

# **Lao PDR: Diagnostics Trade Integration Study**

## **Concept Paper**

### **I. Context**

Lao PDR has undergone a substantial change over the past two decades. The Government initiated the transition from central planning to a market economy in 1986. Fundamental reforms were implemented in the late 1980s and early 1990s under the New Economic Mechanism (NEM). Price controls were lifted and multiple exchange rates were unified. Foreign trade and investment were opened for the first time, as was the case with private participation in agriculture and manufacturing. Family farms became the mainstay of agriculture. Many state enterprises in manufacturing were leased or sold and state-owned agricultural marketing enterprises were dismantled. As government revenue and donor support increased, public investment in infrastructure and in social sectors expanded.

The reform program resulted in a remarkable economic performance in the 1990s, with real GDP growing at more than 6 percent a year. Growth was led by strong exports, which grew at a high rate of 15 percent per year during 1991-2000, even if from a low base. Most of the exports were driven by the nascent private sector. The growth performance of the 1990s brought about impressive progress in reducing poverty. While Lao PDR remains one of the poorest countries in the world, with a per capita GDP of around US\$310, the share of the population below the national poverty line decreased from 39 percent in 1997 to 31 percent in 2002.

Sustaining the growth rates of the 1990s will be difficult unless another round of reforms is implemented. Unlike the 1990s, timber and garments cannot be the major drivers of growth going forward. Garments, which account for about a third of Lao PDR's merchandise exports, will come under tremendous competitive pressure as the Multi-Fiber Agreement (MFA) is being phased out. Lao PDR's exports are heavily concentrated in a few products and diversification would be necessary. Yet agriculture is oriented predominantly towards subsistence production and manufacturing is insufficiently diversified and too dominated by micro enterprises. The existing enabling environment for trade and private investment in Lao PDR has significantly improved in recent years, but it remains less favorable than its neighbors and competitors. Many changes are also occurring in the region itself—China is a WTO member and its exports are booming; Vietnam is in the process of accession and its exports are booming too; Cambodia just acceded to the WTO. These changes may require a repositioning of Lao PDR's export strategy.

The Government recognizes the need to create an enabling environment for development. The 2004 National Growth and Poverty Eradication Strategy—which aims at fostering economic growth with equity, developing and modernizing social and economic infrastructure, and enhancing resource development—sets ambitious growth targets, at 7 percent over the medium term. It also recognizes that growth will need to be sustained through trade liberalization, higher agricultural productivity, foreign direct investment, and private sector development. Reaching the NGPES growth target would require additional hydro and mining development, but also sustained growth of agriculture, manufacturing and services. And for a small economy like Lao PDR, exports would play a critical role in driving that growth.

## II. Objective

The Integrated Framework (IF) is an initiative or program proposed to assist least-developed countries to mainstream trade priorities into their national development plans and poverty reduction strategies and to assist in the coordinated delivery of trade-related technical assistance. While trade can be a catalyst for economic growth, unless trade policy and trade-related measures are appropriately factored into the national planning framework, the gains from trade cannot fully materialize. As part of the IF, the Diagnostics Trade Integration Study (DTIS) develops an integrated strategy and action plan to enhance the global integration of Lao PDR and help boost its exports.

The main objectives of the DTIS are:

- (i) to assist the Government in formulating a pro-poor, pro-growth trade strategy that allows Lao PDR to build its comparative advantage and expand its exports. For that, the DTIS will identify priority actions in specific areas including trade policy, trade facilitation, market access, export financing, and institutional framework.
- (ii) to develop actionable plans in two categories—those that can be implemented immediately in the context of constraints to the investment environment; and other, more fundamental reforms that can be implemented over time.
- (iii) to provide donors with a road map for technical assistance and project support in key areas that would allow Lao PDR to improve its trade performance and its access to international markets.

## III. Key Issues

The fundamental challenge of Lao PDR is to sustain its recent growth rates of 6-7 percent and improve social and development outcomes. Various studies indicate that achieving this goal will require coordinated actions in a variety of areas, including infrastructure development, improved public sector governance and service delivery, improved financial controls, and enabling environment for private sector development in general, and for trade and inward investment in particular. There is no shortage of strategies, road maps, and technical reports pointing out the needs and possibilities. What is needed is to deepen the commitment to reform and build upon the improvements already achieved. Within this framework, the DTIS will focus on providing an understandable and practical strategy that can be implemented, especially one which integrates the various analyses and technical assistance efforts underway. The key issues for the Lao DTIS are:

- (i) ***what are the external constraints and opportunities for the expansion of exports?*** In which countries and products can Lao exports tap into and how can Lao PDR achieve better access? How can Lao PDR take advantage of new opportunities in key markets such as China, Vietnam, and Thailand, and better link up to regional and global production sharing?
- (ii) ***what are the major domestic constraints to realize benefits from export over the short and medium term?*** What is the impact of the business environment on competitiveness and export? What financing, regulatory, and marketing options can be put in place to improve export competitiveness of specific clusters? What are the major bottlenecks in infrastructure, logistics, and internal movement of goods?
- (iii) ***what is the impact of export prospects and imports on poverty outcomes?*** How can Lao PDR develop an export-led growth strategy that benefits the poor? What are the main product lines which would benefit the poor? How can they better access markets and link up to downstream export-oriented producers?

#### IV. Approach

**Pragmatic.** Given the amount of sectoral studies already done for Lao PDR, the Government asked us specifically to take a more pragmatic and practical approach to the DTIS. Building on the findings of the various studies, the DTIS will follow two tracks: first, a traditional analysis of trade issues as in other DTISs with a medium-term view; and second, a more practical cluster analysis with concrete recommendations that address short-term impediments and ways to boost export competitiveness in key clusters.

**Collaborative.** The Bank core team will collaborate with the Lao counterparts at three levels. First, it will work jointly with a core Government team. Second, it will involve border provinces in the discussion during the mission. Third, it will work closely with a core local private sector group. To the extent possible, the Bank core team will include local experts.

**Capacity building.** The approach of the DTIS is to build local capacity while doing the analysis. Capacity building will take place during the main mission, as several interactive workshops and presentations will be organized with key counterparts from the government, the private sector, and academia. This will be complemented by WBI training in areas requested by the Government, including WTO accession and regional competitiveness issues. Some training will be done in other countries of the region to encourage cross-fertilization.

#### V. Budget and Timing

**Budget:** The budget for the DTIS is estimated at \$250,000, provided as trust fund from the IF group. This amount will be used for local and international consultants. In addition, Bank budget will complement the trust fund as follows: \$40,000 for staff travel; \$25,000 for cross-support; and \$50,000 for Bank staff time.

**Timing:**

- (1) Main mission-----February-March 2005  
First draft-----June 2005  
Final draft-----October 2005  
National workshop-----December 2005  
Donor meeting-----February 2006
- (2) Workshops and practical advice starting in February, with the assistance of WBI (Yan Wang).

#### VI. Team

Team Leader: Mona Haddad

Macro assessment	IMF (Qaizar Hussein) and Sjamsu Rahardja
Trade policy	George Fane, Khamlusa Nouansavan, Dr. Leeber Leebouapao
WTO issues	Maika Oshikawa (WTO), Phouvieng Phongsa, and Phil Schuler
Trade and poverty	George Fane and Khamlusa Nouansavan
Market access and regionalism	Paul Brenton
SPS	Kees Van der Meer
Customs	Bill Ledrew and Michel Zarnowiecki
Business environment	Amanda Carlier
Trade facilitation	John Arnold, Ruth Banomyong, Baher El-Hifnawi,
Export competitiveness	J.E. Austin Associates (under Kevin Murphy)

*Peer reviewers:* Philip English (WBIPR); Ronald Hood (ECSPE); Jean Francois Arvis (PRMTR); Robin Carruthers (TUDTR); and Sandy Cuthbertson (consultant).

*Overall guidance on IF issues:* Leen Solleveld

## VII. Key Audience

<u>Audience</u>	<u>Why</u>
<ul style="list-style-type: none"><li>• WTO National Steering Committee</li></ul>	<ul style="list-style-type: none"><li>• In charge of cross-ministerial trade issues related to the WTO</li></ul>
<ul style="list-style-type: none"><li>• Ministry of Commerce</li><li>• Committee for Planning and Investment</li></ul>	<ul style="list-style-type: none"><li>• In charge of trade policy</li><li>• Incorporate trade in the development agenda</li></ul>
<ul style="list-style-type: none"><li>• Ministry of Finance</li></ul>	<ul style="list-style-type: none"><li>• In charge of the government's budget and borrowing strategy</li></ul>
<ul style="list-style-type: none"><li>• Provincial governments</li><li>• Ministry of Agriculture, Ministry of Transport, Ministry of Industry and Handicrafts, Ministry of Tourism, Committee for Planning and Cooperation, National Transport Council</li></ul>	<ul style="list-style-type: none"><li>• Promote the regional business environment</li><li>• Their agenda relates to trade competitiveness</li></ul>
<ul style="list-style-type: none"><li>• Private sector</li></ul>	<ul style="list-style-type: none"><li>• Concerned about global and domestic constraints to trade</li></ul>
<ul style="list-style-type: none"><li>• UN agencies and bilateral donors</li></ul>	<ul style="list-style-type: none"><li>• Provide technical assistance on trade and WTO issues</li></ul>
<ul style="list-style-type: none"><li>• NGOs</li></ul>	<ul style="list-style-type: none"><li>• Strong connections with poverty groups</li></ul>

## VIII. Key Counterparts, Government Engagement, and Outcomes Sought

**Key counterparts.** The Ministry of Commerce (MOC) is our key counterpart and the focal point for other counterparts directly or indirectly linked to trade, including the Ministry of Finance (trade in services, customs), the Ministry of Agriculture, and the Ministry of Transport. Working with all government stakeholders through MOC will ensure better coordination in all aspects of trade. The WTO National Steering Committee, which is a cross-ministerial committee, is also directly involved in the IF process.

**Government engagement.** In March 2004, an informal workshop took place in Vientiane to explain to the WTO 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 counterpart team. A preliminary DTIS mission took place in June 2004 and a workshop was also organized by the WBI on trade issues to improve the understanding of trade issues by government officials. MOC has pro-actively guided our involvement in this process. Following the preliminary mission, the Government expressed its willingness to follow a different approach to the DTIS than the more traditional one envisioned. More specifically, the Government mentioned that many studies and reports have already been prepared for Lao PDR, and that they would like us to take a more pragmatic approach and focus on issues that can be dealt with in a second best environment. The Government's engagement in the IF is also driven by its engagement in the WTO accession process.

***Outcomes sought in the short term.***

1. build capacity of MOC staff to enable them to access and analyze international trade data; better understand implications of commitments in trade; and identify key constraints to Lao's export competitiveness;
2. contribute to the knowledge of Laotian negotiators in order to enable them to better understand WTO issues and undertake more informed negotiations; obtain outcomes from the WTO negotiations in line with their national interest; and better use multilateral negotiations to support the domestic development agenda;
3. increase government priority in reducing key bottlenecks to trade by increasing public investment in trade-related infrastructure, and taking the next steps in customs administration reforms to reduce smuggling;
4. maintain an open trade regime through more informed policy debate that identifies the real constraints to competitiveness and the opportunities in external markets;
5. raise broader awareness among various policymakers, including local governments, on the impact of their policies (e.g., to raise revenue) on trade and pro-poor growth;
6. continue the dialogue on trade with the multilateral agencies, with further demand for their support in this area.
7. take concrete measures that improve the short-term to medium-term prospects for exports in key sectors or clusters.

**IX. Dissemination Plan**

There is a need in Lao PDR for increased awareness about what is going on in neighboring countries in terms of trade performance, trade agreements, and potential markets; where does Lao PDR stand in terms of competitiveness; and what can Lao PDR do to boost its current exports and jump start new exports. There is also a need for increased awareness about the crucial role that trade can play as a source of growth.

Dissemination will therefore aim to reach various policymakers, at the national and local level; research institutes and private sector; and donors that can use the DTIS as a framework for their technical assistance to Lao in the trade area.

Dissemination will take place in the form of workshops and seminars to raise awareness among key policymakers; to foster debate among various stakeholders—industrial firms, government officials, local governments—on the impact of trade policy and the main impediments to export promotion; and to inform donors of the DTIS main findings.

**X. Link to PRSP and Related Work**

A new Country Assistance Strategy is in the process of preparation for FY05-08. Four themes are emerging: (i) investment climate and growth; (ii) building human capital; (iii) governance and transparency; and (iv) security for the poor. The DTIS links closely with the investment climate and growth theme, as trade expansion could be a main driver of growth as it did in the past. The DTIS links up with the other themes as well—building skills would be important to improve competitiveness; and improving governance and transparency will cut the cost of transactions. The DTIS will also analyze the impact of trade on the poor and how to achieve a trade strategy that serves the poor.

Moreover, the Government has recently finalized a National Growth and Poverty Eradication Strategy (NGPES). The NGPES recognizes that growth will need to be sustained through trade liberalization, higher agricultural productivity, foreign direct investment, and private sector development. The Bank's analytical work is supporting these goals through various products. An Investment Climate Survey has

just been launched and an Investment Climate Assessment will be prepared soon. A provincial private sector development policy assessment is also under way. A rural development strategy is currently being developed and will include supply chain analyses for key commodities. The DTIS will link up to these activities as they all fit within the theme of private sector development and competitiveness. Moreover, the DTIS will draw from a poverty assessment currently under preparation.

Finally, the DTIS will draw on a multitude of sectoral reports that were prepared by various institutions, including the ADB, UNIDO, UN-ESCAP, and UNCTAD.

## Annex: Recent Economic and Trade Developments in Lao PDR

*The purpose of this Annex is to provide a descriptive background of the main economic and trade issues in Lao PDR.*

### 1. Economic and political environment

***Lao PDR is one of the poorest countries in East Asia but its goal is to graduate out of the Least Developed Countries group by 2020.*** With an estimated per capita income of US\$320 in 2003 (see Table 1), the Lao People's Democratic Republic (Lao PDR) is one of the poorest countries in the East Asia region. It is classified by the UN as a Least Developed Country (LDC). Today, nearly 73 percent of its population live on less than US\$2 a day, and 25 percent live on less than US\$1 a day. Lao PDR has grown strongly and reduced poverty significantly for more than a decade. In the 1990s, real GDP grew by an annual average rate of 6.3 percent—despite the sharp fall-off during the regional crisis of 1997-1999 period—and exports grew at around 15 percent a year. The share of the poor in the total population fell from 46 percent in 1992/93 to around 31 percent in 2002/03 (using Lao PDR national poverty line of approximately \$1.5 a day)—a significant decline in poverty by most standards. The social indicators have improved too, but they remain among the worst in the region, and close to the average for Sub-Saharan Africa.

***Landlocked but rich in resources.*** Lao PDR has a population of around 5.7 million and a land area of 236,800 square km. Agriculture is the major sector, contributing 51 percent of GDP and employing 80 percent of the labor force. The Lao economy is to a large extent informal, with important black market and unrecorded cross-border trade activities. Infrastructure—roads, telecom, water and electricity—is underdeveloped, but the country has rich natural resources: water (used for hydroelectricity generation), tropical forests (47 percent of land area) and minerals (coal, tin, copper, gold, gemstones, gypsum). Economic growth is driven mainly by investments in hydropower and mining; industrial activity is concentrated in construction and garments, and tourism is gradually becoming a growing source of income in the services sector. Economic activity is concentrated around the capital, Vientiane. Traditionally benefiting from their proximity to Vientiane, the central provinces are economically more dynamic than those in the south or the north and have attracted the largest share of investment, including transport infrastructure. Landlocked, Lao PDR is in the center of the Mekong region, bordered by Thailand, Vietnam, Southern China, Cambodia and Myanmar. Its strategic location on the Mekong River makes it a natural transit corridor for neighboring countries. Lao PDR could significantly benefit from the dynamic sub-regional economic context driven by China, Vietnam, and Thailand.

***Transition to market economy.*** The Government introduced the “New Economic Mechanism” (NEM) in 1986, to begin the transition from a centrally planned to a market-oriented economy. Gradually, price controls were removed, farmers were allowed to work on their plots, the exchange rate system was unified, government’s monopoly on trade was removed, the number of state-enterprises was reduced, and private firms were allowed to operate. Reforms stalled during the regional crisis, as Lao PDR struggled with serious macroeconomic problems (Figure 1). Successful stabilization began in 2000 and structural reforms were revived in 2001. The Committee for Planning and Coordination (CPC) is in charge of promoting foreign investments and coordinating foreign assistance<sup>1</sup>—in 2003, donor-funded programs accounted for 7 percent of GDP, 39 percent of total public expenditure, and 61 percent of the capital budget. Thailand is Lao PDR’s most important partner in terms of foreign investments, and Japan in terms of foreign aid.

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<sup>1</sup> The Committee for Planning and Cooperation (CPC) has recently been renamed to Committee for Planning and Investment (CPI) and the Department of International Cooperation (DIC) has moved to Ministry of Foreign Affairs.

**Fighting poverty.** In April 2002, the Government of Lao PDR finalized an Interim-Poverty Reduction Strategy. Using this and the five-year National Socio-economic Development Plan for 2001-05, the Government adopted a consultative process to prepare the National Poverty Eradication Program (NPEP). The NPEP was presented to the donors' Roundtable Meeting in September 2003, discussed by the National Assembly in October 2003, and subsequently upgraded in early 2004 to the National Growth and Poverty Eradication Strategy (NGPES). It articulates Lao PDR's development framework for poverty reduction, specifies the targets and goals that the country values, and indicates the policy reform and public expenditure programs that will be needed to achieve those goals. In particular, the strategy seeks to (i) maintain macroeconomic stability by increasing revenue and ensuring appropriate fiscal and monetary policy; (ii) deepen structural reforms in public expenditure management, financial sector, state-owned enterprises, private sector, trade and the legal system; (iii) invest in the social sectors to expand access and improve social sector outcomes; (iv) invest in infrastructure such as roads, power, and water supply, and expand access to these services; (v) invest in rural development and natural resource management, including support for agricultural, mining, forestry, and hydropower development; and (vi) strengthen capacity.

**Table 1. Lao PDR and East Asia: comparing development indicators**

	Lao PDR	East Asia & Pacific	Low-income		
<b>POVERTY and SOCIAL</b>					
<b>2003</b>					
Population, mid-year (millions)	5.7	1,855	2,310		
GNI per capita (Atlas method, US\$)	340	1,080	450		
GNI (Atlas method, US\$ billions)	2.0	2,011	1,038		
<b>Average annual growth, 1997-03</b>					
Population (%)	2.6	1.0	1.9		
Labor force (%)	2.4	1.1	2.3		
<b>Most recent estimate (latest year available, 1997-03)</b>					
Poverty (% of population below national poverty line)	31	..	..		
Urban population (% of total population)	25	40	30		
Life expectancy at birth (years)	59	69	58		
Infant mortality (per 1,000 live births)	80	32	82		
Child malnutrition (% of children under 5)	..	15	44		
Access to an improved water source (% of population)	52	76	75		
Illiteracy (% of population age 15+)	47	10	39		
Gross primary enrollment (% of school-age population)	..	111	92		
Male	..	112	99		
Female	..	111	85		
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	<b>1983</b>	<b>1993</b>	<b>2002</b>	<b>2003</b>	
GDP (US\$ billions)	..	1.3	1.7	2.1	
Gross domestic investment/GDP	..	..	20.2	20.3	
Exports of goods and services/GDP	..	21.5	26.9	25.5	
Gross domestic savings/GDP	..	..	..	..	
Gross national savings/GDP	..	..	18.1	20.1	
Current account balance/GDP	..	-7.8	-0.9	-1.6	
Interest payments/GDP	..	0.3	0.6	0.5	
Total debt/GDP	..	149.5	155.0	134.1	
Total debt service/exports	..	8.4	9.0	9.6	
Present value of debt/GDP	..	..	83.2	..	
Present value of debt/exports	..	..	290.0	..	
	<b>1983-93</b>	<b>1993-03</b>	<b>2002</b>	<b>2003</b>	<b>2003-07</b>
<i>(average annual growth)</i>					
GDP	4.8	6.2	5.9	5.3	6.4
GDP per capita	2.3	3.5	3.0	2.4	3.8
Exports of goods and services	20.4	4.2	-8.8	4.8	8.7

**Development diamond\***

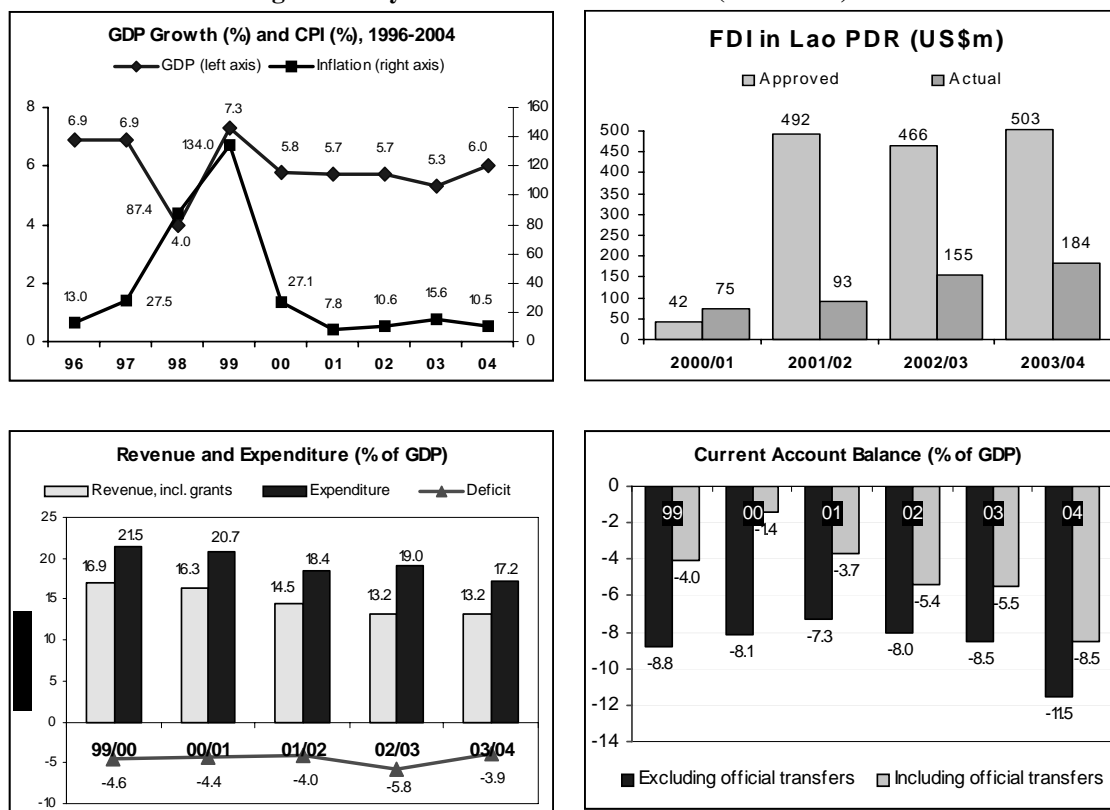
Legend: — Lao PDR, — Low-income group

**Economic ratios\***

Legend: — Lao PDR, — Low-income group

Source: World Bank, Economic Indicators of Development, 2004

**Figure 1. Key macroeconomic indicators (1996-2003)**



Source: IMF and Lao authorities

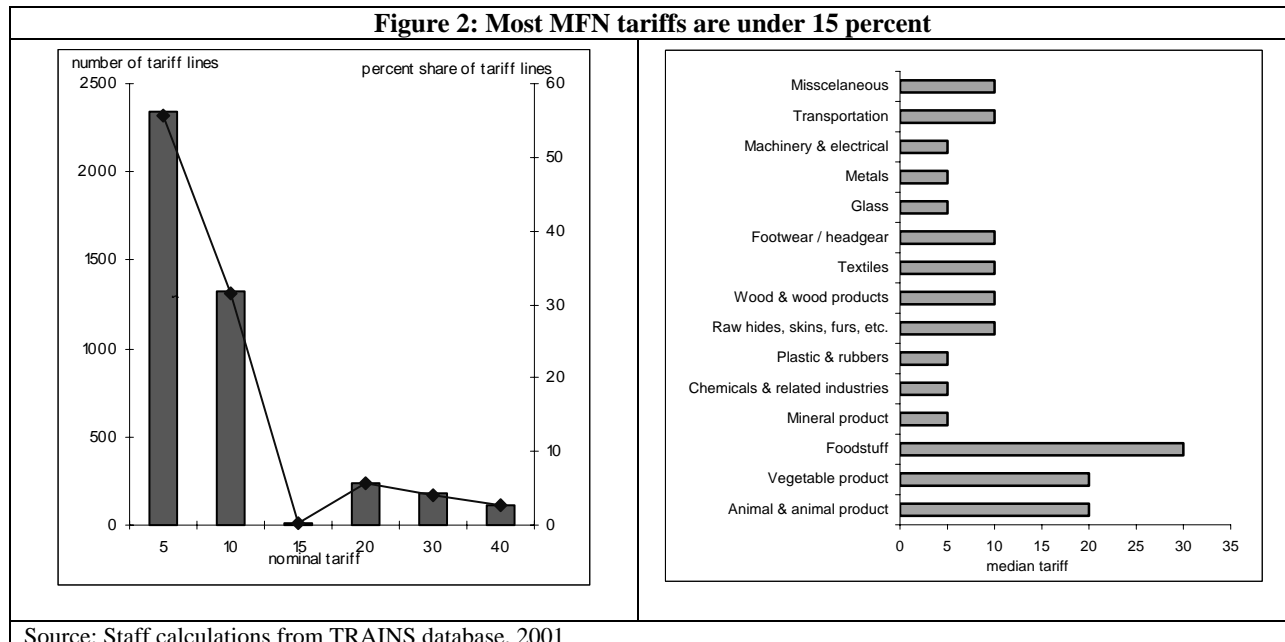
## 2. Trade reforms

**Lao PDR is gradually integrating globally, and more so regionally.** Lao PDR has been integrating gradually into the world economy since 1989. Trade reforms accelerated after the country joined ASEAN and AFTA in 1998 and started to implement the AFTA Common Effective Preferential Tariff (CEPT). Under AFTA Lao PDR expects to reduce its tariff on imports from ASEAN countries to 0-20 percent by 2005 and 0-5 percent by 2008 on 95 percent of its tariff lines. This represents a significant liberalization for Lao PDR as nearly 80 percent of its import comes from the region. Lao PDR's MFN import duties are low and not highly dispersed. The highest current import tariff rate is 40 percent (compared with about 150 percent in 1995) and for most products the tariff rate is below 15 percent (Figure 2). The tariff schedule has six rates: 5, 10, 15, 20, 30, and 40 percent, with an unweighted average of 9.5 percent in 2003. The import-weighted average MFN duty rate on imports is lower and the standard deviation of these rates is only 9 percent. There is some tariff escalation in the tariff schedule, and thus effective rates of protection are likely slightly higher.

**Lao PDR maintains an import-export equilibration plan and a number of non-tariff barriers.** Trade in Lao PDR has been liberalized substantially in recent years. Import restrictions still apply for a limited number of goods, such as fuel, construction materials (cement, steel), and some sensitive agricultural products. Moreover, traders are subject to an import-export equilibration plan. The collapse in export earnings during the 1997 Asian crisis resulting from a sharp drop in Lao PDR's exports to Thailand, its major export destination, led to a crisis of confidence in the value of the domestic currency, the kip. The

Government tightened the licensing restrictions on imports that it had been gradually dismantling. As of October 2004, import and export licensing arrangements have been simplified. To export, companies need to present only an invoice and a packing list to the officials at the border checkpoint (one-stop service). To import, each year importers need to present an annual import plan to the Trade Department and can import against this plan throughout the year.

**Figure 2: Most MFN tariffs are under 15 percent**



Source: Staff calculations from TRAINS database, 2001

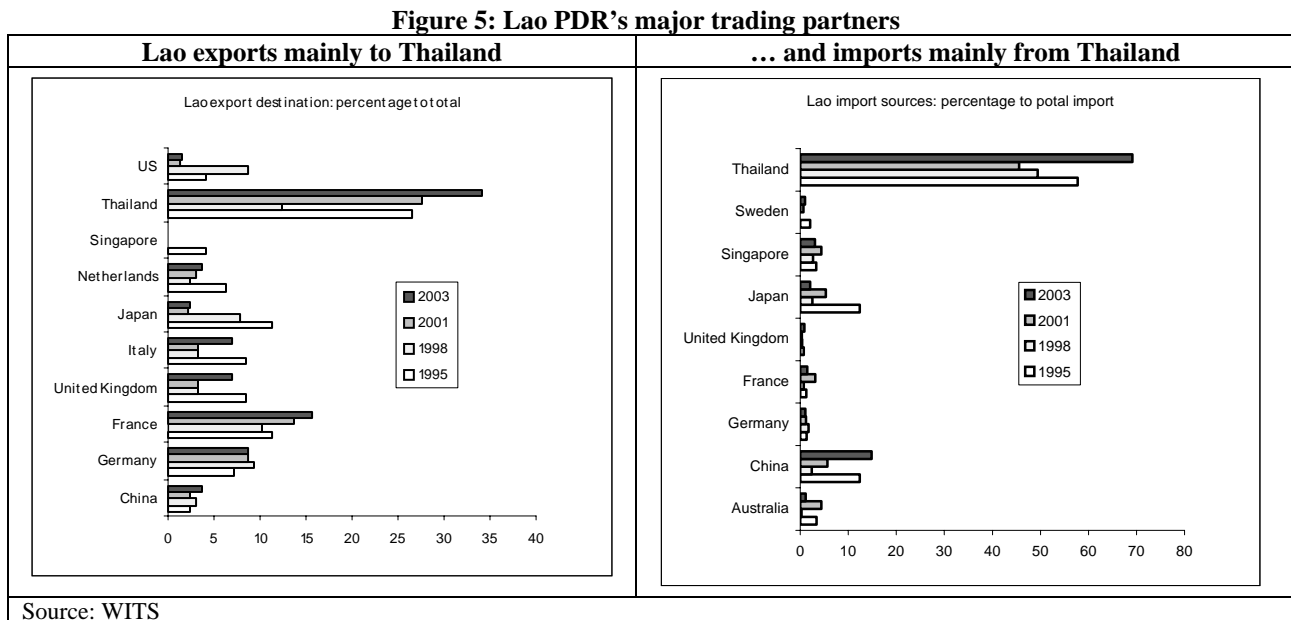
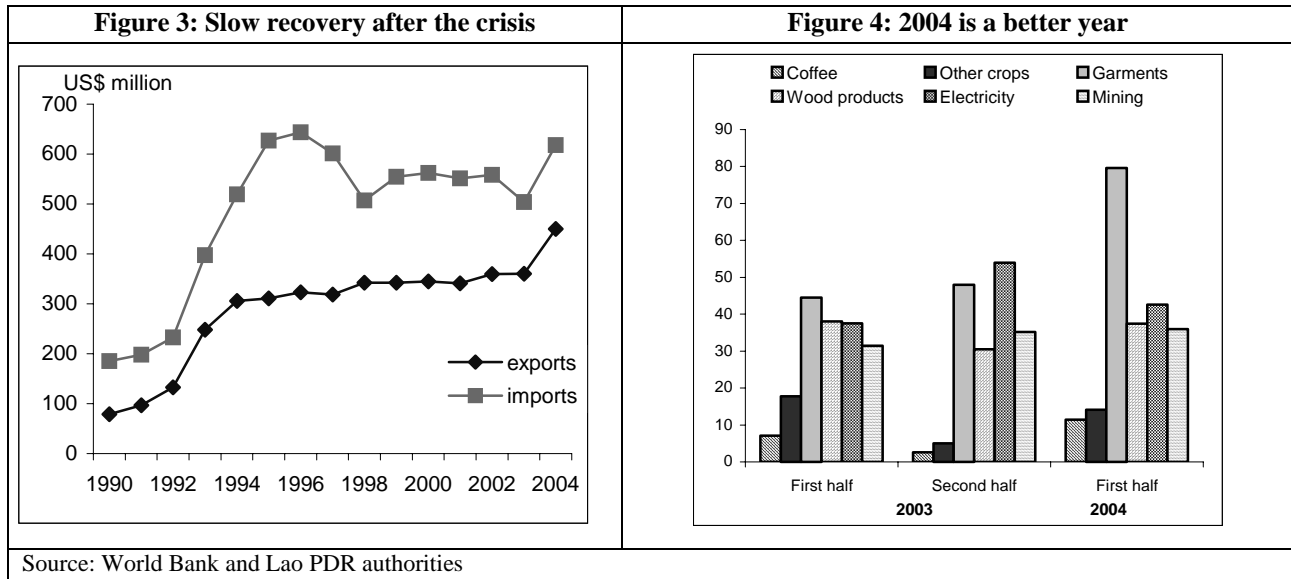
### 3. Trade performance

**Slow recovery of exports after the East Asia crisis.** After growing at an annual rate of 27 percent during 1990-1995, export growth dropped in the second half of the 1990s, as a result of the Asian crisis and in particular the lower demand from Thailand—Lao PDR’s major trade partner. During 1995-2000, exports grew at only 2 percent per year. Exports have yet to recover—a moderate growth of 2 percent was achieved during 2000-2003. In the first six months of 2004, as compared with the same period of 2003, Lao exports increased significantly by 22 percent, or from US\$182 million to about US\$225 million (Figure 3). At the same time, imports went up by about 23 percent, or from US\$252 million to about US\$309 million. The growth in exports was driven mainly by garments, electricity, mining and coffee whereas the growth in imports was driven by machineries and equipment and raw materials for the garment industry.<sup>2</sup> In the first half of 2004, as compared with the same period last year, exports of electricity and mining products increased by about 14 percent, reaching US\$43 million and US\$36 million, respectively (Figure 4). Surprisingly, garments exports jumped by nearly 80 percent, to US\$80 million. Exports of agricultural products grew only at around 3 percent or about US\$26 million. Lao export markets remained concentrated in a few countries: ASEAN (Thailand, Vietnam), China, Japan, Australia, Korea and the EU.

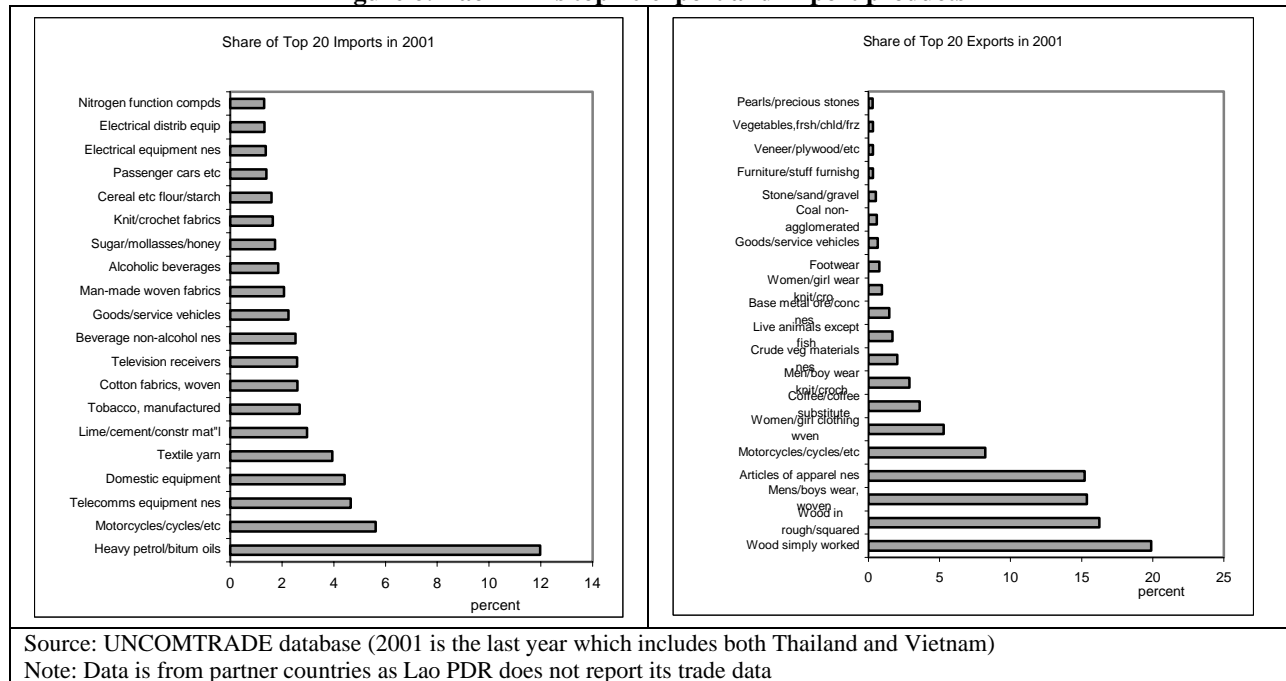
**Reducing export dependency on a few markets and a few commodities would reduce Lao PDR’s vulnerability to external conditions.** The Government is seeking ways to diversify the Lao economy. Currently, nearly 70 percent of official Lao exports of goods remain concentrated in wood products—to

<sup>2</sup> There are large discrepancies among the estimates of exports and imports provided by different agencies in Lao PDR. Discrepancies in Lao export and import data were described in the World Bank Economic Monitor (May 2004 Issue).

Thailand—and garments—to the European Union (Figures 5 and 6). This makes the country quite vulnerable to external conditions, as was experienced during the Asian crisis—given Lao PDR’s dependence on exports to Thailand, external trade was severely damaged by the Asian crisis as exports net of re-exports fell by 10 percent in 1997, as a result of a fall in exports of wood products of almost 30 percent and a fall in manufactured exports of 45 percent. Duty free and quota free access of garment exports to the EU has been crucial to the development of the garment industry. But the expiration in 2005 of the Multi-Fiber Agreement (MFA) will be a test for the competitiveness of Lao textile products. Lao PDR imports goods mainly from neighboring countries, such as Thailand, China, Vietnam and others like Japan, Korea, Australia and EU.



**Figure 6: Lao PDR's top 20 export and import products**



#### 4. Market access

**Lao PDR has access to several preferential treatments in many countries.** Since Lao PDR is not yet a member of the WTO, its exports are not automatically entitled to MFN treatment. Because of Lao PDR's status as a least developed country, some of its exports receive preferences from industrial countries and from the original members of ASEAN. Lao PDR has GSP access to the EU under the Everything But Arms arrangement. It also has a special textile agreement with the EU that exempts its garment exports from EU quotas. Most Lao PDR's exports to Australia and New Zealand already obtain GSP treatment and quotas do not apply; since July 2003, all exports to Australia and New Zealand are admitted free of duties and quotas. Moreover, under the ASEAN integrated system of preferences, the original six ASEAN members provide special treatment to the imports from the four new members (which include Lao PDR). Like other countries that enjoy special preferences as least developed countries, a key challenge to Lao PDR is to be able to use and take advantage of such preferences.

**WTO membership could offer an opportunity to accelerate the economic reform process undertaken by the Government.** The Government also believes that WTO membership will have far-reaching implications for the Lao economy and its integration into the world trading system. Lao PDR applied for WTO accession in 1997 and submitted its Memorandum in March 2001. The Working Party met for the first time in October 2004. The Government of Lao PDR kicked off its membership negotiations by outlining the reforms it has already undertaken and calling on members to take account of its status as a land-locked, least-developed country without a representative in Geneva. Before the next meeting, Lao PDR is expected to submit an action plan for enacting legislation with further information on agriculture, sanitary and phytosanitary measures, technical barriers to trade, services and intellectual property. Lao PDR was also asked to prepare its first offers for market access in goods and services. Members—including coordinators and representatives of groups such as the least-developed countries and ASEAN—strongly supported Lao PDR's membership bid, and called for flexibility and a speedy negotiation in line with the General Council's December 2002 guidelines for least-developed countries' accession.

**Obtaining NTR from the US is an important turning point for Lao PDR's global integration.** Lao PDR signed a bilateral trade agreement with the US in 2003 and was granted Normal Trade Relations (NTR) in November 2004. The removal of this stumbling block opens up the opportunity to make significant progress in Lao PDR's WTO accession process. It also offers opportunities to expand its exports to the US. Before obtaining NTR, Lao PDR was allowed to export to the US but at non-NTR tariff rates which are about twenty times higher than the NTR rates—NTR tariff rates range in most cases from zero to 10 percent, and in a few categories can rise to 30 percent; non-NTR rates range from zero (for some natural resource goods, and agricultural products like tea and coffee that do not grow in North America) to around 90 percent for many light manufactured goods like clothes and toys. The average country receiving NTR tariff rates faced 2.4 percent tariffs on average in 2003. By contrast, Lao PDR faced a rate of over 45 percent. In actual dollar terms, Lao businesses paid US\$1.8 million to the US Customs Services in order to sell US\$3.9 million worth of goods in 2003.

Most of Lao PDR's exports to the US came in six categories—five types of clothes and one of toys. Lao producers of these goods were at a disadvantage, because competitors in Cambodia, Vietnam, Burma, or China could sell their goods with NTR tariffs much lower than the tariffs on goods from Lao PDR (Table 2). In addition to these goods, with the NTR in place, Lao businesses might have opportunities in areas where non-NTR tariffs were so high as to make exports impossible. One example might be handicraft and village-industry type goods. Traditional clothing is a successful export in Thailand but was difficult for Lao PDR to export given the high tariffs. Silk weaving is another example—Thailand exported more than US\$5 million worth to the US in 2003, and Lao PDR none at all.

**Table 2: To have or not to have NTR**

Country	2001 exports to US	Tariffs paid	As percent
World NTR average	\$700 billion	\$18.3 billion	2.6%
Asia average	\$399.7 billion	\$12.4 billion	3.1%
Asean average	\$75.9 billion	\$2.2 billion	2.9%
Lao PDR	\$3.9 million	\$1.8 million	45.3%
Cambodia (NTR in 1996)	\$964.2 million	\$152.3 million	15.8%
Burma	\$470.7 million	\$73.8 million	14.8%
<b>Goods that Lao PDR exports to the US</b>			
Product	NTR tariff		Non-NTR tariff
1. Knitted men's cotton shirts	20%		45%
2. Knitted cotton sweaters	17.3%		50%
3. Woven men's cotton shirts	20%		45%
4. Knitted women's cotton shirts	20%		45%
5. Knitted cotton T-shirts	17.4%		90%
6. Children's riding toys	0%		45%
<b>Goods that Lao PDR does not export to the US (but Thailand does)</b>			
Product	NTR tariff		Non-NTR tariff
Women's handicraft cotton dresses	11.9%		90%
Sun umbrellas	12%		60%
Silk weavings	0%		90%
Rattan or bamboo chairs	0%		60%
Wicker baskets (rattan or bamboo)	0%		50%

Source: Edward Gresser, Progressive Policy Institute, May 2002

## 5. Trade facilitation

*Being a landlocked country, Lao PDR stands to make large gains from improving its transport infrastructure and interconnections with surrounding transit countries.* The state of infrastructure offers certain challenges compared with other countries in the region. There is no railway system in Lao PDR, the road network has a very low density (0.076 km of road per square km) and less than half is paved. Only a small percentage of provincial roads is passable during the wet season. Almost 40 percent of villages are more than 6 kilometers away from a main road, half are inaccessible during the rainy season, and only three-quarter of the district centers have year-round road access (Lao Expenditure and Consumption survey, 1997-98, LECS2). This not only makes it difficult to get outputs to markets, but also increases the import costs of essential consumer products and inputs such as fertilizers. As many villages are not connected to the power grid, a more reliable transport would also allow for a continuous supply of fuel to run the diesel-generating sets. Ensuring adequate transport and communications facilities would play a vital role in the country's economic development and an efficient multimodal transport system can be one of the key factors in increasing Lao PDR's trade competitiveness.

*But inadequate infrastructure is only part of the problem; most delays in shipping occur from institutional bottlenecks and red tape.* Thailand remains the preferred transit route for Lao trade with third countries. Thailand is a regional hub with daily feeder connections to Singapore. Movement of goods through Thailand between Lao PDR and a third country is governed by a Transit Transport Agreement between the two governments (renewed annually). Other avenues for shipping are also available via Vietnam or Malaysia. In addition to inadequate infrastructure, cumbersome customs procedures and corruption (tea money) at the border raise transport costs and increase delivery times for key exports such as garments (Table 3). Trucks cover in 2-3 days the 670 kilometers from Vientiane to the port of Bangkok. Sealed containers have to pass an additional custom inspection at the Thai border. Regulation concerning handling and transportation implies that at the border trucks have to be unloaded and reloaded on Thai trucks. Carriage of Lao transit cargo through Thailand can be done only through designated and licensed road hauliers (only one in Lao PDR). Harmonization and flexibility in working hours at customs could reduce delivery time and cost. These are some of the trade facilitation problems that traders have to deal with and that the Government has been working on resolving.

**Table 3: High costs and time to move containers out of Lao PDR**

Route for a 20ft container	Distance (km)	Total transit time (days)	Total transport cost (USD)	Handling and customs charges (% of total)	Confidence index
Via Danang (Vietnam) <i>Vientiane-Danang-Singapore-Rotterdam</i>	18329	30/32	3420	29.2%	2.7
Via Bangkok (Thailand) <i>Vientiane-Bangkok-Singapore-Rotterdam</i>	17549	30/31	2477	24.8%	2.9
Via Laem Chabang (Thailand) <i>Vientiane-Laem Chabang-Singapore-Rotterdam</i>	17630	30/31	2503	23.7%	3.1
Via Lad Krabang (Thailand) <i>Vientiane-Lad Krabang-Laem Chabang-Singapore-Rotterdam</i>	17624	30/31	2519	22.8%	3.0
Via Port Klang (Malaysia) <i>Vientiane-Lad Krabang-Port Klang-Rotterdam</i>	16905	27/28	2468	21.3%	3.0

Source: Banomyong and Beresford

Note: The confidence index ranges from 1 (almost no confidence) to 5 (very confident) and measures the level of certainty and confidence in the service perceived by respondents.

## 6. Business environment

*The Government's increasing focus on the development of the private sector is commendable, and the authorities are working towards making the business environment more conducive to investment.* The competitiveness of Lao PDR's exports depends not only trade policy and trade facilitation, but also on the business environment. The comparative cost of doing business in Lao PDR is high. While Lao PDR has cheaper labor costs, it has higher average electricity, telecommunication, and rental costs compared to other East Asian countries. In addition to these difficulties, the private sector in Lao PDR faces a cumbersome regulatory environment. Lao PDR ranks 144<sup>th</sup> out of 145 countries reviewed in terms of the length of time it takes to start up a business—it takes 198 days to start a business in Lao PDR, compared with a regional average of 52 days (Table 4). On other indicators Lao PDR ranks better. Foreign investment remains limited and the number of domestic firms is still low—in the entire country with a population of 5.7 million, there are only a few hundred manufacturing businesses with more than 10 employees.

In recent months, the authorities have taken a number of measures to promote both domestic and foreign private investment and improve the environment for doing business in the country. Domestic and Foreign Investment Laws have been recently revised and adopted. The new investment laws provide equal tax incentives and a level playing field for both local and foreign investors. The new domestic investment law gives local investors a better and fairer deal compared to the old one while they will receive incentives and other treatments similar to those for foreign investors. Measures have also been taken to attract FDI through the creation of a one-stop service. In the NGPES, the Government over the medium term plans to: (i) improve the business environment by creating a predictable, transparent, and favorable policy environment and level playing field; (ii) remove remaining biases in administrative procedures and regulations that favor SOEs over domestic or foreign private firms; and (iii) strengthen market institutions, including dispute resolution and contract enforcement.

**Table 4: Results of 2005 Doing Business Review for some East Asian countries**

	Indicators 2004	Average	Cambodia	Indonesia	Lao PDR	Malaysia	Mongolia	Singapore	Vietnam
<b>Starting a business:</b>	Number of procedures	10	11	12	<b>9</b>	9	8	7	11
	Time (days)	58	94	151	<b>198</b>	30	20	8	56
<b>Hiring and firing workers:</b>	Difficulty of Hiring Index	41	33	61	<b>11</b>	-	11	-	44
	Difficulty of Firing Index	45	30	70	<b>80</b>	10	20	-	70
	Firing Costs (weeks)	56	39	157	<b>185</b>	74	17	4	98
<b>Registering property:</b>	Number of procedures	6	7	6	<b>9</b>	4	4	3	5
	Time (days)	94	56	33	<b>135</b>	143	10	9	78
<b>Getting credit:</b>	Cost to create Collateral (% of income per capita)	26	-	3	<b>4</b>	3	2	0	2
	Legal Rights Index	4	4	5	<b>2</b>	8	5	10	4
	Credit Information Index	1	-	3	<b>-</b>	6	3	4	3
	Public registry coverage (borrowers per 1000 capita)	14	-	4	<b>..</b>	339	23	-	8
	Private bureau coverage (borrowers per 1000 capita)	28	-	-	<b>-</b>	..	-	335	-
<b>Protecting investors:</b>	Disclosure Index	2	-	4	<b>1</b>	5	3	5	1
<b>Enforcing contracts:</b>	Number of procedures	33	31	34	<b>53</b>	31	26	23	37
	Time (days)	394	401	570	<b>443</b>	300	314	69	404
	Cost (% of debt)	45	121	127	<b>30</b>	20	23	9	30
<b>Closing a business:</b>	Time (years)	4	..	6	<b>5</b>	2	4	1	6
	Cost (% of estate)	18	..	18	<b>76</b>	18	8	1	18
	Recovery Rate (cents on the dollar)	22	-	11	<b>-</b>	35	17	91	16

Source: World Bank Group (<http://rru.worldbank.org/DoingBusiness/>)

## 7. Sectors with potential for export growth

Lao PDR does not export a large number of products. Most of its exports are concentrated in wood, garments, and agriculture and raw material. Hydro-electric power has contributed significantly to export growth in the early 1990s. As Thailand's growth picks up in the recovery from the Asian crisis, electricity exports are again expected to contribute importantly to future growth. The largest of the planned hydro-electric projects is the proposed US\$1 billion Nam Theun 2 project (Box 1). But such exports may lead to a Dutch disease issue. Lao PDR would need to tap further into its comparative advantage in order to improve the value of its current exports and to jump start new exports

### Box 1. The proposed Nam Theun 2 hydro project (NT2)

A US\$1.1 billion private sector investment project including the development, construction, and operation of a 1070 Megawatt trans-basin diversion power plant on the Nam Theun river, a tributary of the Mekong, in the central region of the country, about 250 kilometers east of Vientiane. This project, involving the construction of a dam to generate power mainly for export to Thailand, constitutes an opportunity for Lao PDR to: (i) combat widespread poverty in the country through additional revenues gained from electricity exports; (ii) help meet Thailand's energy needs and strengthen regional Mekong initiatives; (iii) promote sustainable development and the broader development agenda in Lao PDR; and (iv) benefit from increased future opportunities to implement similar projects in the mining and electricity sectors, as Lao PDR becomes better integrated into global developments and builds relationships with the international private sector. The Government has requested World Bank Group support for this project through, an IDA environmental and social project and a MIGA guarantee.

According to a recent UNIDO study on competitiveness in Lao PDR, several other sectors have potential for export, including agriculture and agro-processing; wood products, including furniture; non-timber forest products; garments; and handicrafts. In addition, tourism is one of the most promising sectors in Lao PDR.

Export of *processed fruits and vegetables* (canned bamboo shoots and mangoes, baby corn, rambutan in syrup, etc.) already exists on a limited scale. Further increase of such niche products on niche markets, most likely the EU where Lao PDR enjoys preferential GSP treatment, will mainly depend on skillful marketing.

There is a huge and growing demand for *meat* in China, Vietnam, and Thailand, with geographically reachable urban markets. These countries are experiencing increasing scarcity of land, while Lao PDR, especially in the south, has large areas of land which is not cultivated or covered with forests, but suitable as pasture. To realize this potential, the Government needs to improve the veterinary legislation and veterinary services, facilitate access to land for pasture, disseminate improved forage species and cultivation techniques, and implement breeding products.

Some 20,000 tons of primary processed *coffee* is currently exported per year from Lao PDR. Secondary processing (roasting, mixing, etc.) may not be viable. However, appropriately packaged and skillfully marketed niche brands may very well be viable internationally, in particular in Europe. The marketing should be based on WTO recognition of geographical indication of origin.

Limited quantities of crude *vegetable oil* is currently produced in Lao PDR based on locally grown groundnuts and soybeans, which are exported to Thailand and then re-imported after further refining in Thailand. As the investment in solvent extraction and further refining require fairly large investments and production to be viable, the Lao market is not sufficiently large to justify such a plant. However, China and Vietnam offer potential export markets which may justify an economically sized plant. There is also some imports of refined palm oil from Malaysia in bulk that

is bottled in Lao PDR. If refined palm oil can be exported to China and Vietnam, the preconditions may be present for a viable palm oil refining project.

*Animal feed* may be viable and could substitute for imports from Thailand and be exported to China and Vietnam. As for many other products, support could be provided by the Government by promulgating legislation on contract farming; creating awareness of grain quality and safety issues; and spreading knowledge about post-harvest techniques. This requires an assessment of sanitary standards.

Exports of *garments* grew mainly because they were not subject to quota or tariff in the EU market—most exports go the EU. Most exports are from foreign owned firms (mainly Thai) that came to Lao PDR because Thailand filled its quota. With the MFA phased out this industry is under threat. The question is how to keep the existing firms as the MFA is phased out, and how should these firms adjust to take advantage of the comparative advantage of Lao PDR (e.g., focus more on labor-intensive products).

*Wood processing* is an important industry in Lao PDR, accounting for a third of gross manufacturing output and export. Lao timber is mainly exported in the form of logs, and very little is processed domestically. Since 1999, exports of logs have been banned, but enforcement has been weak. Nearly all of the exported wood, mainly to Thailand and Vietnam, undergo further value addition in these countries and are then exported to overseas countries. The challenge to the Government is to promote the production and exports of secondary wood products while pursuing its environmental and social objectives.

Lao PDR opened its doors to international tourists in 1989, and since then the *tourism* industry has developed rapidly to become one of the country's largest earners of foreign currency. Lao PDR possesses a beautiful, virtually untouched natural environment and a population that still practices their rich traditional culture. These two characteristics form the basis for the promotion of tourism development in Lao PDR. The Government has taken important steps to implement social and environmental policies and programs in order to promote sustainable tourism development. Additional measures are needed to achieve sustainable tourism development, including infrastructure development, more cooperation and coordination between Lao PDR and its neighboring countries, ecotourism accreditation, and environmental impact assessments of tourism.

# **Outline: Building Export Competitiveness in Lao PDR**

## **Part I: Overall trade issues**

### **Chapter 1: Macroeconomic environment (IMF and Sjamsu Rahardja)**

A stable macroeconomic environment and a stable exchange rate are a pre-requisite for improving export performance. Economic performance has been improving since the adoption in 2000 of a stabilization program and the implementation of a phased program of reforms. Inflation averaged 15 percent during 2000-03, and reached single digit in 2004. The nominal and real exchange rates have been stable throughout the year. Lao PDR has consistently run a very large trade deficit, but a much smaller current account deficit, and both have been declining relative to GDP.

This chapter will: (i) assess the general macroeconomic environment in Lao PDR; (ii) assess the trends in the effective exchange rate vis a vis its major trading partners; (iii) assess the potential impact of the MFA phase out on the balance of payments and the real and nominal exchange rates; (iv) assess the possibility of a Dutch disease from exports of hydro-electric power and its impact; (v) assess the impact of trade liberalization under AFTA commitments on the balance of payments, the real and nominal exchange rates, and the government budget; (vi) assess the role of the foreign exchange control mechanism on macroeconomic management and provide alternative options; and (vii) provide recommendations on how to maintain a stable macroeconomic environment required to preserve the competitiveness of the traded goods sector.

### **Chapter 2: Structure and pattern of trade and investment (Mona Haddad and Francis Ng)**

Most trade takes place with the region, most investment comes from the region, and most export is limited to a few products. While this trend is likely to continue in the short term, some changes in the trade profile of Lao PDR may already be taking place.

This chapter will: (i) examine trends in imports, exports, and investments; (ii) assess Lao PDR's revealed comparative advantage globally and regionally and identify "dynamic" exports; (iii) evaluate the extent of export concentration—for products and markets—and how it is changing; and (iv) provide international comparisons with the trade performance of similar countries.

### **Chapter 3: Trade policy (George Fane)**

Lao PDR has a relatively open trade regime, and is on schedule in its implementation of the AFTA commitments. The remaining trade policy issues include non-trade barriers and the licensing system, export taxes and export bans, and generally ensuring that there is no anti-export bias in the trade regime.

This chapter will: (i) evaluate trade policy in terms of tariffs—dispersion, effective rates of protection; (ii) assess the potential anti-export bias in the trade regime; (iii) assess the potential restraining impact of the export and import licensing, as well as of export taxes and export bans, on export performance; (iv) evaluate other interventions in trade, including state trading enterprises, countervailing measures, anti-dumping duties, and safeguards; (v) assess the impact of trade incentives, including special economic zones and exemptions; (vi) describe the remaining AFTA commitments; and (vii) provide recommendations on how to further simplify the tariff schedule, gradually remove the licensing process, and mainstream trade policy in the national socio-economic plan.

### **Chapter 4: Market access and regionalism (Paul Brenton)**

As a least developed country, Lao PDR enjoys preferential treatment in various countries. Tariffs and quotas are less likely to be a major stumbling block to Lao PDR's exports. However, other market access

issues may be constraining exports—AFTA concessions, for example, are almost unused by Lao exporters.

This chapter will (i) document all the trade agreements and preferences that benefit Lao PDR—with Asean and non-Asean countries, reciprocal or non-reciprocal; (ii) evaluate their consistency with regional and global integration; (iii) assess the benefits and costs to Lao PDR of being involved in several trade agreements (is there a spaghetti bowl effect), and examine the reasons why preferences are often not used; (iv) evaluate market access constraints in export markets arising from other factors such as standards and technical barriers to trade, tariff peaks, or tariff escalation; and (v) provide recommendations to strengthen preferential agreements with other countries and raise the use of existing arrangements.

#### **Chapter 5: WTO accession (Phil Schuler, Maika Oshikawa, and Phouvieng Phongsa)**

With China and Cambodia being now members of WTO and Vietnam in the process of becoming one, Lao PDR's membership gains increased in importance. At the same time, some may be questioning the economic benefits that may emerge from a future WTO membership given Lao PDR's still early stage of development. In addition, since most of its formal trade already enjoys preferential access under GSP or bilateral agreements, WTO accession will provide few new market access opportunities in the short term. WTO membership will, however, imply administrative costs to undertake legal reforms and establish enforcement mechanisms. For the Lao Government, the most important task is therefore to minimize these costs and to find ways to best sequence useful reforms, so that Lao PDR's development priorities are supported—and not burdened—by WTO accession requirements.

This chapter will (i) outline the main requirements for the WTO accession (e.g., tariff bindings, domestic support for agriculture, implementation of trade-related regulatory agreements, etc.) and the likely impact of the Doha Development Agenda; (ii) provide an overall strategy for Lao PDR to use the WTO accession for its economic development program—in agriculture, manufacturing, and services; (iii) provide lessons of experience of similar countries that have recently acceded to the WTO (such as Nepal and Cambodia); (iv) review policies and regulations affected by WTO obligations (e.g., those governing subsidies, standards, intellectual property, state trading enterprises, import licensing, trade remedies, customs, etc.), suggest priorities for Lao PDR's legislative action plan, and identify technical assistance needed to implement these reforms; and (v) analyze ways to maximize the benefits of WTO accession.

#### **Chapter 6: Trade and poverty (George Fane and Kasper Richter)**

The most significant concern of the Government is to achieve a pro-poor growth. Much trade liberalization took place already, and further liberalization is also scheduled as per AFTA commitments. At the same time, Lao PDR is also benefiting from preferential market access—within Asean, with the EU, and with Australia and New Zealand. The recent gain of NTR with the US also opens up new export opportunities for Lao PDR. But such opportunities do not necessarily mean that the poor will benefit. Since Lao PDR started to liberalize its trade regime in the mid-1990s, overall poverty incidence fell from 39 percent in 1997-98 to 32 percent in 2002-03 (based on LECS II and III)—but poverty did not fall everywhere. Remarkably, poverty fell in rural areas but rose in urban areas during this period. Further urbanization and infrastructure investments have improved accessibility of markets for part of the population. The link between trade and poverty will be examined using household data (LECS) for various years.

This chapter will (i) assess the impact of trade liberalization and increased market access (i.e., of import and export) on poverty since the late 1990s; (ii) assess the secondary channels by which trade would benefit the poor, including access of the poor to markets through better infrastructure, off-farm employment in micro-enterprises, barriers between internal markets, changing patterns of rural-rural and rural-urban migration, and the role of remittances from migrant workers; (iii) assess the impact of trade liberalization on prices, availability of commodities, and employment in key sectors of interest to the

poor's consumption and production, and estimate the net impact on the poor; (iv) assess the impact of potential increases in exports, especially of agricultural products, on the poor; and (v) provide recommendations on how to best integrate trade policy into existing plans for poverty alleviation (especially the NGPES).

## **Part II: Building export competitiveness**

Part II of the DTIS addresses export competitiveness issues. It will (i) assess the business environment and cross-cutting issues that affect exports (Chapters 1-3), and (ii) assess the competitiveness of specific clusters that have an export potential.

### **Chapter 1: Business environment and institutional framework for trade and investment (Amanda Carlier)**

Promoting the private sector is a pre-requisite for Lao PDR to be able to take advantage of trade opportunities. But doing business in Lao PDR is still difficult and costly. This puts domestic producers at a disadvantage—both in terms of competing with imports as well as being competitive to export. The problem of high cost of critical services, such as power or telecom, is exacerbated by a cumbersome regulatory environment, at the national level as well as at the provincial level.

Based on the Investment Climate Assessment currently under preparation, this chapter will (i) provide factual mapping/record of all the business regulations and procedures, time and costs there-of, that private entrepreneurs need to go through in order to do business (including detailed information on the existing business start-up, registration and licensing requirements, investment, taxation, access to land and credit, legal and judicial framework, and cost of doing business in the provinces); (ii) develop a feasible Action Plan to strengthen the business environment at the national and provincial level (through streamlining procedures, increase public-private dialogue, improved local official skills/understanding), and identify where the greatest gains can be made through simplifying the procedures and cutting the red tape.

### **Chapter 2: Trade and transport facilitation and customs (John Arnold and Ruth Banomyong)**

As a landlocked country, effective transport is critical to the development of Lao PDR. Not only is it important for Lao PDR to provide efficient connections between the economic centers of the three main regions—Luan Prabang in the North, Vientiane in the center, and Savannakhet and Pakse in the 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—most of the delays in transport take place because of cumbersome procedures and regulations on and off the border.

This chapter will (i) assess the whole trade facilitation chain in terms of infrastructure support—from the manufacturer (packaging, warehousing), to the forwarder, to the line haul (delivery, handling, and transportation on roads and rail), to customs (document handling, goods inspection, export/import approvals) to outbound transport (handling, scheduling), to the user—via the main routes (Bangkok and Danang); (ii) assess the non-infrastructure support of the supply chain, including regulations and institutional arrangements; (iii) assess the trucking sector policies and the extent of backloading of trucks, and provide recommendations on how to promote efficient backloading; (iv) identify the key bottlenecks and prioritize the set of actions that would need to take place to make a difference in the short term and in the medium term; (v) provide options for actions by neighboring countries that would facilitate the transfer of goods from Lao PDR, and options for alternative routing; and (vi) provide an assessment and recommendations on the transit routes through Lao PDR, especially between Thailand and China.

### **Chapter 3: Sanitary and Phyto-Sanitary standards (Kees Van der Meer)**

Lao PDR's exports of agriculture and livestock products will remain important for many years. Such exports, however, can be constrained by the SPS standards in the receiving country. It would be important for Lao PDR to understand what constraints SPS standards face and how to adjust to meet the requirements of the importing countries.

This chapter will (i) identify products where SPS issues have already been raised or are likely to arise as exports develop; (ii) identify the nature of the SPS issues; (iii) assess the policies and the infrastructure (such as seeds or labs) needed to promote higher SPS standards throughout the production chain.

### **Chapter 4: Cluster analysis and sources of export growth**

The Government would like to see exports grow quickly and significantly in the coming years. The effort to help boost exports comes at a time of rapid change in the global economy. The apparel sector will undergo radical change as the former MFA quota regime ended in January 2005 as part of integration into WTO trade agreements. China's continued growth is altering trade patterns globally and regionally with major implications for South East Asia, both in terms of challenges and opportunities. Neighboring countries, such as Thailand and Vietnam, have been highly successful in a number of export industries and in tourism. With Lao PDR's garment exports accounting for about a third of its total exports, and with most of its exports going to the region, the Government is re-assessing its export competitiveness position and ways to better exploit exports as an engine for growth. For that, it would be important to better understand how to adjust the existing exports to changes that are happening regionally and globally; how to increase the value and the volume of its existing exports; how to reach new markets, especially in the region; and how to jump start new exports.

This chapter will examine the real needs and requirements of specific growth sectors and will outline the *practical* steps that private sector and public sector leaders can take to boost exports. Previous studies (see, for example, UNIDO) have identified agro-processing, coffee, livestock, garments, tourism, and wood products among the sectors offering the greatest near-term potential for Lao PDR. While clearly not engaged in "picking winners," this chapter will evaluate the potential for each of these clusters (and/or other depending on discussions with the government and private sector) to improve their competitiveness, evaluate the opportunities and major constraints they face, and develop action plans for implementation in the short term. This more practical and short term approach is being undertaken at the request of the Government of Lao PDR.

The chapter will:

- benchmark the Lao competitiveness;
- provide a cluster analysis for key clusters; and
- provide practical strategic initiatives for each cluster to boost exports.

*Benchmarking Lao competitiveness.* This section will assess Lao PDR's competitiveness at the national level. It will (i) review global and regional industry trends relevant to Lao PDR's main exports; and (ii) prepare a national competitiveness benchmarking that will rank the current competitiveness of Lao PDR in the following areas: exports, investment, human resources, science and technology, infrastructure, and business environment. A number of tools and techniques will be used for the benchmarking, including the Revealed Comparative Advantage, the Global Competitiveness report, the Doing Business report, the World Development Indicators, the Human Development Index, and other comparative reviews of business climate and export performance.

*Cluster competitiveness analysis.* This section will focus on assessing the competitiveness of key clusters (clusters reflect an industry and its main components). The choice of clusters will be discussed with the

government and the private sector, and is likely to include horticulture, coffee, livestock, garments, light manufacturing, wood products, and tourism. The section will (i) assess the current competitiveness of the clusters; (ii) provide examples from other countries on boosting competitiveness; (iii) highlight current domestic opportunities or constraints to boost such exports; (iv) investigate the demand for Lao PDR's products for each cluster among its main trading partners; (v) highlight market opportunities for Lao PDR companies to supply downstream products for regional exports; (vi) develop a strategic agenda to boost exports in each cluster. Depending on the market economics, competitive position, and business environment for a given cluster, a typical strategic agenda for a cluster will prioritize the opportunities and constraints for the cluster, including in the following areas:

- Production processes and productivity
- Supply-chain structure and management
- Development of key related and supporting industries
- Access to profitable markets and Route-to-market strategies
- Administrative barriers to operation and growth
- Infrastructure
- Human resources (technical and management)
- Access to financing
- Marketing and demand-side strategies

*Strategic initiatives for key clusters.* On the basis of the overall assessment of the cluster competitiveness analysis, *specific* strategic initiatives will be developed for a sub-set of clusters depending on the willingness to engage of the private sector. This section relies heavily on interactive workshops with business leaders so that the strategies identified are both understood and supported by local leaders. The objective of this effort is to guide business leaders in Lao PDR in the development of actionable industry cluster strategies that will lead to substantial and sustained boost to exports. The focus of the effort is to stimulate change in thinking and in action by introducing new approaches and identifying strategic initiatives based on what is actually working in other similar industry clusters in similar countries. This section will (i) identify specific industry cluster strategies for repositioning Lao exports in world and regional markets; (ii) identify government initiatives that can be most effective at facilitating this repositioning; and (iii) develop action plans to achieve the goals identified in the industry cluster strategies. Some examples of actual cluster strategic initiatives developed in other countries include:

- Improvement in travel logistics for tourists (air travel, taxis, visas, signage, etc.)
- Development of E-commerce capability by hoteliers and tour operators
- Investment in first eco-tourism lodge
- Market survey and client satisfaction initiatives for Mongolian tourism
- Branding "Ceylon Sapphires"
- Investing in laboratory testing equipment to certify sapphires
- Negotiation of 10% energy price discount through joint procurement
- Improvement in materials and kiln technology to save on ceramics input costs
- Certifying product characteristics and standards for Sri Lankan latex rubber
- Innovating in gourmet coffee production and exports
- Adding product and service features to ornamental flower exports
- Foreign investment attraction efforts to "fill out" the apparel cluster in key related and supporting industries
- Fostering greater responsiveness and customize curriculum in technical training schools and management institutes

### **Part III: Strategy and Action plan**

The final component of the DTIS—and the most important—is the development of an integrated strategy and action plans. This section will document and take stock of all relevant studies and government- and donor-funded technical assistance initiatives in relevant areas and define a framework to coordinate and integrate them. The implementation plans will define a prioritized set of actions that can be implemented immediately—under the existing enabling environment—and fundamental reforms that can be implemented over time.

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