

# Laos DTIS<sup>1</sup>: Aide Memoire of Main Mission

This Aide Memoire reflects (i) the progress achieved in the Integrated Framework (IF) process; and (ii) the initial findings of the main mission. The mission would like to thank the Lao authorities for their feedback, support, and guidance throughout the mission, under the leadership of Mme Khemmani Pholsena, Director General, Department of Foreign Trade, Ministry of Commerce; H.E. Mr. Soulivong Daravong, Minister of Commerce, and H.E. Mr. Siasavath Savengsuksa, Vice-Minister of Commerce. Thanks also go to AusAID and the Australian Ambassador for supporting the role of IF Facilitator and for their close engagement in the IF process during the mission; all IF institutions that actively participated in the mission; other donors and international agencies that worked with the mission; and all the government officials that took the time to meet with the mission members.

## Summary

### **1. IF process:**

- Australia, supporting the role of IF facilitator, engaged closely with the mission and is playing a key part in the IF process.
- It has been suggested that a sub-working group under the Macro-Economic and Private Sector Development Donor working group be used as a forum for IF discussion and coordination under the leadership of the World Bank and the IFF—need for donor coordination highlighted.
- All IF institutions (IMF, WTO, UNCTAD, ITC, UNDP, and World Bank) participated in the mission and are contributing to the DTIS—this would ensure stronger synergies between the DTIS and their existing work on trade.
- The mission not only with the government counterparts and specific donors as required, but also organized several half-day group meetings with donors in Vientiane, with private sector groups in Vientiane for key sectors, and with local authorities and private sector in Savannakhet.

### **2. Mission findings:**

- The development of Lao exports will continue to be limited by resources, in particular capital and labor, and by location. Costs of production are comparatively high, labor productivity is comparatively low, the management of quality and information is insufficiently developed, and pro-activity in marketing approach is insufficient.
- Supply bottlenecks, rather than markets access, are the major constraints for export development. There has been more focus to date on the “supply side” constraints to

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<sup>1</sup> The DTIS is undertaken in the context of the Integrated Framework of Trade-Related Technical Assistance to Least Developed Countries (IF). The IF is a multi-donor multi-agency program established by WTO trade ministers in 1996 to promote the integration of the least developed countries into the global economy. The participating agencies are: IMF, ITC, UNCTAD, UNDP, WTO, and the World Bank. The IF starts with a diagnostic (the DTIS), which is led by the World Bank.

export development (e.g., in tourism and industry); understanding the “demand side” (what does the international market want) is equally important and can help guide investment priorities at both government and business levels.

- The growth of Lao exports will depend on identifying niche markets. The initial focus could be on the short-term expansion of exports within the current environment in order to play a catalytic role in the overall strategy of increasing export competitiveness. Industry cluster strategies for positioning key products in international markets need to be developed. Such strategies would entail market research and deeper understanding of international markets, branding of Lao PDR and its high-value products and services, and industry-government coordination.
- The growth of Lao export capacity will also depend on maintaining an open and liberal international trade regime, simplifying eliminating licensing and approval procedures, and developing better upstream logistics.
- While WTO accession is important, there are likely to be some more pressing priorities on the trade and investment policy front, including the Agreements made or being negotiated by ASEAN with China, Japan, Korea, India, Australia and New Zealand, and particularly the Bilateral Trade Agreement with the USA, which may produce some immediate impetus for legislative and procedural change. Preparing for and implementing these agreements should all help pave the way for meeting the complex demands of the accession process and for implementing the various WTO agreements.

### **3. Next steps:**

- The DTIS report will be prepared over the next 6 months. It will be done in collaboration with the IMF (input into macro), ITC (input into export competitiveness), UNCTAD (input into trade facilitation), WTO (input into WTO accession issues), and UNDP (input into trade and poverty), and with several iterations of drafts with the Government and donors.
- The DTIS team will remain in contact with the IF Facilitator.
- Early drafts of the DTIS chapters and Action Matrix will be sent to the government, donors, and IF institutions in order to get their feedback early on.
- The DTIS team will be exploring ways to mainstream DTIS recommendations and other donor suggestions related to trade priorities and policies into the NGPES and the next Five-Year National Socio-Economic Development Plan. The DTIS is already incorporating the main findings of the mission into a draft background paper on trade for the Five-Year Plan provided by the Government.

## I. The DTIS Mission, Progress in the IF Process, and Next Steps

**Background:** The Integrated Framework is being undertaken at the request of the Government of Lao PDR. In March 2004, the World Bank organized an informal workshop in Vientiane to explain to the WTO/IF National Steering Committee and stakeholders across government the purpose, the process, and the expected outcome of the Integrated Framework. The meeting was led by officials from the Ministry of Commerce, and was attended by all concerned ministries which form the WTO/IF counterpart team. A preliminary DTIS mission took place in June 2004 and a workshop was also organized by the World Bank Institute on trade issues to improve the understanding of trade issues by government officials. Following the preliminary mission, the Government expressed its willingness to follow a more pragmatic approach to the DTIS than the more traditional one envisioned and to focus more on export competitiveness. The DTIS team was changed accordingly.

**Staggered mission:** The DTIS main mission was staggered over several weeks in order to accommodate the Government and to ensure maximum overlap with trade missions of other Integrated Framework (IF) institutions.

The *Customs mission*, consisting of Bill LeDrew (consultant) and Michel Zarnowiecki (World Bank), visited Laos during February 22-25, 2005. The mission had meetings with senior officials of the Ministry of Finance, the Lao Customs Department, the Ministry of Commerce, and importers and representatives of the private sector. The Customs mission also met the IMF Resident Representative, the UNDP Deputy Resident representative in Vientiane, and the French technical advisor to the Minister of Finance. In addition, the mission carried out a field visit to Thanaleng and Friendship Bridge border crossing and clearance station. The Customs mission took place right after the IMF Customs mission which also included Bill Ledrew.

The *Sanitary and Phyto Sanitary (SPS) mission*, consisting of Kees van der Meer and Laura Ignacio (World Bank), visited Laos during February 20-27, 2005. The team visited the main government agencies involved in managing sanitary and phyto-sanitary measures, private sector stakeholders, and specialists in other international agencies. The team also gave a half day seminar sharing the World Bank's experiences in other countries in this area with staff from various ministries and representatives of the private sector. In a wrap-up meeting the team shared its findings with representatives of the Ministry of Commerce. The SPS mission also went to Thailand to collect information about standards in Thailand—Laos's main trading partner.

The *Trade Facilitation (TF) mission*, consisting of John Arnold (consultant) and Baher El-Hifnawi (World Bank), visited Laos during March 14-27, 2005. This team overlapped with the UNCTAD trade facilitation mission that was in Laos during the week of March 21. One UNCTAD trade facilitation consultant (Ruth Banomyong) will also be working on trade facilitation for the DTIS. This will help ensure good coordination between the DTIS and the UNCTAD work. The TF team attended the UNCTAD trade facilitation workshop held in Vientiane. The team met first with the Lao National Transport Committee, as well as private transportation companies and freight forwarders. In addition, the team carried out a field visit to the Friendship Bridge and held discussions with the Thai customs authorities. The TF team would like to extend its appreciation for the support by Vice Minister Somad, Ministry of Transport.

The *main DTIS mission* took place during March 7-17, 2005. It consisted of:

- Mona Haddad (Team Leader)

- Philip Schuler (World Bank) and Phouvieng Phongsa (WTO)<sup>2</sup>: WTO issues
- George Fane and Khamlusa Nuansavan (consultants): trade policy and trade and poverty
- Kevin Murphy, Justin Stokes, and Orzu Matyakub (consultants): export competitiveness

An initial list of meetings is attached (more meetings were organized during the mission).

Several members of the Integrated Framework Institutions joined the mission and the meetings, including:

- UNDP: Mumtaz Keklik, Rie Diebarata, Anna Gaby Guerrero
- UNCTAD: Sven Callebaut, Linh Vu
- ITC: David Van, Franck Caussin, Alain Chevalier
- WTO: Phouvieng Phongsa (Maika Oshikawa could not join from Geneva as planned)

The mission closely collaborated with other international organizations as well, including ADB, FAO, and WHO, and with several donors, especially AusAid (the IF Facilitator).

The DTIS team is also closely working with the IMF team in Washington, DC.

The IF institutions will contribute to the DTIS in the following way:

- UNDP on trade and poverty based on their work for the next Lao PDR Human Development Report (which is on trade and poverty reduction)
- ITC on export competitiveness, based on their work for the export competitiveness project
- UNCTAD on trade facilitation, based on their work for the trade facilitation project
- IMF: responsible for the macro chapter
- WTO: WTO issues

**Briefing of IF institutions in Headquarters:** Prior to the mission, a video conference was organized on February 18, 2005, with all IF institutions in Geneva and Washington. The team leader briefed the representatives of these institutions on where the DTIS stands and what the mission was planning to achieve. The following people attended the video conference: Annet Blank (WTO), Maika Oshikawa (WTO), Celine Bacrot (UNCTAD), David Luke (UNDP), Mona Haddad (WB), Leendert Solleveld (WB), Philip Schuler (WB), Qaizar Hussain (IMF), and Georges Papazafirooulos (ITC). At this meeting, the IF institutions informed each other of the trade-related work they are doing in Laos.

**Briefing of donors and IF National Steering Committee in Vientiane:** A briefing meeting for donors was held on the first day of the main mission and was co-chaired by Mme Khemmani (Ministry of Commerce), H. E. Mr. Alistair Maclean (Australian ambassador to Laos), and Ms. Setsuko Yamazaki (UNDP). H.E. Mr. Siasavath Savengsuksa, Vice Minister, Ministry of Commerce, made opening statements. The Australian ambassador reiterated Australia's commitment to the IF, and the need for donor coordination to make the IF truly effective. The UNDP highlighted the need to effectively use funds under Window II. All donors discussed their work program in trade in Laos. A similar meeting was organized on the first day for the IF National Steering Committee (NSC). A wrap-up meeting for donors and government's IF Steering Committee was also organized at the end of the mission, chaired by the Vice Minister of Commerce. The DTIS team leader presented the main findings of the mission, and Ms. Anna

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<sup>2</sup> Maika Oshikawa (WTO) was not able to join the mission as planned because of health reasons, but is part of the team working on WTO issues.

Clancy (First Secretary, Australian embassy) presented a briefing on Australia's role supporting IF facilitation. The issue of donor coordination was raised, as well as the timing of the DTIS with the upcoming five-year Plan of the Government.

The list of participants is attached.

***The role of Australia as the IF Facilitator:*** Australia has agreed to support the IF Facilitator function for Laos. The mission would like to express its gratitude for all the efforts that the Australian Embassy contributed to its work, and to thank His Excellency the Ambassador for organizing a dinner in honor of the DTIS team, which included donors and government officials.

The role of the IF Facilitator is critical to the success of the IF. This role would include organizing and chairing a group of interested donors; supporting the Government in assessing the institutional needs to efficiently steer the IF process; and supporting the IF Steering Committee in preparing a mapping of the steps following the DTIS (priorities, sequencing, responsibilities). AusAid has been discussing with other resident missions the option of using a DTIS/IF/WTO and Trade Reform Process sub-working group under the existing Macro Economic and PSD donor working group as a forum for donor discussion/coordination of trade issues. The format for such a group is yet to be fully clarified.

AusAid was very closely engaged with the DTIS team, the Ministry of Commerce, and other IF institutions. AusAid also participated in key meetings. Moreover, AusAid co-funded a consultant to join the DTIS mission (Bob Warner) and provide guidance on donor coordination. The consultant is putting in place a preliminary draft on roles and responsibilities, donor matrix and next steps for initial dialogue with other stakeholders in Vientiane.

Over the coming months the DTIS team will remain in contact with the IF Facilitator regarding the following:

- 1) The status of the final drafts of the DTIS and DTIS Action Matrix. Early drafts of the DTIS chapters will be sent to the Government, donors, and IF institutions in order to get their feedback early on.
- 2) Exploring ways to mainstream DTIS recommendations and other donor suggestions related to trade priorities and policies into the NGPES and the next Five-Year National Socio-Economic Development Plan. The DTIS team is already incorporating the main findings of the mission into a draft background paper on trade for the Five-Year Plan provided by the Government.
- 3) Defining roles and responsibilities of key donor and government stakeholders to the IF process (AusAid is already working on this).
- 4) Gearing up for utilization of IF "Window II"<sup>3</sup> funding for trade-related programs which support timely implementation of the DTIS Action Matrix. Window II allocations will be managed by UNDP on behalf of the IF core agencies. MOC and Australia (in the IFF role) are expected to be members of the Local Project Approval Committee (LPAC). The Government of Lao PDR will be responsible for preparing project proposals.

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<sup>3</sup> After the DTIS is completed, a trust fund of about \$1 million is put at the disposal of the government to finance priority technical assistance projects from the Action Matrix, during a transition period of 1 year and before the donors commit to fund trade projects. This trust fund is managed by the UNDP.

5) Identify possible linkages/synergies with new and current donor programs.

**Competitiveness Workshops:** Three industry competitiveness experts moderated four half-day workshops on Lao tourism competitiveness, Lao manufacturing competitiveness, Lao agriculture competitiveness (all in Vientiane), and competitiveness in the Savannakhet region (in Savannakhet). These workshops were attended by government officials (including from MOC, National Tourism Authority, Ministry of Agriculture) and private sector. The workshops were interactive, provided international examples of how clusters succeeded in improving their competitiveness in other countries, and allowed the private sector to interact with government officials to work together on competitiveness issues. The experts also met individually with approximately 25 entrepreneurs, exporters and government officials.

**Next steps:**

- The DTIS will be prepared in the 6-9 months following the main mission, in collaboration with the IMF (macro), WTO (WTO issues), ITC (export competitiveness), UNCTAD (trade facilitation), and UNDP (trade and poverty). Drafts are due to the Team Leader by the end of June, and the content of the IF institutions' contributions to the DTIS has been agreed upon. The DTIS team will remain in touch with and seek the feedback of the IF facilitator, the Government, and other donors as the drafts of various chapters are being prepared. The DTIS team will also work closely with the Government and the IF facilitator to come up with a prioritized list of recommendations for actions, technical assistance and projects needed to better enhance trade and export in particular. This Action Matrix will serve as a common framework that could be integrated in the government's plans as well as guiding donor assistance in trade-related areas.
- Over the next few months, the team will be working closely with the MOC to provide inputs early on from the DTIS work into the preparation of the 2006-2010 Five-Year Plan. The Government will share with the DTIS team early drafts of trade-related reports that are being prepared for the Plan. The DTIS team will try to integrate the DTIS analysis into them to ensure cohesiveness between the DTIS and the Plan.
- Over the next few months, stepping up coordination with donors' planning and programming on trade-related capacity building will also be important—and could start even before the DTIS is completed, under the leadership of MOC and AusAid (as part of their IF facilitator role, through the donor working group meetings).
- Upon completion of the DTIS, a draft will be sent to the Government (MOC and IF Secretariat) for initial comments. The DTIS and Action Matrix are then discussed and validated by all national stakeholders, donors, and IF agencies during a National Workshop and revised in light of these discussions. The Government approves the final Action Matrix.
- Implementation phase: After the approval of the Action Matrix, a donor meeting is held to secure financing of the technical assistance needs identified in the Action Matrix and integrate them into donors' assistance program. Implementation of the IF and interactions with donors is a continuous process. Some of the technical assistance projects can be financed from the IF Window II trust funds, which are managed by UNDP on behalf of donors.<sup>4</sup>

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<sup>4</sup> Window II funds are available to finance concrete, modest, and priority technical assistance projects identified in the DTIS Action Matrix. Window II provides bridge financing until mobilization of donor funds, and allows prompt funding for follow-up technical assistance projects, particularly for trade capacity building. Projects for Window II funding are selected by a Local Project Approval Committee (LPAC) chaired by an appropriate government body. Membership of the LPAC includes as a minimum: the

- Timetable: the following timetable was agreed upon at the preliminary mission of the DTIS, and has been slightly updated.

<b>Task/activity</b>	<b>Responsible entity</b>	<b>Indicative time (agreed upon at the preliminary mission)</b>	<b>Updated Indicative time</b>
Prepare a menu of options for studies to be incorporated in the DTIS, taking account of the need not to duplicate existing & proposed economy-wide and sectoral studies	Team leader	September 2004	September 2004
NSC consults with and takes advice from private sector and mass organizations	NSC	December 2004	December 2004
Final decision by the NSC on the exact elements of the DTIS	NSC	December 2004	December 2004
Drawing up the TOR for the DTIS	World Bank/team leader	January 2005	January 2005
Appointment of the DTIS team (national and international consultants)	World Bank in consultation with NSC & team leader	January 2005	January 2005
Official launch of the DTIS (UNDP to advise IF Secretariat on procedures adopted in other IF countries)	NSC	February 2005	February 2005
Undertaking of the DTIS mission	DTIS team of consultants	February–June 2005	February–March 2005
Preparation of draft Action Matrix.	DTIS team of consultants	July 2005	July 2005
Comments on the draft DTIS report and draft Action Matrix	NSC, IF Working Group, donors, other stakeholders	August 2005	August 2005
Completion and distribution of the draft DTIS report and draft Action Matrix	Team leader	August 2005	September 2005
Convening of the National Workshop to be attended by all stakeholders to validate the DTIS and Action Matrix	NSC	October 2005	November 2005
Final DTIS report and Action Matrix submitted to NSC for approval	DTIS team leader	October 2005	November 2005
Integration of DTIS findings and Action Matrix into NGPES and Five-year Socio-Economic Development Plan	GOL		May-September 2005
Presentation of DTIS & Action Matrix to donors, including at Roundtable	GOL		To be determined

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Ministry of Finance or Planning, the Ministry of Commerce, UNDP Resident Representative or delegate, the Lead IF Facilitator, and the World Bank Resident Representative or delegate.

## **II. The DTIS Mission Main Findings**

### **1. Export competitiveness**

Three industry competitiveness experts moderated four half-day workshops on Lao tourism competitiveness, Lao manufacturing competitiveness, Lao agriculture competitiveness, and competitiveness in the Savannakhet region. Workshop participants revealed a high level of receptivity to further active participation in understanding their current position and working together to implement strategic change. Participants in the four workshops validated that there is keen interest on the part of local entrepreneurs and exporters in learning about international markets, taking advantage of new trading opportunities and cooperating with the Government of Lao PDR to help build exports. There is also great potential for equaling the export growth rates of China, Vietnam and Thailand in coming years. However this will not happen automatically. The team proposes to gather additional data and analysis on the current positioning of Lao PDR exports and to return to Lao PDR to focus in more depth on the design and implementation of specific industry cluster initiatives that can help achieve this goal. The experts also met individually with approximately 25 entrepreneurs, exporters and government officials. ITC is starting a new project on export competitiveness.

The following are key insights and results:

- Lao PDR has the potential to meet or exceed the growth rates of neighboring countries Vietnam and Thailand over the next ten years. By adding value in the production and export process, returns on exports will increase and additional employment can be created.
- However, large scale increases in Lao PDR exports will not be immediate or automatic from signing trade agreements or entering the WTO; proactive efforts must be undertaken to achieve this export potential.
- There is potentially high interest in international markets for a number of Lao export products and tourism offerings—modest examples of export competitiveness are already emerging in coffee, silk, wood and cultural and eco-tourism.
- The Lao PDR is relatively unknown abroad and this provides an opportunity for building a “Lao PDR” national brand for specific high-value industries.
- While some Lao export champions already exist, very little in the past has prepared the average Lao entrepreneur to understand the needs of international markets and respond with world-class offerings; therefore human capacity building in marketing and management is an urgent priority.
- To date there has been much focus on the “supply side” of tourism development and industry development; however understanding the “demand side” (what does the market want) is an important priority as this can help guide investment priorities at both business and government levels.

- It would be helpful to form industry cluster working groups that can better understand their current positioning in world markets, develop a clear vision and design and implement strategic initiatives.
- Implementation of concrete initiatives can boost export competitiveness; examples include improving market linkages, e-commerce, product innovation, branding, workforce development, supply chain management and others.

### ***1.1. Main obstacles to export competitiveness:***

#### **- Obstacles at the enterprise level:**

- First and foremost, lack of marketing information; inadequate information regarding the nature and pattern of consumer demand in various export markets; difficulty in obtaining reliable and up-to-date information;
- Shortcomings in design, poor quality and inferior packaging;
- Limited export supply (shortage of skilled management and labor, shortage of capital);
- Lack of export credit to diversify production and technology;
- Insufficient understanding of international business practices, particularly in international marketing and export development;
- Inadequate human resources.

#### **- Obstacles at the trade support institutional level:**

- Insufficient transport and communications infrastructure, high cost of telecommunications services;
- Insufficient coordination among institutions / agencies dealing with trade matters;
- Lengthy national administrative procedures that lead to cost escalation for producers and exporters (ADB is working with the government on developing a one-stop shop);
- Shortage of available financial resources, financial constraints by lending institutions (short-term lending), high interest rates;
- Lack of laboratories and quality control institutions with international recognition;
- Lack of specialized education and training in trade promotion / export development;
- Lack of institutional infrastructure and skills to access, collect, process and disseminate international market / product trade information; lack of market research services;
- Insufficient Government support to promote exports, carry out market research, undertake market prospect analysis, etc.

The national trade promotion organization (Lao Trade Promotion Centre), a Government agency run by the Ministry of Commerce, was only established in November 2001. It is short of skilled human resources in trade promotion and export development, and also of equipment and facilities. The Lao National Chamber of Commerce and Industry operates seventeen sectoral business associations, acting as a link between their members and Government Authorities, but the Chamber also remains short of resources.

## ***1.2. General recommendations:***

On the basis of intensive work in these industry clusters, there are several general recommendations that would apply across the board.

***Industry cluster strategies.*** Many commercial industries in Lao PDR are still in the early stages of development in positioning themselves to compete in international markets. The Lao PDR industries need to develop a vision, goals and strategy for building export competitiveness. Working together in close communication and cooperation, these leaders can then implement strategies that focus on quick wins as well as building long-term competitiveness.

***Market research and understanding international markets.*** Understanding international markets is critical for building export competitiveness. International marketing capacity in Lao PDR is currently very low across all industries. The industries individually as well as the Government overall, with donor support, should invest in building capacity among young professionals in Lao PDR in market research. Sending at least 30 Lao professionals abroad for training in market analysis and international marketing would create a critical mass of talent for understanding and taking advantage of global market opportunities. At the industry level, supporting the dissemination of industry information can help strengthen the ability of industry associations to provide useful information and services to their members.

***Branding of Lao PDR and its high-value products and services.*** High quality products from Lao PDR are currently undervalued on the international market due to limited recognition of the origin and uniqueness of the products. Building brand value in these high-value areas is critical for positioning Lao PDR to compete in international markets. Overall, the Lao “brand” could be built around themes such as “peaceful people, creative culture”. Within specific industries, branding opportunities are apparent in Tourism, Silk, Coffee, Wood Products, and organic foods. This would include the development of a “Lao PDR” brand, mark of origin, and assistance to firms on trade-marking.

***Industry–Government coordination.*** All four workshops expressed a desire from both industry and government representatives for increased coordination between businesses and the government in achieving increased export competitiveness. It is understood that neither group alone will be able to implement the necessary steps to raising exports—it will take a joint effort with both sectors working towards the same vision. The Government should support the formation of “industry working groups” that would be charged with improving the measurable performance of export competitiveness in their industries.

***Improving financial services.*** Lao business participants were nearly universal in their agreement that they do not have access to finance, that finance is too costly and that this represents a major barrier to expansion. For most business people, this was the most serious constraint in the business environment.

## ***1.3. Tourism: Targeted strategy for attracting niche markets***

Significant investment is occurring in building the supply of the Lao PDR tourism industry; however, the industry is not clear on what types of tourists it wants to attract and how to effectively promote tourism to those audiences. Limited information is available in Lao PDR on tourist needs and preferences by motive of travel. This information is critical for guiding the industry in setting a targeted strategy. International expertise could be useful in helping the

industry segment the global tourism markets by motive of travel, identify the most attractive niche markets appropriate to Lao PDR offerings, prepare appropriate marketing efforts and thereby increase the number of tourists arriving, the average spending per day and the length of stay. Other important steps to attracting the right tourists include: improving the ability of Lao tour operators to proactively target attractive clients, improving the language, communication skills and professionalism of tour guide and other service providers and providing upgraded certification.

**1. Fortify the Tourism Industry Cluster Working Group under the leadership of the National Tourism Administration (NTA) and the Association of Travel Agencies.** The tourism industry in Lao PDR appears to have the necessary components to develop into a well-organized, efficient, and strategic industry cluster. Many of the stakeholders in the cluster are already coordinating and sharing information. Qualified and motivated leadership is emerging eager to develop Lao PDR into a world-class tourist destination. An industry cluster working group would articulate a vision, strategic goals and strategic initiatives leading to improved tourism revenues without damaging the culture or the environment. The strategy should set measurable goals for revenues and employment. The working group could then coordinate activities and interventions to best promote an attractive positioning for Lao PDR among world tourism market segments.

**2. Mobilize international expertise in tourism to inform action.** This should include at least one world-class tourism strategy expert with linkages to major international tour operators and with a special knowledge of long-haul cultural and eco-tourism. Other short or long term experts should be mobilized to implement various elements of the strategy developed by the industry. For example, Lao PDR also has opportunities to become a regional and international conference destination, having hosted important international summits.<sup>5</sup> The expert should have practical experience in developing and promoting high-value tourism industries in low-income countries and contacts in the international tourism industry. The key international expert would help motivate the industry, bring international knowledge to it, serve as a catalyst for action, coordinate short-term expertise, help design strategic initiatives and assist in securing financing for the implementation of these strategic initiatives and investments.

**3. Implement strategic initiatives (illustrative).** The strategic initiatives will be identified by the industry cluster itself and then validated by international expertise that will test feasibility and help with implementation details for each strategic initiative. The following are illustrative only.

a. Enhance Market Knowledge in Lao PDR Tourism Industry

- Develop market knowledge and detailed information about specific customer segments attracted to Lao PDR, in partnership with WTTC and WTO.
- Survey international travel agents in current image of Lao PDR
- Identify attractive segments and develop appropriate itinerary and package tours; conduct targeted market promotion to attract desired segments
- Implement “Tourism Accounting” to codify and disseminate results annually

a. Invest in Human Resource Development

- Establish of a Vocational Center of Excellence on hospitality management, tourism marketing, and customer service to provide certificates in functional

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<sup>5</sup> Even in Savannakhet there was an international conference being held with participation by Vietnamese, Thai and Lao representatives and included a visit by the Princess of Thailand.

expertise including reception, office management, guest house management, catering, etc.--seek Swiss expertise as they have the world's best hospitality training expertise

- Assist new tourism faculty at the National University to develop appropriate curriculum for training future managers in the tourism industry
- c. Improve Quality of Lao Tourism Experience
- Survey tourists in Lao PDR for feedback on satisfactory and unsatisfactory qualities
  - Conduct tour guide training and certification focused in delivering high service
  - Establish certification committee for hotels, restaurants, guest houses aligned with ASEAN standards
- d. Strengthen associations within the tourism cluster, including the Association of Travel Agents, the Hotel and Restaurant Association and a potential tour guide association
- e. Improve regional coordination of tourism bodies at the provincial level. This would include regional tourist information centers and guidebooks, annual meetings of provincial tourism officials, and joint promotion and marketing
- f. Establish Luang Prabang tourism cluster working group to coordinate and develop strategy specific to the region
- g. Develop strategy for maximizing the value of ASEAN integration for Lao PDR tourism. This would include joint promotion and marketing for tourism with neighboring countries
- h. Develop tourist sites, including classification of sites

#### ***1.4. Manufacturing: Understanding market needs, connecting with buyers***

In manufacturing, while some sectors, especially garments, are facing difficulties, others are emerging and have a good potential to do well.

The *garments* sector in Lao PDR seems to be experiencing pressure from the expiration of the MFA.<sup>6</sup> One apparel manufacturer in Savannakhet noted that two of the five producers in her area had closed down. Apparel manufacturers in Vientiane reported continued severe price pressure from buyers. Realigning Lao PDR garments around its expertise as well as cheap labor will require a more focused understanding of customer needs.

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<sup>6</sup> The Multi Fibre Agreement (MFA) was the system under which importing countries assigned quotas. It ended on January 1<sup>st</sup> 2005. It is expected that the result will be large increases in market share for China and India where there is a dense cluster of suppliers and low-cost producers. There will continue to be a role for suppliers based on quick turn-around time, quality, service and focus on niche products. Some countries close to the USA and Europe will compete on this basis. It is still unclear where and how Lao PDR can compete in these new market realities, but apparel production has been a traditional first step in the transition from agriculture to manufacturing for many countries.

The session in Vientiane revealed that at least one company planned to open up an *assembly operation* to produce automobile filters for export to Thailand, indicating the potential for twin-plant and input manufacturing for Thai industries.

There are many emerging success stories in Lao *handicrafts*. High value silk products are being sold to interior designers in New York. High value and uniquely designed wood products are being exported to the San Francisco area. Unique, hand-made and high value cotton products using natural indigo and other dyes are being exported from Savannakhet to Japan. These still represent modest quantities and in many cases, Lao exporters have relied on international technical assistance and marketing capability, including Lao people living in foreign countries. Still, handicraft exports not only increase foreign exchange and trade integration; they do so in a way that *strongly benefits lower income groups*. This contributes to the Government's objective of achieving economic growth in ways that also help share the benefits of growth and reduce poverty.

There are two urgent priorities for boosting handicraft exports: 1) improving customer knowledge and market contacts and 2) improving design capabilities. Much can be done to assist current and potential handicraft producers and exporters. It is important to build market research capacity, participate in international trade shows, develop e-commerce capability and link up with importers in foreign markets who are willing to pay attractive prices.<sup>7</sup> Design capabilities in Lao PDR are still very weak. Design skill will raise the value of exports. Master craftsmen and women make up to three times as much as normal craftspeople. Creating a Lao center of design and innovation would build human resource capacity and continue to spur product innovation. Value-added manufacturing in wood exports is clearly an important opportunity to fully capture the value of unique wood in Lao PDR. It may be unrealistic to expect sawmills themselves to forward integrate into furniture production but there are a number of entrepreneurs already interested.

***Special Economic Zone.*** Given the construction of the new bridge at Savannakhet and the focus on the East-West Corridor connecting Myanmar-Thailand-Laos-Vietnam, the planned Special Economic Zone (SEZ) could potentially attract light manufacturing (based on the JICA study, 2001). It is important to confirm the demand assumptions of the SEZ by conducting more in-depth surveys of manufacturers in Thailand, Vietnam and abroad to confirm the “demand side” feasibility and the conditions under which firms would transfer operations or add capacity in Laos. After confirming this, it is necessary to expedite progress on the SEZ using international best practice and strategic partners who can provide financing, engineering, management expertise and—most importantly—the ability to attract a critical mass of tenants. If these steps are taken, the SEZ might generate 20,000 jobs in its first five years of operations. However, workforce development and training are constraints to effective implementation.

Commissioning a comprehensive survey of Thai industries to identify companies willing to create satellite plants for light manufacturing in Lao PDR, and the conditions required for them to do so, would be an important first step in investigating this opportunity. Unlike the JICA study, this survey should include site visits to companies in Thailand.<sup>8</sup>

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<sup>7</sup> For example, the non-profit group “Ten Thousand Villages” is an importer of handicrafts that passes on “fair prices” directly to artisans in developing countries much as “fair trade certified” coffee passes on higher prices to coffee farmers.

<sup>8</sup> The JICA study used faxed surveys to companies in Thailand and Vietnam. The response rate was relatively low. Only a handful of companies indicated existing plans to establish operations in Lao PDR although many others indicated interest in the SEZ.

#### Specific recommendations:

- Provide marketing expertise to Lao handicraft and manufacturers to help them identify clients outside the country
- Encourage design skills for furniture development—Sweden and Denmark both have world class furniture design capability
- Explore feasibility of eucalyptus plantations in areas without current old-growth forest for potential pulp and paper and forest product use
- Establish a “Lao Center of Excellence for Design” along the lines of the Rhode Island School of Design to promote and expand design skills
- Facilitate trade show participation by Lao exporters who cannot yet afford to go on their own to expose them to buyers, trends and other useful information and contacts
- Assist exporters in establishing quality certifications, mark of origin, trademarks and brand names to enhance appeal of Lao exports
- Create Lao labels for flagship products in silk, cotton and wood
- Improve supply chain management, factory management, financial management, logistics management and human resources management by establishing practical management education training with international assistance
- Create tailored financial products enabling successful exporters to expand operations
- Assess the potential of the Special Economic Zone in Savannakhet
  - Conduct “demand side” verification of feasibility by determining how many companies currently operating in Thailand and Vietnam would set up operations in Lao PDR given specifically stated conditions
  - Create the conditions to attract a “world class” developer who would not only finance and manage the site but also ensure that international companies located there
  - Create training facilities that qualify Lao people for employment opportunities

#### ***1.5. Agriculture: Improving market linkages and increasing standards***

Examples already exist of Lao entrepreneurs marketing high-value agricultural exports to international markets in coffee and organic rice. There have also been recent successes in expanding pork production for the domestic market, exporting selected horticulture products, selling non-wood forest products (e.g. herbal medicine) and establishing rubber production for export. The investments being made in road infrastructure will create not just transport corridors but economic development corridors as well. Agriculture is still the major provider of livelihoods in Lao PDR and agro-exports can help reduce poverty. To do this, it will be necessary to improve village-market linkages, ensure knowledge of fair price, develop agricultural credit, implement export standards and grades, and encourage value-added processing of natural resources. These needs were highlighted during the workshop on agricultural competitiveness along with closer communication between government and the commercial sector. The following provides more specific guidance on coffee and horticulture.

#### Coffee

- With prices recently trending upwards and the oversupply on the market from Vietnam gone, the timing could be right for Lao PDR to penetrate this market
- Organic certification and fair trade certification offer additional value for Lao exporters who can take advantage of this

- There are already examples of successful entrepreneurs marketing Lao coffee through niche market channels internationally
- There could be good potential to export Arabica (which has higher prices in world markets than Robusta), but currently there is very little production and limited knowledge of how to cultivate and process. So volumes are still limited. Efforts are underway to boost Arabica production with French international assistance and expertise
- Lao coffee is unknown which presents the opportunity for the market to try something new; however, the quality delivered to international buyers needs to be carefully managed as a few bad shipments could tarnish the country image
- Farmers can capture additional value through initial coffee processing at the farm level and the FAO project is undertaking this
- Price knowledge and information dissemination via radio and other means can assist the farmer in capturing full value for his product
- Some issues regarding consistency of supply were raised—rocks and other material often appear in coffee from farmers

#### Horticulture

- Increasing purchasing power in neighboring countries will provide attractive markets for Lao horticulture
- Lao PDR should implement the “Good Agriculture Practices” initiative and eventually adopt HACCP and ISO standards
- Assistance in market identification and market linkages would help local growers and exporters make better decisions and increase exports
- Organic certification should be attained for qualifying products
- Packaging and branding assistance can help increase the value of Lao exports
- As production increases, farm-to-market strategies will need to be developed that include creation of a cold storage chain, warehouses, distribution facilities and customs clearance

## 2. Customs

The Lao Customs Department, supported by extensive technical assistance, has undergone for several years a reform and modernization process. But its institutional capacity and performance still need further strengthening.

**a. importers face difficulties clearing goods at customs.** Practically every shipment is physically inspected, and often sampled; Levels of duty can be high, thus encouraging systematic under-valuation;<sup>9</sup> Smuggling is widespread, with under-reporting of goods at approved points of entry; Inward processing procedures are complicated.

**b. processing by several government inspection and control agencies is not always well coordinated.** At some border locations up to 10 separate government inspection and regulatory agencies intervene in the clearance of goods, vehicles and people.

**c. the Customs Department does not exercise full managerial control over field operations** as provincial authorities have been delegated responsibility for their management and operation including the recruitment, transfer and promotion of staff, and collection of duty. The **human resource capacity needed to carry out the customs’ headquarters responsibilities is also weak.**

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<sup>9</sup> Altogether, tariff on excise goods represents 90 percent of the value, to which unofficial payments must be added.

Recognizing that considerable progress has been made to date in reform and modernization, and that donors have been and continue to actively support and assist the Customs in their reform efforts, the Department could focus on the following priority objectives:

**a. Legislation:** High priority needs to be given to the implementation of the new Customs Law and supporting regulations. Extensive work will be required to develop the new regulations, including a detailed assessment of existing regulations, writing of new or revised regulations, and in implementation activities such as training and public information.

**b. Organization:** The Government needs to continue to develop a national Customs administration. Initial efforts to improve the control of field operations through the Monitoring and Control program and restructuring and strengthening the Customs Department headquarters organization should continue.

**c. Strengthening human resource.** Building the Department's human resources capacity and professionalism of staff is needed in order to implement modern Customs practices consistently throughout the country. In order to implement successfully the national customs administration and to meet the demands to be placed on the department by WTO membership and regional commitments under the GMS and ASEAN, much greater priority will need to be given to developing the capacity of departmental human resources. A comprehensive human resource plan is required.

**d. ICT.** Significant improvements in trade facilitation, revenue collection and internal controls in the Customs Department can only be achieved with the implementation of an automated and comprehensive Customs processing system. The Department therefore needs to develop a comprehensive ICT strategy, based on a careful analysis of its requirements and capacities.

**e. Preparation of a transition strategy for implementation of the WTO Valuation Agreement.**

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

**g. Strengthening enforcement capacity in order to reduce smuggling and other illegal activities.**

### **3. Trade Facilitation**

As a landlocked country, effective transport is critical to the development of Laos. Not only is it important for Laos to provide efficient connections between the economic centers of its three main regions (in the North, Center, and South); it should also ensure that the country is well connected to its neighbors in order to stimulate trade and reduce one of the most significant bottlenecks to the movement of goods. But trade facilitation is not only about infrastructure and building roads. Delays in transport and increased cost of transport takes place also because of cumbersome procedures and regulations on and off the border.

UNCTAD is assisting transit stakeholders in Lao PDR to improve transit transport operations along the Vientiane-Bangkok/Laem Chabang transport corridor. To achieve this objective, the project will support the development of corridor-based institutional and technological solutions enabling to monitor day-to-day operations, to design and implement readily applicable solutions, and to formulate longer-term strategies for trade and transport facilitation. The project includes:

- 1) A guide to cluster development which should help their active participation in the formation of three trade and transport facilitation clusters gathering public and private partners along the corridor: one in Vientiane, one in the Thanaleng-Nong Kai border area and one in Bangkok-Laem Chabang.
- 2) A handbook on transit corridor analysis which looks at the different aspects of a transit system, including physical and institutional infrastructures, transport services and equipment, procedures and documentation, regulatory frameworks.
- 3) A manual on how to apply the supply chain management approach to the operation of the transit corridor and how to define the role of clusters and of each of their participants in the analysis and improvement of the performance of the corridor.

### ***3.1. Issues on the Lao logistics sector:***

Much has been made of the fact that Laos is a landlocked country; however, this condition has three dimensions:

- (i) ***Physical isolation from foreign markets:*** This is not a significant problem since the distances to major markets and gateway ports in Thailand and Vietnam are less than 700 km, a day's travel by truck.
- (ii) ***Availability of logistic services:*** There are limitations on the availability and quality of logistic services but these are due primarily to the volume of traffic and constraints on competition rather than the fact that the country is landlocked. Quite the contrary, Laos benefits from access to the Thai transport system, which offers a large number of competing providers and a better quality of service than could be sustained with the relatively small volumes shipped to and from Laos.<sup>10</sup>
- (iii) ***Infrastructure and border crossings:*** This includes both the land borders and international gateways. It adds time and costs for shipments due to limited official crossings as well as cumbersome procedures. Various efforts to improve the efficiency of Laos-Thailand border crossings have been reasonably successful but there has been a lack of consistency and sustainability in these efforts. As a result, examples of world-class facilitation exist alongside traditional restrictive practices and rent-seeking activities. The efficiency of supply chains, as measured by their time, cost, and reliability, is sufficient to permit larger Laotian companies to compete with its neighbors in certain export markets. However, improvements are required if there is to be broader participation in these markets and expansion into new markets.

Of the various difficulties facing Laotian foreign trade, one of the more important is the high cost for moving goods between Lao PDR and its neighbors. The time and reliability of these movements are less of a problem. While there has been considerable focus on the potential benefits from the recently signed transit agreement with Thailand, more needs to be done internally, including simplifying procedures, to take advantage of this agreement. This focus on external impediments ignores the fact that significant competitive advantage can be gained through improvements in internal procedures. Most important among these are government procedures associated with import and export trade.

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<sup>10</sup> This is less true in the case of Vietnam where the border crossings are located far from urban areas and the roads are not as well developed.

Three fundamental problems confronting Laos in the area of trade and logistics are:

- limits on scale
- market access
- supply chain management

### ***3.1a. Economies of scale:***

***Understanding the nature of production and trade in Laos helps understand the logistics problems.*** Both trade and logistics offer substantial economies of scale. For trade, there is not only the reduction in unit costs that can be achieved through increased capacity but also the ability to spread the costs for maintaining international design and marketing capacity over a larger revenue base. Since Lao companies are small-to-medium scale, they are at a competitive disadvantage in terms of cost of production.

In order to overcome the disadvantages associated with scale and market access, Lao exporters focus on market niches that are less interesting to larger producers and where size is not a weakness but a strength. This implies a focus on contract manufacturing for smaller markets. It requires greater agility to provide more personalized service including smaller order sizes and more frequent design changes. Competitive advantage is enhanced by offering lower labor costs and greater worker flexibility complemented with effective use of technology to improve quality and productivity. With this arrangement, the buyer provides most inputs and logistics. The buyer is responsible for design, quality control and marketing activities but these would gradually be shared with the producers. FDI is important not only for financing but also for technology and management capacity. Over time, local management could increase their capacity by utilizing the variety of ITC solutions available to small-scale producers and by developing capacity to procure inputs directly and subsequently to manufacture these inputs as part of an integrated manufacturing process.

Both garment and textile and wood product manufacturers apply this model. The former use imported fabric and accessories procured by the buyer or ordered directly according to manufacturers specifications. The latter use domestic sources of wood, either natural or plantation, but are limited in size by the availability of wood. Thai middlemen and foreign buyers provide design, marketing and quality control. The manufacturers of textiles and wood products also provide their own designs. As these enterprises grow, they reduce their dependence on foreign managers and overseas buyer for designs, quality control, and inputs. Further, they will have the opportunity to subcontract production from the smaller domestic enterprises.<sup>11</sup>

These enterprises sell primarily FOB Bangkok. Their inputs are ordered primarily C&F Bangkok. The buyer nominates the port and shipping line. Since the manufacturers have limited capacity for supply chain management and arrange shipments through Lao forwarders for exports and Thai forwarders for imports. Because of the small volumes shipped many of the goods are moved as loose cargo and consolidated by Thai forwarders in either Nongkhai or Bangkok. The same situation applies for inputs. As the size of shipments increase, more cargo is be shipped in containers ex-factory but the companies continue to rely on logistics providers for shipments up to Bangkok.

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<sup>11</sup> Presently, there is no subcontracting because of problems with quality and lack of capital to invest in production technology.

***Scale is also an issue for transport and logistics.*** Most of the polemics regarding high transport cost for landlocked, or otherwise isolated countries, is, in fact, due to economies of scale. Small cargo volumes are much more costly to ship than large volumes. For example, it is much less costly to ship goods from China to Europe than from Bangkok to China?, and from Bangkok to Manila than from Mindanao to Manila. Laos logistics service providers are small-to-medium enterprises and thus less efficient than their Thai competitors.

The Laos trucking industry is composed primarily of independent operators with 6 and 10 wheel trucks. The largest companies have relatively small fleets and rely on independent operators for peak capacity. There are few articulated trucks and no container chasses.<sup>12</sup> The trucks are able to haul cargo long distances (up to 800 km) internally and to transport carry cargo to the Vietnamese ports; however, they do not operate in Thailand in part because of the difference in the side of the road on which vehicles operate (driving on the right versus left) but also because of the lack of backhaul cargo. Although the predominant flow of cargo is inbound, Lao trucking companies do not have an effective mechanism for booking import cargoes on the backhaul. In contrast, Thai trucks carrying cargo to Laos can carry domestic cargo as their backhaul, which allows them to offer lower rates for imports to Laos. In the case of trade through Vietnam's ports, Lao trucks transport exports and on the return trip wait at the border to pickup a secure a backhaul from Vietnamese truckers unwilling to enter Laos.

For logistics services, the limitations due to scale need to be addressed through tailoring of these services. It is necessary to devise strategies to consolidate cargo so as to increase the size of individual shipments. This will allow for the use of larger vehicles and vessels, more frequent service, and faster handling equipment. Greater consolidation is achieved through improvements in freight forwarding and development of facilities for consolidation. At the same time, it is necessary to develop larger transport companies in order to improve fleet management. These companies can not only handle larger orders but also introduce better systems for cargo booking and fleet management. In Laos, this consolidation can be achieved through mergers. These mergers will not affect the competitiveness of international freight movements since, under the new transit agreement, the principal source of competition will not be internal but rather from Thailand. Also, it is unlikely to affect the competitiveness of the domestic market because of the predominance of independent operators. However, there are alternatives including more formal subcontracting of independent truckers by the larger firms and joint ventures with larger Thai logistics providers, which has already occurred.

The transshipment activity at Nongkhai is expected to decline as a result of the new transit agreement. This intermediate activity increases the cost and time for cargo movements but does not significantly improve truck utilization. In the future, Nongkhai will serve only as a point of customs clearance for transit movements. It would continue to serve as a point for consolidation of Laotian LCL cargo or bonded warehousing of imports only if the government of Laos is unable to create an attractive environment for this business.

### ***3.1b. Market access:***

Problems of market access constrain trade and transport in two areas:

- information about the market;
- regulation of participation.

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<sup>12</sup> The only fleet of articulated trucks is used for internal distribution of beer.

***Lack of market information.*** For Laotian logistics service providers, the constraint on market information is primarily in the area of securing backhaul cargo. The forwarding companies lack brokers that can arrange backhaul shipments from Bangkok and from Vietnamese ports. Because the foreign sellers and buyers who nominate the clearance agents lack knowledge of the qualifications of Lao logistics service providers, it is expected that any foray by Laos forwarders into this market will be done through joint ventures with Thai companies. Indeed, both SMT and Lao freight have already developed such relationships but their participation is generally limited to the movement up to Nongkhai.

***Regulations on market access.*** For the logistics industry, domestic regulations affecting market participation do not appear to have a significant impact. The regulation of the transport industry is relative light and there is no regulation of freight forwarders. Instead, there is a need for greater regulation, specifically for customs clearance agents. Under the current system, there is no restriction on who may act as a clearance agent and they are not required to pass a test on customs procedures. Also they are not liable for their actions. As a result, they lack knowledge as to the formal procedures and emphasize informal arrangements. Equally important, in the absence of a professional organization, Customs has no channel through which to communicate changes in procedures. Most troubling, this arrangement discourages the introduction of modern procedures and technology.

Regulations affecting market access are more problematic for Lao service providers that wish to enter the Thai market. While the new transit agreement nominally provides open access for Lao transporters, the requirements for licensing Lao trucks and drivers that can operate in Thailand is less clear. Once the new transit agreement with Thailand is fully operational, Lao trucks can transport import, export and transit cargo in Thailand, but they will face a much more competitive market. Lao shippers will be able to use any of 13 transit clearance agents for transit cargo and even more for trade with Thailand. Approximately 170 Thai trucking companies will compete for transporting these goods. Already, there has been a significant drop in the freight rates to Bangkok and more is anticipated. As more and more trucks bypass Nongkhai, Lao trucking companies will lose their traditional market of cargo movement between Vientiane and Nongkhai.

In order to compete for through movements to/from Bangkok, Laos trucking companies will need to invest in new trucks that can operate efficiently in Thailand, to increase fleet size and to improve management capacity and skills in order to compete with the relatively well-organized Thai logistics industry. Lao trucking companies have some competitive advantage from lower labor costs but this is offset by higher capital costs and less access to backhaul cargoes.

Lao forwarders will face similar competitive pressures. They have yet to develop the skills and range of services that would allow them to compete effectively in the Thai market. LIFFA remains a local association while TIFFA, Thailand International Freight Forwarders Association, is a full member of FIATA. The latter has a large membership and offers training courses in various aspects of the freight forwarding business. In addition, most of the major international integrated logistics service providers, 4PLs, have regional offices in Bangkok and provide a full range of services. Only a subset of these operate in Laos primarily to arrange land transport for project cargo, personal effects, and donor supplied imports.

### ***3.1c. Supply chain management:***

So far, the Lao exporters have been able to compete with relatively long order cycles, 3-6 months. This has allowed them to avoid large inventories despite long lead times for imported inputs. It

also allowed them to complete the lengthy approval procedures for both inbound and outbound shipments. The transit times for inbound and outbound shipments has been kept to acceptable levels as a result of the short transit distance to Bangkok, the increasing frequency of feeder services available in Thai ports and the reform of port operations at Klong Toey. This despite the need to use four separate transport services between Vientiane, Nongkhai, Bangkok/Lam Chabang, Singapore/Hong Kong and the overseas market. The practice of shipping FOB/C&F Bangkok has allowed for the use of factory-port movements with domestic forwarders rather than door-to-door shipments with international forwarders. The problem is that these conditions have been satisfactory for a relatively small number of producers who have been able to compete through lower labor costs and preferential access to markets despite lower productivity and more costly logistics.

If Laos is to expand its trade and compete effectively with its neighbors then it must improve its logistics. Assuming that this expansion involves small scale producers rather than large scale factories similar to those in Vietnam and China, then the logistics will have to handle larger numbers of small shipments. At the same time, exporters will have to offer the same lead times and order fulfillment capabilities as their larger competitors. Since these lead times are decreasing, there will be a need to be a tightening of the supply chains through better use of inventories, tighter integration of movements and reduction of procedural delays at the borders. It is anticipated that a large portion of the movements by sea will continue to be LCL but that the transit times will have to be comparable to those for FCL movements. Assuming that the new producers serve primarily niche markets, there will be a need for greater flexibility in organizing shipments. Air freight is expected to increase as exports of perishables and high value goods increase. Door-to-door movements are expected to increase as buyers order for delivery to specific retail outlets or inland distribution centers.

Ultimately there will be a need to not only reduce the cost for logistic services but also to improve supply chain management. Since small-scale manufacturers cannot afford to maintain staff trained in supply chain management, it is left to the local forwarding industry to provide these skills. It will also be necessary for the government to eliminate impediments to efficient supply chains. While customs documentation does not appear to be a problem, there will be a need to introduce ITC systems to speed the processing of these documents. These systems will also increase transparency. It will also be necessary to avoid arbitrary changes in procedures that would have a negative impact on delivery times and order fulfillment.

### ***3.2. Initial recommendations:***

There are a number of initiatives that the government can undertake to improve the performance of the supply chains for goods traded with Lao PDR's neighbors and foreign countries, thereby improving the competitiveness of exports and reducing the cost of imports. These include changes in procedures that require relatively little investment. Most of them would build on existing practices and either simplify them or remove key constraints:

- ***Introduce a single document for approval of imports and of exports.*** The document would have provision for multiple signatures by the approving agencies. Once accepted, a procedure for electronic submission of these documents would be developed along with a process for expedited approvals in order to reduce the incidence of informal payments.
- ***Simplify procedures for door-to-warehouse or door-to-port movements of containerized goods on the Vientiane-Bangkok corridor.*** This would involve expanding and regularizing practices already developed for clearing both inbound and outbound full

container loads (FCLs) at the warehouses of the major exporters and importers, e.g. WFP, Unilever, Trio. Since this would involve an increase in the workload of customs and other border officials, procedures would be developed for scheduling clearance activities and compensating officials for the time spent away from their office. This would be a pilot project that could later be expanded to other corridors.

- ***Establish an Inland Container Depot/Dry Port near the border*** where the shipping lines could deliver containers, receive cargo for loading into containers and reposition empties. This facility would allow importers to return empties to the ICD rather than to Bangkok. Similarly, it would act as a dispatch point for empty containers to be loaded with exports and thus avoiding bringing empty containers from Bangkok. The facility would significantly reduce, though not eliminate, the occurrence of empty backhauls.<sup>13</sup> It would also reduce the cost for repositioning empties by combining two 20' containers on a trailer, by repositioning empties to shippers within Thailand and by, eventually, moving empties by rail from Nongkhai. The ICD would also provide a focal point for transactions with both the shipping lines and the trucking companies.
- ***Introduce a consolidation service for small freight shipments on the Vientiane-Bangkok route.*** The current practice of consolidating loads at Nongkhai would be replaced by a similar activity at a container freight station (CFS) in Vientiane. At the CFS, domestic containers would be loaded with export cargo, sealed, and transported to a bonded transit warehouse in Bangkok where the cargo would be reconsolidated in marine containers for overseas shipment. In the reverse direction, LCL/LTL imports would be consolidated into domestic containers at the Bangkok transit warehouse. They would then be moved under seal to the Vientiane CFS. This initiative requires an agreement from Thai customs to treat these movements in the same way as shipments that are consolidated/deconsolidated at Nongkhai. This facility would be accessible not only to domestic forwarders but also to Thai companies, since they currently offer the same service in Nongkhai and have a presence in the Vientiane market. It would also be offered to foreign logistics service providers operating in Vientiane. This CFS could be located at the proposed ICD.
- ***Provide assistance to the logistics industry to develop their capability.*** For the trucking companies this would involve financing for equipment suitable for hauling containers on the roads in Thailand. This could be in the form of ensuring access to lending directly to the trucking companies or to companies that would lease the equipment. For the forwarding companies, this would involve training in modern logistics utilizing programs available through TIFFA, FIATA or the Bank's Distance Learning Program.
- ***Introduce measurements of performance at the border crossings.*** These would be used to monitor the impact of the approval and clearance on trade. There are a number of standard indicators of efficiency. Some measure the effectiveness of trade facilitation, e.g. processing times and door-to-door transit times, while others measure the efficiency of the resources used, e.g. number of clearances per customs agent or signatures required. The introduction of these measures provides valuable feedback to government not only on current performance but also on the improvement or degradation in performance achieved as a result of various initiatives.

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<sup>13</sup> Empty backhauls would continue because of the imbalance of full container movements with inbound dominating. There would also be a mismatch with inbound shipments using the containers of regional carriers and the exports using the containers of the international lines.

#### **4. Sanitary and phyto-sanitary issues**

- The Government is concerned about SPS standards and feels that something should be done. In particular, the WTO accession process adds to the sense of urgency. However, the analytical skills for analyzing the present SPS capacities and identifying priorities in capacity building are limited. An overall assessment of SPS capacities is not available.
- Official agricultural trade data for Lao PDR range around US\$15 million and certainly underreport actual trade. Data from different sources vary significantly. Coffee is the most important agricultural product. Cows and buffalo are a traditional export. In addition there is a series of crop products fluctuating year by year.
- Exports of wood products are increasing and amount over US\$5 million per year.
- Estimates of informal border trade in agricultural products range for 10-40 percent of total exports. Reasons for informal trade are manifold. The number of formal border crossings is only a dozen or so along a border of thousands of kilometers in length. Informal trade among villages and districts on both sides of the border is natural given the isolation of many areas and will only decrease slowly over time. In addition, there is smuggling of products for which the existing border procedures are too cumbersome, or transactions costs too high. In the case of bovine livestock, demanding sanitary checks encourage the informal border trade route.
- Lao PDR seems to have no bilateral agreements or interagency MOUs yet with neighboring and other countries about SPS procedures to be followed in cross-border trade. In the context of ASEAN, however, activities are being carried out to improve border procedures. These activities seem to be beneficial to Lao PDR. Several donors and international agencies have provided and are providing assistance for building capacities in particular SPS fields.
- Lao PDR capacities for managing food safety, animal health and plant health in cross border trade are weak. Testing facilities and trained staff are very limited. Certificates are issued without adequate databases, surveillance, testing and inspection. As for other trade regulatory services, there are governance problems in carrying out SPS border controls.

##### ***4.1. Agricultural potential and challenges ahead:***

- Lao PDR has a high agricultural growth potential. In its vicinity there are 200 million people in China, Vietnam, and Thailand with rapidly growing incomes and demand for products which Laos can produce. The abundance of good soils and favorable climatic conditions in the highlands offer unique comparative advantage for producing temperate and off-season fruits and vegetables which are in high demand. Technology and market access can be provided by investors from neighboring countries who are already active in these fields. Some of these companies have even well-established supply chains to top-end of the market in Europe and Japan. For investors in fruits and vegetables for top-end markets absence of reliable phyto-sanitary services can involve significant risks for their investment. Hence, the Government and private sector should jointly develop basic capacities for providing tailor-made services for emerging new industries.

- Expansion of cultivated areas in the lowlands allows farmers to earn more income by expanding cultivation of traditional crops such as rice and maize. These products have low requirements for SPS services.
- Demand for high quality beef in neighboring countries is rapidly increasing. Availability of large areas of grassland in parts of Lao PDR offers opportunities for production of high quality beef. However, the present capacities for animal disease surveillance and quarantine of bovine animals are insufficient. Reliable and easy market access would probably also require extensive negotiations with neighboring countries on disease surveillance, quarantine and border procedures. The cost of necessary veterinary controls and investments for developing high quality beef exports are high. A feasibility study is needed covering costs and benefits of public and private investments.
- To date the use of agrochemicals in Laos is limited. However, with further diversification of agriculture use of pesticides will increase. Given the widespread use of illegal pesticides in neighboring countries and risk of illegal import, control capacities in this area deserve assessment. Regulation, monitoring, promoting good agricultural practice, and enforcement of regulations will become important elements in promoting food safety and human health at home and in preventing restrictions of exports in foreign markets.

#### ***4.2. Tentative conclusions and the way forward:***

- In general the capacities for managing SPS by the Government and the private sector fall short of what is prudently needed for realizing the growth potential in agriculture through diversification and further opening for international competition. Shortages are not merely lack of budget, skilled staff and laboratory equipment; they include better governance, legislation, regulation, databases, monitoring, evaluation, negotiating skills, and, last but not least, private sector capacities.
- Main priorities for better facilitating exports by adequate SPS capacities are in the field of potential and emerging formal exports of fruits and vegetables, green coffee, perhaps some other fresh products, and possibly high quality beef. For these products SPS services can be important elements of the investment climate. For products for which packing wood is used for shipment the new ISPM 15—which requires treatment of packing wood—should be addressed. Needs for monitoring and control of markets of agrochemicals deserves further assessment. In general, traditional products and informal trade pose limited risks for food safety and plant and animal health hazards. Indirect measures to control this informal trade through reducing transaction costs of border handling and domestic surveillance of hazardous diseases and pests are preferable by far over efforts to directly control border trade.
- The Government of Lao PDR is budget constrained and has limited human resources. Expanding SPS capacities can only be achieved gradually and will require selectivity, and shared funding and shared implementation by the private sector. Selectivity has to be guided by assessments of costs and benefits. In many cases part of the implementation and cost can be left to the private sector, while the Government can concentrate on core public roles and oversight of self-control measures by the private sector. Strengthening industry associations, such as for coffee and wood products will be an important element in promoting self-control by the private sector.

- Lao PDR has still significant governance problems in border procedures. For several products reported formal and informal transaction costs contribute a high share of total cost in the supply chain and erode competitiveness. Sanitary and phyto-sanitary controls contribute to this. Therefore, there is a risk that expanding sanitary and phyto-sanitary controls will do more bad than good, especially in areas of low SPS risks and in situations where governance is poor.

#### ***4.3. Next steps:***

Given (i) the Government's efforts to promote growth and to improve governance, (ii) the fact that SPS issues can be an important element in the investment climate for the areas of high growth potential, and (iii) the Government's limited analytical capacities, the mission recommends that the Bank follows up on the DTIS by providing support for preparing an action plan for SPS capacity building with priorities which reflect opportunities and costs. An interactive process with public and private sector stakeholders and outside analytical support for preparing an action plan is an important element in capacity building.

### **5. Trade policy and WTO accession**

***On trade policy,*** Lao PDR is gradually integrating globally and more so regionally. Trade reforms accelerated after it joined Asean, and tariffs have been substantially reduced as part of the Asean Free Trade Area agreement. This liberalization will continue as AFTA commitments are fully implemented by 2008.

Tariffs have been reduced substantially in recent years: the average tariff stands at around 9 percent, tariff dispersion is low, and the maximum tariff is 40 percent. Import restrictions still apply for a limited number of goods, such as fuel, cement, steel, and some sensitive agricultural products—as is the case in many countries, including some developed countries. Licenses for imports and exports, while typically easy to obtain, are a hassle to the business community. Laos could develop more efficient options and procedures for importing and exporting.

More recently, the main progress made by Lao PDR has been its successful conclusion of the NTR with the US. This is important because NTR provides increased market access to the US; it increases the potential for attracting FDI from US investors; and the US-BTA could have a positive impact on improving the regulatory and business environment.

Continuing its AFTA implementation will also be important for Lao PDR's integration into the region. So far, very few of the AFTA concessions are being used—and this is a problem not only in Laos but in many Asean countries. Some of the reasons could be lack of incentive given the small difference sometimes between AFTA rates and MFN rates; complicated procedures to provide the origin of the products; and lack of training of customs officials in recognizing the AFTA agreement.

***On WTO accession,*** Lao PDR is currently in the fact-finding phase of accession negotiations. A working party to consider the Lao application to join the WTO was formed in 1998. Laos submitted its Memorandum of the Foreign Trade Regime in 2001 and held the first meeting with its working party in October 2004. The next working party meeting has not yet been scheduled, although some express the expectation that it will be held by the end of 2005. Working party members expect the government to submit in advance of that meeting a number of documents describing aspects of the country's trade regime in more detail. These include standard questionnaires on agriculture (ACC/4), standards and technical regulations (ACC/8), services

(ACC/5) and intellectual property rights (ACC/9). The government has received additional questions about specific issues presented in its Memorandum. Finally, the government must submit an initial legislative action plan listing laws that need to be passed or amended to comply with WTO rules.

These are the very next steps needed in the long road for WTO accession. The amount of time typically spent between the first working party meeting and the adoption of the working party report varies substantially across countries. For countries at similar level of development as Laos, such as Nepal and Cambodia, it took about one to three years to obtain WTO accession after the first working party meeting. So far Laos has been proceeding with its WTO accession at somewhat slower pace than these countries.

Laos is receiving a lot of technical assistance for its WTO accession. While it is important for Laos to get different perspectives from various groups, there may be a need for better coordination of TA to avoid duplication and avoid constraining the capacity of the government.

The DTIS will present a more detailed analysis of how Lao PDR can move forward through the accession process. But priorities and technical assistance needs for the immediate future include the following areas:

- The most immediate procedural priority is to complete the *ACC checklist documents*. These are purely descriptive and technical, but require a good understanding of the issues. The UNDP/AusAid project on WTO accession includes support for all checklist documents and the EU is planning to support in the preparation of the checklist on standards.
- *Legislative action plan*: Preparing the legislative action plan is a second immediate procedural priority. Based on discussions at the Ministry of Commerce and Ministry of Justice, no consensus exists yet on which ministry will take the lead in preparing this document. Preparing and maintaining revisions to the document will require close cooperation between the Ministry Commerce, Ministry of Justice, Prime Minister's Office, the National Assembly. ADB is working with the government on legal upgrading in various areas including the financial sector, commercial sector, insurance, and TRIPS legislation. ADB is also assisting in the training of judges and prosecutors.
- *Improving interministerial coordination*. Close cooperation between ministries is a prerequisite for WTO accession in particular and effective trade policy more generally.
- *Capacity for economic analysis*. Trade negotiations need to be supported by economic analysis, either into the benefits or the costs of trade agreements, and their impact. Strengthening the capacity of the Foreign Trade Department as well as departments in other ministries involved in the WTO accession will be needed.

## **6. Trade-poverty link**

Lao PDR has made great progress on poverty reduction. Poverty incidence fell from 45 percent in 1992/93 to 39 percent in 1997/98 and then to 33 percent in 2002/03. The fact that the largest reductions in poverty in the period 1997/98 to 2002/03 have been in the poorest areas is especially encouraging: in the poorest rural districts, classified by the Government as the highest priority, the fall was from 63 percent to 50 percent and total rural poverty incidence fell from 43

percent to 38 percent; the fall in the more prosperous urban areas was smaller—from 22 percent to 20 percent. Much of this poverty decline occurred as Laos was liberalizing its trade regime. Of course, poverty is still high in Laos and mainstreaming trade into the poverty agenda is a key issue for the DTIS. In the Lao context, this means making sure that trade reform plays a central role in the NGPES. There are three main trade policy components of the NGPES (national growth and poverty eradication strategy) :

- Reduce barriers to trade with ASEAN under the AFTA scheme.
- Reduce barriers to trade with other countries by working to join the WTO.
- Reduce behind the border barriers to trade by improving infrastructure and administrative procedures. Donor projects and TA can help achieve this objective.

The CPI (committee for planning and investment) is currently engaged in drawing up the next National Socio-Economic Plan, which will cover the period 2006–10. A draft should soon be available. A very important influence on the next Five-Year Plan will be the NGPES. The plan for 2006–10 will be consistent with the NGPES. Mainstreaming the DTIS into the Five-Year Plan and the implementation of the NGPES is very important. Because of the sequencing issue—with the Five-Year Plan coming out before the DTIS, it was agreed with the Government that the DTIS team will provide input and comments to the background paper being prepared on trade issues for the Five-Year Plan, in order to ensure that the analysis of the DTIS is integrated in the plan.

Trade benefits the poor through its growth effect. But there are direct linkages between trade and poverty that need to be explored. The DTIS team is working on these important issues with the UNDP that is currently undertaking a trade and poverty report. Some of the linkages between trade and poverty include: improved access to markets that allows the poor to better take part in the economic activity generated by increased trade. The total length of paved roads grew by 22 percent during 1998-2003. Even more rapid growth has occurred in the roads that connect the remote parts of the country to the rapidly growing network of major roads. Other direct linkages between trade and poverty include the role of migration and remittances in alleviating poverty; and the impact of trade liberalization in general and in key commodities of importance to the poor on the income and consumption patterns of the poor. The DTIS will be looking at these and other linkages.