 2010 law, in case of joint venture, it stipulated that foreign capitals have to share at least 10% of total capitals. It is decreased comparing to previous laws. As for concession project, minimum registered capital rate for foreign enterprise is 30%.

(2) Investment License

In 1988 and 1994 laws, the maximum term for investment license for foreign enterprises was 20 years for a joint venture enterprise and it was 15 years for a wholly owned enterprise. It was too short for foreign enterprises. It may indicate anxiety of the party and government on FDI. In 2004 law, it extends to 50 years. In 2010 law, there is no limitation for general foreign investment. As for concession project and special economic zone, it offers 99 years. Comparing to previous laws, limitation was eased significantly. It is an indication of their needs for FDI and their favorable treatment to FDI.

(3)Incentives related to Duties and Taxes

In 1988, it stipulated that foreign enterprises are entitled to a profit tax exemption from 2 to 4 years from the first year of recording profit. After that, 50% exemption of profit tax for 5 to 6 years was applied. In 1994 law, there was no stipulation about profit tax exemption. It means that it followed previous law. However in 2004 law, it changed the incentive that the rate of exemption was depended on the investment location. It divided investment location into 3 zones;

- Zone 1 is mountainous, plain and plateau zones with no economic infrastructures to facilitate investment;
- Zone 2 is mountainous, plain and plateau zones with a moderate level of economic infrastructure suitable to accommodate investments to some extent;
- Zone 3 is mountainous, plain and plateau zones with good infrastructure to support investment.

Investment in Zone 1 shall be entitled to a profit tax exemption for 7 years and thereafter shall be subject to profit tax at the rate of 10 %. Investment Zone 2 shall be entitled to a profit tax exemption for 5 years, and thereafter shall be subject to a reduced profit tax rate of half of 15 % for 3 years and thereafter a profit tax rate of 15%. Investment Zone 3 shall be entitled to a profit tax exemption for 2 years and thereafter shall be subject to a reduced profit tax rate of half of 20 % for 2 years and thereafter a profit tax rate of 20%. In 2010 law, it basically followed to 3 zones of investment of 2004 law but it newly added level of promoted business into 3 such as level 1, 2 and 3. Incentives given by the government is according to the level, which is business classified as level 1 is given most favorable incentives, business classified as level 2 is given 2nd most favorable incentives and business classified as level 3 is given least incentives. The details are following:

Zone 1

・Level 1 business: profit tax exemption for 10 years

・Level 2 business: profit tax exemption for 6 years

・Level 3 business: profit tax exemption for 4 years

Zone 2

・Level 1business: profit tax exemption for 8 years

・Level 2 business: profit tax exemption for 4 years

・Level 3 business: profit tax exemption for 2years

Zone 3

・Level 1business: profit tax exemption for 6 years

・Level 2 business: profit tax exemption for 2 years

・Level 3 business: profit tax exemption for 1years

Considering change of incentive, I would be able to say that the government changed the policy of incentives on profit tax exemption in order to attract FDI. On the other hand, I can observe that especially in 2000s, the government has had another objective, which is to promote foreign investment to remote area for poverty reduction

(4) Income Tax

In 1988 law, it stipulated rate of income tax for foreign workers at 5 to 10%. In 1994 and 2004, the rate was same. However, in 2010 law, because of corresponding to WTO, they plan to change the rate from 10% to progressive taxation from 0 to 25% proportioned to actual income. It can be a negative factor for foreign enterprises but it is depend on income.

(5)Import Tax

In 1988 law, there was no stipulation about import tax exemption. At that time, the government did not have much knowledge about incentives for FDI or it could be a strategy of the government to manage FDI. In 1994 law, it stipulated that a foreign investment enterprise shall receive import duty and tax privileges of 1 % only for equipment, machinery, production and transportation vehicles necessary for use in its business production or construction within the project, but not imported for other purposes, and are not available in the country or do not have sufficient volume according to the needs of the foreign investment enterprise. In 2004, these were exempted from taxation. It is clear that the change of tax rate is a promotion for FDI. However, in 2010 law, there is no clear stipulation for exemption for import duties and tax because they cannot give much privilege to foreign enterprise by discriminating against domestic enterprises in terms of WTO regulations.

As mentioned above, incentives stipulated in the law was changed positively in accordance with promotion policy of the government. From 1988 law to 2004 law, incentives for foreign enterprises were much improved. However, in 2010, they have to consider not only promotion of FDI but also WTO. Therefore, some of incentives defined in previous laws were deleted or changed negatively for foreign enterprises.

3. 4 FDI trend and characteristics in Lao PDR

Before further going to analyze the trend and pattern of FDI in Lao I would explain some limitation of FDI data in Lao PDR. According to the foreign investment data in Lao PDR, it remains quite difficult to get an accurate and up-to-date profile of FDI activity (IMF, 2010). The disparity between the large amount of approved FDI inflow figures and the actual or committed FDI inflow figures are quite considerable, for instance, approved FDI projects take time to implement – some may never be implemented. The actual inflow of foreign capital for a certain year is therefore normally smaller than the amount of approved investments for the same year. IMF (2010) pointed out that government of Lao investment figures significantly overstate actual investment, as they include all approved projects regardless of whether the investment actually takes place. Both the World Bank and the IMF have lower estimates than Lao government figures. However, this study combined the figure from various sources to investigate the FDI trend and pattern in Lao PDR and in term of the FDI value of investment figure, this study mainly use the approval rather than actual FDI.

3.4.1 FDI from 1975 to 1988

As stated above, Lao PDR introduced first FDI law in 1988. Therefore, introduction and attraction of FDI into the country was begun after 1988, however, there were some related business activities from 1975 to 1988.

After 1975, some companies from former Soviet Union and China came to invest in Lao PDR and established some factories in manufacturing sector but there was no statistics in Ministry of Planning and Investment (MPI). MPI started collecting data of FDI systemically after introducing a law on FDI in 1988. Therefore, it is not exaggerated to say that foreign investment in Lao PDR was not begun until 1988. However, as for resource sector, Vilaihong (1999) indicated that there were some geological investigations for future investment in the sector done by former Soviet Union, Vietnam and east European countries.

For example, Vietnam did geological investigation from 1975 to 1980 and verified that there was iron ore deposit in Xiangkhouang province. Besides, from 1988 to 1989, Vietnam did geological investigation for lead and zinc in Vang Vieng district in Vientiane province. In case of former Soviet Union, they published a report that they verified 69 sedimentary gold deposits. From 1987 to 1989, they conducted primary investigation for oil and gas with Lao geologist. Even former Czechoslovakia conducted some investigations for sedimentary gold deposit in Oudomxay province and Xayabouli province along the Mekong River from 1984 to 1988.

However, those were the only investigation and there was no commercial operation in resource sector except gypsum, which was mined at Dong Hen deposit in Savannakhet province, and it was exported to Vietnam. Even though many countries knew that there are many mineral deposits in Lao PDR, they could not develop and invest for commercial production during 1970’s and 80’s. Also, as Soviet Unions and Eastern European countries collapsed in late 1980’s, technical and financial support for geological investigation was decreased dramatically. Instead, by opening up its country for western countries and FDI, international organizations and western companies started coming into Lao PDR.

3.4.2 FDI from 1988 to 1994

After introduction of the law in 1988, there was a positive trend of FDI. Table 3.1 illustrates that there were nine registered foreign investments in 1989 and registered capital was over $ 29 million. At that time, agriculture was the dominant sector of economy, which accounted for more than 60%. In 1989, comparing to 1988, GDP growth rate was 12.8% and growth rate of industrial sector was 35%, which was astonishing. Looking at the detail in nine investments, there were five investments in import-export sector, one in garment, one in banking, one in distillery manufacturing, and one in repair and sale of sawmill. All of them were in the form of joint ventures between Thai and Lao investors. Thailand is next door to Lao PDR and language of Lao and Thai is very similar to each other so that it is easier for Thai companies to invest in Lao PDR in terms of access and language.

In 1990, there were only six projects invested consisting of two investments in garment sector, one in consultancy, one in import-export, one in hydropower and one in motorbike assembly. Total value of registered capital was only US $ 3.8 million. Even though the amount of registered capital was less than previous year, the investments in industry and resource sector increased little by little. It surely affects GDP growth positively.

GDP growth rate in 1990 was 6.7%. By category, agriculture was 8.7%, industry was 16.2%, and service was -0.4%. Comparing to previous year, rate of 3 sectors decreased, especially service sector. Since industry sector grew at 16.2 %, which was the highest among the 3 sectors, it surely led economic growth and it could be understood that its high growth was supported by FDI in the sector. As mentioned above, there were some investments in industry sector such as garment and motorbike assembly which were never seen in the country.

Until 1994, which was the year of amendment of the law on FDI, number of investment and the amount of registered capital were basically increased. Along with this trend, GDP growth rate also increased except 1991 and 1993. In 1991, even though FDI was increased both in number and amount, GDP growth rate was 4.0%, which dropped from 6.7% in 1990. As can be seen in table 3.1, share of agriculture of GDP at that time was still 58.2% and growth rate of the sector was -1.7% so that decrease of GDP growth rate was affected by agricultural sector. In another words, if FDI were not increased, GDP growth rate would be much decreased than 4.0%. The same reason can be applied to the year 1993.

In 1994, the amount of registered capital was $ 1,313 million and it was the highest amount of FDI at that time. This was because of two big energy investments such as Theun Hinboun Hydropower Project in Borikhamxai province and Hongsa Lignite Power Project in Xaiyabuli province. The amount of registered capital is $ 280 million and $ 900 million respectively. This was the beginning of big investment in resource sector.

Table 3.1

FDI and Economic structure, 1986-1994

	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP（Real） Growth Rate (%)	4.8	-1.1	-1.8	12.8	6.7	4.0	7.0	5.8	8.1
Agriculture	5.1	-1.2	-4.2	9.9	8.7	-1.7	8.3	2.7	8.3
Industry	15.6	-16.0	-2.4	35.0	16.2	19.9	7.8	10.0	10.7
Service	-1.1	8.0	4.1	10.1	-0.4	6.5	3.9	7.7	5.5
Ratio by Industry（Nominal GDP)									
Agriculture	56.3	57.2	60.3	60.8	61.2	58.2	59.1	57.5	57.1
Industry	17.8	13.8	11.9	12.9	14.5	16.8	17.0	17.7	18.0
Service	24.8	27.4	23.7	22.0	24.3	25.0	23.9	24.7	24.9
Number of Approved FDI	—	—	—	9	6	21	39	67	67
Registered Capital of FDI ($million）	—	—	—	29.8	3.9	27.7	69	77	1,313

Source: Author based on:http://www.adb.org/Documents/Books/Key_Indicators/2009/pdf/LAO.pdf、
http://www.adb.org/Documents/Books/Key_Indicators/2003/pdf/LAO.pdf、Data provided By Ministry of Planning and Investment.

3.4.3 FDI from 1995 to 2004

As can be seen in table 3.2, since 1990s, FDI in Lao PDR has been increased in terms of both number and amount. In addition FDI had become the key important role in Lao PDR's transition to a market economy and contributed to the country's rapid economic growth during the 1990s. Of course, there are less approved projects and amount in some years. It depends on the situation but at least FDI in Lao PDR is in steady condition in 1990s. In 1995, number of approved project dropped from 67 projects in 1994 to 26 projects and the amount of registered capital also decreased but from 1996 onward, both figures increased constantly. It's believed that the rise in FDI in Lao PDR during 1990s aside from amended the FDI law in 1994; the rise in FDI also was associated with the global economic boom at that time, with increased FDI worldwide.

However, in July 1997, Asian Financial Crisis that occurred in the region brought about a slowdown in FDI and economic growth in Lao PDR, mainly through a slowdown in economic activity in Thailand, as a financial sector in Thailand was overwhelmed by the crisis. Lao economy was closely linked to Thai economy and FDI source was mainly from Thailand. Lao economy was also affected by the crisis as known in 1998 a year after crisis occurred. GDP growth rate in 1998 was 4% which is the lowest figure in these 20 years. However, seen in Table 3.2, number of FDI projects did not change much.

Yet in 1998, the amount of registered capital became highest ever at $ 1,459 million. This is because there was a Nam Theun 2 (NT2) Hydropower project in the year. NT2 has a generation capacity of more than 1000 MW and enables Lao PDR to export to the Electricity Generating Authority of Thailand (EGAT). It also supplies 75 MW of electricity for domestic use. The project is expected to generate annual revenues for the government averaging about $30 million (nominal) per year during the first ten years while commercial debt service is paid, then rising sharply thereafter to an average of approximately US$110 million (nominal) from 2020 to 2034. Therefore, this large project sustained economy as a whole. If there were no large project such as NT2, GDP growth rate would be much less than 4 %. It means that since mid of 1990s, FDI in resource sector has sustained Lao economy.

After the crisis, the amount of registered capital decreased dramatically in 1999, and it was back in 2000 but it decreased again in 2001. These up and down indicate that Thai economy, which is the biggest investor in Lao PDR, was not stable and it affected FDI in Lao PDR.

As shown in Table 3.2, it is able to say that FDI was back in track in 2002 or even greater than before. First of all, looking at GDP growth rate, rate was up and down from 1999 to 2001 but it became stable in 2002. Since then, GDP growth rate has remained at more than 6%. Also, number of FDI jumped in double in 2002. From the year 1990 to 2001, average number of FDI projects was 44 projects annually but the average number of FDI from 2002 to 2008 jumped up about 144 projects annually (table 3.3).

Considering the capital, it depends on the projects. If there are some big projects, the amount of capital increases but on the other hand, if there are only small projects, the amount is not high. Looking at the Table 3.2, we can see that even though the number of FDI projects was over 100 projects in 2003, however, the amount of registered capital was not corresponding to the number. But it is not an indication of unstable economy of the country. From macro-economic data, Lao economy as well as FDI was back in track in 2002.

Table 3.2

FDI and Economic Structure, 1995-2004

	1995	1996	1997	1998	1999	2000	2001
G D P（Real） Growth Rate (%)	7.1	6.9	6.9	4.0	7.3	6.3	4.6
Agriculture	3.1	2.8	7.0	3.1	8.2	4.2	-0.6
Industry	13.3	17.2	8.1	9.2	8.0	9.3	-1.5
Service	10.2	8.5	7.5	5.5	6.7	6.9	14.7
Ratio by Industry（Nominal GDP)							
Agriculture	55.0	52.9	52.8	53.3	53.7	48.5	45.5
Industry	19.0	20.0	21.1	22.5	22.6	19.1	18.3
Service	26.0	26.2	26.2	24.2	23.6	32.4	36.2
Number of Approved FDI	26	40	54	52	62	45	50
Registered Capital of FDI ($million）	842	335	748	1,459	294	537	395

Source: Author based on:http://www.adb.org/Documents/Books/Key_Indicators/2009/pdf/LAO.pdf、http://www.adb.org/Documents/Books/Key_Indicators/2003/pdf/LAO.pdf、Data provided By Ministry of Planning and Inves

3.4.4 High Growth Rate from 2005 to Present

As mentioned above, since 2002, the number of FDI projects doubled. This is because investment environment in the country has been improved and many foreign companies start looking at Lao PDR as a next destination for investment in the era of economic competition and integration. In 2004, FDI inflows have suddenly increased and reached almost US$ 507 million, and continued to increase until 2008. This increase was mainly due to the regional economic recovery from the crisis, and of course, amendment of the law on FDI in 2004 has offered more favorable environment to FDI. As a consequence, foreign mining companies began to increase production in the mining sector in Lao PDR. Moreover, the FDI inflows to Lao PDR continue to rise during this time as a result of ASEAN-Australia and New Zealand agreements on the trade and investment (Gunawardana and Sisombat, 2008). However, the global economic crisis in 2008 has made FDI to drop to around US$ 1,406 million in 2009. The decline of FDI was due to the delay of new hydropower and mining projects, as well as slow growth in the resource sectors (ADB, 2010). According to the 7th National Socio-Economic Development Plan (7th NSEDP) (2011-2015), Lao PDR has set a goal to attract FDI US$1.6 billion per annum for sustain economic development and to graduate country form poverty in 2015.

However, for GDP growth, especially from 2006 to 2010, according to the release at 9th Congress of the Party, average GDP growth rate during five years period was 7.9% per annum, and reached 8.4% in 2011[1]. Comparing with other countries in the region and even in the world, Lao PDR is one of the most rapidly growing countries. Some say it is new developing country. High growth in recent years began since the beginning of 2000s.

As stated above, Lao economy became stable in 2002 and investment environment was improved in the beginning of 2000s. In addition, entering into 2000s, economic structures were changed along with increase of FDI. Table 3.3, illustrates that

---

[1] GDP growth rate in 2011 is used in the study was estimated by WB. The figure of GDP in 2011 vary depend on source of information, according to IMF, GDP growth rate in 2011 is 8%

agricultural share of total GDP decreased from 53% in 1999 to 48% in 2000, and then, it decreased continuously that it only shares 30% in 2010. On the other hand, share of industry and service has been increasing. As for industry, its share of GDP has increased continuously since 1988, only in 2000, share dropped by three points and then, it increased again in 2002.

This structural change has occurred in many other developing countries too. As economy grows, and FDI comes into industry and service sector, structure of agricultural dominant economy shift into more industry and service dominant economy. Lao PDR is no exception. As Table 3.3 shows, structural change in economy in Lao PDR occurs along with the increase of FDI. However, agriculture is still important sector for Lao PDR because nearly 80% of population is still in the remote area and almost 75% of labour forces are engaged in agriculture for their livelihood.

Table 3.3

FDI inflow to Lao PDR, 2005-2011

	2005	2006	2007	2008	2009	2010
G D P（Real）Growth Rate (%)	6.8	8.7	7.8	7.2	7.6	8.4
Agriculture	0.7	2.5	8.6	2	2.5	4
Industry	10.6	14.2	4.4	10.2	10	12.5
Service	9.9	9.7	9.1	9.7	9	8.4
Ratio by Industry（Nominal GDP)						
Agriculture	36.7	32.4	33.4	32.1	31.1	30
Industry	23.5	29.8	28.3	27.8	28.9	31.4
Service	39.8	37.7	38.3	40.1	39.4	38.6
Number of Approved FDI	129	192	177	160		
Registered Capital of FDI ($million）	175	3,729.7	830.9	5,066	2,914	3,322

Source: MPI

3.5 FDI by industry composition, 2000-2011

Tables 3.4 illustrates that agriculture is still important in Lao economy. Agriculture is ranked number one in term of the number of FDI projects and it is ranked number three by the total value. FDI in agriculture sector partly reflects interest in rubber plantations. Recently, Lao government is trying to promote the contract farming instead of granting concession over large area for agriculture and rubber tree plantation.[1] However, looking at agricultural share of total GDP, its contribution to economy is decreasing.

The country's top largest investment sector from 2000 to 2010 remained mining and electricity generation (hydropower)[2] with an investment value of US$5.1 billion and US$ 4.6 billion respectively. The first substantial foreign investments were made in the garment and wood products industries in the early 1990s, telecommunications and hydropower took over some years later, and mining emerged as a major investment sector around the turn of the millennium. However, garment industry and telecommunications industry have lost shares over time, and hydropower and mining sector became the attractive sectors since the first concentration, which began in the early 1990s, when foreign investors began to explore for potential natural resources, notably in 1990 to 1993 (World Bank, 2003).

---

[1] interviewed with MPI's staff

[2] Major power projects under construction include NT2, Xeset2, Nam Ngum 2, Sekaman 3, Then Hinboun Expansion, Nam Lik 1-2 and Nam Ngum 5; main power dams in pipeline are Hongsa Lignite coal-power plant (the power purchase agreement (PPA) has been signed and construction of the plant is expected to begin in 2010 and complete by 2015), Nam Ngum 3, NT1, Nam Ngiep 1 and Nam Ou hydropower projects (construction of these projects is likely to begin by 2011 and 2012). Investment in the mining sector is also expected to resume from 2010 with the expansion of the Sepon project (recently approved expansion plan of US$64 million in total). See more in Appendix C

Table 3.4 FDI by industry composition, 2000-2011

Sector	Number of Project	Value
Mining	240	$ 5,122,469,310
Electricity Generation	27	$ 4,603,870,341
Agriculture	890	$ 2,364,880,107
Service	586	$ 2,281,612,033
Industry & Handicrafts	807	$ 1,911,221,976
Construction	111	$ 657,931,728
Hotel & Restaurants	374	$ 563,239,271
Banking	18	$ 240,763,622
Trading	230	$ 230,609,655
Wood Industry	178	$ 227,431,528
Telecom	13	$ 134,348,895
Public Health	10	$ 63,208,606
Consultancies	135	$ 59,651,659
Garment	47	$ 41,369,549
Education	64	$ 26,923,280

Source: the compilation is provided by MPI

3.5 Type of FDI in Lao PDR

Three different types of investment are recognized by the Law in Lao PDR as mentioned in previous section; 100% foreign-owned enterprise, joint venture, and business by contract. However, since 1988-2011 only joint venture and 100% foreign-owned enterprises have been the common types of FDI in Lao PDR, in term of capital registered and project implementation. For business by contract, this type of investment is rarely pursued by investors as it is not eligible for tax incentives and cannot be used for activities requiring a concession (DEDL Mekong, 2011). Table 3.5 shows the share in type of investment in

Lao PDR during 1988-2011, of which 100% foreign-owned accounts for greater share in term of number of project while joint venture accounts for greater share in term of value of investment accounts for 56% of total values. For the joint-venture investments, private sector and state owned-enterprises share almost the same amount of value.

Table 3.5 Type of Investment in Lao PDR, 1988-2011

Type of Investment	No. of Projects	Value (US$)	% of Total Value
100%Foreign Investment	1979	8,446,968,990	43.64203299
Joint Venture	1077	10,908,153,607	56.35796701
Total	3056	19,355,122,597	100

Source: By the author, based on data provided by Ministry of Investment and Planning

3.6 FDI by country of origin

Since 1988, Lao PDR has attracted investors almost from 53 countries. When looking at the major investors in Lao PDR, ASEAN investors have become the largest sources of FDI in Lao PDR. Vietnamese and Thai investors are among the largest investors in Lao PDR.

Thailand has been the dominant investor in Lao PDR since Lao PDR opened the country for foreign investor and it was the top of the list of investor in Laos from then until 2009 in term of approval investment. From 1988 to 2011, FDI from Thailand amounted to US$ 4 billion, which was estimated to account for 19.2% of gross total investment. However, according to latest data, Vietnam has replaced Thailand as the biggest foreign investor in Lao PDR, which investments accounted for US$ 4.8 billion on 436 projects, and accounted for 23% of total investment. Recently, investment from China has increased rapidly. China invests mainly in mining, hydropower, and rubber plantations. Thus, China has become a major investor as well with investments amounting to US$ 3.3 billion and ranked as the third in the list. As addressed by UNCTAD; Lao PDR naturally attracts Thailand, China and Vietnam due to their geographic proximity and the inherent interest in exploring a relatively untapped market. In addition, investment from South Korea is expected to grow in the near future. Lao PDR and South Korea signed a formal agreement to strengthen cooperation in mining, electricity and renewable energy in 2009 (UN, 2010).

Table 3.5 Approved FDI by Country of Origin (Top Ten Investors), 1988-2011

No	Country	Projects	Value of Investment (US$)	Percentage
1	Vietnam	436	4,852,140,452	23.1852532
2	Thailand	741	4,020,037,334	19.2091685
3	China	804	3,332,270,043	15.9227717
4	South Korea	287	619,928,170	2.96223734
5	France	226	508,449,428	2.42955225
6	Malaysia	96	417,108,773	1.99309411
7	Japan	106	414,937,461	1.9827188
8	Australia	90	391,678,812	1.87158071
9	India	22	150,604,702	0.71964284
10	America	112	147,192,467	0.70333797

Source: Ministry of Investment and Planning

3.7 Concluding Remarks

The chapter summarized and analyzed about law on FDI in Lao PDR. Since establishing the first law on FDI in 1988, Lao PDR amended it 3 times, in 1994, 2004, 2009. Comparing 4 laws, we can observe trend and policy of the government toward FDI. First, even though the government needs FDI for recovery from the war, their position toward FDI was ambiguous. From analysis, it can be said that the government had an intention to control FDI more strictly than that today. However, entering into 1990s and since they have new national goal for graduation from LDCs, they start attracting FDI more than ever and established favorable environment through amendment of the law.

However, as Lao PDR faces with WTO, they have to change the law corresponding to WTO requirement, which is equalization between domestic and foreign companies. Therefore, law amended in 2009 was not favorable to foreign companies in some parts. However, since 1988, investment environment in Lao PDR has been improved overall, and FDI has been coming into the country and increasing over the decade.

Overall, agriculture is one of the most invested sectors in terms of both number of projects and value. However, since mid 1990s, mining and electricity have become the key sectors for both FDI and economy as a whole. During Asian economic crisis, big investment in electricity sustained Lao economy and lessened influence of the crisis. Entering 2000s, along with the increase of FDI, economic structure has also changed and it can be observed that FDI in industry and service sectors can be a factor for the change. Especially, in industry sector, according to statistics from 2000 to 2011, Mining and electricity generation may be the most influencing sector today.

CHAPTER IV

FDI IN NATURAL RESOURCE SECTOR AND ITS IMPLICATION ON LAO ECONOMIC DEVELOPMENT

4.1 Introduction

There has been an intensive debate on the role of FDI in economic development in host countries, especially in developing economies by providing capital, foreign exchange, technology, competition and by enhancing access to foreign markets (World Bank, 1999; Caves, 1974; UNCTAD, 1991). Therefore, in general, the implication of FDI is summarized as FDI contribute to economic growth; exports, imports and balance of payments; foreign exchange earnings and reserves; technology diffusion and transfer; human capital development and training and skills development; job creation; employment and labour relations.

As stated in chapter 3, overall trend in FDI in Lao PDR is very positive, and especially in resource sector, there are massive FDI in that sector which influence on economy of the country. It is not exaggerated to say that resource sector is a key leading sector of the economy. Recent economic growth cannot be accomplished without that sector.

It has been more than a hundred year that many countries are interested in resource sector in Lao PDR. In old times, during colonial period, one of the purposes of the French was to exploit mineral resources in Lao PDR. China and Vietnam had such interest too. However, because of lack of human and capital resources and civil war, they could not develop resource sector in Lao PDR. After establishment of Lao PDR in 1975, the country still didn’t open its country to outside world and there some geological investigation of former Soviet Union and East European countries as well as Vietnam. It was in late 1990s that investment environment in Lao PDR was improved and many foreign companies started investing into the sector.

This chapter investigated the FDI in resource sectors, which means mining and electricity generation, and analyzed how resource sector contributes to Lao economy. Moreover, this chapter also discusses the negative impact of these sectors.

4.2 FDI in Natural Resource Sector

Initially, inward investment flowed into the manufacturing and service sectors; however, the natural resource sectors, particularly hydroelectric power and mining have recently dominated market investments. Many concessions and licenses have been given. The energy sector, especially hydropower, where foreign companies are already present, remains largely untapped. It is estimated that Lao PDR has a potential to generate about 26, 500 MW from hydro sources but only about 10% of which has been developed. Also, Lao PDR is likewise abundant in mineral wealth. As only 30% of territory has been exploited, there are promising opportunities awaiting future investors.

4.2.1 Mining Sector in Lao PDR

Lao PDR has variety of undeveloped mineral resources. Recently, the mining sector is one of the biggest contributors to national revenue in Lao PDR and plays a key role in the Government of Laos’s (GOL) economic development strategies. It is also one of four priority sectors for investment and industrialization[3] (Voladet, 2009).

[3] the others being energy, agriculture and tourism

As mentioned in Chapter 3, there were some geological surveys from 1975 to 1990 by socialist countries. However, since former Soviet Union collapsed and democratization occurred in Eastern Europe, investigations stopped. Instead of those socialist countries, because of opening up the country, international organizations and western countries were coming into Lao PDR.

According to Sugimoto (2010), British geological department made a geological map of 1: 1,000,000 in Lao PDR covering all over the country. It pointed out 479 mineral sites in the country. In the same years, British geological department started geological investigation in Lao PDR supported by Asian Development Bank (ADB). In 1991, UNDP and Lao geological department surveyed for barites in Vientiane province. State Coal Mining Enterprise got a concession in the area and started producing and exporting to Thailand.

Not only international organizations but also private companies started coming into Lao PDR. Companies in neighboring countries started investing in mineral sector in Lao PDR. In 1994, joint venture of Yunnan Corporation for International Techno-Economic Cooperation of China and State Agriculture Industry Development Enterprise Imp-Exp & General Services of Lao PDR started operating cement factory in Vientiane province. Thai company, Vieng Phoukha Coal Mine started exploitation of coal in Luangnamtha province in 1994.

Because of this situation, Lao Government established a law on Mining in 1997. As mining sector become main strategy for economic development of Lao PDR, GOL, has improved the legal framework to make the country more attractive as an investment destination for foreign investors thus, in 2008, the National Assembly passed a new version of its mining law, which promulgated by President in 2009. The new law aims to ensure the efficiency of the exploration, mining and processing of minerals in conjunction with environmental protection and socio-economic development (Lao PDR

National Assembly, 2010) [4]. However, the implementation documents have not been completed therefore, it is has been said that in the past three years mining sectors have an uncertain period.

According to the Mining Law in 1997, the law did not satisfactory guaranteed for assets and other rights of foreign companies, some barriers were created for mining development by current mining laws itself, for instance, government must have equity in FDI mining projects, but government equity is not well defined. In addition, unless the government decides otherwise, assets including machines, facilities, which belong to foreign companies, shall became government property when the company withdraws or dissolve (Kyophilavong, 2008). Moreover, rate of royalties and income tax[5] was decided by negotiation with the government, and different terms and conditions are negotiated for each and every mining project. Therefore, these constraints discourage investors from even starting exploration, and even though geological surveys were continued in late 1990s, the mining sector was not activated until 2000s.

Lane Xang Minerals Limited, which was 100% subsidiary company of major mineral company Rio Tinto, started prospecting gold and copper in Sepon Mines in Savannakhet province.[6] Also in 1994, Phu Bia Mining Limited got a concession of gold and copper mines of 5000 km2 in former Xaisomboun Special Zone (Vientiane Province at present) and started prospecting. These two big companies are operating and contributing to Lao economy today.

[4] The new law consists of 7 parts with 104 articles. Its purpose is to define principles, rules and measures regarding the management, preservation, and utilization of minerals and minerals resources; and monitor mineral activities, aiming to ensure effective prospecting, exploration, mining and processing of mineral in conjunction with environmental protection. These activities should also be consistent with the national socio-economic development plan, in order to create the conditions for gradual economic growth, industrialization, and modernization; sustainable mineral development; and improvements in multi-ethnic people's living conditions.

[5] The range of tax rate for mining project is usually between 40%-50%

[6] More informationon Sepone Mine see Appendix B

As of 2000, gypsum and tin were the main products of mining sector and besides these, there were barites, coal and sapphire, which can be exploited with low technology and capitals. Most of the mines were still under investigation at that time.

It was 2003 that mining sector of Lao PDR entered new phase. Lane Xang Minerals started producing gold in 2003 and also started producing copper in 2005. At that time, some investigations also finished and moved to production. In 2005, Lao-China Oriental Minerals Development started operating copper deposit in Louangnamtha province. Pan Australian Resources started producing gold in 2006, and copper in 2008 at Phu Kham mining deposit.

As of 2010, there were 269 projects (82 prospecting phase, 110 exploration phase, 74 exploitation phase) and three Feasibility Study (FS) phase, held by 36 domestic companies (83projects) and 119 foreign companies (186 projects). Foreign concessions holders include 59 Chinese companies (102 projects), 38 Vietnamese (55 Projects), six Thai (7 projects), four Australian (7 projects), four South Korean(5 projects), one Canadian (1 project), one German(1 project), one Indian (1 project), one Japanese(1 project), one British (1 project) and three Russian companies(6 projects), and existing companies must be able to expand their operations in the future in order to achieve the government's goal (Boungnaphalom, 2010).

Table 4.1 FDI in Mining Sector since 2000

Year	Value	Total FDI	Share of Mining
2000	$ 1,584,400	$ 537,294,000	0.29%
2001	N/A	$ 395,041,000	N/A
2002	$ 750,000	$ 1,423,852,000	0%
2003	$ 14,770,000	$ 144,668,000	10.2%
2004	$ 31,624,572	$ 506,541,000	6.2%
2005	$ 40,460,463	$ 175,354,000	23.0%
2006	$ 68,135,110	$ 3,729,702,000	1.8%
2007	$ 70,678,043	$ 830,961,000	8.5%
2008	$ 2,159,512,461	$ 5,066,782,658	42.6%
2009	$ 285,987,713	$ 1,406,751,937	20.3%
2010	$ 667,345,921	$ 2,914,314,272	22.8%
2011	$ 1,781,620,625	$ 3,322,836,164	53.6%

Source: Author based on data provided by MPI.

According to Table 4.1, FDI in mining sector increase since 2003 continuously. When there were some big investments from Vietnam, China and Thailand in the sector the value in the year was high comparing to the other years. However, overall, it has been increasing continuously. In the year 2006 and 2007, its share was low comparing to the other year because FDI in electricity generation was so high. Its share was 54.5% and

30.3% respectively. Therefore, even though the share of total FDI of mining sector decreased, it increased in electricity generation sector instead. It means that FDI in resource sector shares nearly half of total FDI.

4.2.2 FDI in Electricity Generation

As stated in Chapter 3, electricity generation is the second largest sector of FDI in the country. Besides minerals, Lao PDR has a comparative advantage in electricity generation. Lao PDR is endowed with water resources and enjoys a strategically advantageous location within the GMS. Moreover, there are many branches of Mekong River in the country so the strategy of the government of Lao PDR is to develop its hydropower resources to earn export revenues from neighboring countries, especially Thailand, and to meet the steadily growing need of domestic production and consumption

Becoming the "battery of Southeast Asia" through exploiting its power potential has been a longtime dream of the Government of Lao PDR (GOL) and its backers (Lao PDR, 2010). In 2000 the first Power Sector Strategy was developed. According to the strategy, the two overall aims are to: "maintain and expand an affordable, reliable and sustainable electricity supply within the country to promote economic and social development; and to promote power generation for export to provide revenues to meet the development objectives" (Lao PDR 2001). However, the capital investments needed for large hydropower projects were beyond the capacity of Lao Government. On this basis, and in line with the new economic policy, the government has begun since the beginning of the 1990s to seek the participation of foreign investors in projects. Therefore, foreign investors started to invested in this sector in the beginning of 1990s together with mining sectors.

Recently, only about 10% of the country's hydropower potential had been developed over the last 30 years**.** Main foreign investors in hydropower in Lao PDR are Thai, French, and Korean, Chinese and Malaysian companies. Lao PDR has also signed an MOU to provide 7,000 MW of energy after 2015 to Thailand, and 3,000 MW of electricity to Vietnam until 2020. Large and long-term investment has started to expand in this sector, including the Nam Theun 2[7] hydroelectric project. It is estimated that the investment in this sector alone could reach US$ 5.2 billion over the next five years.

[7] More details of project see Nam Theun 2 power Co. Ltd (http://www. namtheun2.com)

Table 4.2 FDI in Electricity Generation

Year	Value	Total FDI	Share
2000	$ 500,000,000	$ 537,294,000	93.0%
2001	$ 360,000,000	$ 395,041,000	91.1%
2002	$ 1,295,000,000	$ 1,423,852,000	90.9%
2003	$ 0	$ 144,668,000	0%
2004	$ 5,000,000	$ 506,541,000	0.98%
2005	$ 5,250,000	$ 175,354,000	2.99%
2006	$ 2,017,102,200	$ 3,729,702,000	54.0%
2007	$ 350,539,385	$ 830,961,000	42.1%
2008	$ 830,000,000	$ 5,066,782,658	16.3%
2009	$ 288,660,000	$ 1,406,751,937	20.5%
2010	$ 457,110,341	$ 2,914,314,272	15.6%
2011	$ 35,100,000	$ 3,322,836,164	1.05%

Source; Author based on data provided by MPI.

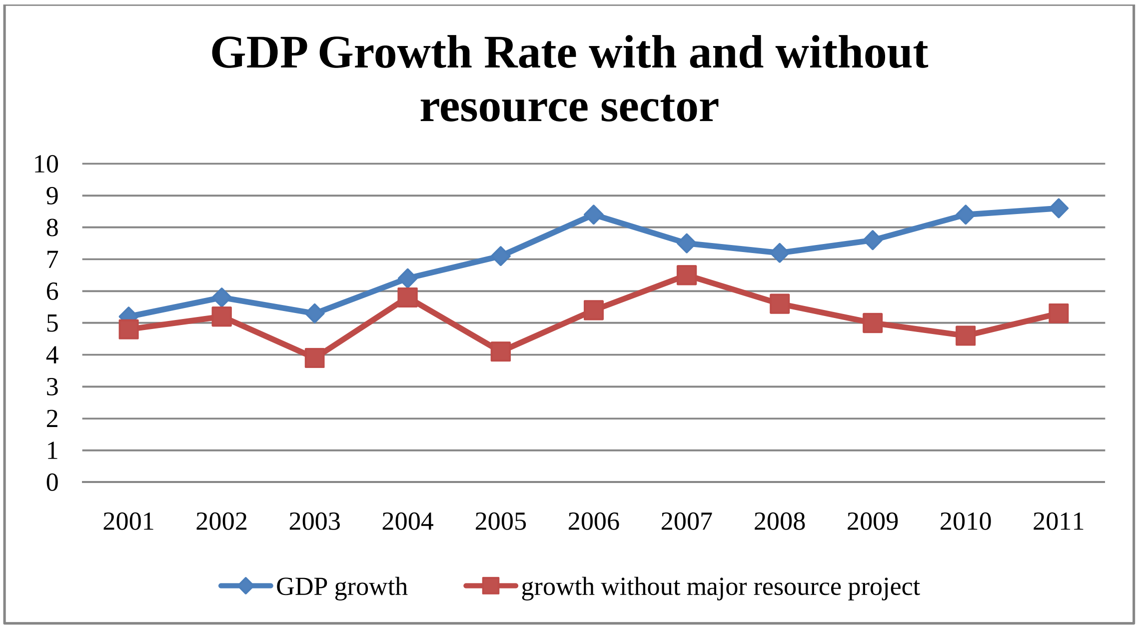
Table 4.2 shows FDI flow to Lao PDR in electricity generation from 2000 to present. There are up and down in the amount of FDI electricity generation because there are some big projects in some years and there are not in some years. In 2003, there was no investment in the sector. However, last 10 years, electricity generation sector has sustained Lao economy especially at the beginning of 2000s. First three years of 2000s, there was not much investment in FDI in mining sector. Instead, investments in electricity generation sector shared more than 90% of total FDI. Since then, the share decreased but it shared certain amount of total FDI. Share of FDI in electricity generation together with mining sector, the share was more than 50 % of total FDI in the country.

4.3 The Implication of FDI in Resource Sector on Economic Development in Lao PDR

According to the 10 year socio-economic development plan (2001-2010), the plan stressed the importance of FDI, It is necessary to be aware that FDI is an organic part of the economy and will be further developed in parallel with the country’s socio-economic development process. As shown in the chapter 3, GDP has positive direction with FDI. A large part of GDP high growth rate period came from increased foreign investment flows in industrial sectors, particularly in mining and hydropower sectors.

Natural resource sectors especially FDI in hydroelectric power and mining sectors are boosting GDP growth. Figure 1 illustrates that these sectors contribute almost three quarters of GDP. The contribution of the resource sectors to economic growth has increased significantly in the past five years and projected to drive future growth. Large mining and hydropower projects, through both direct and indirect effects on economic activity, have been key contributors to the country’s solid growth record of 7.5% per annum over the most recent period, 2004-10 (Figure 1), particularly when global copper prices were at their height in 2005-06. The natural resource sector’s contribution to GDP growth increased from approximately 2.8% in 2009 to 3.7% in 2010. Between 2011 and 2015, the sector is expected to grow 3 percent, and up to 3.5% between 2016 and 2020 (World Bank, 2011). It has been noted that the role of natural resources in Lao PDR’s economy is greater than in any other countries of the GMS (Bann, 2011).

Figure 1:



Source: estimate staff, recent project, World Bank, 2011.

Note: estimated figure for year 2011

As FDI increases, it contributes to economy. If FDI in resource sector increases, it can be a main factor contributing to the economy. Take a broad look at correlation between economic development and FDI in mining sector. Table 4.3 shows the share of mining and electricity generation sectors in total GDP. Share of mining sector in GDP has been increasing continuously. GDP share of mining sector increased in 2003. It was along with increase of FDI in that sector. Since then, the contribution of mining to GDP has risen significantly until 2006. After 2006, the number was up and down because of Asian Economic Crisis but it has shared certain amount of value. As of 2011, it is estimated that the mining sector's contribution to GDP has risen to around 9% (ICMM, 2011). According to the table, it is indicated that FDI in Mining sector started influencing country's economy in the beginning of 2000s.

For electricity generation sector especially hydropower sector, even though according to the figure in table 4.3, the share in GDP is lower than mining sector but based on the potential of large hydropower project such as the Nam Theun 2 (NT2) hydroelectric power project, it will contribute a significant amount to GDP in the future. According to IMF (2010), it is stressed that NT2, not only has the potential to alter the FDI landscape of the country, but will provide significant benefits to the economy of the Lao PDR. The large foreign investment inflow, estimated at approximately $1.3 billion, is expected to generate a sizable income stream for the next three decades and beyond. Through taxes, royalties and dividends, the people of the Lao PDR stand to be significant beneficiaries, as long as these revenue streams are well managed.

Table 4.3 Share of Resources Sector in GDP (US$1000)

Year	Total GDP	GDP in Mining		GDP in Electricity Generation	
	(Current Price)	Current Price	Share in GDP	Current Price	Share in GDP
1998	4286	8.2	0.20%	124.7	2.91%
1999	9972	19.3	0.20%	389.7	3.91%
2000	12917.5	25.9	0.20%	565.2	4.38%
2001	14854.2	32.1	0.20%	689.2	4.64%
2002	17682	45.1	0.20%	865.3	4.89%
2003	21287	562	2.60%	929.5	4.37%
2004	25151.5	507.8	2.00%	1079.2	4.29%
2005	28947.8	1674.8	5.80%	1027.3	3.55%
2006	35980.9	4543.7	12.60%	1090.5	3.03%
2007	40467.1	4245.3	10.40%	1058.9	2.62%
2008	46214.7	4595	9.90%	1114.7	2.41%
2009	47566.6	3220.4	6.70%	1253.7	2.64%
2010	54282.6	4027.1	7.40%	1999.6	3.68%

Source: ADB, *Key Indicators 2011*.

4.3.1 FDI and Government Revenue

Another macro-economic impact of FDI flows is their contribution to the government budget and therefore to reducing the fiscal deficit.

The revenues from mining and electricity generation come from many different sources, including: land fees, royalties, profit tax, turnover tax, and personal income tax. Apart from taxes and royalties, the government also receives dividend payments from those sectors in which it holds on equity stake of 10% from two big mines companies: Phubia Mining and Sepone Mine Company. The mining sector is one of the biggest contributors to national revenue in Lao PDR and plays a key role in Government of Lao's economic development strategies. It is also one of four priority sector for investment[8].

Table 4.3 General Government Revenue, 2002/03-2007/08 (Unit: Billion Kip)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Revenue	2,345	2,822	3,387	4,266	5,341	6,436
Tax	1,928	2,337	2,803	3,641	4,721	5,624
Direct Tax	365	401	522	693	1,170	1,655
Profit Tax	225	222	307	459	919	1,322
Mining Sector	0	0	0	73	477	805
Hydropower Sector	0	0	45	42	39	65
Others	225	222	263	344	403	451
Income Tax	140	179	215	234	252	333

[8] Four priorities sectors for investment consist of mining, energy, agriculture, and tourism.

Table 4.3 (Con't) General Government Revenue, 2002/03-2007/08 (Unit: Billion Kip)

Indirect Tax	1,562	1,936	2,281	2,948	3,550	3,970
Turnover Tax	466	594	673	887	1,046	1,229
Excise Tax	293	483	523	800	999	1,191
Import Duties	316	351	429	515	573	674
Royalties	286	289	341	447	529	474
Natural Resource Tax	23	32	95	218	274	308
Hydropower royalties	45	32	57	57	43	56
Timber royalties	218	225	189	172	212	110
Other	417	484	584	625	620	401
Nontax	417	484	584	625	620	811
Dividends	87	106	178	175	157	293
Mining and hydropower	0	0	42	42	32	243
Overflight revenues	174	198	222	229	231	235
Other	156	180	185	222	232	283

Source: IMF (2008, and 2009)

Table 4.3 illustrates the contribution of resource sectors in government revenue. Since 2006/2007, mining sector started to contribute to government revenue significantly via taxes, royalties, and dividends being paid by two big mines companies. There was no tax revenue from mining and electricity generation sectors in FY 2002/03 and 2003/04. There were no dividends either. There were only royalties from both sectors, which means that there were some projects in the sectors but they were not doing commercial production yet. As for mining sector, the government started collecting profit tax from mining sector in FY 2005/06. Tax came from Sepone Gold Mine in Savannakhet province because they could begin commercial production in 2003. Since then, because of high price of the gold in world market, profit tax from Sepone Gold Mine increased significantly in FY 2006/07. Mining sector contributed to government revenue 477 billion kip, which increase almost 6 times from FY 2005/06, and reached 805 billion kip in FY 2007/08, which was about half of the total profit tax. The dramatic increases in 2008 due to high global copper prices that led high income to two big mines companies In 2010, Sepon mine only generated revenue to GOL around US$ 159 million[9]. According to ICMM report, the contributions of big mining projects to government revenue are estimated to reach around US$ 166 million annually for the period 2011-14, and rising to around US$ 215 million for the period 2015-19 (ICMM, 2011).

Also, since FY 2004/05, there has been dividend from mining sector. Dividend is coming from state owned enterprises which are operating mining projects with foreign companies. In Lao PDR today, almost all the mining projects are done by joint venture between state owned enterprises and foreign companies. In most cases, Lao provide land for share. From FY 2004/05 to 2007/08, dividend from mining sector has been increased 5 times. It is estimated that the cumulative revenues of the mining sector will total US$ 2 billion by 2025, and this would be roughly account for 25% of GDP[10] (United Nation, 2010).

For electricity generation sector, since March 2009, Nam Theun2 (NT2), which is the biggest hydropower in the country, started operation. In June of the same year, the government got revenue of $ 600,000 from NT2. Also, from March 2009 to December 2010, NT2 paid concession royalty of $ 9.13 million to the government. In next 20 years. NT2 is expected to bring $ 2 billion to the government. Therefore, electricity sector is and will be one of the most important sectors for economic development in Lao PDR.

[9] For more information see “Sepon Today”, the newsletter of MMG LXML Sepon.
[10] See more Final Report, sector Plan for Sustainable Development of the Mining Sector in Lao PDR, a study commissioned by the World Bank to the Mitsui Mineral Development engineering Co. Ltd. (MINDECO).

With large public revenues from mining and hydropower flowing to fiscal accounts as a consequence government's fiscal deficit has reduced significantly (World Bank, 2011).

4.4.3 Export performance

The FDI flows especially in resource sectors have contributed to Lao's exports by providing necessary investment capital, know-how and modern technology, and access to international markets. Contribution of resource sector to economy is proved by export of that sector.

Figure 2 Foreign Trades in Lao PDR

Source: Ministry of Industry and Commerce

Lao export grew rapidly since 2000, even though foreign trade continued to be in deficit but foreign trade development appears to be following a positive trend, as increasing in export is result in decrease of trade deficit (figure 2). In 2009, overall export decreased sharply due to a sharp declined in mining exports but then grew up again by almost 59% in 2010, and total exports are estimated to increase to 72% by 2015. The growth of total exports are driven largely by export of electricity and mineral (main mineral products are copper, and gold). Thus, it can be said that natural resources have therefore become the largest and fastest growing export in Lao PDR and contributed to the fast growing of foreign trade in the last decade.

Table 4.4 shows export value of mining and electricity generation sectors. Table 4.4 shows that, at the beginning of 2000s, export of minerals was only 1.2% of total export. However, since FY 2002/03, share of minerals in total export value has increased constantly. Today it shares more than 50% of total export of the country. Even though increase of price of metals in the world market is the main reason for rapid increase of export, increase of export of minerals can bring hard currency into the country.

As for export of electricity, electricity exports have been important since the late 1990s and several ongoing hydropower projects will increase the sector's export capacity in the future. Table 4.6 shows export value of electricity since 2001/02. Before increase of FDI in mining sector and starting commercial production of that sector, main export of Lao PDR was electricity, timber, forestry and agricultural products. These three products shared more than 70% of total export. Of these, electricity was the biggest products of the country. As shown in Table 4.4, during the beginning of 2000s, it shared more than 20% of total export and most of them were exported to Thailand.

When look carefully, the export of electricity from 2005/06 to 2007/08, the share dropped but the amount of export did not much change as before. It is probably, the decrease of share happened because share of minerals increase during the same year. Since 2008/09, amount of export value of electricity has increased again and its share also has increased. Electricity exports are expected to reach US$ 341 million in 2011 and US$500 million by 2012. Therefore, together with minerals, export of resource sector shares more than 70% of total export. The increases of export revenue are considered financially sustainable revenue for Lao government to meet poverty reduction project. It is needless to say that the sector significantly contributes to whole economy.

Table 4.4 Export Value in Mining and Electricity Generation

Year	Minerals		Electricity		Total Export
	Value	Share	Value	Share	
2001/02	$ 3,903,928	1.20%	$ 92,694,000	28.70%	$ 322,618,759
2002/03	$ 46,502,906	13.20%	$ 97,360,000	27.60%	$ 352,624,287
2003/04	$ 67,435,528	18.00%	$ 86,295,297	23.00%	$ 374,320,000
2004/05	$ 128,353,401	28.20%	$ 94,629,997	20.70%	$ 455,624,613
2005/06	$ 485,632,486	55.30%	$ 101,190,281	11.50%	$ 878,008,548
2006/07	$ 545,830,904	59.00%	$ 72,110,283	7.70%	$ 925,567,566
2007/08	$ 774,239,181	69.20%	$ 97,133,745	7.40%	$ 1,307,459,552
2008/09	$ 523,610,734	46.50%	$ 274,592,635	24.40%	$ 1,124,402,537
2009/10	$ 1,048,524,074	58.60%	$ 288,996,579	16.10%	$ 1,788,937,756

Source: Author elaborated data from Ministry of Industry and Commerce, and data provided by IMF

Moreover, resource sectors not only provide direct but also provide indirect contribution to Lao economic development as a whole. As discussed above the direct contribution is the sector's output from the production phase, which include mineral products from mining (copper, gold, silver and others) and electricity from the power sector, which increase the total export and government revenue. Mining and hydropower projects can help households escape poverty is by providing employment and income opportunities, either directly in project employment, or in businesses that related to those sectors. For example, in two big mining companies: Sepon and Phubia mines have made contribution to job creation in local communities. The two mines have played a significant role in improving and supporting the new development of local businesses that involve to the mine, for example, food production, farming, restaurant, and so on. Although these jobs will employ a small percentage of the total labor force, they tend to provide higher and more stable incomes than subsistence agriculture. Moreover, increased Government revenues which are then spent on the implementation of the Poverty Reduction Strategy, for instance, a large portion of the GOL's revenue from mining sector is allocated to trust fund for Community Development therefore, poverty headcount had been reduced significantly for more than a decade, the national poverty line fell from 46% of the population in 1992 and 1993 to 28 % in 2007 and 2008 to 26% in 2010(World Bank, 2011).

However, even though mining and electricity generation contribute to job creation, and expected to increase but employment in these sectors is likely to remain small. In addition, jobs connected to mining and hydro projects tend to be concentrated in the construction period of the project and are usually available for a limited period of time.

4.5 Negative Impacts

As mentioned above, by expansion of mining and electricity generation projects Lao PDR gain high benefits from such as revenue from that sector also increase due to increasing tax collection and royalties from investors and it contributed to finance of government. Foreign trade and GDP grow rapidly. As export of minerals and electricity increases it will bring hard currency to the country. It means resource sector influences whole economy of the country very positively. However, aside from positive benefits by developing mining and hydropower, they would bring negative impact on environment and society as well as on Lao economic development in the long run.

First of all, everybody knows that minerals will be drained in the future. Therefore, depending on mineral for economic development is not sustainable for long time. It means that as minerals are exploited, tax revenue from the sector also end up. Operation period is depending on amount of deposit and mining speed. For example, Phu Kham gold deposit in Vientiane Province is expected to be drained in 12 to 14 years[11]. During 12 to 14 years, the government can receive tax revenue from Phu Kham deposit and can export gold to world market. Of course, it will bring many benefits to the government financially. However, since most mining output is export-oriented, issue on how to sustain economy will occur after the declining of production. Moreover, after exploitation, they cannot get anything but there will remain dug land. In another word, there will be land problem in the future.

Economic vulnerable can appear in the future as can see in table 4.3, revenue of the government. In FY 2007/08, in total revenue of 6,346 billion kip, resource sector shares approximately about 23%. As for mining sector, it shares approximately about 17% of total revenue. Even so, mining sector shares 17% of total revenue. But according to above argument, it is not sustainable for long time; therefore it is not exaggerated to say that 17% of the revenue will disappear in some way or another. If it happened, it surely gives negative impact to the economy.

Same things will happen to export sector. Table 4.4 shows export value of mining sector. It shares more than 50% of total export of the country today. This amount of export will not be sustainable either. Mining sector's share in total value is larger than that of tax revenue. Therefore if mining sector is not sustainable and export of minerals will be decreased largely, it will give massive negative impacts to economy.

[11] Website of Info mine (http://www.informaine.com/index/pr/Pa921293.PDF)

On the other hand, electricity sector is much more durable than mining sector. However, there is a problem of demand and price. More than 95% of electricity generation in Lao PDR is exported to Thailand. Because of single market, electricity export of Lao PDR is depending on Thailand, there are two problems. First problem is demand. Today, Lao government and Thai government made an agreement to export of electricity to Thailand from Lao PDR but if the demand of Thailand decreases, Thailand may not import electricity from Lao PDR the amount upon which they made an agreement. Also, price is a problem. Even though the price of purchasing is decided by between Lao PDR and Thailand and made in agreement, if economic situation in Thailand is devastated, they may suggest price reduction. Depending on single market is always with some kind of risk.

In addition to above problems, both mining and electricity sectors face problem of land and environment. It already happened in many areas of the country. Some impacts have already been observed by both NGOs and International Organization in mining projects such as: water pollution, massive siltation, toxic metal discharges and groundwater pollution. Hydropower plants also termination migratory activities in the area which will result in a desperate need for food by the people who depend on fish as their main staple of survival. Moreover, usually foreign investment project in mining and electricity project needs massive land area. Therefore, almost every project makes big concession agreement with government. In that case, people are likely to be moved from project areas. They need compensation and new area for living. However, people usually complain about amount of compensation and other supports from the government.

In National Assembly in 2009, there were some reports that foreign companies did not return land to people even after the expiration of the agreement. Also, people are forced to accept compensation price offered by the company. Their problems happen around the country and the number of the case is increasing.

Environmental problems are always pointed out by international organizations and NGOs. Most recent case is Xaiyabuli Dam Project. This is a large project which is planned to construct a dam in mainstream of Mekong River. This is the first time that Lao government plans to construct a dam in mainstream of Mekong River. They made an agreement with Thai company for purchasing and construction of the dam. Therefore, electricity produced by that dam will be exported to Thailand. However, Vietnam and Cambodia oppose this plan because they insist that the project will give negative impact to Mekong Delta in terms of biodiversity which eventually brings adverse affect to life of the people in that area. Also, many international NGOs raise their voice against the plan. In 2011, Mekong Committee discussed the plan and they decided to postpone the plan due to lack of studies on social and environmental impact.

4.4 Concluding Remarks

This Chapter analyzed correlation between FDI in resource sector and Lao economy. From statistics about FDI in minerals and electricity, statistics of GDP share by industry, statistics about government revenue, and statistics about export, It can said that increase of FDI in resource sector contributes to economy as a whole. Since 2002 or 2003, FDI in resource sector has increased and along with this trend, share of resource sector in total GDP, revenue and export from the sector has also increased. Increase of revenue from resource sector certainly contributes to government finance. Also, increase of export of the sector contributes to get hard currency. These increases in some important economic factors surely stabilize macro economy of the country. At present, both mining and electricity sectors brings significant benefits to the government especially on finance. However, there also are some problems which mentioned above. As Lao PDR depends on resource sector, they always have to take some risk.

CHAPTER V

DISCUSSION AND CONCLUSION

5.1 Summary of finding

This study is aimed at understanding the FDI situation in Lao PDR, and the role of FDI in economic development in Lao PDR by focusing on resource sector.

After establishing Lao People's Democratic Republic in 1975, Lao People's Revolutionary Party set a goal for building a socialist country; therefore, they confiscated factories and financial institutions. Then, they started collective farming in order to increase production. However, their socialist way of economic development was a failure and they realized that they had to change their course. In 1979, The Seventh Resolution, passed at 7th plenary session of the 2nd Central Committee by the ruling LPRP, marked the start of the country's shift toward a market-oriented economy. The resolution affirmed the government's commitment to utilizing a market economy, as the necessary path to economic development. A change in economic policy was necessary (Stuat-Fox, 1996). At the plenum, Kayosne Phomvihane, who was a general secretary of the party, said that there were five economic sectors in Lao PDR such as sate economy, collective economy, state capitalism, individual economy, and private economy. Kaysone said that state and collective economy played a central role in five economic sectors but he also said that they would use all the sectors in order to expand production. It means that even though LPRP confirmed in 1975 that they would proceed to Socialism not through the stage of Capitalism, they changed their Socialist aim by introducing "market principles."

This reform was confirmed at 4th congress of the party in 1986 and defined formally in constitution in 1991. Constitution formalized the establishment of market-oriented economy, explicitly permits private enterprise and foreign investment, and defined many important principles of the country. Even though law on Foreign Investment was implemented in 1989, this establishment of the constitution was a threshold of FDI in Lao PDR. It should be noted that country's investment policies are major role in attracting FDI to invest in the host country. Therefore, there has been significant improvement over the past decade in Lao's legal and institutional framework for the approval and monitoring of foreign investment. Investment incentives have also been revised and streamlined. FDI inflow to Lao PDR has a positive trend, during 1989 and 2011, Lao PDR has received a total inflow FDI nearly US$ 20 billion. The increase of FDI reflected the country's ability to attract FDI and the successful of the investment incentives, which provided by government.

As environment of receiving FDI was improved, FDI coming into Lao PDR has also increased. In 1996, the Party set a new goal for nation building, which is graduating from least developing country's status by the year 2020. This is one of the most important aims of the country today. In order to achieve the aim, they have to develop their economy at the higher pace than before. Because of this reason, Lao government needs much more FDI than before and they actively attracted FDI into resource sectors such as electricity and minerals. Since late 1990s, FDI coming into this sector has led economic development of the country.

To a large extent, the natural resources sector, particularly hydroelectric power and mining, has driven recent economic growth. This boom in natural resource exploitation has brought significant benefits to Lao PDR's economy both direct and indirect way. For direct benefits, FDI has positive impact on economy in the form of higher economic growth, an increase in fiscal revenues, and export performance. From 2006 to 2010, average GDP growth rate in Lao PDR was 7.9% and last year, 2011, it was 8.4%. Comparing to other countries in the region, the rate was one of the highest and Lao PDR is one of the growing countries in the world today. For export, mining and electricity generation has become the largest of Lao exporter account for 70% of total export volume. The export of mining and electricity are expected to grow and contribution to Lao economy in the next decade. Increasing of FDI in Mining and hydropower brought significant revenue to government income and improve balance of payment. Natural resource sector contribute about 23% of total government's revenue. Moreover, FDI brought a benefit on infrastructure improvements, local business where mining companies are located, and improving living standard of people, which eventually stabilize economy as a whole.

However, there is also negative aspect of the FDI in resource sector. Needless to say, there is environmental problem such as biodiversity and land. Also, land confiscation from the people and amount of compensation is the problem. Today many people complain about economic and land problem related to FDI to National Assembly. Nevertheless, the party and government have to depend on resource sector and they keep attracting FDI into that sector.

5.2 Future Dependence on Resource Sector

At the 9th congress of the party in 2011, the Party announced 7th NSEDP (2011-2015). In the plan, they set average GDP growth for next five years at least at 8%. It means that they are aspiring for higher growth than before. In order to achieve that goal, they say they need total investment of US$ 150 billion for next five years to invest in key infrastructures required for achieving industry and agriculture growth, to invest in public utilities, rural development, and poverty reduction and so on. As for the required US$150 billion, they set targets as following; 10-12% from state budget investment, 24-26% from ODA, private investment including FDI 50-56%. It means that they need US$ 7.2-7.8 billion of ODA and US$ 15-17 billion of private investment including FDI. Also, they need to increase export value at 20% annually. They have to continue to depend on external demand and situation for their economic development like before.

Take a look at their estimation of their needs for $ 150 billion for total investment. According to the 7^{th} NSEDP, they have to invest 32% of GDP in order to achieve GDP 8%. For this, they need US$ 75 billion of foreign and domestic private investment for next five years and about US$ 15 billion annually. Since domestic private investment in not so big, it means that they have to depend on FDI, especially on resource sector.

In the five year plan, they plan to complete construction of eight electric generation plants and start construction of 10 plants. In the latter plan, which is start construction of 10 plants, total construction fee is $ 11.2 billion. It can cover most of the total investment, $ 150 billion, which they need. In addition, they plan to export cathode copper approximately 400,000 ton, copper 1.5 million ton, gold 30 ton, limestone 600,000 ton, etc. In order to accomplish these targets, of course they need FDI into resource sector. They have to depend on FDI in resource sector much more than today in order to develop its economy for next five years.

5.3 Challenges and Issues related to FDI in Lao PDR

As can be seen in previous chapter, growth in Lao PDR has been mainly driven by FDI and most of the FDI flow to Lao PDR was driven by mega projects in mining and hydroelectric power sectors such low investment outside of the resource sectors may not sustain high growth or support diversification in the long term.

Even though, the government has made significant improvement in business environment however, IMF (2010) point out that significant challenges on doing business in Lao PDR still remain, such as the availability of domestic infrastructure is insufficient. Poor quality of roads and many main roads are still under construction. In addition, many parts of the country especially in rural areas access to road remain difficult. Electricity is also not available in many remote areas and poor transmission lines. Most of infrastructure construction and improvement projects are still heavily rely on international aid (IMF, 2010).

Another major concern is faced by investor in Lao PDR is the availability of labor in terms of quality and quantity. Although the country is well known as having the low cost labor compares to neighboring countries, it has been recognized that the Lao PDR has a shortage of skilled labour. There is an abundant supply of labour but a limited number of highly skilled workers that can meet the investor requirments. Currently, there are few training centre and vocational schools, which aim to produce more qualify skilled labor for an on-going demand of labor by foreign investors. Moreover, a lack of full transparency and the inconsistent interpretation and implementation of sector level regulations still poses problems for investors according to KPMG (2011) point out that the legal process in Lao PDR is very bureaucratic.

5.4 Conclusion and Policy Implication

Lao economy today is sustained by resource sector. FDI comes into the sector, then it lead to increase tax revenue and export of minerals and electricity, which eventually stabilize state finance and economy. This is a main mechanism of economic development of Lao PDR today. Party and government have an intention to continue this policy at least until 2020 because they need such a high economic development in order to achieve their goal of graduating LDCs status in 2020. Since manufacturing sector is not matured yet, they have to depend on resource sector for economic development. Of course they realize the problems in terms of environment, biodiversity, land and compensation; nevertheless, they have no other choices. Therefore, they clearly mention their intention to depend on resource sector for next five years in 7th socio-economic development plan.

However, their strategy for economic development is so dependent on external demand. If economic situation turned worse, then amount of FDI coming into Lao PDR and export of minerals and electricity might decrease, which eventually influence macro economy and growth. It means that they cannot control their economic growth by themselves because they are largely dependent on externality. I think that they will not face the problems, which I mentioned above, in immediate term but in the long run, they might.

Even though depletion of the resource and environmental problems are not avoidable, there is something they can do at present time for future economic development. As discussed in the chapter 5, both tax revenue and export value from resources sectors has been increasing. Therefore, the government has much more budget to build socio-economic infrastructure which will sustain economic and social activity of the people such as education, road, and distribution system and so on.

As mentioned above, Lao PDR is lack of quality human resources and economic infrastructures. For economic development, not only economic capitals but also human capitals are important factor in long run. Therefore, if current financial situation is improving and they can get much revenue from resource sector, they should utilize that money to build human resources for future economic development. In addition, they should build other socio-economic infrastructures such as road, bridges, and others too.

Moreover, to sustain economic development in the long run the government need to enhance sustainable investment in more diversified sectors Lao PDR currently is concentrated in resource based sector for economic development until 2020. However, aside from resource based sectors, it is very important for the Lao government to encourage more investment and enhance investment climate to promote fast and sustained growth of non-resource sector such as manufacturing and services sectors. In addition, government revenue from resource based sector is expected to increase significantly in the near future. Therefore, a more comprehensive fiscal policy and adequate government policies are important to stabilize and manage the revenues from resources sector in order to ensure efficient investment in the future. Aside from attracting foreign investor the government should concentrate more on domestic investment. To that end, legal framework plays a crucial role in promoting and enabling environment for business both foreign and domestic investments thus, enhanced transparency is required for Lao PDR to facilitate foreign direct investment and avoid the impact of natural resource volatility. Also, to maximize the contribution of natural resource sectors government should introduce some policies to encourage linkages with domestic business and local people as a consequence local people will gain benefits from spillover in technology and know-how.

Last but not least, as mentioned mining and hydroelectric project brought the impact on environment and harm the local people however, to develop economy Lao PDR still need FDI on those sectors for generate investment thus, it is require comprehensive Environmental Impact Assessment (EIA) for project approval and monitoring investors.

Even though Lao government may not solve the problems, which they may face in the future, today, but they can at least prepare for the future economic development when resource sector cannot be utilized as same as today. This may be the biggest challenge for Lao PDR.

References

Asian Development Bank. (2003b). Lao PDR: Power Sector Strategy Study. Final Report, Volume I. ADB TA 3374 – Lao

Asian Development Bank. (2011), Key indicators of developing Asian and Pacific Countries, Asian Development Bank, Manila.

Alfaro, L., (2003). Foreign Direct Investment and Growth: Does the Sector Matter?. Harvard University, Harvard Business School, Working Paper.

Bende-Nabebde, A., (2001). FDI, Regional Economic Integration and Endogenous Growth, Some evidence from Southeast Asia. Pacific Economic Review 6(3), pp. 383-399

Blomström, M. and A. Kokko. (2002). The Economics of Foreign Direct Investment Incentives, Working Paper 9489, NBER Working Paper Series.

Bourdet, Y. (2000). The Economics of Transition in Laos – From Socialism to ASEAN Integration, Edgar Elgar Publishing, Cheltenham

Banga, R. (2003). Impact of government policies and investment agreement on FDI inflows, Indian Council for Research on International Economic Relations (ICRIER). Working Paper No. 116

Borensztein, E., de Gregorio, J., and J-W Lee, (1998). How does foreign direct investment affect economic growth?, Journal of international Economics 45, pp.115-135.

Boungnaphalo, E. (2010). Mineral development in LAO PDR. Paper present at International Conference on Mining “Staking a Claim for Cambodia”, PhnomPenh. Available at http://www.un.org.kh/undp/images/stories/special-pages/mining- conference-2010/docs.

Brahmbhatt, M and Ekaterina Vostroknutova. (2010). Development with a rapidly expanding natural resourcessector: challenges and policy options for Lao PDR. Lao PDR Development Report 2010 background paper, Washington, DC.

Chansomphu, V., and Ichihashi, M. (2011). Foreign Direct Investment, real exchange rate misalignment, and export performance of Lao PDR, Journal of International Development and Cooperation, Vol.17, No.2, 2011, 31-51

Chesami, M. (2005).The role of government in the attraction of Foreign Direct Investment: A case study of South Africa and Cameroon. MA thesis: THE University of the Western Cape.

Cox, R, W. (1994). Global restructuring: Making Sense of the Changing International Political Economy. In Political Economy and the Changing Global Order. London: The Macmillan Press Ltd.

De Mello, L. (1999). Foreign Direct Investment Led Growth: Evidence from TimeSeries and Panel Data," Oxford Economic Papers, 51, 133-151.

Dunning, J. H. (1988). The eclectic paradigm of international production: A restatement and some possible extensions. Journal of International Business Studies, 19(1), 1-31.

Fane, G. (2006). Trade liberalization, economic reform and poverty reduction in Lao PDR (Well-being achievement in Pacific Asia), Journal of the Asia Pacific economy. 11(2), 213-226.

Freeman, N. (2001). The rise and fall of foreign direct investment in Laos, 1988-2000, Post-Communist Economies, 13:1, 101-119

Government of Lao PDR. (2006). Sixth national socio-economic development plan (NEDP) for 2006 to 2010. Vientiane: Ministry of Planning and Investment

Government of Lao PDR. (2011). Seventh national socio-economic development plan (NEDP) for 2011 to 2015. Vientiane: Ministry of Planning and Investment

Gunawardana, J. P and Sisombat, S. (2008). An Overview of Foreign Investment Laws and Regulations of Lao PDR, International Journal of Business and Management, May 2008, p. 31-41

International Council on Mining and Metals (ICMM). (2011). Utilizing mining and mineral resources to foster the sustainable development of the Lao PDR.

IMF. (2008). IMF Executive Board concludes 2008 Article IV Consultation with the Lao People's Democratic Republic, International Monetary Fund. Available at www.imf.org/external/np/sec/pn/2008/pn08109.htm

Ivarsson, S. (1995). The Quest for Balance in a changing Laos: A political analysis.

Nias Press.

Kyophilavong, P and Toyoda, T. (2004). An Econometric Analysis of the Lao Economy –Simulation Using Macroeconomic Model-, in Amakawa. N and Yamada. N esd., Laos: Transformation to the Market Economy under a Single- Party Regime. Kenkyu Sosho (IDE Research Series) No.545, Institute of Developing Economies (IDE), JETRO, Japan.

Kyophilavong, P and Toyoda, T. (2008). Foreign Capital Inflow in the Natural Resources Sector: Impacts on Lao Economy, paper presentation to international conference, Bangkok, 20-21 November 2008

Lao National Academy of Social Science (2010) Sathaaban Vithanyasaat Sangkhom haeng Saat [2010] Pavatsaat Phak Pasaason Pativat Lao (Dooy Sang Kheep) (in Lao).

Lao People's Revolutionary Party (LPRP). (1986) Eekasaan khoong koongpasum nyai khang thii IV khoong pak pasaason pativtat Lao. (in Lao).

Lao People's Revolutionary Party (LPRP). (1996) Eekasaan khoong koongpasum nyai khang thii VI khoong pak pasaason pativtat Lao. (in Lao).

Lao People's Revolutionary Party (LPRP). (2001) Eekasaan khoong koongpasum nyai khang thii VII khoong pak pasaason pativtat Lao. (in Lao).

Lao People's Revolutionary Party (LPRP). (2006) Eekasaan khoong koongpasum nyai khang thii VIII khoong pak pasaason pativtat Lao. (in Lao).

Oraboun, S. (2011). Lao PDR's Industrial Development Policy and Intermidiate Goods Trade in Intermediate Goods Trade in East Asia: Economic Deepening Through FTAs/EPAs, edited by Mitsuhiro Kagami, BRC Research Report No.5, Bangkok Research Center, IDE-JETRO, Bangkok, Thailand

Otani,I., and Chi Do Pham, (1996). The Lao People's Democratic Republic: systemic transformation and adjustment, International Monetary Fund.

Perera, O. (2011). Investment Incentives for sutainable development: the case of Lao PDR, International Institute for Sustainable Development

Pholsena, V. and R. Banomyong. (2006). Laos - from Buffer State to Crossroads, Mekong Press, Chiang Mai.

Pholsena, S and Phonekeo. D. (2004). Lao hydropower potential and policy in the GMS context, United Nations Symposium on Hydropower and Sustainable Development, Beijing International Convention Centre.

Radetzki, M. (1994). From Communism to Capitalism in Laos: The Legal Dimension, Asian Survey, University of California Press Stable, Vol. 34, No. 9, pp. 799-806 available at http://www.jstor.org/stable/2645166.

Reis, A. (2001). On the Welfare Effects of Foreign Investment. Journal of International Economics 54, 411-427.

Stuart-Fox, M (1986). Laos: Politics, Economics and Society, London: Frances Printer.

Stuart-Fox. (1997). History of Laos. Cambridge University Press, Cambridge.

Thayer, A. C, (2000). Laos in 1999: Economic Woes Drive Foreign Policy, in Asian Survey, Vol. 40, No.1 Jan-Feb 2000, pp. 43-48.

UNCTAD. (2006). World investment report 2006: FDI from developing and transition economies: Implication for development. New York: United Nations.

United Nation. (2010). an investment guide to the Lao People's Democratic Republic: Opportunities and Conditions, United Nation, New York

Voladet, Saykham. (2009). The plantation industry in Laos: An examination of the role of ministry of planning and investment. National Economic Research Institute (NERI).

World Bank, (2010). Lao Economic Monitors. World Bank, Vientiane**.**

World Bank, (2011). Lao Economic Monitors. World Bank, Vientiane**.**

World Bank. (2009). Lao PDR Economic Monitor 2009 – End-Year Update, World Bank,Vientian. available at http://siteresources.worldbank.org/INTLAOPRD/Resources/293582-1096519010070/534072-1229571730280/LEM_No.14_Dec2009.pdf

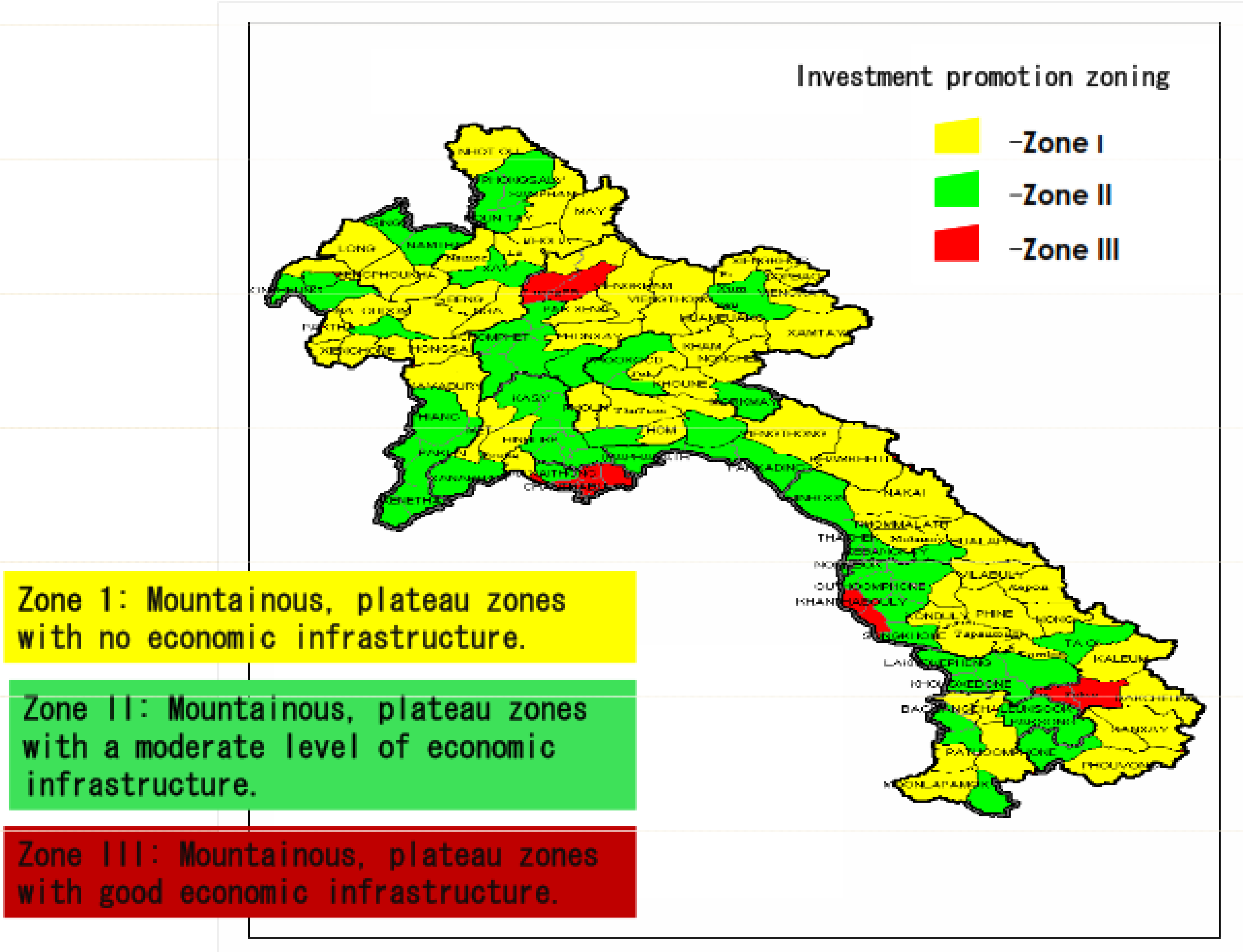
World Bank. (2011). Lao PDR Development Report – Natural Resource Management for Sustainable Development,Country Economic Memorandum, Washington, DC.

World Bank. (2011). World Development Indicators, Statistical Database. Washington, DC.

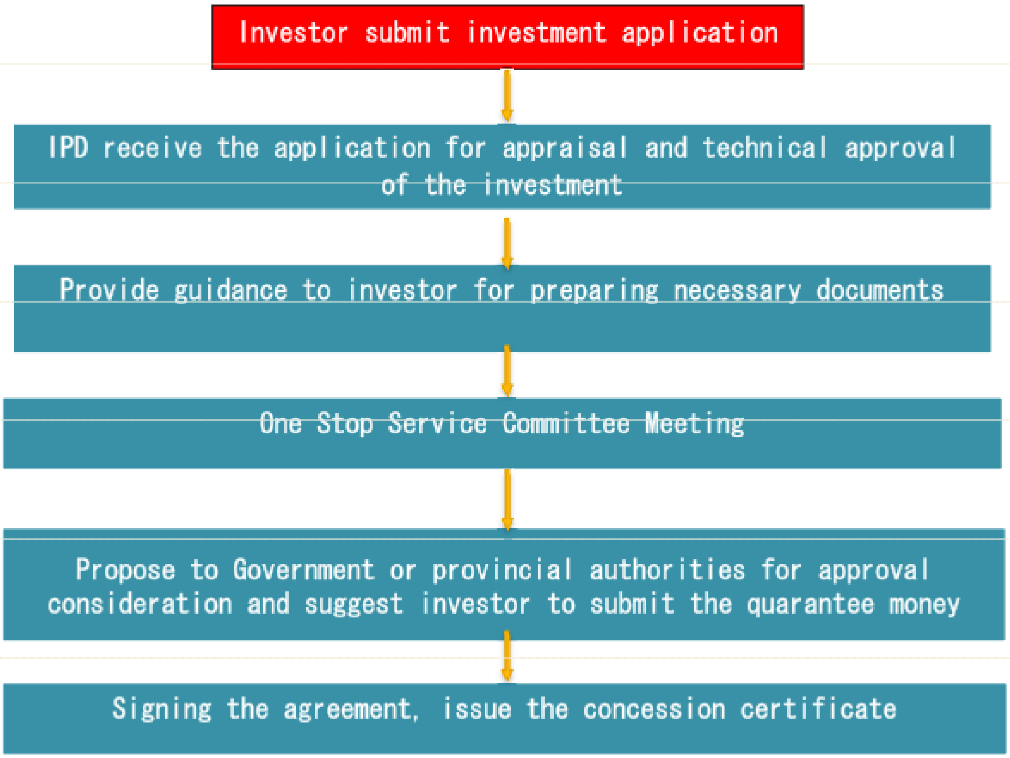
APPENDICES

Appendix A

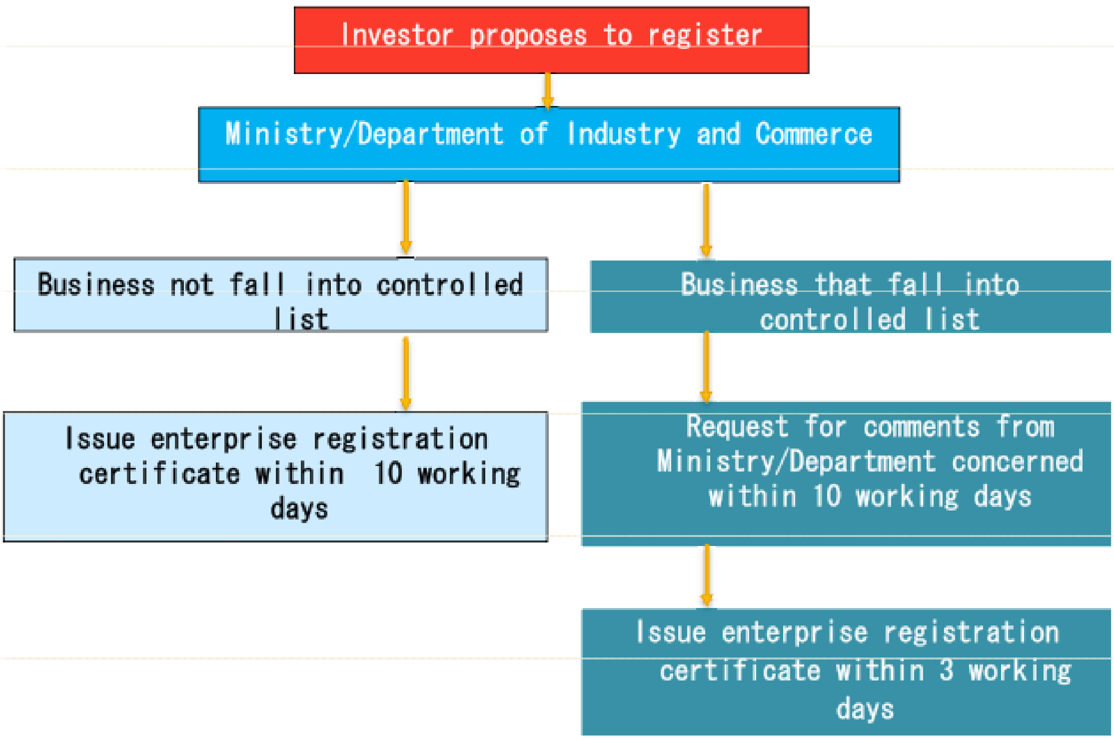
Investment Promotion Zoning



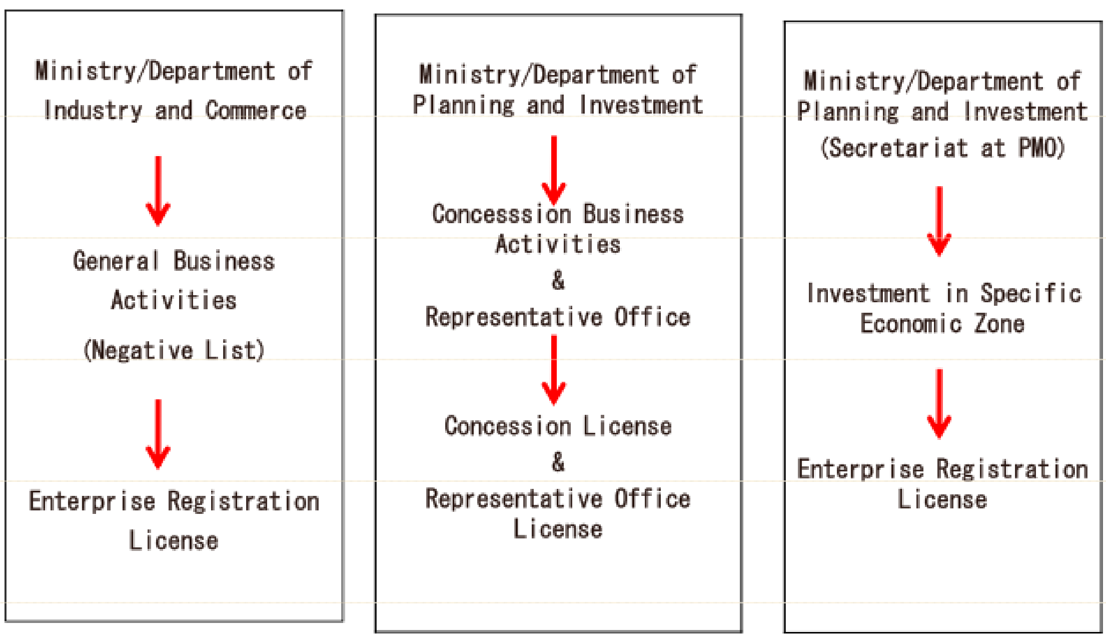
Approval Procedures for Concession Investment



Approval procedures for investment in general activities



Procedure of getting the license



Appendix B

Industrial closed to foreign investors

Activities	condition
Manufacturing	
Manufacturing of Lao dolls	Reserved for Lao citizen
Manufacturing of products of copper, silver and gold (jewelly)	Reserved for Lao citizen
Munufacturing of authentic Lao musical intruments	Reserved for Lao citizen
Manufacture of blankets and mattresses with cotton and kapok	Reserved for Lao citizen
Fishing, operations of fishing hatcheries and fish farms; service activities incidental to fishing	

Table Distribution by percentage of workers by industry group in the non-family farm 2006

Sector	Percentage
Agriculture and allied activities*	3.5
Mining and related activities	1.3
Manufacturing	17.9
Electricity	1.1
Construction	2.1
Trade (wholesale and retail trade)	22.9
economic service	8.1
education	8.1
Health	1.8
Entertainment, art,etc	4.7

Source: Economic Census of 2006, cited in MPI, and UNDP, 2009

* Agriculture in this table refers to commercial agriculture outside the family farm sector

Appendix C

Power Projects in Lao PDR Operational and Under Construction

name of Project	Location	Capacity	Investors	Planned Market
Power Projects-Operation				
Houy Ho	Champasak/Attapue	150 MW	Edl 20% Suez Energy (Belgium) 60% HHTC (thailand) 20%	Thailand
Nam Dong Hydropower	Lauangprabang	1 MW	EdL	Lao PDR
Nam Ko	Oudomxay	1.5 MW	EdL	Lao PDR
Nam Leuk Hydropower	Vientiane	60 MW	EdL	Lao PDR/Thailand
Nam Mang 3 Hydropower	Vientiane	40 MW	EdL	Lao PDR/Thailand
Nam Hgum 1 Hydropower	Vientiane	155 MW	EdL	Lao PDR/Thailand
Nam Phoa	Bolikhamxay	1.6 MW	Provincial Authority	Lao PDR
Selabam Hydropower	Champasak/Attapue	5 MW	EdL	Lao PRD
Se xet 1	Saravane	45 MW	EdL	Lao PDR/Thailand
Theun-Hinboun(IPP)	Bolikhamxay	210 MW	EdL 60%, Nordic 20%, GMS 20%	Lao PDR/Thailand

Power Projects- Under Construction (Update 30 March 2009)

Nam Lik 1-2 Hydropower (IPP)	Vientiane	100 Mw	EdL 20%, CWE (China) 80%,	Lao PDR
Nam Ngum 2 Hydropower (IPP)	Vientiane	615 MW	Edl 25% CH. Kanbang (Thailand) 28.5% PT Construction & Irrigation Co., (Lao PDR) 4% Ratchaburi (Thailand) 25% Bangkok Expressway PLC (Thailand) 12.5% TEAM Consulting Engineering 1% Shalapak Group (United States) 4%	Thailand
Nam Nhone	Bokeo/Laungnamtha	2.4 MW	Nam Nhone Power Company 100%	Lao PDR
Nam Ngum 5 Hydropwer	Laungprabang/Xiengkhouang	120 MW	EdL 15%, Sinihydro (China) 85%	Lao PDR
Nam Theun 2 Hydropower (IPP)	Khammuane	1080 MW	LHSE (Lao PDR) 25% EDF (France) 35% EGCE (Thailand) 25% ITD (Thailand) 15%	Lao PDR/Thailand
Se xet 2 Hydropwer	Saravane	76 MW	Edl	Lao PDR/Thailand
Tad Salen	Savanakhet	3.2 MW	SIC Manufacturer (Thailand) 100%	Lao PDR
Theun-Hinboun Hydropower expansion (IPP)	Bolikhamxay	220+60 MW	EdL 60% Nordic Group (Norway) 20% MDX (Thailand) 20%	Lao PDR/Thailand
Xekaman 3 Hydropwer (IPP)	Sekong	250%	EdL 15%, VLP (Vietnam) 85%	Lao PDR/Vietnam

Source: Data from Department of Energy and Promotion Development, adapted by United Nation (2010). An investment guide to the Lao People's Democratic Republic: Opportunities and Conditions, United Nation, New York

Sepone Mining

Sepon was the Lao People's Democratic Republic's first large-scale mining project. Originally established by Rio Tinto in 1999, and later bought by Australia's Oxiana (OZ) one year later for $26 million, it has, since June 2009 been acquired by Minmetals, a Chinese State-owned mining company. The new management has announced that the change in ownership would not affect the company's commitments to the Lao Government, workers and communities around the mining sites, and that there will be no lowering of environmental or safety standards.

With proven reserves of 48.8 tons of gold and 812 tons of copper, it remains the country's largest mine with an annual output of 102,390 oz in gold and 62,541 tons in copper in 2007. Copper and gold from Sepon currently account for 50 per cent of Lao People's Democratic Republic total merchandise exports. The mine's cathode copper-making plant is to be upgraded in 2010, with an expected costing of $178 million, which will lift annual output to 80,000 tons while cutting production costs by 10 per cent 23.

Under OZ, with most of its local staff (numbering 2,000 in 2008 compared to 300 expatriates) initially lacking many required skills, staff annual training formed part of the company's commitment. In the past years, workers were sent on exchange programmes to OZ's mines in Australia and professors from leading Australian universities were invited to the Lao People's Democratic Republic to conduct training courses. The company had likewise invested $500,000 in local community development, mainly in schools, small surgeries and clean water projects. In addition, the company accommodated its staff and provided social facilities within the mine compound. Finally, in order to reduce the impact of the mine on the local community and environment, OZ had also taken extensive measures to contain leech ponds, control river sediments, and plant trees to prevent erosion.

BIOGRAPHY

Chintana Khouangvichit was born in Vientiane, Capital city of Lao People's Democratic Republic. She has been awarded a Bachelor Degree of Business Administration majoring in Business Finance from the University of the Thai Chamber of Commerce in 2004. From 2004 to 2010, Chintana worked at the Faculty of Economic and Business Management, National University of Laos (NOUL) as a teaching staff. In late 2010, she won a scholarship from Rockefeller Foundation to study in the Master program in Southeast Asian Studies at Chulalongkorn University.