CHAPTER V

THE ROLE OF FOREIGN DIRECT INVESTMENT

5.1 Introduction

Having initially lacked a domestic private sector, Lao's transitional economy opened its doors to foreign capital in the late 1980s and 1990s, and in effect ''imported'' a ready-made private sector from outside. This foreign-invested sector has grown to be quite a substantial part of the corporate sector in the transitional economy of the region, and interaction with host country economy – both through direct linkages with local firms and more personal interaction – has also assisted in the development of domestic business capacity, in wide range of ways.[1] The inputs for a host country that can come from foreign investment activity go well beyond just capital and can (potentially at lest) span a range of other non-financial attributes: new technology, skills and design, organizational and management techniques, overseas market information and access, and so on.

In general the increasing economic difficulties faced by the centrally planned economy from the early 1980s and the implementation of reforms was depicted as confirmation that there was no desirable or, indeed, viable, alternative to the market economy. For development theory and practice this gave further strength to the neoliberal perspective on development under the centrally planned states of both Eastern Europe and the Third World that could be presented as extreme examples of the distortions to the market and the overgrowth of the state that were becoming recognized as inimical to development in the Western market economies and the global system as a whole.[2]

The issues of FDI are both extremely pertinent to the Laos transitional economy. Thus, Savannakhet, in the context of developing province undergoing economic

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[1] Denis Hew and Loi Wee Nee, Entrepreneurship and SMEs in Southeast Asia (Singapore: Institute of Southeast Asian Studies, 2004), p. 224.

[2] Chris Dixon, Developmental lessons of the Vietnamese transitional economy. (London Metropolitan University, 2003), p. 3.

transition, the development of a vibrant foreign investment sector can do much to assist in the provision of job (particularly outside the main cities, where foreign investors and larger cooperation tend to gravitate), and as a shock-absorber in down-sizing of 100 per cent foreign-owned business ventures, and serves as the ''seed bed'' of transitional Savannakhet next generation of FDI. Indeed, for the Savannakhet's FDI in transitional economy, the question is not whether they should pursue an FDI strategy, but how best to go about it.

Savannakhet is making the transition from command to market-oriented economies as the country is gradually and actively welcoming inward foreign direct investment activity, and have done so for a number of years. FDI inflows are regarded as an important method of boosting economic development and growth, and assisting in the transition process – consisting of both economic reforms and business liberalization measures – currently underway in the region. On paper at least, the (still evolving) laws and regulations pertaining to FDI activity are relatively liberal, such as permitting 100 per cent foreign-owned business ventures across a fairly wide range of business sectors.[3] As FDI inflows have accrued, and the confidence of policy-makers has grown, the foreign investment regimes in the transitional economy has continued to improve, in tandem with marked improvements to the wider business environment in the host country.

As the term ''transitional economy'' implies, Savannakhet is undergoing a process of business liberalization and economic reform: moving away from the centrally planned economic models of the past that failed to deliver their intended goals, and towards more market-oriented economic systems that have already delivered commendable economic results.[4]

Thus, the emergence of the transitional economy in Savannakhet has brought a new dimension to the development debate. Initially, events in the region depicted as confirming that there was no viable alternative to the market economy and the neoliberal perspective on development.

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[3] Nick J. Freeman and Frank L. Bartels, The Future of Foreign Investment in Southeast Asia (London: Routledge Curzon, 2004), p. 170.

[4] Denis Hew and Loi Wee Nee, Entrepreneurship and SMEs in Southeast Asia (Singapore: Institute of Southeast Asian Studies, 2004), p. 221-222.

More significantly, Savannakhet's transitional economy has experienced high rates of economic growth and large-scale inflows of investment with programs of limited and gradual reform. However, the transitional economy has proved to be a complex and problematic process, with recurrent economic and political crises and a wide range of situations and trajectories. These have taken place in the context of the continuation of single party rule, high levels of state intervention and significant direct control of production.

5.2 The History of Foreign Direct Investment at the National Level

When looking at FDI activity in the Laos, one tends to focus on the inflow of foreign capital that has occurred over the last decade or so, as part of the economic transition process that the country has been undergoing since the late 1980s. When foreign private capital was generally not permitted into the country in the year preceding their 'opening up'. The policy-makers have been on a relatively steep learning curve; learning how to attract, retain, sustain, manage, harness, monitor – and then attract yet more – FDI inflows. This process is partly a science, and partly an art, as policy-maker in the other Southeast Asian countries will testify.

It is also a fairly relentless process, as the extremely competitive environment for attracting FDI flows poses ever-new challenges for host country that wish to stay ahead of the game. Priorities are accorded to projects which promote exports, exploit natural resources, transfer high technology, increase employment, save energy, or contribute to regional economic development.

As part of the French colonial empire, indeed, some interesting parallels between the FDI inflow patterns of today and those of the first three decades of the twentieth century are worth noting briefly. The industrial revolution helped drive the first major investment foray into 'emerging market' – in the form of colonial possessions – as the major European economies sought out new territories from which to source resource inputs and as markets for their manufactured products. In Laos, tin mining was the only business sector that received substantial foreign investment under French colonial rule.

The 'story of foreign investments in [colonial] Laos is really a story of French investment'. Non-French investment in Laos was deterred through the use of tariff and non-tariff barriers and currency regulations for non-French business; and subsidies and assistance for French businesses.

The return of peace to Indochina in the 1980s lead to renewed interest in sub-regional economic cooperation to develop the Mekong River and its riparian areas. Laos and GMS countries form a natural economic territory with shared resources as well as ethnic and culture links. The development potential for Lao Government is severely constrained by shortages of financial and technical resources and poor infrastructure.

The difference in the stage of economic development amongst the GMS countries is also illustrated by investment. Generally, all GMS countries including Laos are in need of FDI. It is only recently that the GMS countries began exporting capital. As one of the new ASEAN members, Laos belongs to the grouping that is only a recipient of FDI. Due to differences in levels of development, the type of investment flows into this grouping is also different both in terms of technology and sectors. According to these basic issue, it can be concluded that Laos must seriously with other countries in the region in order to attract FDI. It is also to bear in mind that its main competitors are not only the GMS countries but rather the new ASEAN member whose growth patterns are similar to Lao PDR's.

The foreign investment law was introduced in mid-1988 and was amended in March 1994, serves various purposes of stimulating inflows of foreign technology and management capable of generating employment and improving the country's infrastructure, as well as manufacturing capability with an export orientation. Significantly, the law provides: (1) guarantee or protection of foreign capital and assets against nationalization and requisition by administrative procedure; (2) security for repatriation of profits; (3) tax holiday up to four years; and (4) exemption of taxes for profits reinvested.[5]

According to the Law on the Promotion of Foreign Investment of Lao PDR, foreign investment means the importation of capital, which includes assets, technology

[5] Chris Dixon, Developmental Lessons of the Vietnamese Transitional Economy. (UK: London Metropolitan University, 2003), p. 3.

and expertise, into the Lao People's Democratic Republic by foreign investors for business purposes.[6]

This law, essentially similar to the Vietnamese one, also allows for three types of investment – business by contract, joint ventures, and wholly foreign-owned enterprises – before its amendment. But after its amendment only last two forms remain.

The government also set about establishing the '' enabling environment'' thought necessary in order to develop a market economy and to attract investment from new capitalist sources. This involved a whole series of legal, administrative and institutional changes, including democratic reforms, and also adoption of more standard, but radical macro stabilization policies introduced under different structural adjustment programs directed towards trade and budget deficits

Before 1989, there was very little foreign investment from outside the Soviet Bloc. Significant levels of investment began in 1989, when investments of some US$64 million were licensed; by 1992 the annual figure was US$160 million, two and a half times as great. The number of approved investments continued to increased in 1993, 79 projects having been approved in the first half year. Investment up to the end of 1992 were about equally divided between joint ventures and wholly-owned foreign enterprises, with some business by contract.[7]

From September 1988 to June 1994, 511 foreign investment (excluding large projects and hydro-power projects) licenses were approved, mounting to US$ 780 million in aggregate value. The most attractive industries for foreign investors are identified as tourism, forestry, mining, petroleum, and garment which are more for export rather than serving the domestic market.[8] Initially, joint ventures had been the preferred structure for foreign investment in the Lao PDR. But up to 1994, wholly foreign-owned investment had caught up and shared about half of the total approved licenses. In terms of the number of licenses awarded, garments, other manufacturing,

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[6] Law on the Promotion of Foreign Investment in the Lao People's Democratic (Laos, 2006.)

[7] Mya Than & Joseph L.H. Tan, Laos' Dilemmas and Options: The Challenge of Economic Transition in the 1990s: (Singapore: Institute of Southeast Asian Studies, 1997), p. 135.

[8] Ibid,. 76.

and agribusiness were the preferred sectors. The most important sectors by value were wood-based industries and banking.[9]

Investments by ASEAN nations in Laos have been growing yearly. Up to December 1994, specifically Thailand, Singapore and Malaysia are the largest investors as a group – accounting for 43 percent of the aggregate FDI in the Lao PDR. Although the tend of substantial FDI flows to Southeast Asia began around thirty years ago (led by Singapore's contrarian stance towards foreign investment, and its pioneering policies to attract FDI), the 're-opening' of Indochina to foreign investment, in the late 1980s and early 1990s, coincided with a particularly strong 'bull market' period in most forms of private capital flows – FDI, portfolio investment and commercial bank lending – to the emerging markets in general. And within the emerging markets universe, Southeast Asia was a major recipient of private capital inflows, buoyed by a consensus view that the region was a particular fertile ground for investors seeking attractive risk-adjusted returns. In 1990, for example, Southeast Asia attracted 36 per cent of all FDI flows to developing countries, and the region exceeded China's FDI inflows by more than threefold. Another group of emerging market counties attracting foreign investor excitement at this time was the transitional economies of the former Soviet Union, Eastern Europe and Asia.[10] Therefore, as transitional economies located in Southeast Asia, it is not surprising that Laos stimulated foreign investment appetite, when the Sub-region opened its doors to private capital inflows in the early 1990s. The Indochinese country like Laos not only stood at the nexus of the emerging markets and transitional economy growth 'investment stories', it was also well positioned to capture the beginnings of a substantial intra-Southeast Asia FDI flow phenomenon. The domestic corporate sectors of Malaysia, Singapore and Thailand had started to generate fairly significant FDI outflows of their own in the early 1990s, until the Asian financial crisis brought rapid end to much of this activity – with the marked exception of Singapore. Until today, other Southeast Asian countries are ranked as the top investors in Laos (as

[9] Seiji Finch Naya and Joseph L.H. Tan, Asian Transitional Economies: Challenges and Prospects for Reform and Transformation (Singapore: Institute of Southeast Asian Studies, 1995), p. 187-188.

[10] Ibid,. 77.

measured by approved capital inflow pledges), and Thai investors almost dominate FDI activity in neighboring Laos.

Laos was absent as a success on the transitional economies. Where transitional economy have run into severe problems, often some combination of falling output, decline in average incomes, sharp increases in poverty, rising mortality and falling birthrates, rapid inflation and so on.

Foreign investment authorized between 1991 and 1997 was even more unequally distributed over the country and was concentrated on the industrial sector and energy. Liberalization and deregulation policies have been implemented only more recently in Laos, as these are also smaller and poorer markets, they have been less successful in attracting FDI than GMS countries. However, Laos' economic and trade liberalization in the last decade has resulted in a large-scale inflow of FDI into Laos.

FDI inflows to Laos are of more recent origin and have flowed largely into resource, infrastructure, and tourism development as well as light industries.[11]

There are about 35 countries investing in Lao PDR such as Thailand, United States of America, South Korea, Malaysia, Taiwan, Australia and so on. In total there are 728 projects of which 244 are Thai projects. Where the financial crisis erupted and expanded to other Asian countries and the world.[12] Thus, this phenomenon has directly or indirectly made Lao PDR dependent on the Thai economy and so it has been unavoidably affected by the upheaval of the financial and economic crisis in Thailand.

Thailand is the leading foreign direct investor ($2.7 billion), accounting for 43% of total investment over the period 1991-1997. It is followed by the United States ($1.4 billion, 22%), Australia ($0.53 billion, 8.5%), South Korea (0.47 billion, 7.5%), Taiwan ($0.43 billion, 7%), Malaysia ($0.33 billion, 5.3%), the European Union ($0.19 billion, 3%) and Japan ($0.14 billion, 2.2%).[13]

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[11] Chia Siow Yue and Marcello Pacini, ASEAN in the New Asia: Issue & Trends (Singapore: Institute of Southeast Asia Studies, 1997), p. 54.

[12] Ibid., p. 4.

[13] Buanthavy Sisouphanthong and Christain Tailard, Atlas of Laos: Spatial Structure of the Economic and Social Development of the Lao People's Democratic Republic (Denmark: Nordic Institute of Asian Studies, 2000), p. 26.

1997-1998, ASEAN region is embroiled in a serious economic crisis, a factor that is expected to result in a substantial slowdown in the region's economic growth. As turn in the Southeast Asian countries, Laos cannot avoid the impact of such a crisis.[14] The crisis has affected FDI in the Lao notably in terms of capital inflows, FDI decreased after the Crisis; it peaked at $2.6 billion in 1995 and went down to as low as $20 million in 2000, especially capital inflows form Thailand, the largest investor in the Lao PDR, have decreased sharply because Thai investors have faced financial shortage themselves.[15]

The Asian Economic Crisis exacerbated the current debt situation of Laos. The breakdown of trade between Thailand during the Crisis sent Laos into a period of massive inflation that caused an almost tenfold devaluation of its currency.

5.3 Foreign Direct Investment in Savannakhet

At present, evaluating actual implementation of approved investment projects is very difficult for Savannakhet province. Certain statistical sources show serious discrepancies in actual investment inflows that can range to million of dollars. Recognizing the importance of these shortcomings for its investment policy, strategy assessment and evaluation, the government has set up a monitoring system to follow up on actual implementation of investment projects.

Furthermore, there are relatively few ''official'' venture capital investors active in Savannakhet's transitional economy, and they are all foreign (in terms of both management and funds raised). A number of factors appear to be currently inhibiting the development of venture capital activity in this economy. In the limited space available here, it can identify some of the more immediate obstacles to greater venture capital activity. First, the current regulatory environment is not wholly conduct to venture capital activity. Local and foreign investee companies must also get approval

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[14] Ibid., p. 51.

[15] ASEAN University Network and the Korean Association of Southeast Asian Studies, The Conference on Economic Crisis in Southeast Asia and Korea: Its Social, Cultural and Political Impacts (Thailand, Bangkok, February 2000), p. 151.

from the provincial peoples' committee, and possibly also the prim minister's office, prior to selling share to foreign investors.

Secondly, the current standards of corporate accounting and levels of transparency in country's transitional economy are a general deterrent to many equity investors, including venture capital funds. At the very least, the degree of capacity necessitated that venture capital investors spend substantial time and resources conducting thorough investment appraisals and due diligence of potential investee companies. The legal fees can also be substantial when the official approval process to acquire shares in local companies is complicated, and/or take time. These sorts of obstacles and delays can add considerably to the operating costs for the venture capital firm, which then impacts on the viability of investments. High transaction costs also oblige venture capital companies to pursue larger investment deals, and thereby make it very difficult for them to invest in Lao's transitional economy.[16]

FDI activity in the business sector largely dominates Savannakhet domestic economy – agricultural activity – for a variety of reasons. This feature, along with the clustering of FDI activity in a handful of locations, means that foreign investment activity does not directly impact on a large proportion of Savannakhet's total population (834.245), although some indirect impact has undoubtedly been felt. Relative to other measures of FDI activity, foreign capital's role as a major source of employment in Savannakhet still remains quite modest. Savannakhet has also found it quite difficult to attract private capital into major infrastructure projects, despite the promotion of BOT (build-operate-transfer) and similar contractual agreements, and the assistance of such initiatives as the Asian Development Bank's Greater Mekong Sub-Region Program. Some FDI activity has been oriented towards serving the domestic market in the country.

However, as Savannakhet has found, having a small economy means that a single large FDI project can have a potentially substantial impact on its entire economy, even adding whole percentage points to regional GDP.

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[16] Denis Hew and Loi Wee Nee, Entrepreneurship and SMEs in Southeast Asia (Singapore: Institute of Southeast Asian Studies, in 2004), p. 234-235.

The province, present, today more than ever, an huge potential for attracting a significant number of high caliber local, as well as foreign investors. Socio political stability, in addition to economic and financial constancy, is some of the essential factors for the prosperity of this promising province. Moreover, inexpensive land offering a high productivity potential over a variety of sectors, in additional to low cost labor and low energy rates are all additional aspects that make of this up and coming province a true East-West Economic Corridor (EWEC).

Furthermore, and perhaps the key catalyst for the forecasted rapid development of this region is the tax exemption for foreign investments and one-door-service policy adopted by the province.

Mr. Sithon Nunthalath, Head of the Planning and Investment Service of Savannakhet province says '' Savannakhet has plentiful productive land that is suitable for agricultural and industrial investment, due to the political stability, the good infrastructure in addition to the Province's investments in the electrical infrastructure that serves as a backbone to production. Moreover, the irrigation infrastructure guaranties water for production in both seasons. Furthermore, the transportation infrastructure completes the necessary package, thus creating a solid basis for business development.''[17]

However, Savannakhet province faces a important issue regarding the lack of qualified human resources, especially in the areas of business administration, accounting and information technology, as well as skilled labor. There fore, the Province's investment policy highly stresses the issue of labor development.

From 1992 until 2006, Savannakhet has had 54 FDI projects with a total volume of USD 843,004,640. The agricultural and forestry sector stand at the front line with 14 projects totaling USD 446,975,628 representing 53.02% of the total business volume. In second position comes the energy and mineral sector with 2 projects totaling USD 327,300,000, representing 38.83% of the total volume. In third position comes the service sector with 17 projects with a total value of USD 47,688,368 representing 5.66% of the overall business volume, and finally, the industrial sector, with 21 project

[17] Interview with Informant No. 5, 14 December 2007

totaling USD 21,040,644, representing 2.50% of the overall business volume. This EWEC has had significant potential for attracting numerous FDI to the Savannakhet province, especially foreign investors who have set foot in the region with substantial business ventures after the completion of the 2nd Mekong bridge. Therefore, and to accommodate trade and investment activities in the province, Savannakhet official have arranged 3 economically vital location or Special Economic Zone.

There is grate diversity of investments in the form of joint ventures comprising 22 companies, as well as wholly foreign-owned enterprises counting 32 companies. These companies come form the 16 countries mentioned above, including China (15), Thailand (16), Vietnam (6), South Korea (2), France (2), Singapore, Finland, Malaysia, India, Hong Kong, Taiwan, Japan, England each having one company. Moreover, Mr Sithon Nunthalath says ''if compared to Japan, as an analogy, Savannakhet will be similar to Osaka which it the commercial and investment zone.''[18]

Table 5.1 Figures of Foreign Direct Investment at Savannakhet, during 1992 – 2007

Country	Capital ($USD)	Percent	Projects
India	350,000,000	41.52	1
Australia	319,500,000	37.90	3
Thailand	76,512,071	9.08	16
South Korea	26,740,000	3.17	2
Vietnam	26,027,701	3.09	6
China	22,786,945	2.70	15
England	11,300,000	1.34	1

[18] Ibid,. p. 19-21.

Singapore	4,302,199	0.51	1
Malaysia	2,638,456	0.31	1
Japan	900,000	0.11	1
Finland	720,000	0.09	1
Hong Kong	500,000	0.06	1
France	307,268	0.04	2
Sweden	170,000	0.02	1
Taiwan	300,000	0.04	1
New Zealand	300,000	0.04	1
Total:	**843,004,640**	**100**	**54**

Source: Department of Planning and Investment of Savannakhet, Potentials and Investment Opportunities, 2007

Table 5.2 Foreign Direct Investment by sector since 1992-2007

Sector	**Capital ($USD)**	**Per cent**	**Projects**
Industries	21,040,644	2.50	21
Energy and Mine	32,300,300	38.83	2
Agriculture	446,975,628	53.02	14
Service	47,688,368	5.66	17
Total	**843,004,640**	**100**	**54**

Source: Department of Planning and Investment of Savannakhet, Potentials and Investment Opportunities, 2007

Oxiana, an Australian mining company, is bringing in more than $400 million a year in foreign exchange through exports of gold and copper.

Every year, Savannakhet province gains USD22 million from the gold and coppers mind and it is projected that in 2007 the province will get USD 27 million. Also the Lan Xang Mineral Limited (LXML) assistance for community development is about USD 500,000 per year as it help GDP per capital of Vilaboury district to attain USD 500-600. Furthermore, the LXML contributed USD 800,000 to building the provincial sport stadium.[19]

It is concluded that at present, mines are the main potential for the economy and social development of Savannakhet province because the mining projects create employment for the locals. People living around the projects sell their product and agricultural produce. However, the energy sector has the weak point due to lack of hydropower dams and electricity import.

There are various groups of businessmen from Malaysia, China, Singapore and Taiwan are studying the infrastructure and the possibilities in more than 200 ha at a particular location the belongs to Kaisone Phomvihan district.

The future policy agenda for promoting FDI in Savannakhet may actually shift outside the direct sphere of the foreign investment regime per se. This notion is supported when one looks at the sorts of issues that foreign investors usually cite as the main obstacles they face when conducting FDI projects in Savannakhet, most of which pertain to the wider host country business environment. They include: excessive regulation and red tape, inadequate legal infrastructure and weak enforceability, poor physical infrastructure, weak banking and financial markets, privileges still enjoyed by state owned firms, inadequate local input suppliers and service providers, poor and/or expensive communications, high land costs, corruption, high tax rates, inadequate property right protection, currency controls, etc.

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[19] Savannakhet, The Charming Golden Land (Investment and Tourism Magazine. No. 1, October, 2007), p. 36-38.

Arguably, Savannakhet has made slow progress in this realm, and may explain in part why FDI inflows are not picking up sufficiently. FDI project's slow progress to date was due to shortage in land availability.

Savannakhet is not very successful in attracting foreign investment compare to the other investment areas in GMS countries. There were increasing complaints from foreign investors, particularly non-Laotian foreign investors, that the business environment in Savannakhet was not favorable. In particular, inadequacies of infrastructure (especially transportation and energy), unclear rules, punitive charges, and problems in dealing with the government bureaucracy.[20]

5.4 Differing Foreign Direct Investment experiences

Foreign capital was relatively quick to respond to the promulgation of foreign investment laws in Laos, and aggregate FDI inflows have been quite admirable. Table 5.3 and 5.4 show FDI stocks per capita for ASEAN compare (in 2000) and FDI stocks as percentage of GDP during the 1990s compared, respectively.

Table 5.3 FDI stock per person in ASEAN compared, 2000

Country	USD
Laos	122
Thailand	388
Indonesia	286
China	271
Vietnam	225

[20] Ibid.

Philippines	167
Malaysia	2,341
Cambodia	62

Source: UNCTAD, Incentives and Foreign Investment. New York: United Nation, 2001

Table 5.4 Inward FDI stock as percentage of GDP ASEAN compared, 1990-1999

Country	1990	1995	1999
Thailand	9.6	10.4	17.5
Laos	1.4	11.9	42.8
Vietnam	3.6	31.1	55.6
China	7.0	19.6	30.9
Indonesia	34.0	25.0	46.2
Malaysia	24.1	32.9	65.3
Philippines	7.4	8.2	14.9
Cambodia	13.4	17.0	19.4

Source: UNCTAD, Incentives and Foreign Investment. New York: United Nation, 2001

However, Laos has seen much of the FDI activity cluster in a relatively few geographical locations and business sectors, and have registered mixed success in its attempts to better disburse this FDI activity, partially through the use of various fiscal incentive schemes and the creation of industrial zones. Since the late 1997, Laos has been member of the ASEAN, and is committed to various initiatives that relate – directly or indirectly – to foreign investment activity, including the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA). These regional initiatives will have some influence on the overall FDI profiles of the country, and partially drive future FDI policies, such as in the field of national treatment. Other agreement relation to economic reform and business liberalization efforts – for which external assistance is being provided, or on which subsidized loans are dependent – should also help the country tackle at least the host country obstacles that foreign investors often identify.

Another FDI experience related to foreign investment data itself. Although great strides have been made in improving the foreign investment data in the region, it remains quite difficult to get an accurate and up-to-date profile of FDI activity in the country. The disparity between the lofty approved/pledged FDI in flow figures – typically recorded by the relevant licensing body in the host country – on the one hand, and the more humble disbursed/ committed FDI inflow figures – often captured in the balance of payments data – on the other, are quite considerable where a handful of mega-projects and Special Economic Zone have been approved but not yet implemented, and yet this important distinction is not always made clear to the casual observer. Just capturing and collating FDI data can be tricky, if multiple agencies are given the authority to issue FDI licenses. But things get even more blurred when one considers a range of factors that are not always being captured by the official statistics, such as: increasingly substantial FDI activity being funded through reinvested earnings of existing project; joint venture projects where the local equity contribution – commonly in the form of land use rights – is often included in official FDI inflow data; funding assistance through local or foreign bank loans, inter-company loan components; stalled FDI projects that may or may not have had their licenses revoked; exaggerated or inflated equity commitments by investors; and informal, small-scale investment activity enacted by overseas nationals that often goes unlicensed.

FDI will continue to be crucial in meeting Laos' capital needs for development. Also, the role of the private sector will be enhanced in future infrastructural development. This is significant, as the 1995-2000 government investment programs includes: US$98 million in road building and upgrading; US$41.5 million for various health care, education, and vocational training; US$56 million for irrigation; and US$40 million for rural development, particularly to encourage sedentary cash-cropping instead of slash-and-burn cultivation. The government explicitly called for overseas development assistance under various arrangements, including bilateral and multilateral ones, thus for Laos, a greater for transitional economy host governments in facilitating FDI flows to this country could also be envisaged through financial and technical assistance arranged bilaterally as well as through multilateral agencies.[21]

5.5 Policy implication and the extend of Foreign Direct Investment

Globalization in the form of FDI flows has affected the pattern, structure and form of trade in Laos as well as economic growth, especially the growth of the manufacturing sector. The current challenge is to continue to grow in the midst of declining inflows of FDI and at the same time to move up the value-added chain of production and to reduce the dependence on semi-skilled and unskilled labor in the manufacturing sector. Clearly, the government has also identified this need, as seen in the increasing emphasis on skill-intensive and technology-intensive FDI in line with the industrial objective of moving up the value-added chain.

Creating FDI-friendly policies induce the required increase in high-technology FDI requires going beyond incentives per se and must instead address improving Laos's overall geographical advantages. Given the policy preference for moving into higher value-added manufactured goods and the human capital requirements of this type of production, there is an urgent need to complement FDI policies with a suitable human capital formation policy. Producing workers who can think, adapt and innovate should be of the utmost importance if Laos is to succeed in attracting high-technology FDI. This of course has significant implication for education policy in the country, and not only at tertiary level, as the love of learning and creative thinking should be instilled at the formative stages of the education process. Rapid change in technology will also

[21] Interview Informant No 10, 22 December 2006.

require Laos to shift toward implementing the life-long learning paradigm in its education policy.

In addition, given the high rate of domestic savings and the positive resource gap in the country, domestic investment has to be harnessed for development in order to reduce the dependence on FDI. Concurrently indigenous research and development capabilities have to be fostered in order to move Laos up the technology ladder. Given the government's considerable investment in research facilities of rubber and sugar, there need to be a greater effort to promote the growth of these two sub-sectors, especially in the downstream segments of these industries.

Increasing competition for FDI also points to the need for regional cooperation in this area, as this can help to substitute for declining individual geographical advantages or compensate for individual geographical disadvantage in the region. Modalities for cooperation can take the form of improving the implementation of the AFTA, deepening economic integration beyond AFTA, joint promotion of FDI, improving transport and communication networks in the region, accelerating plans for the proposed ASEAN investment area and harmonizing investment regulation among member countries.[22]

There is growing recognition that some problems can only be addressed effectively through a regional approach. A careful division of labor has been developed, in which the GMS Program will provide assistance to address binding constraints to poverty reduction that are best addressed regionally, complemented by national program support to address poverty reduction constraints in key sectors and thematic areas.

The Government's long-term strategy is "growth with equity" with the long-term aim of eradicating severe poverty. Reaching this ambitious goal will require persistent high economic growth, averaging at least 7% per annum between 2005 and 2020.

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[22] Gloria Davies and Chris Nyland, Globalization in the Asian Region: Impact and Consequences (UK: Edward Elgar, 2004), p.76-77.

In addition to loans from international organizations, FDI has been a major source of support for the country's balance of payments. In 1999, FDI was $79 million. From 1995 to 1997, FDI in the energy sector accounted for more than half of all private FDI. However, in 1998 and 1999, the share decreased as a percentage of total FDI. In 1999, investments in the energy sector accounted for $27 million. From 1996 to 2000, the country approved 263 projects for more than $1.6 billion. The total amount of actual FDI received in this period was substantially less, although part of this represents commitments for future investments, particularly in the hydroelectric sector. FDI will be increasingly important as the amortization payment of the official debt increases and trade expands as a result of the country's greater integration in ASEAN.

Laos, a land-locked country with abundant natural resources but still among the world's least developed nations, has begun opening its doors to international investors with incentives for companies that participate in its development.

Laos, which derived 45.4% of its economic growth from agriculture-related industries in 2005, was moving gradually toward industrialization, noting that agriculture accounted for 51.9% of GDP in 2001. The change reflects a shift of focus in line with other communist nations including China and Vietnam to a more market-oriented economy.

Country is more open to FDI; government allowed foreign participation with a requirement that local participation has to be at least 30% and are offering various incentives to investors who are willing to invest in our country that offers abundant cheap labor, although government acknowledged that labor skills remained low.

Laos has a labor force of about 2.9 million people out of its 5.6 million populations. The country has population growth of 2.4% and gross domestic product of a mere $2.7 billion, or per capita GDP of just $491. Laos's GDP was set to rise by 7.5% during 2006-07 after having grown by 6.2% between 2001 and 2005. Per capita GDP is set to rise to $591, thanks to the continued inflow of investments.

The opening up of the economy by the government to more private participation has helped push the share of private investment participation by foreigners to around

60% in 2005 against 22% in 2001, while decreasing public spending to 35.7% against 63.8% in the same periods.

The government in Vientiane has also been busy approving various FDI ventures in the country. In 2006, Laos received $2.68 billion in FDI against $1.25 billion in 2005 and $492 million in 2002. Total projects approved reached 158 in 2006 against 127 in 2005. Thailand is the country's largest investor with $1.33 billion invested from 2001 to March 2006, followed by China with $763 million and Vietnam with $463 million.

Approved FDI from 2000 to March 2006 represented 919 projects worth more than $5.57 billion, nearly double the country's GDP during 2006. The majority of the investments were in electricity generation, agricultural and mining sectors. Apart from this the country's bilateral agreements with 23 countries offer investment promotion and protection. It is also in the process of joining the World Trade Organization (WTO).

To promote the country's central location, Laos has been working to make itself the link between robustly growing China and the 10-member ASEAN countries via its network of roadways. The government is helping by offering a guarantee against expropriation and nationalization without compensation, allowing the remittance of dividends and profits back to home or third countries, and offering long-term land leases of 50-75 years.

Key areas that the government wants to promote are production for export, agricultural-related processing and forestry, industrial processing, human resource development and public health. Infrastructure, production of raw materials and development of tourism, especially ecotourism, are also priorities.

Apart from this the government has various designated zones that offer tax breaks from 10% to 25% and ranging from two to seven years. Favorable import/export duties, an income tax of just 10% for expatriate employees, and additional incentives can be negotiated for large projects.

Laos is also offering investors the Savannakhet economic zone located in an area with a high-potential workforce. Linked to the various highways, it is touted as the prime site for future growth.

FDI will continue to play a major role in the efforts of Laos as they expand their industrial and marketing structures. In the process, occasional policy issues and points of friction between foreign investors and the host countries are bound to arise. This is especially true as the country now has a clearer picture of what they want to achieve economically. They are placing a greater emphasis on national self reliance and are increasingly sensitive to trade imbalance and external factors which might affect their internal social situations. But to the foreign investor who must risk time and money, it sometimes appears that the resultant investment rules and policies are unfair and onerous.

FDI is also directly accompanied by technological, managerial, and marketing resources, which can often pose more serious investment bottle-necks than financial resources. The extent and nature of effects of FDI on Laos/host country depend on the volume and nature of investments, phase of project cycle, the policy framework, and the corporate strategies of investing firms. First, the larger the volume of FDI, the greater the quantitative impact on host-country production, employment, skill generation, technology transfer, and exports. The large scale of FDI will ensures, inter alia, larger direct and indirect investment effects than in Laos where scale of FDI is much smaller. Second, traditional FDI in import-substitution industries enjoying import protection tends to be less beneficial to the host country, as there is less pressure to be efficient and competitive and great opportunity for monopoly profits, although such investments create infant industries and promote local linkages. Export-oriented investments are more internationally competitive and have more positive effects on the balance of payments. FDI in Laos are increasingly export-oriented and help develop efficient export industries.

Third, lag effects mean that mature investment projects produce more spinoffs than new projects. The impacts of FDI on skills development, technology transfer, and linkages generally improve overtime, particularly when the host country makes corresponding efforts to improve the absorptive capacity through human resources development, research and development and development of a local supporting parts and components industry. Fourth, increasingly, corporate strategies of multinational corporations allocate different parts of the value chain to different geographical locations in accordance with the assessments of national and industry competitive advantages.

Although the benefit of FDI are increasingly recognized, there remain concerns over possible ''crowding out'' of domestic enterprises, excessive concessions to foreign firms, and unequal distribution of FDI within a country resulting in widening development gaps between sub- regions. First, a large influx of FDI creates opportunities for local businesses through joint venture and backward and forward linkages, but the financial and technological ownership advantages of foreign multinational corporations could crowd out domestic enterprises through competition in both the production and factor markets. To offset this, host countries would need to upgrade local enterprises and develop supporting industries. Second, there is the danger that the intensified competition for FDI may induce the host governments to offer excessive investment incentives and unduly relax environment, labor safety, and prudential regulations. Too generous tax holidays and concessions can reduce government tax revenues, while heavy subsidies on industrial land and infrastructural facilities can impose a heavy burden on government resources. Lao government need to rationalize their incentive structures to ensure that they are not giving to much away. Third, the creation of export processing zones and special economic zones in selected areas to attract FDI has contributed to widening development and income gaps between sub-regions of country to offsets this, Lao government is increasingly creating investment zones and providing investment incentive for disadvantaged areas, including the formation of growth triangles to encompass peripheral regions.[23] While the importance of FDI for the transitional economies is duly recognized, one must not lose sight of the fact that demands for FDI is outpacing its supply. It is unlikely that foreign investors will rush in just because the doors are open. Most investors would opt to sit on

[23] Chia Siow Yue and Marcello Pacini, ASEAN in the New Asia: Issues & Trends (Singapore: Institute of Southeast Asian Studies, 1998), p. 44-45.

the fence and adopt a wait-and-see attitude. There is still a strong preference among foreign investors for countries with proven track record. Competing for FDI means not just offering cheap labor and tax incentives but also providing infrastructural and institutional supports and consistent, coherent, and transparent policies with continuity.

To be sure, economic cooperation with immediate neighbors can expedite the process. This cooperation need not necessarily be a formal one. The emergence of GMS program in the border areas can lock in the reform process. Thus Laos can benefit much by linking up with ASEAN. Economic cooperation with neighbor is particularly critical for Laos, which is land-locked.[24]

5.6 Impact of Foreign Direct Investment

FDI have helped lift many Laotians out of poverty, with the poverty rate declining from 48% in 1990 to 33.5% in 2003 and 28.7% currently. FDI can make a significant contribution, both to growth and to the extent to which growth impacts on poverty levels. The contribution of domestic investment has sometimes been limited, either by a lack of understanding of the channels through which domestic investment can reduce poverty, or by a lack of methods to assess the impact of domestic investment on poverty.

One of the most direct impacts of FDI activity is the resettlement of communities to make way for it. Many households may have to lose houses, rice granaries, small shops and land. Resettlement plans have been carefully drafted, but past experiences warn that they may not be sufficient to ensure adequate compensation as agreed-upon standards are rarely applied, regulation on land tenure and titling is unclear, and malpractice in disbursements is rampant.

Affected households too often become worse off in the process, with assigned locations lacking services and being smaller in size and with land less fertile than in the

[24] Seiji Finch Naya and Joseph L.H. Tan, Asian Transitional Economies: Challenges and Prospects for Reform and Transformation (Singapore: Institute of Southeast Asian Studies, 1995), p. 68.

original places. Displacement also occurs with land grabbing – a growing phenomena resulting from speculation for growing value land adjacent to the road. Once resettled or displaced, communities will have to undergo dramatic changes, having to adjust to new surroundings, occupations, lifestyles, social norms and economic systems, under the prospect of an uncertain future.

More generally, road and other infrastructure projects revolutionize the lives of upland ethnic communities, enticing them to move down and abandon subsistence agriculture for market-based activities.

Logging, expansion of commercial cultivations, and restrictions imposed on swidden agriculture further limit the resources on which they depend, compelling them to look for alternatives along the road or in locations made less distant by the road, notwithstanding the many risks awaiting them.

An indication of these changes is the growing relevance of non-farming activities for ethnic communities affected by the economic activity. Former cultivators now seek work in mining companies, construction projects or in other low-skilled jobs in urban city, or even across the Mekong into Thailand. With low literacy levels, no relevant work experience and lacking bargaining power, now landless, wage-dependent, ethnic people become an under-strata in the multi-layered hierarchy of labor that is evolving around the road No. 9, finding exploitation rather than welfare in the promised world of 'development' and 'modernity' regulated by market forces.

Besides those moving from the upper slopes, many come to the new road from outside the province and even the country, making extremely pluralist societies of relatively homogenous communities. The flows are many and diverse: retailers and traders settle in prime locations to exploit the road potential; construction companies, when from Vietnam or Thailand, often bring their own workers and establish large settlements near the road; and tourists, officials, and traders from various nationalities and ethnic groups venture in opened-up territories.

Whether the promised benefits of poverty reduction and better access to basic social services, electricity and water, information and communication for local populations will compensate for their eventual losses remains an open question. For now, the little we know seems to indicate that greater inter-interaction and access to market opportunities stemming from the economic project, while of aggregate value for the sub-region, will inevitably have distressing consequences for those communities and groups already in a disadvantaged position. Justified fears that ethnic communities will lose their cultural identity and social cohesion, without even being able to gain financial security in return.

5.7 Investment Program and Impact on Poverty

Main trends in foreign investment projects with respect to poverty as observed so far are:

- Most of the projects involve infrastructure and many people say they are better off because of infrastructure (roads, schools, clinics, markets) that allow access to the sale of goods and the purchase of new goods, and to health and education services.
- Agricultural production, however, has not improved and has often become worse, especially after village relocations, and is not sufficient for sustainable livelihoods.
- Livestock disease remains a major problem and has not been resolved.
- Roads are said by villagers to be ''good'' because they allow villagers to access markets for the sale of forest products which they rely upon for subsistence but which they say are consequently being depleted.
- Only a few individuals in each village have become wealthy and are benefiting in an unequal way from infrastructure projects.

It is now widely accepted that poverty reduction, and progress towards the Millennium Development Goals, depends not only on economic growth but also on the extent to which such growth is 'pro-poor'. Domestic investment can make a significant contribution, both to growth and to the extent to which growth impacts on poverty levels.[25]

However, the contribution of domestic investment has sometimes been limited, either by a lack of understanding of the channels through which domestic investment can reduce poverty, or by a lack of methods to assess the impact of domestic investment on poverty.

5.8 Conclusion

Laos has approved a raft of resource-based investment projects, mainly in mining and hydropower, and some concerns have been raised over issues of natural resource management and income generation.

The host country business environment in the transitional economy of Laos has improved in terms of physical infrastructure; communications and transport system; trade and investment regime; general perceptions and government treatment of FDI sector; foreign currency and financial transactions; and so on. This has been of benefit to various elements of the corporate sector, including local investors. Clearly, the policy agenda is wide-ranging.[26]

The host country investment agencies of Laos would benefit from becoming better informed of the international business environment, and acquiring a more advanced understanding of their economies' and corporate sectors' competitive strength – where province of Savannakhet best fit into the 'global food chain', there is little utility in continuing to generate lengthy lists of projects that the province wish to see FDI input, as has been done in the past. It has to be recognized that FDI flow patterns are driven as much by 'push factors' as they are by 'pull factors'. Another mini-revolution is underway in the field of international business today, which will have an

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[25] UNDP/ODI Workshop, The role of public investment in poverty reduction (London: Overseas Development Institute, 2005)

[26] Denis Hew and Loi Wee Nee, Entrepreneurship and SMEs in Southeast Asia (Singapore: Institute of Southeast Asian Studies, 2004), p. 233.

impact on the kinds of FDI activity we are likely to see in this developing country in the coming years.

Laos transitional economy struggling as late developers needs to develop modern industrial structures as well as infrastructures (for example, systems of transport and telecommunications) and upgrade their human resources. Indeed, there is a great and urgent need for a wide spectrum of such development project – which certainly open up vast opportunities for FDI and multinationals to make notable contributions in areas such as modern technology, organizational and managerial know-how, international marketing, and export promotion.

FDI has the potential of contributing positively to the growth and development process in the transitional economy.

To what extent FDI can contribute to the developmental potential of transitional economies will depend on the policies of the host. Given this potential, national and international policies should encourage and facilitate the flow of FDI to stimulate development in this transitional economy.[27]

Reforming socialist economy like Lao PDR may have a number of factors in their favor, such as low-cost labor, attractive natural resource endowments, and potentially important domestic market. But, the negative factors could weigh against or even outweigh these advantages, such as the high cost of doing business and serious impediments and weaknesses in the legal, financial, and industrial infrastructure. There are also bureaucratic bottle-necks in the investment approval process.[28]

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[27] Seiji Finch Naya and Joseph L.H. Tan, Asian Transitional Economies: Challenges and Prospects for Reform and Transformation (Singapore: Institute of Southeast Asian Studies, 1995), p. 71.

[28] Ibid