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Policy Towards Foreign Direct Investment in Laos: Essence, Attractive and Problematic Features, and Impacts

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Abstract: This research delves into Laos' economic transformation from a closed system to an open market, attracting significant foreign direct investment (FDI) post-1986. Despite challenges like regulatory ambiguities and administrative inefficiencies, FDI, especially in sectors like hydro energy and mining, has markedly boosted Laos' GDP and employment opportunities.

Keywords: Foreign direct investment, Laos, attractive, problematic features.

1. Introduction

1.1. Economy of Laos in a nutshell

Since its establishment in 1975, the Lao People's Democratic Republic had adopted a closed foreign policy and a planned economy, which is why international scholars described the early Laos as the "forgotten Southeast Asian country." Since 1986, Laos has been implementing reforms and opening up, introducing the New Economic Mechanism, gradually transitioning from a natural economy to a commodity economy, and opening up trade and investment to the outside world. In 1989, the Lao government reached an agreement with the World Bank and the International Monetary Fund to undertake fiscal and monetary reforms, encourage private enterprise and foreign direct investment, and privatize state-owned enterprises. In addition, Laos maintains a flexible exchange rate, reduces tariffs and eliminates redundant trade controls improving local market conditions and boosting economic growth. Laos' economic reforms gained incredible momentum after joining the Association of Southeast Asian Nations (ASEAN) in 1887, followed by its accession to the World Trade Organization in 2012. In order to get rid of the label of a backward country, the Lao government announced the National Development and Poverty Eradication Strategy (NGPES) in 2003. Foreign direct investment (FDI) and official development assistance (ODA) are the priority sources of funding for Laos because of the poor infrastructure, human resources and productivity [1].

With the reform and opening up, Laos has been trying to optimize its economic and industrial structure, prioritizing agriculture and forestry, developing secondary industries and tertiary services, and improving infrastructure construction. The main crops in Lao agriculture are cotton, corn, peanuts, rice, coffee, and tobacco. The main industrial activities are mining, forestry, electricity, textiles, chemicals, and pharmaceuticals, almost all of which are produced on a small scale. The service sector has been renewed since the reform and opening up. In terms of the share of economic sectors in GDP structure, in 2021, Laos has the largest share of the service industry with about 38.85% of GDP, followed by agriculture and forestry with approximately 16.07% and foreign direct investment with about 5.1% [2].

2. Laos' FDI Policy

2.1. Development of FDI

According to UNCTAD's *World Investment Report 2021*, FDI inflows to Laos increased to USD 968 million in 2020 from USD 557 million a year earlier, despite the global economic crisis triggered by the Covid-19 pandemic [3]. The stock of FDI was USD 10.9 billion in 2020. Projects in hydro energy production and mining resource development account for around 80% of cumulative foreign investment over the past decade (mining and hydropower accounted for 95.7% of FDIs in 2019, according to the Lao government statistics, the latest data available). Transportation infrastructure, tourism and large-scale agroforestry projects are also attracting new investors. In addition, the government aims to integrate Laos into regional supply chains through the development of light manufacturing industry, making the country a low-cost export base. According to data from the National Investment Promotion Department, the leading investors in Laos are large neighboring countries such as China, Thailand and Vietnam, but also France and Japan.

The government has pursued a policy of promoting foreign direct investment, and the investment law was amended at the end of 2016. Foreigners can invest in any sector or enterprise unless it poses a threat to national security, health or national traditions, or could negatively impact the environment [4]. There are incentives available to foreign investors and "special" and "specific" economic zones, such as the Vientiane Industrial and Trade Area, which has successfully attracted major manufacturers from Europe, North America and Japan.

2.2. Diversified foreign investment structure

The structure of foreign direct investment in the Lao Special Economic Zones, for example, is diversified and includes both governmental and private investment in retail, real estate, infrastructures such as hydropower and road building, agriculture and mining. In terms of overall foreign investment attracted to Laos from 1988 to 2018, the largest share of investment is in infrastructure such as hydropower (31%), followed by mining (20%), and in third place is agriculture (13%). In addition, the scale of foreign investment in the real estate construction, service and retail sectors is also larger.

2.3. FDI policy essence

It is worth noting that, firstly, the Lao government actively encourages foreign companies to invest in hydropower projects in Laos. As of the end of 2018, more than 20 foreign-invested hydropower projects are under construction and already built. Since Laos is rich in hydro resources, it has made significant profits from electricity exports to China, Vietnam and Thailand. For example, Nam Theun 2 Power Company Limited (NTPC) is the largest hydroelectric project in the country, with shareholders including Lao Holding State Enterprise (25%), Thailand Electricity Generating Public Company Limited (25%), Electricite de France International (35%), Italian-Thai Development Public Company Limited (15%) [5].

Secondly, Laos developed Tourism Strategy 2006-2020 and Tourism Development Plan 2021-2025, which focuses on the development of three tourism regions, Luang Prabang, Luang Namtha, Xiengkhaung, and Bokeo in the north, Vientiane, Khammuane, Savannakhet in the central part, and Champasak, Attapue, Salavanh in the south, which have attracted a large influx of foreign investors [6]. The government partnered with over 500 overseas companies, increased the number of international tourism ports to 15, and adopted a series of policies to support transnational tourism development, such as lowering visa fees, relaxing visa standards, reducing entry procedures and increasing financial spending on tourism infrastructure development [7]. According to the Lao government statistics, Laos hosted domestic and foreign tourists from the beginning of 2010 to the end of 2018, supplying more than 8.9 million people. In 2018, Laos' tourism industry generated a total of USD 1.235 billion, with the primary sources of foreign tourists being Thailand, Vietnam and China in that order.

Third, the Lao government followed the successful cases of neighboring countries to develop Special Economic Zones. SEZ businesses can enjoy a ten-year corporate profits tax reduction and a preferential tax rate of 8% after ten years.

Fourth, the Promotion of Overseas Investment Act and the Promotion of Local Investment Act were merged and replaced by the Investment Promotion Act No. 14/NA. The new highlights are (1) a simplified registration process for new business; (2) no annual limit for investment in promotional activities; (3) extension of tax benefits, ten-year tax exemption for corporate profits tax and five-year extension of benefits for education and medical projects; (4) legal access to local funds for foreign investors; (5) foreign companies can own land and buildings in Laos; (6) foreign investors can invest in real estate projects; and (7) promotion of SEZs and industrial park development [8].

3. Attractive Features towards FDI

3.1. Incentive programs

3.1.1. Grant for Capital Investments

Article 9 of the Investment Promotion Law in Laos encourages investment in sectors such as high technology, environment-friendly agriculture and processing industries, cultural and historical tourism, education and vocational training, hospitals and pharmaceuticals, infrastructure, modern commercial centers and exhibition center construction. The government grants at least 200 million LAK incentives for investments in these sectors. Suppose a foreign-funded enterprise employs at least 30 Lao skilled workers or hires more than 50 Lao laborers with an employment contract of at least one year. In that case, it will be rewarded by the provisions of relevant laws [4].

3.1.2. Taxation Benefits

In terms of profits tax, VAT and tariff, Article 11 of the Investment Promotion Law provides for a 10-year tax exemption for foreign investors in industries where investment is encouraged, particularly in clean agriculture, ethnic sectors and education, with an additional 5-year exemption period. Article 12 stipulates that raw materials, equipment and parts imported for production are exempt from tariffs and subject to VAT at a rate of 0% [4].

Enterprises investing in "Zone 1" enjoy the highest level of state investment incentives, i.e., no profits tax for the first ten years of operation and only 10% of the annual operating profit after ten years; all enterprises in "Zone 2" are exempt from profits tax for four years, after which they are required to pay 15% of the annual operating profit; enterprises investing in "Zone 3" are exempt from profits tax for the first two years, and after two years, they are required to pay 20% of the annual profits tax [4].

3.1.3. Special Economic Zones

The ASEAN Committee adopted a resolution supporting the establishment of Special Economic Zones in developing countries to promote development in 2007. The Lao government also recognizes the SEZs as an essential tool for attracting foreign investment, promoting economic growth and creating jobs. Hence, they passed several bills over the years to support the establishment of SEZs. For example, thanks to the Asian Development Bank's Greater Mekong Sub Region, the Bokeo Golden Triangle SEZ was invested by the Dok Gneio Kham Group for approximately USD 3 billion, including hotels, hospitals, duty-free stores and seaport operations [9]. The government built the Mekong Bridge and a highway connecting China and Bokeo to attract tourists worldwide and develop regional trade. There is also the similar Savan-Seno SEZ.

3.2. Investment and development of human capital

The Lao PDR established the Ministry of Labor and Social Welfare in January 1993 and implemented laws and regulations such as the Labor Law. The Lao Prime Minister's Office issued Notification No. 829/PMO on June 21, 2022, setting the minimum wage for general workers at LAK 1,200,000 per month [10]. In order to meet the labor use demand by investors, priority recruitment of Lao citizens is advocated. In the case of specialization, foreign laborers may be freely employed. It is necessary to facilitate foreign investors and laborers in terms of residence and entry or exit, including entry-exit visas for their families concerned.

3.3. Strong and transparent legal system

Laos's current foreign investment law is based on the Investment Promotion Law issued in 2009. In April 2011, the Lao government launched the Regulations on the Implementation of the Investment Promotion Law, which supplemented and adjusted some of the provisions of the Investment Promotion Law. A further amendment to the original Foreign Investment Law was made in 2016, introducing a new Investment Promotion Law, which contains 12 parts and a total of 109 articles in the revised Foreign Investment Law. The new Foreign Investment Law aims to expand the concessions for investors, stimulating and benefiting from foreign investment in Laos.

In addition to the laws related to foreign investment frequently mentioned in this article, it is worth noting that Laos provides for secured interests in moveable and non-moveable property under the 2005 Law on Secured Transactions and a 2011 implementing decree from the Prime Minister [11]. In 2011 the National Assembly passed a comprehensive revision of the Law on Intellectual Property which brings it into compliance with WIPO and Trade-Related Aspects of Intellectual Property standards (TRIPS) [12].

4. Problematic Features Towards FDI

4.1. Uneven application of laws

One is the lack of access system. Developing countries generally take the industrial access system as an essential means to control the entry of foreign capital. Taking China as an example, they have made explicit provisions in the Provisions on Guiding the Direction of Foreign Investment and the Catalogue for the Guidance of Foreign Investment Industries. Laos has less legislation in related aspects, only some local regulations.

Second is the lack of a sound mechanism for the supervision of foreign investment practices. In order to expand the scale and projects of foreign investment, Laos has further lowered its entry standards and liberalized its entry market. Allowing foreign investors to enter without strict supervision will bring a big blow to the development of domestic enterprises, which puts more competition and pressure on domestic firms. Moreover, the lack of strict control of foreign-invested enterprises can trigger financial risks because foreign investors can quickly divest after short-term business failures, which can harm the development of the Lao economy, especially for small or inexperienced enterprises that lack financial security. In addition, Laos' opening areas include many industries that are restricted to developing countries, such as insurance, banking, and energy. It is worth mentioning that Laos does not have a stable securities market at present, so the massive capital attraction under such circumstances will not lead to the objective formation of an orderly and regulated securities market in Laos but will cause financial market turmoil due to the lack of financial regulatory mechanisms.

4.2. Policy and regulatory ambiguity

There are no published, formal restrictions on foreign exchange conversion, though restrictions have previously been reported, and because the market for Lao kip is relatively small, the currency is rarely convertible outside the immediate region. The Accounting Law places no limitations on foreign investors transferring after-tax profits, income from technology transfer, initial capital, interest, wages and salaries, or other remittances to the company's home country or third countries provided that they request approval from the Lao government [13]. However, there is a need to be alert to the fact that this could create currency risks, which would be very detrimental to economic development as well as foreign exchange reserves.

4.3. One stop service in name only

First, the Lao government's one stop service remains inefficient, with delays at every step. While the Investment Promotion Law clearly states that investments in state-controlled enterprises require a maximum of 8 working days to receive a state concession, the actual implementation is still not done within 60 working days, because most Lao government employees are not efficient in performing their assigned duties. Second, the corruption problem in Laos is a deterrent to FDI entry. As a result of the World Bank *Enterprise Survey*, nearly 40 percent of businesses believe that solving problems in Laos requires giving gifts to government officials, far exceeding the 21.1 percent in East Asia and the Pacific and 12.1 percent globally [14].

5. Impacts

5.1. Economy

5.1.1. Positive Contribution towards National GDP

The large inflow of foreign direct investment is responsible for the rapid growth of Laos' GDP, which in 2001 was USD 1.764 billion, an increase of 9.8% over the previous year [15]. Since then, Laos' economy has started to rise steadily. According to World Bank statistics, between 2003 and 2018, Laos' GDP grew at an average rate of more than 6%, from USD 2.02 billion to 18.74 billion [16]. Laos' GDP growth rate from 2019 to 2021 is slightly lower than in previous years, mainly due to the slowdown in global economic growth affected by the Covid-19 pandemic and the fall in mineral prices, which for Laos relies heavily on mineral exports, fluctuations in mineral prices can directly affect economic growth.

5.1.2. Positive Contribution Towards National Balance of Payment

Trading activities in multinational companies contribute to the balance of payment in Laos. The Lao PDR maintains its balance of payments through a foreign exchange management system, and the Investment Promotion Law requires the approval of the relevant banks for foreign exchange transactions [17]. However, it is alarming to note that Laos is beginning to show signs of Dutch disease. The influx of FDI into the natural resource sector led to an income increase and the appreciation of the Lao currency, which led to the relatively expensive goods produced in Laos. This phenomenon weakens the competitiveness of the Lao manufacturing industry and slightly affects the sustainability of the Lao economy.

5.2. Employment

Foreign-owned companies contribute significant job creation in the Laos labor market. The effects of FDI on employment in Laos include increasing the demand for high-skilled labor, promoting the level of wages, generating technology spillovers, and promoting human capital development. Twelve SEZs in Laos are beneficial in creating jobs and increasing the income of workers. Total employment involving foreign and local labor in SEZs reportedly increased from 11,000 workers in 2014 to 18,000 in 2018, with Lao workers accounting for almost half of the total number [18]. Lao workers make up nearly 80 percent of the total number of workers in the Savan-Seno and Vientiane Industrial And Trade Area.

6. Conclusion

Foreign direct investment in Laos involves primary, secondary and tertiary industries, mainly mining, hydropower and timber processing. The entry of foreign investors can not only make up for the shortage of domestic capital but also introduce advanced technologies, increase employment and improve the structure of foreign trade.

In general, the opportunities for foreign investors in Laos outweigh the challenges due to the outstanding advantages of natural resources, industry selection and cheap labor. In January 2016, the 10th National Congress of the Lao People's Revolutionary Party adopted a vision for the development of Laos in 2030, which mentions the result of a green economy, the expansion of international trade cooperation and the improvement of the regulations of the Lao economic system [19]. In addition, Laos adopted a strategic plan for economic and social development for 2016-2025 and released the Government's Economic Priorities Program for 2021-2023 [20]. It is clear that the Lao government is very active in developing the economy and attracting foreign investment. The results of Laos' development are also evident to all, as we can see from the GDP growth rate of over 6% in recent years. A series of initiatives in industrial structure reform, market and financial system reform, and infrastructure development have also played a positive role in improving the environment for attracting foreign direct investment in Laos.

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