OECD Investment Policy Reviews

LAO PDR

OECD

asean

OECD Investment Policy Reviews: Lao PDR

OECD
BETTER POLICIES FOR BETTER LIVES

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Please cite this publication as:
OECD (2017), *OECD Investment Policy Reviews: Lao PDR*, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264276055-en

ISBN 978-92-64-27598-0 (print)
ISBN 978-92-64-27605-5 (PDF)
ISBN 978-92-64-27607-9 (epub)

Series: OECD Investment Policy Reviews
ISSN 1990-0929 (print)
ISSN 1990-0910 (online)

T9he statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Photo credits: Cover © iStockphoto.com/mnunes; © Shutterstock.com/Denis Babenko; © Shutterstock.com/Xebeche.

Corrigenda to OECD publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

© OECD 2017

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgement of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to *rights@oecd.org*. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at *info@copyright.com* or the Centre français d'exploitation du droit de copie (CFC) at *contact@cfcopies.com*.

Foreword

This first *OECD Investment Policy Review of the Lao People's Democratic Republic* (Lao PDR) uses the OECD *Policy Framework for Investment* to present an assessment of the investment climate in Lao PDR and to discuss the challenges and opportunities faced by the Government of Lao PDR in its reform efforts. It includes chapters on trends in foreign investment and trade, the legal framework for investment, regulatory restrictions on foreign investment, corporate governance, investment promotion and facilitation, promoting and enabling responsible business conduct, infrastructure connectivity and the investment framework for green growth.

The *Review* was prepared in partnership with the ASEAN Secretariat and in close collaboration with an inter-ministerial taskforce established and chaired by the Ministry of Planning and Investment. A draft version of the *Review* was discussed at a workshop gathering government agencies and stakeholders organised by the Government of Lao PDR in Vientiane in April 2016. The draft *Review* was also presented and discussed in the OECD Advisory Group on Investment and Development in Paris in October 2016.

The *Review* has been prepared by a team comprising Stephen Thomsen, Alexandre de Crombrugghe, Hélène François, Fernando Mistura, Tihana Bule, John Hauert, Naeeda Crishna Morgado and Austin Tyler from the Investment and Corporate Affairs Divisions of the OECD Directorate for Financial and Enterprise Affairs and the OECD Development Co-operation Directorate. Secretariat inputs were received from Chung-a Park. The *Review* was supported by the ASEAN-Australia-New Zealand Free Trade Agreement Economic Cooperation Support Programme.

The information in this *Review* is current as of April 2017.

Table of contents

Acronyms and abbreviations 11

Preface 15

Executive summary 17

Assessment and recommendations 19

Notes 50

References 50

Chapter 1. **Trends in foreign investment and trade in Lao PDR** 51

Lao PDR has gradually integrated into the global economy 52
Economic challenges 54
FDI trends 56

Notes 64

References 64

Chapter 2. **The legal framework for investment in Lao PDR** 67

Summary 68
Regulatory reforms for Lao PDR's transition towards a market-based economy 71
Enhancing the rule of law in the law-making process 72
The 2016 amendment to the Law on Investment Promotion 80
Dispute settlement mechanisms 84
Access to land ownership 90
Protection of intellectual property rights 92
International investment agreements 97

Notes 104

References 104

Chapter 3. **Regulatory restrictions on FDI in Lao PDR** 107

Summary 108
Lao PDR is relatively less restrictive than many regional peers 110

Some regulatory restrictions on FDI in Lao PDR are uncommon 113
The legal and regulatory regime covering market access lacks transparency and predictability 119

Notes 121

References 122

Annex 3.A1. Regulatory restrictions on foreign investment in Lao PDR 124

Chapter 4. **Corporate governance in Lao PDR** 133

Summary 134
Developing a corporate governance framework 134
Ongoing reforms to the ownership and governance of SOEs 138
Challenges remain in expanding the capital market 139

Notes 143

References 143

Chapter 5. **Investment promotion and facilitation in Lao PDR** 145

Summary 146
Institutional framework for investment promotion and facilitation 147
Marketing Lao PDR and attracting the right investors 153
Facilitating investment and reinvestment 157
Using tax incentives more cautiously 163
Enhancing the development impact of FDI through business linkages 169

Notes 184

References 184

Chapter 6. **Promoting and enabling responsible business conduct in Lao PDR** 187

Summary 188
Scope and importance of responsible business conduct 189
RBC as a development opportunity in Lao PDR 192
Maximising investment benefits and addressing perceived country risks through RBC 194

Notes 205

References 206

Chapter 7. **Infrastructure connectivity in Lao PDR** 211

Summary 212
Taking stock of infrastructure connectivity challenges in Lao PDR 215

Lao PDR's infrastructure connectivity development strategy 221
Establishing an enabling environment for infrastructure investment 223

Note 233

References 233

Chapter 8. **Investment framework for green growth in Lao PDR** 237

Summary 238
Green growth in Lao PDR: turning challenges into opportunities 242
Regulatory and policy framework for green investment 246
Financing for green growth and climate change 257

Notes 261

References 261

Tables

1. Development indicators in Lao PDR, Cambodia and Viet Nam, 2015 26
2. Doing Business in Lao PDR and neighbouring countries 36
1.1. Lao PDR's main exports and imports, 2014 53
2.1. Comparison of ASEAN members' investment frameworks 73
4.1. Main laws and regulations relating to corporate governance in Lao PDR 136
4.2. Listed firms on the Lao Securities Exchange, ... 140
5.1. Doing Business in Lao PDR and neighbouring countries, 2017 158
5.2. Elements to consider in a cost-benefit analysis 169
7.1. Selected infrastructure indicators across ASEAN countries and China 217
7.2. Electricity tariffs in Lao PDR and ASEAN, USD¢/kWh, 2014 218
8.1. National policies and regulations related to green growth and environment 249
8.2. Focus of adaptation projects in key sectors 251
8.3. Environmental funds in Lao PDR 259

Figures

1. GDP per capita and growth in Lao PDR, 2000-2015 25
2. Evolution of GDP by sector 25
3. FDI in relative terms in Lao PDR and the region, 2015 27
1.1. Investment to GDP ratios in Lao PDR, Cambodia and Viet Nam, 2000-2015 54
1.2. The most problematic factors for doing business in Lao PDR 55
1.3. FDI inflows to Lao PDR, 1986-2015 56

1.4. Approved FDI projects in Lao PDR by sector, 1989-2015 57
1.5. Approved FDI projects in Lao PDR by country of origin, 1989-2015..... 58
1.6. FDI in relative terms in Lao PDR and the region, 2015..... 59
1.7. FDI inflows to Lao PDR and neighbours in relative terms, 1990-2015..... 60
3.1. Lao PDR is restrictive by global standards but relatively open in Southeast Asia..... 111
3.2. FDI restrictions by sector, Lao PDR vs ASEAN9 112
3.3. Few countries discriminate against foreign investors..... 116
3.4. Lao PDR's minimum capital requirements in international comparison 117
4.1. Financial Supervisory Structure in Lao PDR 137
4.2. LSX market capitalisation and trading volume, 2011-15..... 141
5.1. Core investment promotion and facilitation measures 150
5.2. Investment approval procedures in Lao PDR under the 2009 *Law on Investment Promotion*..... 157
5.3. Determinants of FDI spillovers 170
5.4. Ranking of local suppliers in Lao PDR and regional peers, 2016..... 172
7.1. The World Bank's Logistic Performance Index, Infrastructure indicator..... 220
7.2. Infrastructure weakness is a deterrent to ASEAN trade integration..... 220
7.3. Infrastructure investment needs in Lao PDR and selected ASEAN economies..... 222
7.4. Private participation in infrastructure in Lao PDR and regional peers, 2000-14 227
8.1. Primary energy consumption in Lao PDR..... 244
8.2. Targets for renewable energy development in Lao PDR up to 2025 254
8.3. Climate-related development finance to Lao PDR, 2013-14 258

Boxes

1. The Policy Framework for Investment..... 22
2. Lao facts and figures 24
1.1. Avoiding the "resource curse": The case of Botswana..... 62
2.1. Elements of the rule of law..... 74
2.2. Options for implementing regulatory transparency..... 77
2.3. Viet Nam: Gradual improvements in the investment framework since the 1980s 79
2.4. Recognition and enforcement of arbitral awards..... 89
2.5. Thailand 20-year programme to title rural land 92
2.6. IP rights reform in Viet Nam..... 94
2.7. ASEAN Intellectual Property Rights Enforcement Plan..... 95
2.8. The benefits of IP rights in developing countries: The shifting debate..... 96
2.9. International Investment Agreements signed by Lao PDR 98
2.10. Public scrutiny and reform of international investment agreements 99

2.11. Two approaches to specifying and limiting the FET provision 101
3.1. Calculating the OECD FDI Regulatory Restrictiveness Index 110
3.2. Minimum capital requirements often fail to achieve their objectives 118
4.1. OECD principles and guidelines on corporate governance 135
5.1. Main functions of the IPD 151
5.2. Driving doing business reforms: the example of Rwanda 161
5.3. Advantages and disadvantages of tax holidays 168
5.4. Chile's world class supplier development programme 174
5.5. Clusters and linkage programmes in Costa Rica, Brazil and Malaysia 179
6.1. The OECD Guidelines for Multinational Enterprises 190
6.2. The role of government in promoting responsible business 191
6.3. Using National Action Plans as tools for promoting RBC 194
6.4. Improving conditions in global supply chains through policy innovations 199
6.5. Debunking the pollution haven hypothesis 201
7.1. The rationale for private participation in infrastructure 225
7.2. Indonesia's institutional structure to mobilise private investment in infrastructure 229
8.1. Renewable energy potential in Lao PDR 245
8.2. Addressing environmental issues requires effective regional governance ... 248
8.3. Promoting private participation in decentralised energy solutions in Lao PDR 255

Acronyms and abbreviations

AANZFTA	ASEAN Australia New Zealand Free Trade Agreement
ACIA	ASEAN Comprehensive Investment Agreement
ADB	Asian Development Bank
AEC	ASEAN Economic Community
ASEAN	Association of Southeast Asian Nations
BCEL	Banque pour le Commerce Extérieur Lao
BDS	Business Development Services
BIT	Bilateral Investment Treaty
CIP	Committee for Investment Promotion
CLMV	Cambodia, Lao PDR, Myanmar and Viet Nam
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee
EDL	Electricité du Laos
EDL-Gen	Electricité du Laos-Generation Public Company
EDRC	Economic Dispute Resolution Centre
EIA	Environmental Impact Assessment
EIU	Economist Intelligence Unit
EPF	Environment Protection Fund
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FSB	Financial Stability Board
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GIZ	Gesellschaft für Internationale Zusammenarbeit
GMS	Greater Mekong Subregion
ICSID	International Centre for Settlement of Investment Disputes

ICT	Information and Communication Technology
IEE	Initial Environmental Examination
IFC	International Finance Corporation
IIA	International Investment Agreement
ILO	International Labour Organization
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
IP	Intellectual Property
IPA	Investment Promotion Agency
IPD	Investment Promotion Department
IPO	Initial public offering
IPP	Independent Power Producer
ISDS	Investor-State Dispute Settlement
LAK	Laotian Kip
Lao PDR	Lao People Democratic Republic
LBF	Lao Business Forum
LDC	Least Developed Country
LNCCI	Lao National Chamber of Commerce and Industry
LPI	Logistics Performance Index
LSC	Lao Securities Commission
LSCO	Lao Securities Commission Office
LSX	Lao Securities Exchange
LUNA	Lao PDR-United States International and ASEAN Integration
MENA	Middle East and North Africa
MFN	Most Favoured Nation
MNE	Multinational Enterprise
MOIC	Ministry of Industry and Commerce
MONRE	Ministry of Natural Resources and Environment
MOST	Ministry of Science and Technology
MPI	Ministry of Planning and Investment
MPWT	Ministry of Public Works and Transport
MST	Minimum Standard of Treatment
MW	Megawatt
NAP	National Action Plan
NCSEZ	National Committee for Special Economic Zones

NEM	New Economic Mechanism
NGPES	National Growth and Poverty Eradication Strategy
NSCC	National Strategy on Climate Change
NSEDP	National Socio-Economic Development Plan
NT	National Treatment
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OSU	One-stop Shop Unit
PFI	Policy Framework for Investment
PPP	Public-Private Partnership
RCEP	Regional Comprehensive Economic Partnership
RBC	Responsible Business Conduct
SDG	Sustainable Development Goal
SEZ	Special Economic Zones
SME	Small and Medium-sized Enterprise
SMEPDO	SME Promotion and Development Office
SOE	State-Owned Enterprise
THB	Thai Baht
TRIPs	Trade-Related aspects of Intellectual Property Rights
TVET	Technical Vocational Education and Training
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
USA	United States of America
USD	United States Dollars
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Preface

by

Souphanh Keomixay, Minister of Planning and Investment of Lao PDR
and Angel Gurría, Secretary-General of the OECD

The Government of the Lao People's Democratic Republic (Lao PDR) can take justifiable pride in its accomplishments over the past three decades. Substantial economic reforms have led to high and sustained growth rates and rising overall living standards, although more still needs to be done to reduce poverty. The government aspires to graduate from least developed country status by 2020 – a significant ambition achieved by few countries. Foreign direct investment has played a key role in supporting economic development but domestic investment has also been strong. The government is engaged in a number of ambitious reforms to improve the business environment and further reap the benefits of investment, increasingly focusing on attracting responsible and sustainable investments. The newly-amended Law on Investment Promotion, which was being revised during the process of this Review, takes on board a number of OECD recommendations and is intended to be an important step forward.

Going forward, the economy will need to diversify away from over-reliance on natural resources, increase labour productivity, strengthen competitiveness and ensure the sustainable use of natural resources to allow widespread progress in human development. The government is aware of these challenges which are common to many countries at the same level of development and is starting to address them. This first OECD *Investment Policy Review of Lao PDR* offers valuable policy recommendations across a broad range of policy areas in order to make the most of investment as an engine to boost the country's economy and the well-being of its citizens.

Based on the *Policy Framework for Investment*, the *Review* illustrates the government's commitment to reform and its willingness to align with international best practices. It recognises Lao PDR's achievements but also provides an independent view of what can be done better. Its policy

recommendations focus on the need to strengthen policy coherence and reform implementation through an inclusive law-making process, solid institutions and stronger co-ordination within government. The *Review* also stresses the need to maximise the benefits of investment by reinforcing linkages between foreign and domestic businesses, promoting responsible business conduct, and attracting investments that can support green growth and economic diversification.

This *Review* is the result of close co-operation between the Ministry of Planning and Investment and the OECD. While the OECD brought its deep, inter-disciplinary expertise, the MPI drove the cross-agency process, involving the private sector and civil society and providing critical inputs to the report. The *Review* takes place amid strengthened collaboration between the OECD and the Association of the Southeast Asian Nations (ASEAN), which Lao PDR chaired in 2016. It builds on the OECD's investment work with the ASEAN, a partnership that allows for an open and fruitful exchange of information and practices with regional peers.

We would like to express our gratitude to the ASEAN-Australia-New Zealand Free Trade Area Economic Co-operation Support Programme for supporting the *Review*. It is with great pride that we present this comprehensive and forward-looking advisory report, the first full length country review of Lao PDR by the OECD and a harbinger of deeper co-operation to come to make development in Lao PDR even stronger and more sustainable.

Souphanh Keomixay,
Minister of Planning and
Investment of Lao PDR

Angel Gurría,
Secretary-General
OECD

Executive summary

The development of the Lao People's Democratic Republic (Lao PDR) has been a success by many measures over the past two decades. For a sparsely populated and land-locked country that has had to overcome the devastating effects of years of war and civil strife, it has managed to sustain high and relatively stable growth for over two decades. Living standards have improved to the point where Lao PDR has become a lower middle income economy and could graduate from least developed country status by 2020. Foreign direct investment has played a key role in supporting this growth, although domestic investment is also booming. The country is becoming more integrated both regionally and globally, joining ASEAN in 1997 and the WTO in 2013.

While the Lao government can take justifiable pride in these accomplishments, success breeds new challenges – sometimes requiring different solutions from what has worked in the past. Growth will need to be broader and more sustainable, in part by addressing the many bottlenecks which have impeded a more diversified pattern of investment. Neighbouring countries are also not standing still and the Lao investment policy framework will also need to be judged relative to its peers. Despite the strong economic performance to date, one third of the population still lives on less than USD 1.25 a day, productivity in the labour force is low, modern infrastructure is lacking, and public governance suffers from capacity constraints and corruption. Growth has depended on natural resources, and unsustainable resource use patterns exacerbated by the increasing effects of climate change, could threaten economic and social development gains.

To overcome these challenges, the government will need to establish a transparent and improved rules-based regulatory framework. The recently amended *Law on Investment Promotion* has provided an opportunity to push in this direction, which to some extent it has. In line with OECD advice during this *Review* process, the amended law removed an onerous minimum capital requirement for foreign investors, thus encouraging potential investments from smaller firms from neighbouring and OECD countries.

Investors have also complained about long delays and complex procedures for registering a business, and the various entry modes, as well as the registration procedures for all private investors, will need to be further streamlined. The amended *Law on Investment Promotion* offer some institutional improvements and the 2012 *Law on Laws* should eventually increase transparency and help ensure greater coherence among regulations, but this will require resources and capacity building for officials. Greater recourse to public consultations will also help to raise the quality of new laws and their consistency with the overall legal framework.

The government should also reconsider its incentive policies. Fiscal revenue will be needed to improve the investment climate, such as by modernising infrastructure and raising workers' skills. Public spending on education remains low. Infrastructure investments may also be encouraged by the new public-private partnership framework which is currently being developed together with the ADB. Beyond these reforms, more could be done to improve the development impact of investment. Projects in the mining sector and in hydropower have provided the backbone for sustained improvements in living standards but have come with mixed effects on the environment. Ultimately, the economy will need to diversify by building a competitive manufacturing sector to absorb employment from the agricultural sector and to tap into regional value chains.

Lao PDR will also need to manage its abundant natural wealth of minerals, land, water and forests sustainably. An investment framework for green growth and sustainable development is beginning to be instituted, but as in other areas, policy co-ordination across government, increased institutional capacity and strengthened environmental governance overall will be essential. Beyond sustainability, the development impact of investment will be enhanced through greater efforts to promote business linkages with domestic companies and responsible business conduct (RBC) on the part of investors. Lao PDR has made substantial progress in aligning its legal framework with international standards but could do more in terms of implementation, and RBC can play a complementary role.

The government recognises many of the challenges outlined above, and this first OECD *Investment Policy Review of Lao PDR* demonstrates its willingness to address them. Sustained and inclusive growth will require a whole-of-government approach to reform to improve consistency and coherence across policy areas. It also requires a concerted effort to improve public governance, including a clear and transparent regulatory framework developed through wide public consultations. Local and international civil society can play a complementary role in ensuring sustainable and inclusive outcomes. The Lao government has built a solid foundation on which to construct the next phase of its development.

Assessment and recommendations

Introduction

The development of the Lao People's Democratic Republic (Lao PDR) has been a success by many measures over the past two decades. For a sparsely populated and land-locked country that has had to overcome the devastating effects of years of war and civil strife, it has managed to sustain high and relatively stable growth for over two decades. Living standards have improved to the point where Lao PDR has become a lower middle income economy and could graduate from least developed country status by 2020.[1] Foreign direct investment has played a key role in supporting this growth, although domestic investment is also booming. The country is becoming more integrated both regionally and globally, joining the Association of Southeast Asian Nations (ASEAN) in 1997 and the World Trade Organization (WTO) in 2013.

While the Lao government can take justifiable pride in these accomplishments, success breeds new challenges – sometimes requiring different solutions from what has worked in the past. Growth will need to be broader and more sustainable, in part by addressing the many bottlenecks which have impeded a more diversified pattern of investment. Neighbouring countries are also not standing still and the Lao investment policy framework will also need to be judged relative to its peers. In spite of the strong economic performance to date, one third of the population still lives on less than USD 1.25 a day, productivity in the labour force is low, modern infrastructure is lacking, and public governance suffers from capacity constraints and corruption. Growth so far has depended on natural resources, and unsustainable resource use patterns exacerbated by the increasing impacts of climate change, could threaten economic and social development gains.

To overcome these challenges, the government will need to establish a transparent and improved rule-based regulatory framework. The recently amended *Law on Investment Promotion* provides an opportunity to push in this direction, which to some extent it has. Although Lao PDR is not an

outlier in the region in terms of its restrictiveness towards foreign investment, it nevertheless had a high minimum capital requirement for foreign investors in general business activities in the earlier investment law, which was increasingly becoming an anomaly as other governments remove restrictions in this area. In line with OECD advice during this *Review* process, the amended law presented before the National Assembly in November 2016 removed this requirement, thus encouraging potential investments from smaller firms in both neighbouring and OECD countries. The government recognises that the key policy objective is the potential development impact of a given investment and not its size.

Investors have also complained about long delays and complex procedures for registering a business. The government will need to further streamline and align the various entry modes, as well as the registration procedures for all private investors, and the amendments to the *Law on Investment Promotion* offer some institutional improvements. More broadly, the 2012 *Law on Laws* should eventually increase transparency and help to ensure greater coherence among regulations, but this will require resources and capacity building for officials. Greater recourse to public consultations will also help to raise the quality of new laws and their consistency with the overall legal framework.

The government should also reconsider its incentive policies. Tax incentives can sometimes be used to compensate for a high-risk, high-cost environment, but more often they are icing on the cake for investors. They should be used less generously and more transparently, and their effectiveness regularly assessed. Fiscal revenue will be needed to improve other areas of the investment climate, such as by modernising infrastructure and raising workers' skills. Public spending on education remains low. Infrastructure investment will also be encouraged by the new public-private partnership framework which is currently being developed together with the Asian Development Bank. Beyond these reforms, more could be done to improve the development impact of investment. Projects in the mining sector and in hydropower have provided the backbone for sustained improvements in living standards, but have come with mixed effects on the environment. Ultimately, the economy will need to diversify by building a competitive manufacturing sector to absorb employment from the agricultural sector and to tap into regional value chains.

Lao PDR will also need to manage its abundant natural wealth of minerals, land, water and forests sustainably. The government is beginning to institute an investment framework for green growth and sustainable development, but as in other areas, policy co-ordination across government, increased institutional capacity and strengthened environmental governance overall will be essential. Beyond sustainability, the development impact of

investment will be enhanced through greater efforts to promote business linkages with domestic companies and responsible business conduct (RBC) on the part of investors. Lao PDR has made substantial progress in aligning its legal framework with international standards but could do more in terms of implementation, and here RBC can play a complementary role. The government should promote RBC principles among domestic and foreign firms to encourage investors to abide by domestic and international standards even when they are not adequately enforced on the ground through stakeholder pressure to conform to expectations. RBC standards can also be incorporated into investment promotion strategies from the start and in international agreements to which Lao PDR is party.

The Lao government recognises many of the challenges outlined above, and this first OECD *Investment Policy Review of Lao PDR* demonstrates its willingness to address them. Sustained and inclusive growth will require a whole-of-government approach to reform to improve consistency and coherence across policy areas. It also requires a concerted effort to improve public governance, including an understanding of how a clear and transparent regulatory framework developed through wide public consultations can by itself help to improve implementation. Local and international civil society can play a complementary role in ensuring sustainable and inclusive outcomes. The government has built a solid foundation on which to construct the next phase of its development.

It is against this background that this *OECD Investment Policy Review of Lao PDR* examines the country's investment policies in light of the *Policy Framework for Investment* (Box 1). After an overview of trends in foreign investment and trade (Chapter 1), the *Review* focuses on the country's legal framework for investment (Chapter 2), regulatory restrictions on FDI (Chapter 3), corporate governance (Chapter 4), investment promotion and facilitation (Chapter 5), policies to promote responsible business conduct (Chapter 6) infrastructure connectivity (Chapter 7) and the investment framework for green growth (Chapter 8). The main findings and recommendations of this *Investment Policy Review* are presented below.

Box 1. **The Policy Framework for Investment**

The *Policy Framework for Investment* (PFI) helps governments to mobilise private investment in support of sustainable development, thus contributing to the prosperity of countries and their citizens and to the fight against poverty. It offers a list of key questions to be examined by any government seeking to create a favourable investment climate. The PFI was first developed in 2006 by representatives of 60 OECD and non-OECD governments in association with business, labour, civil society and other international organisations and endorsed by OECD ministers. Designed by governments to support international investment policy dialogue, co-operation, and reform, it has been extensively used by over 25 countries as well as regional bodies to assess and reform the investment climate. The PFI was updated in 2015 to take this experience and changes in the global economic landscape into account.

The PFI is a flexible instrument that allows countries to evaluate their progress and to identify priorities for action in 12 policy areas: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; promoting responsible business conduct; human resource development; infrastructure; financing investment; public governance; and investment in support of green growth. Three principles apply throughout the PFI: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

The value added of the PFI is in bringing together the different policy strands and stressing the overarching issue of governance. The aim is not to break new ground in individual policy areas but to tie them together to ensure policy coherence. It does not provide ready-made reform agendas but rather helps to improve the effectiveness of any reforms that are ultimately undertaken. By encouraging a structured process for formulating and implementing policies at all levels of government, the PFI can be used in various ways and for various purposes by different constituencies, including for self-evaluation and reform design by governments and for peer reviews in regional or multilateral discussions.

The PFI looks at the investment climate from a broad perspective. It is not just about increasing investment but about maximising the economic and social returns. Quality matters as much as the quantity as far as investment in concerned. It also recognises that a good investment climate should be good for all firms – foreign and domestic, large and small. The objective of a good investment climate is also to improve the flexibility of the economy to respond to new opportunities as they arise – allowing productive firms to expand and uncompetitive ones (including state-owned enterprises) to close. The government needs to be nimble: responsive to the needs of firms and other stakeholders through systematic public consultation and able to change course quickly when a given policy fails to meet its objectives. It should also create a champion for reform within the government itself. Most importantly, it needs to ensure that the investment climate supports sustainable and inclusive development.

The PFI was created in response to this complexity, fostering a flexible, whole-of-government approach which recognises that investment climate improvements require not just policy reform but also changes in the way governments go about their business.

For more information on the *Policy Framework for Investment*, see:
www.oecd.org/investment/pfi.htm

Lao PDR has experienced strong and steady growth from substantial reforms

After independence in 1975 (Box 2), the government applied a centrally-planned economic system. All industrial and trade sectors were nationalised and the agricultural sector was collectivised. The government provided the capital and production means, set prices and determined the exchange rate. In 1986, given the poor results of this system, the government launched the New Economic Mechanism (NEM) to prepare the foundation of a market economy (Pham, 2004; ERIA, 1994). NEM was initiated at the same time as *Doi Moi* (renovation policy) in neighbouring Viet Nam. Major reforms included:

- liberalising both domestic and foreign trade;
- abolishing price controls;
- liberalising agriculture and ending the state monopoly on rice distribution;
- raising government revenue through budgetary and tax reforms;
- reforming the banking system, including by separating the Central Bank from commercial banks;
- creating a single exchange rate;
- reforming/privatising state-owned enterprises;
- promoting private sector participation in the economy, including foreign direct investment;
- developing a legal framework for private sector development; and
- promoting autonomous management of companies.

Following NEM-related reforms, the macroeconomic situation improved considerably. The battle against inflation was particularly successful, as the yearly inflation rate was brought down from 76% in 1989 to 7% in 1993. Production grew steadily, exports surged and poverty started to decline, especially in urban areas, although unemployment in rural areas remained high and the inequality gap between rich and poor widened.

Box 2. **Lao facts and figures**

Official name: Lao People's Democratic Republic, established 1975

Population: 6.8 million

Geography: 236 800 sq km, mountainous (70%), forest (68%), arable land (6%)

International borders (km): Cambodia (541), China (423), Myanmar (235), Thailand (1754), Viet Nam (2130)

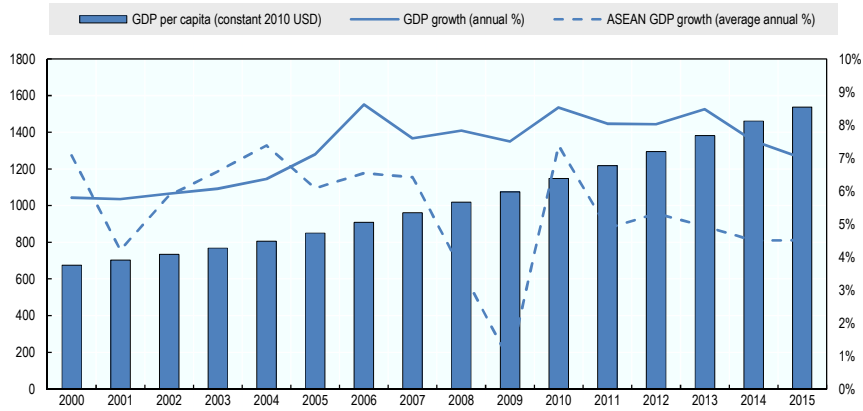
Economy (2015): GDP: USD 12 369 million; GDP per capita: (current) USD 1 818; (PPP) USD 5 691

Natural resources: timber, hydropower, gypsum, tin, gold, gemstones, copper, silver, zinc

The economy has expanded rapidly in the past two decades, largely as a result of natural resource development. GDP growth has been above 7% for the whole of the past decade, one of the highest and steadiest in Southeast Asia (Figure 1). As a consequence, GDP per capita more than doubled in the past 15 years and overall living standards have improved considerably. Growth has been mostly driven by abundant natural resources, especially on the back of hydropower generation and mining (particularly copper, gold and silver).

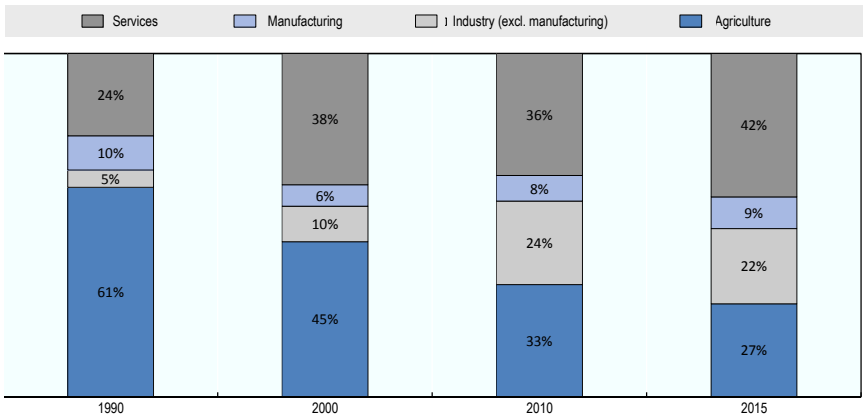
The evolving structure of the economy reflects these recent developments (Figure 2). While the share of services (mostly tourism, transport and retail) in GDP has changed relatively little since 2000 (from 38% to 42%), the share of industrial activity – excluding manufacturing – increased dramatically from 5% in 1990 to 22% in 2015, reflecting the natural resources boom generated by large mining investments. The share of manufacturing has never exceeded 10% of GDP and is mostly composed of garments and wood processing although light electronics and other assembly activities are increasing, notably in special economic zones. The share of agriculture in GDP decreased from just over 60% in 1990 to 27% in 2015, but forestry remains a major economic pillar. Agriculture still represents approximately three quarters of total employment, however. Within the services sector, tourism has become more prominent. Visitor arrivals rose by 10% in 2014, placing tourism second behind mineral exports as a foreign-exchange earner (EIU, 2015).[2]

Figure 1. **GDP per capita and growth in Lao PDR, 2000-2015**



Source: Author's calculations based on World Development Indicators (2016).

Figure 2. **Evolution of GDP by sector**



Note: Industry comprises mining, manufacturing, construction, electricity, water and gas.

Source: World Development Indicators (2016).

Despite natural resource driven growth, development has been uneven. Lao PDR was ranked 138 out of 188 countries on the United Nations Development Programme's 2015 *Human Development Index*, which takes account of multiple facets of development, including living standards, health and education. Poverty remains widespread, especially in rural areas where unemployment rates are high. Inequality has risen, as illustrated by the

increase of the Gini Index from 34.7 in 2002 to 37.9 in 2012. While its GDP per capita falls in between neighbouring Cambodia and Viet Nam, almost one third of the Lao population still lives on less than USD 1.25 a day, a significantly higher share than its regional peers (Table 1).

Table 1. **Development indicators in Lao PDR, Cambodia and Viet Nam, 2015**

	Lao PDR	Cambodia	Viet Nam
GDP per capita (current USD)	1812	1159	2111
GDP per capita in PPP (current USD)	5676	3483	6023
HDI ranking (out of 188 countries)	138	143	115
Population living below USD 1.25 a day in PPP (%)	30.3	10.1	2.4
Gini Index (2012)	37.9	30.8	38.7

Source: UNDP; World Bank.

Widespread progress in human development is also hampered by unsustainable patterns of natural resource use. Much of the population is still highly dependent on natural resources for their livelihoods, and investment in natural resources – hydropower, mining, forestry – has driven economic growth over the past two decades. While each project in this area must be assessed on its own merits, the overall impact of the boom in natural resources has also resulted in increasing degradation and pollution. Forest cover decreased from 70% in 1943 to 42% in 2002. Furthermore, despite progress on rural electrification, one million people still lack access to energy. These trends are exacerbated by the country's vulnerability to climate change.

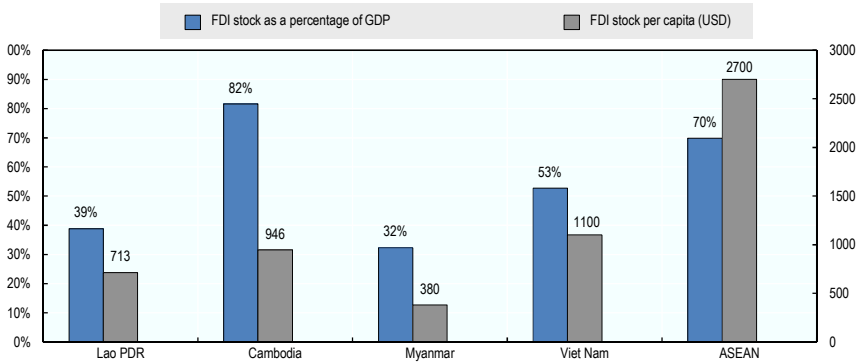
FDI has surged but the investment climate hampers further growth and diversification

Promoting foreign direct investment became a priority in the National Socio-Economic Development Plan for 1991-95, but FDI inflows only started to take off around 2005 and have grown dramatically and almost steadily since 2009 to reach a record USD 1.22 billion in 2015, doubling the FDI stock in only three years. Lao PDR is nevertheless still outperformed by most of its regional peers as a recipient of FDI (Figure 3). The stock of inward FDI as a share of GDP amounts to 39%, which is rather high on a

global scale but only just over half of the regional average of 70% and well below neighbouring Viet Nam (53%) and Cambodia (82%). The same trend is apparent when FDI is compared to the size of its population.

Foreign investors are particularly active in natural resources (two thirds of the total FDI stock), namely hydroelectricity generation, mining and agriculture (mostly timber and rubber). Other sectors include real estate, tourism and other services. FDI in manufacturing is mostly located in the few operational special economic zones. The vast majority of foreign investments (75%) come from neighbouring China (with 30% of total approved projects since 1989), Thailand (25%) and Viet Nam (20%), which are also its main trading partners – representing together over three quarters of exports and almost 90% of imports. Malaysia is the fourth largest investor, while OECD investments are mostly by Korean, French and Japanese companies.

Figure 3. **FDI in relative terms in Lao PDR and the region, 2015**



Source: UNCTAD FDI database (2016).

The large flows of foreign investment into natural resource industries in Lao PDR have brought significant development benefits. FDI has contributed to economic growth, government revenues as well as export earnings, as mining products and electricity account for over two thirds of total exports. At the same time, such investments are typically capital-intensive, creating relatively few jobs and generating few business linkages with the rest of the economy. Multinational enterprises (MNEs) in these sectors also sometimes bring foreign labour for the construction and operation of their activities. Nevertheless, if the fiscal resources arising from these industries are properly managed, they can help transform natural capital into physical, social and human capital.

Resource-seeking FDI could nevertheless pose some social and environmental risks if not conducted with due diligence. Responsible business conduct by MNEs and adequate environmental and social regulations are essential to ensure such investments contribute positively to sustainable economic development. International good practice suggests that good governance and strong institutions are key ingredients to successfully realise the potential contribution of natural wealth to socio-economic development.

In parallel, special economic zones (SEZs) have been set up to help develop and diversify the economy. They have been able to attract FDI projects, mostly of relatively small size if compared to natural resource-based investments but in higher value-added sectors such as manufacturing and logistics. Zones in Lao PDR are not fully developed, with the exception of Savan-Seno, which has attracted world-class MNEs and contributes towards integrating the economy in regional production networks. SEZ development is taking on an increasingly central role in the government's investment promotion strategy.

The government faces challenges ahead but is acting upon them

The Lao economy suffers from low labour productivity and an inadequately educated workforce, which affect the quality of jobs but also its capacity to attract more investment. It lacks modern and affordable infrastructure, especially transport, which is vital for a landlocked country and also faces governance issues. Private sector representatives complain of a widespread lack of transparency, constant policy uncertainty and inconsistent application of the law. Corruption is perceived as a major concern, as reflected in the *Corruption Perception Index*, where Lao PDR ranked 123rd out of 176 countries in 2016, albeit a substantial improvement over 2015 (139th position).

The government recognises these challenges and has identified private investment, both domestic and foreign, as a key engine of economic growth and development. The Seventh National Socio-Economic Development Plan (NSEDP) for 2011-15 aimed to achieve the Millennium Development Goals (MDGs) by attracting quality FDI to generate government revenue, create sustainable jobs and transfer skills and technology while safeguarding the environment. Coinciding with the conclusion of the MDGs and the roll out of the post-2015 development agenda, the Eighth NSEDP for 2016-20 aims to fully incorporate the recently adopted Sustainable Development Goals (SDGs) and adapt them to the Lao context. The Plan focuses on developing education and labour skills, pursuing economic diversification and supporting the development of small and medium-sized enterprises.

Investment climate reforms can work as a powerful force for implementing the SDGs, in particular SDG 8 to *promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all*. Under the right conditions, FDI can enhance an economy's productive capacity and growth potential, drive job creation and income growth, lead to transfers of technology and know-how, and spur domestic investment. Investment should not be seen as an end in itself, however, as the development impact of investment will depend as much, if not more, on the quality of the investment as it does on the quantity.

The lack of clarity and transparency of the regulatory framework poses risks for investors

Build a solid, inclusive law-making process to support more effective implementation

The investment policy and vision of the government is reflected in the laws, regulations and policies relating to the admission of investors, the rules governing established investment, and the protection of their property. Both domestic and foreign investors need to know that their rights and property will be respected. By enhancing investor confidence, sound investment protection guarantees are likely to increase not only the levels, but also the quality of investment, its durability and its contribution to economic development. Regulatory risk can also be mitigated through stakeholder consultations when policy reforms are undertaken. To the extent possible, it is essential to ensure that the legal and institutional infrastructure is built upon a general principle of rule of law. Any ambiguity in the legal system also opens the door for corruption.

Laws and regulations in Lao PDR are sometimes unclear, are not always easily accessible and often lack an official English translation, and overlaps across various related regulations are common. The lack of transparency in regulations and in administrative practices is often coupled with an uneven and inconsistent application of law across administrative bodies and provinces. Implementation, including promptly adopting implementing decrees, is the main challenge encountered in the ongoing reform process. Even well-drafted laws will have little positive impact if not well implemented. Administrative practices and mindsets hardly keep pace with the regulatory reforms initiated in the past years. Likewise, draft laws and regulations are not sufficiently made available to the public for feedback. When they are, deadlines are short and comments are not always taken on board. The Lao Business Forum, a dialogue platform established in 2005 to gather government and private sector representatives to discuss business

climate challenges, was a good initiative but has not functioned for several years.

Recognising these challenges, the government passed a *Law on Laws* in 2012, also referred to as the *Law on Making Legislation*. It provides that all laws must be available on the official gazette website, although this has not been fully implemented yet. The *Law on Laws* also provides for a clear hierarchy of the various regulatory instruments and clarifies which ones should prevail. Public consultation also became a legislative requirement, as part of the government's commitment to improve the regulatory infrastructure. Drafting laws in a transparent and inclusive process helps ensure the buy-in of all stakeholders to the reform.

The government also suffers from a lack of capacity at all levels of government, including at provincial level, which impedes the effective application of investment regulations. As a result, a significant gap between the *de jure* and *de facto* regime for investment exists. By its own admission, the Ministry of Justice lacks sufficient resources and knowledge to fulfil its mandate and is often left with an impracticably short timescale to review draft laws. This highlights the importance that must be given to building more capacity within the government on technical matters.

Policy recommendations:

- Implement the transparency provisions of the *Law on Laws*;
- Strengthen the role of the lead agency in ensuring the consistency of draft laws with existing legislation;
- Improve access to laws and regulations, and ensure that official translations into English are made available to investors. Avoid ambiguous legal language that leaves room for inconsistent interpretations and arbitrary administrative practices;
- When consulting line ministries and stakeholders, give sufficient time prior to enactment to leave enough leeway to take comments on board and modify the draft where appropriate;
- Increase regular dialogue with the private sector and consider re-establishing the Lao Business Forum;
- Ensure that the enactment of laws is promptly followed by the adoption of implementing decrees (as stipulated in the *Law on Laws*);

- Undertake training, capacity-building and awareness raising programmes in administrative bodies at central and provincial levels. Raise awareness on newly enacted laws and new institutional configurations.

Push forward the implementation of the newly amended investment law and related reforms

The first FDI law was enacted in 1986. After successive amendments, the 2009 *Law on Investment Promotion* provided a single regulation governing both domestic and foreign investment under the same umbrella. The government has recently amended its investment law to further align it with international good practices, the ASEAN Comprehensive Investment Agreement (ACIA) and WTO commitments. Strong attention will need to be given to the coherence of its provisions with other interacting laws and regulations. Implementing the provisions of the *Law on Laws* would greatly help to ensure that the consistency of the overall legal framework is preserved.

Stakeholders tend to agree that the main weakness of the 2009 *Law on Investment Promotion* was its poor implementation. This had largely hampered the positive impact that was to be expected of the impressive legislative reforms undertaken in the past five years. It is difficult for businesses to comply with regulations whose application is subject to variable and sometimes arbitrary interpretations. The complex institutional framework, dictated by the three existing routes for investment – general business activities, concessions and SEZs – has partly been responsible for the lack of effective implementation and for adding to investor uncertainty.

The amendment of the law on investment promotion was meant to send a positive signal in favour of private sector development, so as to create the conditions for further transitioning towards a market-based economy. Endowed with a narrower material scope, which now excludes indirect investment, as well as with clearer definitions such as of the nationality of the investor, the new law aims at providing enough legal predictability and security to investors and at further strengthening the legal environment for investment. It contain standards of protection and guarantees that investors will be treated fairly and without discrimination, while also reinforcing their obligations. Yet, despite substantial improvements, it retains some ambiguities, notably with regard to the forms of expropriation that are prohibited and to the conditions upon which investors can recourse to dispute settlement mechanisms.

The law reform is also an opportunity to reassess the pertinence of existing restrictions on FDI and how to make them more transparent. Lao PDR maintains a relatively restrictive regulatory environment for foreign investors when compared to many other countries, despite comparing relatively favourably against the ASEAN average. Some of the measures in place are rather unusual when compared to the broad international experience and may discourage potential investors in some sectors, although the newly-amended *Law on Investment Promotion* seems to go in the right direction (*e.g.* removing discriminatory minimum capital requirements imposed on foreign investors). Thus far, the legal and regulatory regime also provided only limited transparency and predictability to investors with regards to market access rules and conditions. This needs to be addressed in the context of current reforms in order to support more adequately the implementation of the newly amended framework.

Policy recommendations:

- Implement the new investment law in an inclusive manner, with wide consultation mechanisms;
- Make sure the new law and its implementing decrees clarify the institutional framework for investment with simplified and better defined roles and responsibilities;
- Clarify the legal provisions for investment dispute resolution;
- Clarify the scope of protection against expropriation;
- Adopt a negative list approach to list all existing exceptions to national treatment in a regulation, to facilitate its revision over time and to enhance the clarity and predictability of the investment regime for foreign and domestic investors;
- Reassess and streamline or remove existing discriminatory restrictions to foreign investment where pertinent. Where such discriminatory policies are deemed necessary, ensure that they are not greater than needed to address specific risks and concerns and regularly assess them against their intended objectives;
- Follow-up the law revision with capacity and awareness building initiatives across all levels of government.

Reinforce the regulatory framework to provide increased guarantees to investors

The judicial and legal framework should be able to resolve disputes efficiently and fairly, whether before courts or through arbitration. Good enforcement procedures enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. When procedures for enforcing contracts are overly bureaucratic and cumbersome or when contract disputes cannot be resolved in a timely and cost effective manner, companies may restrict their activities.

The government could consider the possibility of providing access to arbitration mechanisms as an alternative way to solve investment disputes. Although arbitration remains costly and therefore not easily accessible for smaller businesses, it is often favoured by the business community to bypass difficulties commonly faced when bringing dispute cases before domestic courts, given delays in the resolution of cases. In most countries, arbitration plays a primary role as an alternative dispute resolution mechanism, to settle disputes between foreign investors and host states. While it is not advisable to grant investors an automatic right to bring any investor-state dispute settlement case before international arbitration by providing a unilateral consent to arbitration in the investment law itself, the authorities could consider the option of merely opening the possibility for the parties to agree to arbitration, based on an agreement between the disputing parties. It would be a cautious approach, as it would show a pro-arbitration stance, often needed to reassure foreign investors, without overcommitting or surrendering too much regulatory leeway.

Recognising the shortcomings of the existing *Land Law* and its lack of implementation, the Land Administration Department, under the Ministry of Natural Resources and Environment, is currently revising the law. The ongoing revision aims to improve and streamline the land titling system and to reduce the number of land disputes, while introducing two new categories of land: community land and communal land. Although improving the existing legislation is undoubtedly much needed, amending the law will not be sufficient to overcome implementation challenges. The priority should remain to build institutional coherence and capacity to improve the management of the land titling and certificate system.

Intellectual property (IP) protection is weak but steadily improving. Starting from a virtually non-existent regulatory framework, the authorities are making strong efforts to progressively bring their IP legislative and institutional framework in line with their international commitments. The establishment of the Ministry of Science and Technology in 2011 was a

positive step in this direction. There are no specialised IP courts yet and the issuance of the IP dispute decree, which will define administrative remedies, is still pending. In the meantime, the lack of guidance makes it challenging to enforce IP rights and to sanction infringements. There is no system to formally register copyrights but, instead, an automatic protection is reportedly granted when the work is created.

Lao PDR has also a broad network of international investment agreements, both stand-alone treaties and investment chapters in broader free trade agreements. Like its ASEAN peers, Lao PDR's recent investment treaty policy has in many cases been driven by a new regional dynamic: since the conclusion of ACIA in 2009, ASEAN Member States have collectively signed agreements with Australia and New Zealand, Korea, China, Japan and India, and have engaged in additional regional negotiations. In parallel to its multilateral approach, the government aims to build and adopt an increasingly informed and cautious approach to negotiating international investment agreements.

Lastly, while Lao PDR has made progress towards developing a sound framework for corporate governance in recent years, the overall legal and regulatory corporate governance framework remains challenging, with scattered inconsistencies and at times limited awareness by market participants. State-owned enterprises remain particularly prominent in key sectors such as telecommunications, finance, energy and mining. The *G20/OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State-owned Enterprises* are useful benchmarks for policymakers as they continue to develop and assess the progress in developing the framework for corporate governance.

Policy recommendations:

- Build capacity for court judges and arbitrators;
- Push forward efforts to create an independent commercial arbitration body;
- Provide for a right of appeals before independent bodies to challenge administrative decisions, in particular expropriation decisions;
- Consider establishing more specialised courts, such as intellectual property courts and land courts, fully independent from ministries;
- Push forward the revision of the *Land Law*;

- Move ahead with adopting intellectual property guiding decrees, such as those on dispute resolution and administrative remedies;
- Continue to adopt a consistent investment treaty approach aligned with national development objectives and international commitments;
- Strengthen the organisation of the state ownership function of state-owned enterprises, the rights and equitable treatment of shareholders, and disclosure and transparency requirements.

The business environment lacks predictability and may discourage small investors

Minimum capital requirement for foreign investors have been removed

As discussed in Chapter 3, Lao PDR has had until recently a relatively restrictive regulatory environment for foreign investors for a landlocked country with a small domestic market, particularly when compared to neighbouring Cambodia and Viet Nam, despite being relatively less restrictive than other economies in the region. Such regulations should be constantly evaluated, as regulatory restrictions on FDI may involve some important costs to the economy, notably in terms of lower productivity.

Until recently Lao PDR imposed a discriminatory minimum capital requirement on foreign investors across all economic sectors covered under the 'general business activities' category of the 2009 *Law on Investment Promotion*. Foreign investors, unlike domestic ones, were subject to a specific minimum capital requirement of one billion kips, roughly USD 124 000. Lao PDR was among the few countries in the world that discriminated between domestic and foreign investors in the application of minimum capital requirement. The early rationale for countries to adopt minimum capital requirements was essentially to protect consumers and creditors from risky and potentially insolvent business, but evidence suggests that such a requirement does not necessarily achieve its objective.

As recommended in an earlier draft of this *Investment Policy Review*, the newly-amended *Law on Investment Promotion*, presented before the National Assembly in November 2016, removed this minimum capital requirement for general business activities. This reform is an important one as minimum capital requirements are more likely to affect less-capital intensive industries and particularly SMEs. Small entrepreneurial companies are common in many service sectors, including more knowledge-intensive

activities, and its discriminatory nature potentially led foreign investors to pass on certain investment opportunities or decide to locate elsewhere. In sectors where barriers to entry are relatively low and investors and labour are largely mobile, any particular barrier to investment may act to hinder the country's competitiveness in the sector.

Make it easier to start a business by streamlining procedures and systematising attached conditions

Starting a business is a major challenge for all investors in Lao PDR, as illustrated by its ranking at the 160th position out of 190 economies for 'starting a business' in the World Bank *Doing Business 2017* (Table 2). Different entry points for investors, with a different process for investment approval procedures, coexist. The Ministry of Industry and Commerce is responsible for investments in general activities while the Ministry of Planning and Investment for those in concessions. Until recently, the National Committee for SEZs was responsible for those in zones, but the newly amended *Law on Investment Promotion* has moved this responsibility under the MPI. These distinct entry points bring a certain degree of confusion to investors, especially when incoherent or conflicting messages are delivered. Some provisions of the *Law on Investment Promotion* are subject to interpretation, creating unpredictability and leaving too much space for discretionary decisions. Each entry point is presented as a one-stop shop but none is functioning properly.

Table 2. **Doing Business in Lao PDR and neighbouring countries**
Ranking out of 190 countries (2017)

	Lao PDR	Cambodia	China	Myanmar	Thailand	Viet Nam
Ease of doing business	**139**	131	78	170	46	82
Starting a business	**160**	180	127	146	78	121

Source: World Bank.

In general activities, investors face long delays in obtaining their business licence from the Ministry of Industry and Commerce, particularly for activities included in the list of controlled businesses, which constitute the majority of economic sectors. Line ministries need to be consulted for approval and deadlines vary markedly from one case to another, depending on the sector, the nature and the location of the project. They are also subject to negotiable fees, making the whole process highly unpredictable and non-

transparent. Projects are sometimes refused by line ministries with no clear justification. Most investors liaise with the relevant line ministries directly to try to speed up the process, which renders the one-stop shop unnecessary and unsuccessful. Additional approvals and requirements from other ministries are also necessary, which contradicts the definition of a one-stop shop. According to stakeholders, long and complex procedures seem to particularly affect wholly-owned foreign businesses and small and medium-sized enterprises (SMEs).

For investments in concessions, a number of documents need to be prepared by investors before their application is considered and screened by the Ministry of Planning and Investment. This process is reported to be multi-layered and complex, and timeframes are not clearly defined, leaving space for discretion and unpredictability. Similarly to general activities, investors need to go to many different ministries to get the relevant licences and approvals.

The government recognises the need to improve the business environment so that the private sector can contribute effectively to economic growth. Long delays and costly procedures to establish a new business entity are a major obstacle to new investment and entrepreneurial activity. Adequate responses are a challenge. One-stop-shops with single-point authority can be costly and, if not efficient, can create an additional burden for investors. Priority should be given instead to streamlining administrative procedures and making them more transparent and rules-based.

Policy recommendations:

- Set up an inter-ministerial and multi-stakeholder taskforce supported at the highest level of government to identify and eliminate all unnecessary licences and administrative obstacles to start and operate a business;
- Prepare client charters with clear deadlines and standard fees for licensing. The MPI and MOIC could consider signing memoranda of understanding with line ministries to ensure deadlines are systematically met or penalties are applied if not;
- Keep the one-stop-shops as simple as possible, as their effective implementation can be complex and costly, and give them a facilitating role rather than making them mandatory entry points;
- Enhance the role of the Investment Promotion Department as a facilitator, hand-holder and information provider for prospective and newly-established investors;

Streamline tax incentives and ensure greater transparency

The government offers a wide range of tax incentives, mostly tax holidays, to investors. They are granted based on the economic activity and geographic location. The large number of existing tax incentives and their dual categorisation by business activities and zones makes the current regime potentially confusing and complex. Companies do not seem to operate on an equal footing and are not fully aware of what to expect and under which conditions.

Incentives in SEZs are different from one another and investments in concession activities do not benefit from clear and standard granting criteria since they are negotiated on a case-by-case basis. In the latter case, the government and the investor negotiate a master list that includes all incentives and the conditions under which they apply. The negotiations involve multiple government bodies and leave too much room for discretion which can create unnecessary and counterproductive market distortions (by favouring some firms over others); it can increase the risk of corruption and undermine good governance objectives fundamental to achieving an attractive investment environment; and it can also give more bargaining power to investors during the negotiation phase and create opportunities for rent-seeking. The investment environment, including the incentives policy, should provide readability and predictability, where all investors can expect to be treated fairly and equitably.

Although overall tax incentives are quite clearly stated in the 2016 *Law on Investment Promotion* (as was the case in the previous version of the law), many others are defined in separate decrees and legislation, and those under the concession regime are provided through executive decrees or agreements. Tax incentives are thus not adequately scrutinised by the National Assembly and do not provide sufficient transparency in their granting and operation. Oversight by the law-making body is fundamental to transparency and accountability in the governance of tax incentives.

A complex and unclear incentive system not only makes it less predictable for investors but also more difficult for the authorities to administer. Master lists are sometimes vague and difficult to implement properly. No study on the costs and benefits of tax incentives is publicly available and the authorities recognise that, so far, they have not significantly helped attract investors in remote and disadvantaged areas.

Policy recommendations:

- Simplify the incentives regime and make it more transparent and rules-based;

- Ensure that granting/qualification for tax incentives is automatic, according to predetermined, uniform and clearly declared criteria to ensure that all investors are treated fairly and equitably;
- Ratify all tax incentives for investment through the National Assembly to ensure greater transparency and accountability in the governance of tax incentives;
- Consolidate all tax incentives and their eligibility criteria in the main body of tax law to increase the system's transparency and to provide more means to the revenue authority to effectively administer them;
- Build internal capacities to conduct a cost-benefit analysis to ensure that tax incentives serve their purpose of attracting investment and that revenue forgone is not excessively high.

Further efforts to improve the economy's competitiveness will help attract new investors

Adopt the new PPP framework to encourage efficient private investment in infrastructure

The Eighth NSEDP for 2016-20 recognises the importance of infrastructure development for transitioning from a land-locked to a land-linked economy. While Lao PDR has enhanced connectivity to its main trading partners over time, investments to upgrade transport networks are necessary to keep pace with demand. Infrastructure development is also crucial to link isolated rural areas to markets and strengthen the development of the tourism sector. Annual tourist arrivals have grown rapidly but remain low compared to other countries in the region and highly concentrated in Vientiane Capital. A key impediment to more inclusive tourism growth has been inadequate transport access to secondary destinations.

Meeting future demand for infrastructure will require investments estimated at USD 11.4 billion over 2010-20, which puts investment needs at levels much above those estimated for neighbouring countries and largely above the resources currently committed to infrastructure development from the government and donor community. In the past, investment in infrastructure has been largely undertaken by the government, with strong support from donors, whose assistance has often outpaced the level of government resources allocated to infrastructure. Private investment in

infrastructure has been limited, but the government is willing to encourage greater private sector participation.

With the support from the Asian Development Bank, the Ministry of Planning and Investment seeks to implement a new public-private partnership (PPP) framework to strengthen the legal and institutional framework as the starting point for this to happen. Establishing such a building block is necessary. Lao PDR has no proper PPP legal and institutional framework in place yet. The draft framework brings some important regulatory and institutional mechanisms to improve infrastructure delivery capacity, such as the establishment of a PPP unit and a project development facility, but many challenges remain unaddressed. A number of issues would need to be further clarified by regulations and guiding documents.

Private investment will not solve any funding issue impeding further investments in infrastructure, but it can be an important ally in promoting a more efficient use of available resources when undertaken in a propitious and competitive environment. It is the role of the government's new PPP framework to ensure that infrastructure investments are carried out in the most efficient manner. For this, further efforts are needed to improve the planning and assessment of infrastructure projects so as to ensure value for money.

Policy recommendations:

- Strengthen capacity and co-ordination across the government for planning and assessing infrastructure priorities to ensure infrastructure strategies are well integrated with overall industrial strategies. In the past, for example, inefficient last-mile transport infrastructure to secondary destinations may have hindered greater tourism development and diversification;

- Consider establishing a framework for preparing public investment and PPP proposals to facilitate project comparison and prioritisation according to projects' socio-economic importance, environmental sustainability and financial feasibility. Ensure infrastructure project selection and prioritisation incorporates budget constraints and follows structured project appraisal procedures and cost-benefit analysis;

- Ensure that the PPP policy is grounded on efficiency rather than fiscal motives. Continue to devote enough public resources to infrastructure investment and build capacity to carefully assess and

allocate risks between parties in PPPs so as to secure value for money;

- Ensure a transparent and competitive tendering environment during the selection stage of PPP investors so that they are based upon value for money expectations. Direct appointment should be reserved for exceptional cases;

- Clarify some of the draft language in the PPP decree, including on roles and responsibilities among institutions, specific procedures for smaller projects, land clearance and compensation issues, and circumstances under which renegotiations are permitted;

- Ensure implementation regulations and guidance documents are clearly drafted and that there are no inconsistencies between the PPP decree and other related legislation, such as the newly-amended *Law on Investment Promotion*.

Mobilise private investment in green sectors and develop a comprehensive renewable energy policy

Green growth implies fostering economic growth and development while ensuring that the natural assets continue to provide the resources and environmental services on which our well-being relies. Investment for green growth includes, among other things, investment in infrastructure such as renewable energy, energy efficiency, water purification and distribution systems, transport and housing, the preservation of natural resources and waste management. A green investment framework combines a number of elements, starting with a strong governmental commitment at both the national and international level to support green growth and to mobilise private investment that will help achieve these objectives.

Lao PDR is beginning to institute an investment framework for green growth and sustainable development. It approved a National Strategy on Climate Change in March 2010 by focusing on the main domestic priorities such as agriculture and food security, energy, forestry and land use change and water. The *Environment Protection Law* was revised in 2012 and lays out the framework for national safeguards that help mitigate the adverse effects of investment in natural resources. To promote green investment, the government has set up a National Renewable Energy Strategy, specifying long-term targets for renewable energy supply in the total energy mix, and has piloted several decentralised renewable energy solutions.

Additional efforts to develop a green growth strategy are underway, led by the Ministry of Planning and Investment, which will span different

sectors and serve as the umbrella strategy. In addition, the Eighth five-year National Socio-Economic Development Plan (2016-20) emphasises the need for economic, social and environmental considerations to be addressed in order for the country to achieve middle-income status.

More efforts are needed to position the country as a competitive destination for green investment and to improve the quality of investment overall. While the basic legislation and general government direction seem to favour sustainable development and environmental protection, there is a substantial need to build capacity to ensure that institutions can implement such regulations and monitor their implementation. Also, at present, the government relies almost entirely on international funding and donor contribution for the promotion of green growth and environmental protection. Efforts should also be made to promote green investment in the energy sector. The government has not come up with supportive renewable energy policies or an implementation plan. Efforts on renewable energy and energy efficiency have so far been sporadic and *ad hoc*, largely due to the focus on exploiting hydropower resources.

The authorities will need to progressively increase their efforts to mobilise private investments in renewable energy, which have been hampered *inter alia* by inadequate pricing mechanisms and the lack of a strong, independent regulatory authority.

Policy recommendations:

- Strengthen environmental institutions and build technical capacity to improve the quality of investment, and promote green investment in the energy sector;
- Push forward the preparation and adoption of the overarching green growth strategy, with the aim of increasingly positioning Lao PDR as an attractive location for green investment;
- Building on the Renewable Energy Development Strategy, prepare a comprehensive renewable energy policy and implementation plan to achieve the specified targets, with a focus on decentralised energy solutions that deliver environmental and development benefits;
- Actively diversify funding sources for green growth, including accessing new sources of climate finance and philanthropic funding for development, and promote the use of grant resources to catalyse private capital.

Allocate more resources to education and involve the private sector in human resource development

Policies that develop and maintain a skilled and adaptable workforce, and ensure the full and productive deployment of human resources, support a favourable investment environment. Low skill levels and labour productivity are among the major constraints to investment in Lao PDR. While real wages have continuously risen over time, labour productivity has not improved, thus affecting firm-level competitiveness. The World Bank estimates that productivity is about half of what would be expected for a country at the same level of development. The *Global Competitiveness Report 2016-17* ranks Lao PDR 106th out of 138 economies for higher education and training.

The government is well aware of the necessity to improve its education system and the Eighth NSEDP 2016-20 puts education and productivity growth at the centre of its action plan. This includes improving the quantity and the quality of primary, secondary and tertiary education as well as vocational education and training. While emphasis is put on expanding the educational basic infrastructure to increase access to education, curricula for vocational and university education will be further adapted to the economy so as to develop and upgrade the necessary skills. Creating the environment for increasing the supply of qualified individuals not only requires educational reforms but also private sector involvement. The government recognises that there are currently few links between education institutions and the private sector and understands the need to involve business in designing and implementing the human resource development strategy.

In spite of the acknowledged weakness of the education system, public spending in education remains comparatively low. A whole-of-government approach would be necessary to evaluate options to increase the budget allocation in education, including by reducing tax incentives granted to investors. No public cost-benefit analysis of tax incentives for investment exists, and the potential revenue forgone could be high compared to the needed resources for the state to invest in education and skills development – a longer-term measure to attract FDI.

As improving the education system is a longstanding priority to raise overall competitiveness, parallel measures can be put in place in the short-term, such as facilitating the import of the necessary skilled labour to avoid undermining the growth of potentially competitive sectors. Training programmes for workers by employers could also be further encouraged, as they can increase productivity and the spillovers from MNEs to local firms with higher absorptive capacity for new knowledge and technology.

Policy recommendations:

- Increasingly involve private sector representatives in designing and implementing human resource development strategies to ensure the relevance of existing curricula vis-à-vis the needs of the labour market;
- Consider redesigning the tax incentives regime, after a thorough cost-benefit analysis, to increase revenue collection and secure the necessary resources to invest in education and skills development;
- Further encourage businesses to upgrade workers' skills through on-the-job training as well as apprenticeships, traineeships and internships;
- As a short-term measure, facilitate the import of specific skilled labour to fulfil the demand in key competitive sectors.

The benefits of FDI can be further maximised through active government intervention

Promote RBC principles and priorities within the government and among existing investors

Responsible business conduct (RBC) principles and standards set out an expectation that all businesses – regardless of their legal status, size, ownership structure or sector – avoid and address negative effects of their operations, while also making efforts to contribute positively to sustainable development wherever they operate. RBC is centred on integrating environmental and social issues in core business activities and ensuring that stakeholder rights are respected. RBC is not only of relevance to foreign investors and customers; it matters to any domestic business that wishes to participate in global value chains. RBC expectations are growing and increasingly formalised in international agreements, domestic laws and company policies.

Awareness of RBC principles and standards is not yet widespread in Lao PDR, although a number of initiatives related to corporate social responsibility have been undertaken by the private sector. In principle, an adequate legal framework that protects the public interest and underpins RBC has been partially established, although more efforts are needed to ensure its implementation. Further alignment with international principles and standards in areas related to human rights, labour relations and the environment is advisable.

At regional level, references to RBC have been included in new ASEAN blueprints. The Economic Blueprint specifies that enhanced stakeholder engagement is central to promoting transparency and making progress in ASEAN integration. ASEAN labour Ministers also adopted in May 2016 the *Guidelines for Corporate Social Responsibility on Labour* to provide broad guidance to governments, employers' and workers' organisations on engagement, social dialogue and compliance with core labour standards. As ASEAN members move toward a unified regional approach and in light of the continuing policy dialogue on investment between OECD and ASEAN, there is significant scope to increase dialogue and co-operation on RBC issues.

Promoting and enabling RBC is of central interest to policymakers wishing to ensure that business activity contributes to broader value creation and sustainable development. According to the *Policy Framework for Investment*, governments can promote and enable RBC in several ways through: (*i*) *regulating* – establishing and enforcing an adequate legal framework that protects the public interest and underpins RBC, and monitoring business performance and compliance; (*ii*) *facilitating* – clearly communicating expectations on what constitutes RBC, providing guidance on specific practices and enabling enterprises to meet those expectations; (*iii*) *co-operating* – working with stakeholders in the business community, worker organisations, civil society, the general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC; (*iv*) *promoting* – demonstrating support for best practices in RBC; and (*v*) *exemplifying* – behaving responsibly in the government's role as an economic actor.

Mainstreaming RBC within the Lao government and clearly communicating RBC priorities and expectations would promote and enable better practices among foreign investors and domestic industries alike. Promoting RBC as a way of bridging the skills gaps and increasing productivity could bring particular advantages to Lao PDR.

Policy recommendations:

- Ensure that investment incentives and concession agreements are targeted and well-designed, with due consideration of their environmental and social impacts. Strengthen RBC expectations in upcoming investment-related legislation and promote an approach to investment consistent with international standards for responsible business. Promote more transparency on how environmental and social issues are considered in investments, including in SEZs.

- Clearly communicate expectations on RBC and consider establishing a focal point on RBC in the government. Provide guidance on accepted practices, support and participate in awareness raising events, and promote policy coherence and alignment on RBC. Consider developing a National Action Plan on Responsible Business Conduct, in collaboration with stakeholders and in line with international good practices.

- Align the legal framework for protecting human and labour rights with international standards.

- Actively promote RBC among domestic businesses, including through targeted industry-specific programmes. Encourage the establishment of firm-level grievance mechanisms and cross-sectoral learning for addressing environmental and social risks.

- Include RBC expectations in FDI attraction efforts and as one element to facilitate information exchange between foreign and domestic firms. Include RBC criteria in supplier databases and in matchmaking events.

- Encourage internal and external training by employers. Communicate to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC – and recognise those that do it.

Develop business linkages between MNEs and SMEs

Business linkages between foreign and local companies are the channel through which FDI spillovers can be maximised, owing to the productivity gains resulting from the transfer of knowledge and technology from foreign affiliates to domestic companies and workers. Linkages mostly depend on the characteristics of both foreign and domestic firms and will not necessarily occur automatically, but their creation can be influenced by adequate government institutions, policies and measures. They depend first and foremost on the availability and capacity of domestic firms. Creating a business environment that is favourable for both domestic and foreign firms, supplemented by SME development policies and programmes to raise their absorptive capacities, is an important first step. Other, more proactive, measures can also be taken by the government to encourage linkages and interactions between MNEs and SMEs – and attract FDI with a higher spillover potential.

Few linkages between foreign affiliates and local firms currently exist in Lao PDR, notably due to the type of FDI attracted and the lack of absorptive capacities of local SMEs. The SME Promotion and Development Office is in charge of SME development, and a *Law on SME Promotion* was enacted in 2011 to support the implementation of its activities, but resources are insufficient to effectively support SMEs. Building absorptive capacity of domestic companies not only requires a horizontal approach to SME development but also industry-specific capacity-building to help them achieve technological upgrading and meet quality standards. While it is important to help SMEs to meet international quality standards, it might be more critical to help them meet industry-specific requirements, as the latter are more inclined to assist SMEs to integrate into international supply chains. Technical support and training also need to involve industry associations and MNEs themselves.

Information exchanges between foreign and domestic firms are not sufficiently facilitated by government agencies. The authorities could take some measures, on the one hand, to inform MNEs on potential local suppliers and their expertise, and, on the other hand, to inform SMEs on foreign investors' needs in terms of products and services, standards and delivery expectations. While information exchange facilitation is typically a function that can be led by investment promotion agencies, experience worldwide shows that successful linkage programmes require strong inter-agency co-ordination and a genuine engagement from the private sector.

Creating business linkages also has implications for the government's FDI attraction strategy. Some MNEs are more inclined than others to source locally, depending on their global production strategy, FDI determinants, entry mode and ownership structure. Many governments also use SEZs to attract investors, create jobs and increase export earnings, but economic activities within SEZs tend to generate weak linkages with domestic firms if not firmly embedded in a wider development agenda, including appropriate connectivity to the rest of the economy and reduced barriers to investment. More elaborate SEZs that follow a cluster approach – concentrating on strategic sectors and supporting SMEs with technology absorption – are more successful at creating linkages with the local economy.

Policy recommendations:

- Implement industry-specific programmes, in collaboration with the private sector, in key economic sectors, such as mining, hydropower, garment, tourism, forestry and agro-processing to help maximise the impact of FDI through linkages;

- Increase efforts by the Investment Promotion Department and other government agencies to prepare industry-specific supplier databases and arrange matchmaking events between foreign affiliates and potential suppliers;
- Increasingly focus FDI attraction efforts on investors that have a long-lasting interest in the region and are more inclined to source locally or contribute to industrial cluster creation;
- Allow domestic companies to participate in the activities within SEZs, especially manufacturing, to ensure a level playing-field and facilitate FDI integration through geographic proximity and networks;
- Provide aftercare services to existing investors to strengthen their links with the local economy and encourage them to use domestic suppliers.

Attract "quality" investors, including through a better co-ordinated FDI attraction strategy and by incorporating RBC and green growth standards in investment promotion

Lao PDR is endowed with abundant natural resources, including minerals, water and forests, which need to be managed responsibly in order to serve the purpose of sustainable economic growth. The Seventh NSEDP for 2011-15 emphasised the need to follow a development path that keeps a balance between economic growth and environmental protection but there is a lack of an institutional base to ensure that all new hydropower, agricultural and mining projects comply with a certain minimum level of environmental and social precautions. The government aims not only to ensure that these projects comply with environmental and social safeguards but also to increasingly target investors that have a solid reputation in RBC practices and sustainable natural resource management. At the same time, it is also putting increased emphasis on diversifying the economic sectors for FDI to further maximise the benefits for the local economy. Although these objectives are laudable, the government has not yet developed a well-crafted investment promotion strategy at the service of sustainable development and economic diversification.

The Investment Promotion Department (IPD) under MPI is well placed to promote, target and attract "quality" investment, in other words investments that generate jobs, create value-added and meet certain social and environment criteria. The IPD is currently mostly active in policymaking and negotiation of concession agreements. In order to be able

to perform these functions and build related capacities, implementing decrees of the revised *Law on Investment Promotion* should give the Department a stronger and more precise legal mandate to conduct promotional activities.

The development of SEZs has also taken on an important role in the government's investment attraction strategy but zones are unevenly developed and occupied. A closer monitoring of RBC practices in zones will be necessary to ensure SEZ investments are responsible and sustainable. Co-ordination among government agencies needs to be improved to ensure consistent messages are delivered to investors and promotion activities serve the country's overall development objectives.

Policy recommendations:

- Develop a well-crafted investment promotion strategy that focuses on priority industries, supports economic diversification, incorporates RBC expectations and is aligned with the newly-revised *Law on Investment Promotion*.

- Better co-ordinate FDI attraction measures among government stakeholders, notably the Investment Promotion Department and the Secretariat of the National Committee for SEZs, to ensure consistent and constructive messages and activities are delivered;

- Consider offering targeted incentives for developing green sectors, such as renewable energy and energy efficiency, and sustainable/responsible projects;

- Reinforce government institutions in charge of implementing, monitoring and enforcing national safeguards systems, and provide them with additional means to monitor hydropower, mining and agricultural projects and ensure they comply with environmental and social safeguards;

- Conduct more systematic aftercare to retain existing investors and encourage reinvestments, focusing on companies with a high developmental impact and strong RBC practices.

Notes

1. Lower middle income is a World Bank classification and least developed country is a UN classification.
2. Thailand provides the largest number of tourists to Lao PDR, while the number of Chinese visitors rose by over 70% in 2014.

References

Economic Research Institute for ASEAN and East Asia - ERIA (1994), *Transition to Market Economies in Asia*, The Keizai Bunseki No. 137, Tokyo.

Economist Intelligence Unit (EIU) (2016), *Country Report: Lao PDR*, June 2016, London.

Chi Do Pham (2004), *The Lao Economy: Review of New Economic Mechanism and the Challenge of Integration,* Banking College of the Bank of the Lao PDR, Vientiane.

Chapter 1

Trends in foreign investment and trade in Lao PDR

This chapter describes the Lao People's Democratic Republic's (Lao PDR) gradual integration in the world economy and the role of trade and investment in its economic development. It reviews trends in foreign direct investment in Lao PDR using various national and international data sources. It also looks at the performance of foreign investment relative to neighbouring and regional economies and its impact on the local economy.

Lao PDR has gradually integrated into the global economy

After embarking on an ambitious structural reform process in 1986 under the New Economic Mechanism, Lao PDR gradually moved from a centrally planned economy to a more open, private sector-led and market-oriented economy and progressively integrated into the world economy. In 1992, it joined a programme of sub-regional economic cooperation among Greater Mekong Sub-region countries supported by the Asian Development Bank and designed to enhance economic relations among members. In 1997, Lao PDR became a member of the Association of Southeast Asian Nations (ASEAN), one of the fastest-growing regions in Asia, which boosted its economic reforms and supported its growing integration into the regional and global economy.

Following the move of neighbouring China (2001), Cambodia (2004) and Viet Nam (2007), Lao PDR became a member of the World Trade Organization (WTO) in 2013 after 15 years of negotiations. During this period, over 90 laws and regulations were enacted to be aligned with WTO principles, including on trading rights, import licensing, customs valuation, investment, sanitary and phyto-sanitary measures, technical barriers to trade, and intellectual property rights. Lao PDR became the last ASEAN Member State to join the organisation. In September 2015, it was one of the first WTO members to ratify its Trade Facilitation Agreement, which contains provisions for expediting the movement, release and clearance of goods, and includes co-operation and capacity building components.

Tariffs are bound at 18.8% on average for all products (19.3% in agriculture and 18.7% in non-agricultural sectors) and Lao PDR has committed to liberalise ten services sectors.[1] These commitments are meant to be implemented fully over a maximum period of seven years after the date of accession (2020). The government will also need to disseminate its accession package to various stakeholders so that, on the one hand, public agencies better understand the contractual obligations that bind the country and, on the other hand, the private sector is aware of the new opportunities that arise from joining the WTO.

Lao PDR maintains strong trade relationships with its neighbours. In 2014, Thailand accounted for over a quarter of its exports and 55% of its imports. China represented 35% of its exports and a quarter of its imports, while Viet Nam followed as the third trading partner (EIU, 2015). These three countries are also the largest sources of foreign investment (see below). Lao PDR's major exports are mining products, which represent almost half of exports, and electricity – which are also the two major economic sectors attracting FDI (Table 1.1). Lao PDR's imports mostly

include intermediate products and raw materials as well as capital goods. These figures confirm that economic growth and trade are driven by the exploitation of natural resources while manufacturing products are mostly imported.

Table 1.1. **Lao PDR's main exports and imports, 2014**

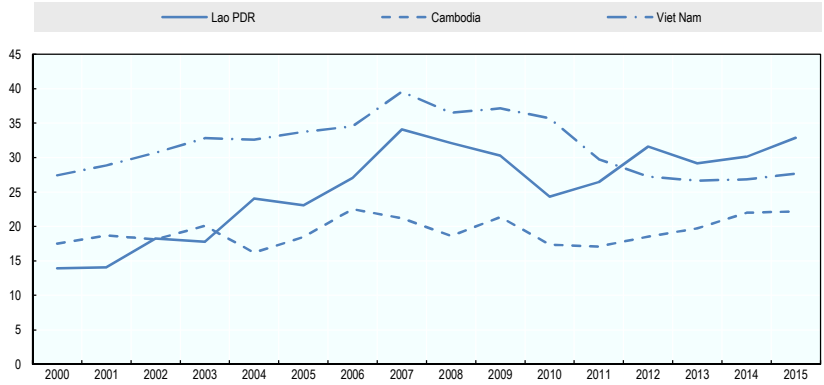
Exports	% of total	Imports	% of total
Mining products	48.3	Intermediate products and raw materials	43.4
Electricity	21.4	Capital goods	29.6
Garments	7.6	Durable goods	18.6
Agricultural and forestry products	8.6	Electricity	1.8

Source: EIU, 2016.

While FDI has been a key driver of growth in the past ten years, domestic investments have increased significantly over the same period. Investment as a share of GDP peaked in 2015 at 33% (Figure 1.1), higher than either Cambodia (22%) or Viet Nam (28%) and reflecting the natural resource boom, considering that its investment to GDP ratio was below that of its neighbours until 2003.

Private investment has increasingly been recognised by the authorities as a key engine of economic growth and development. Promoting FDI became a priority of the government in its third five-year National Socio-Economic Development Plan (NSEDP) for 1991-95 while the development of small and medium-sized enterprises (SMEs) became an area of greater focus since the adoption of the National Growth and Poverty Eradication Strategy in 2004. More recently, the Seventh NSEDP for 2011-15 aimed to achieve the Millennium Development Goals through economic growth, human resource development and improved social welfare. The Seventh NSEDP put emphasis on mobilising quality FDI with a view to generate government revenues, create sustainable jobs and generate transfers of skills and technology while safeguarding the environment. The Eighth NSEDP (2016-20) focuses on developing education and labour skills, pursuing economic diversification and supporting the development of SMEs, with the ambition to graduate from least developed country status by 2020.

Figure 1.1. **Investment to GDP ratios in Lao PDR, Cambodia and Viet Nam, 2000-2015**



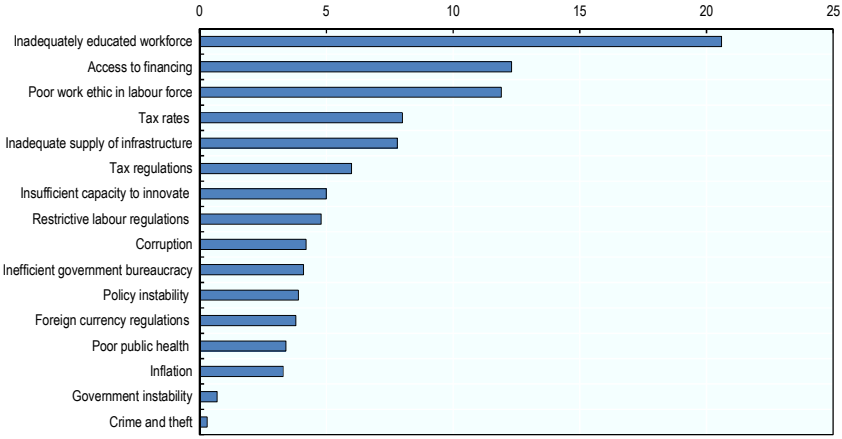
Source: World Development Indicators (2016).

Economic challenges

The government faces considerable challenges to achieve sustainable economic development. Growth has not been sufficiently inclusive, as poverty and inequality remain high. The economy is not sufficiently diversified and the resource movement effect, coupled with the appreciation of the real exchange rate (by 50% between 2001 and 2009), has generated slow growth of non-resource sectors, notably manufacturing and agriculture (OECD, 2016).[2]

Low productivity constitutes one of the major challenges in Lao PDR's socio-economic development, which not only affects the quality of jobs but also the investment climate as a whole and the capacity to attract more and better investment. The World Bank's *Investment Climate Assessment of Lao PDR* notes that an inadequately educated workforce has become the main constraint to private sector expansion (World Bank, 2014). The survey undertaken for the *Global Competitiveness Index 2016-17* strongly corroborates these findings (Figure 1.2) Low productivity also affects the development of domestic SMEs and hinders the creation of business linkages with foreign affiliates. The objective of the upcoming NSEDP to focus on education and labour skills is a recognition by the government of the necessity to tackle this problem as a priority.

Figure 1.2. **The most problematic factors for doing business in Lao PDR**



Note: From the list of factors, respondents were asked to select the five most problematic for doing business and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

Source: World Economic Forum (2016), *The Global Competitiveness Report 2016-2017*.

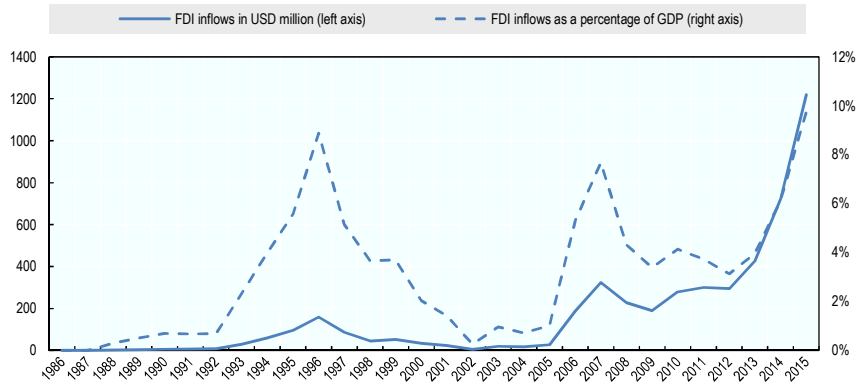
The country also lacks modern and affordable infrastructure, especially transport, as also reflected in Figure 1.2. As the only landlocked country in ASEAN, but strategically located between China, Thailand and Viet Nam, Lao PDR will need transport facilities to achieve sustained growth and attract investors. In the context of a natural resources boom, the government will need to find a sustainable model of development, where natural resources are preserved and exploited in an environment-friendly manner and through responsible business practices. To face these challenges, Lao PDR will not only need to attract more investment but also to make sure investors act responsibly.

Lastly, Lao PDR also faces governance issues, with private sector representatives complaining of a wide-ranging lack of transparency, constant policy uncertainty and inconsistent application of the law. Corruption is perceived as a major concern, as reflected in the *Corruption Perception Index*, where Lao PDR ranked 123rd out of 175 countries in 2016, a strong improvement from 145th out of 175 in 2014 but still a poor result globally and regionally, although better than either Cambodia (150th) and Myanmar (147th).

FDI trends

FDI has played an important role in Lao PDR's recent economic growth. Although NEM reforms were initiated in 1986, FDI flows to Lao PDR only started surging in 2006, after a short peak in 1996 (Figure 1.3). Prospects for increased inflows of FDI in the coming years are encouraging, including in the non-resource sector, with the full implementation of the ASEAN Economic Community. Lao PDR is also increasingly perceived by multinational enterprises (MNEs) as an alternative to production bases in Thailand or southern China as well as an opportunity to reach the broader Mekong region (US Department of State, 2015).

Figure 1.3. **FDI inflows to Lao PDR, 1986-2015**

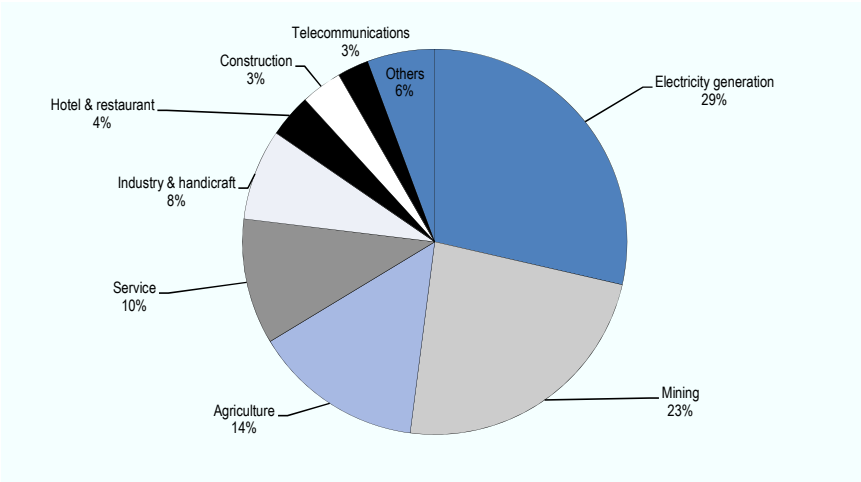


Source: UNCTAD FDI database (2016).

FDI by sector and country

Foreign investment in Lao PDR is prominent in electricity generation and mining (Figure 1.4) representing over half of the total FDI stock and contributing strongly to the rapid economic growth over the past decade. The mining sector in Lao PDR mostly comprises junior companies from Australia, China and Canada.[3] The largest mining projects are Phu Bia Mining Ltd., which is 90% owned by Pan Aust Ltd. and 10% by the government, and Lane Xang Minerals Ltd., which is 90% owned by MMG Ltd. and 10% by the government (OECD, 2016). Both Pan Aust Ltd. and MMG Ltd. are Chinese-owned but Australian-operated companies. Hydropower projects and dams are dominated by Chinese and Thai investors, active in generation, transmission and trading of electricity. FDI in forestry and agriculture include timber and rubber and originate primarily from ASEAN Member States and East Asian economies.

Figure 1.4. **Approved FDI projects in Lao PDR by sector, 1989-2015**

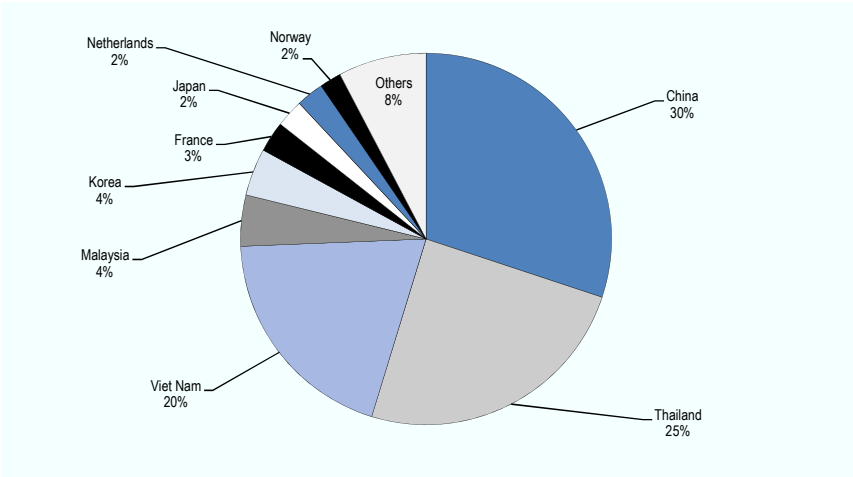


Source: Author's calculations based on Investment Promotion Department.

FDI in Lao PDR is dominated by three of its largest neighbours, China, Thailand and Viet Nam, which are also its main trading partners. The three countries account for almost three quarters of all approved FDI projects (Figure 1.5). Chinese investors, with almost a third of total investments, are concentrated in hydropower generation, transmission and trading of electricity but also in mining, agriculture and real estate. Thai and Vietnamese investments are concentrated in hydropower, agriculture and construction projects.

Investment by OECD-based companies is rather low in Lao PDR. Korea, the largest OECD investor country, is the fifth most important foreign investor with only 4% of Lao PDR's FDI stock. Korean companies are well anchored in the economy, however, and are present in different economic sectors. Kolao Holdings, for instance, is one of the largest Korean investors present in manufacturing, mostly active in the automobile industry (including processing and assembling activities as well as distribution). Lao PDR and the Republic of Korea have been expanding economic and political ties, including with the creation of a Korea Trade-Investment Centre office in Vientiane in 2011, a direct flight connection between Vientiane and Seoul and the rapidly growing number of Korean tourists.

Figure 1.5. **Approved FDI projects in Lao PDR by country of origin, 1989-2015**



Source: Author's calculations based on Investment Promotion Department.

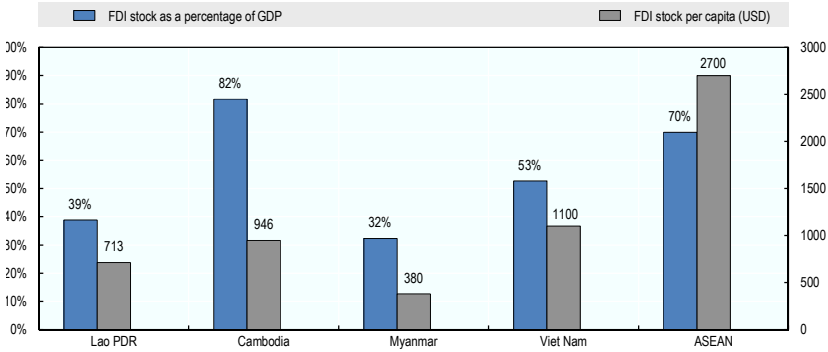
Japan, which is the largest investor in ASEAN as a whole, only accounts for 2% of total FDI projects in Lao PDR. This might be explained by the fact that Japanese companies are mostly present in small manufacturing operations rather than large mining and hydropower projects. Nikon, for instance, established a camera production operation in 2013. The same year Toyota Boshoku established a plant to produce interior components and seat covers for automotive manufacturers operating in the region (ASEAN, 2014). Suzuki (automotive) and Toshiba (hydropower) are other Japanese investors. Other recent OECD investments include the Coca-Cola Company (USA) and Bosch (Germany). Although not a major investor in absolute terms, Australia has a long-lasting presence in many different sectors of the Lao economy, including mining, manufacturing and financial services.

Most of the manufacturing FDI is located in SEZs. Savan-Seno in Savannakhet, the first SEZ established in 2002, is particularly appealing to companies wishing to locate on the East-West Economic Corridor linking Viet Nam, Lao PDR, and Thailand. In addition to Korean and Japanese investors – very present in SEZs – neighbouring countries are active in zone development and investment. At least four of the ten special economic zones in the country were established with Chinese financing. In the context of ASEAN integration, Malaysian and Thai manufacturing companies have also invested in apparel plants to benefit from lower labour costs and preferential market access to the European Union (Farole and Winkler, 2014).

FDI performance

Lao PDR doubled its total stock of foreign investment between 2010 and 2015 but is still low by regional standards, with the sole exception of Myanmar – although inflows into Myanmar are growing rapidly (Figure 1.6). The country's total FDI stock as a percentage of GDP (39%) accounts for just over half of ASEAN's average (70%), which suggests that foreign investment still plays a limited role in the Lao economy as compared to regional peers. Neighbouring countries such as Viet Nam (54%) and Cambodia (81%) show a substantially stronger role of FDI in their economy. The same is true when FDI is normalised by population. The stock of FDI per capita of USD 713 in Lao PDR, although growing rapidly, is lower than almost all its neighbours – except Myanmar – and especially compared to the region's average of USD 2700.

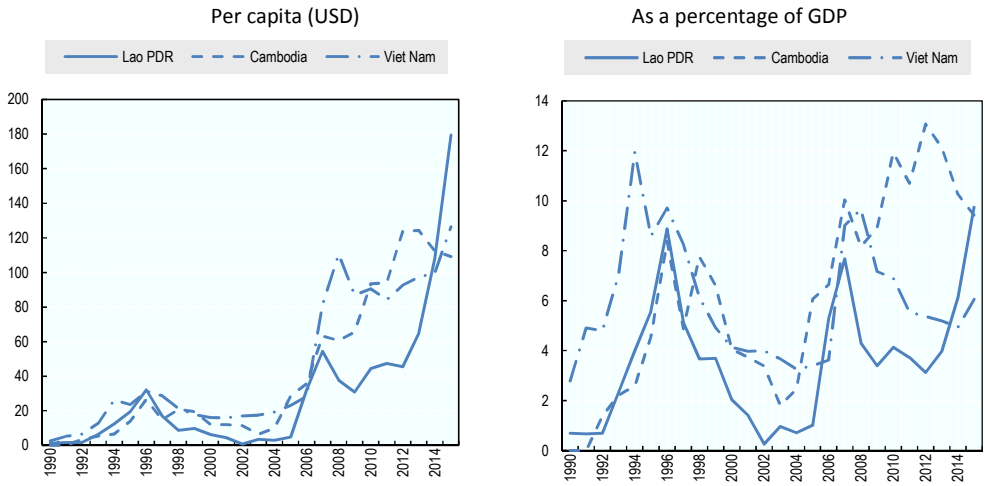
Figure 1.6. **FDI in relative terms in Lao PDR and the region, 2015**



Source: UNCTAD FDI database (2016).

Looking at performance over time, FDI inflows to Lao PDR in relative terms – both per capita and as a percentage of GDP – have almost always been below neighbouring Cambodia and Viet Nam since 1990 (Figure 1.7). It is only in 2014, when it attracted significantly higher amounts of FDI than previous years that Lao PDR reached the level of its regional peers and surpassed them in 2015. Its stock of FDI as a share of total FDI stock in CLMV countries has stayed roughly constant at around 2-3% since 2000, equally suggesting little progress in attracting FDI attraction *vis-à-vis* its neighbours.[4]

Figure 1.7. FDI inflows to Lao PDR and neighbours in relative terms, 1990-2015



Source: UNCTAD FDI database (2016).

Impact of FDI

Under the right conditions, FDI can enhance an economy's productive capacity and growth potential, drive job creation and income growth, allow the transfer of technology and know-how, and spur domestic investment, including through the creation of local supplier linkages (OECD, 2015a). Such benefits can act as a powerful force for development and poverty eradication, but investment should not be seen as an end in itself. The growth and development impact of investment will depend as much, if not more, on the quality of the investment as it does on the quantity.

A closer look at the type of FDI in Lao PDR provides insights into the nature of its economic impact. Most FDI projects are directed to natural resource sectors (mining and hydropower) and evidence suggests that they have been among the main drivers of economic growth though capital accumulation over the past decade (Kyophilavong and Nozaki, 2015; Nolintha, 2015). The nature of these projects makes them also major contributors to exports, as mining products and electricity account for over two thirds of total exports (Table 1.1 above). Natural resource exploitation by foreign MNEs also generates government revenues, which represent a significant fiscal take for the authorities (Nolintha, 2015). With the appropriate policy framework, government revenues can help transform natural capital into physical, social and human capital (OECD, 2015b). The International Monetary Fund notes that mining revenues in Lao PDR are low, however, which undermines the opportunities for the government to

increase its spending on education and health that are below the level of comparable countries (IMF, 2015).

The exploitation of natural resources is also associated with certain risks, not the least being the "Dutch disease", which occurs when the domestic currency appreciates as a result of the increase in resource prices, affecting in turn the production and export of other tradable goods. Researchers found that Lao PDR is no exception to this trend with a real exchange rate appreciation of 3.5% on average due to foreign capital inflows during a period of three years (Kyophilavong and Nozaki, 2015). Another study found that the real exchange rate appreciation negatively affected the price competitiveness of the garment industry, one of the major non-resource tradable sectors, although these firms benefitted nonetheless from technological upgrading (Nolintha, 2015).

Another feature of natural resource endowments is the risk they pose in terms of encouraging rent-seeking behaviour and corruption instead of entrepreneurial and value-adding activities (OECD, 2015b). In Lao PDR, large investment projects in natural resource sectors are subject to concession agreements, usually negotiated on a case-by-case basis between the government and the investors, as explained in subsequent chapters of the report. This approach allows private investors to receive strong protection provisions from these agreements, but it has also generated opportunities for rent-seeking among dealmakers and facilitators while discouraging structural reforms in the wider investment climate (World Bank, 2014). These deals typically encompass generous tax incentives, which generate significant revenue losses for the government although, as explained above, they constitute one of the main expected benefits from natural resource-seeking FDI. The examples of Chile and Botswana show that good governance and strong institutions are key ingredients to successfully realise the potential contribution of natural wealth to socio-economic development (Box 1.1).

The contribution of foreign investment to employment has been limited and can also be explained by the nature of FDI projects (Nolintha, 2015). Many MNEs operating in the natural resource sectors in Lao PDR either bring foreign labour for the construction of their projects or hire local workers but mostly for low-skilled jobs and during a limited period of time. As the authorities devote considerable efforts and sometimes resources to attract large foreign investors, domestic SMEs tend to feel, if not left out of the government's attention, sometimes discriminated in favour of large foreign companies.[5]

Box 1.1. **Avoiding the "resource curse": The case of Botswana**

Botswana is a sparsely populated, arid, landlocked country. At independence in 1966, it was one of the world's poorest countries, with per capita income of just USD 70 a year. In the first few years following independence, about 60% of current government expenditure consisted of international development assistance. There were only 12 kilometres of paved roads, and agriculture (mostly cattle farming for beef production) accounted for 40% of GDP. About 40 years later, in 2007, Botswana had 7 000 kilometres of paved roads, and per capita income had risen to about USD 6 100 (equivalent to USD 1 000 in 1966 prices and USD 12 000 at purchasing power parity), making Botswana an upper-middle-income country, comparable to Chile or Argentina.

Botswana's extraordinary growth was fuelled by minerals, particularly diamonds, but underpinned by good governance. The government established respect for property rights and the rule of law. It maintained a high degree of transparency, which was reinforced by continuing the Tswana tribal tradition of consultation. In addition, the first post-independence government made two key decisions: it passed a Mines and Minerals Act that gave all mineral rights to the state rather than to the tribal authorities and renegotiated a deal with the mining firm DeBeers in 1975, which allocated half of all net profits from diamond mining to the state. Also, Botswana did not adopt a policy of import substitution, nor did it expand the extent of state-owned producing entities.

The ensuing revenues for the government, primarily from diamond exports, were channelled into investments in education, health care and infrastructure, while tight fiscal control was maintained. A contributing factor has been the creation of a set of fiscal rules – a Sustainable Budget Index – to avoid deficits. In particular, government expenditure must stay in line with non-mineral fiscal revenues in order to make sure that key government functions can be kept up in case of a downturn in the commodity sector. A similar mechanism is in place in Chile.

Source: OECD (2015b) based on "Botswana's Success: Good Governance, Good Policies, and Good Luck", in *Yes Africa Can, Success Stories from a Dynamic Continent*, World Bank.

Similarly, resource-seeking FDI is usually capital- and technology-intensive, limited in time and conducted in isolation, thus generating few spillovers and business linkages with domestic companies (Farole and Winkler, 2014). It is usually considered that market-seeking and efficiency-seeking FDI tend to generate more linkages, except, in the case of the latter, if they are exclusively motivated by cheap labour and focused on assembly and export activities. These tendencies are not set in stone and policies can be implemented to facilitate linkages and enhance the development impact of FDI (see Chapter 5 on investment promotion and facilitation). Lastly,

resource-seeking FDI are particularly likely to have potentially harmful consequences if not conducted with due diligence. Mining, hydropower and forestry investments in Lao PDR have important social and environmental implications, and for which responsible business conduct by MNEs is a key component for making investment work for development (see Chapter 6 on responsible business conduct and Chapter 8 on investment framework for green growth).

In parallel, SEZs have been developed to meet the development objectives of the government, which gave more importance to SEZ development in its Seventh NSDEP for 2011-15. Since Savan-Seno – the first zone in the country – was established in 2002, SEZs have attracted numerous FDI projects, mostly relatively small if compared to natural resource based investments, but in higher value-added sectors such as manufacturing and logistics. The Secretariat of the National Committee for Special Economic Zones estimates that, as of mid-2015, 213 companies invested USD 1.2 billion and that approximately 10 000 workers were employed in SEZs – although the proportion of Lao citizens among these workers is unknown.

It is difficult to assess the developmental impact of FDI in SEZs, but foreign investments in zones generally create direct jobs and, under certain conditions, can help a country diversify its economy and participate in global or regional value chains. The success of Savan-Seno is a good illustration of this contribution, as the zone has managed to attract world-class MNEs and integrate regional production networks with Thailand, notably as part of the production defragmentation of large companies based in Thailand (Kyophilavong and Nozaki, 2015; Nolintha, 2015). SEZs usually tend to stimulate few linkages with domestic firms, however, as explained above. Working conditions in Lao SEZs and their social and environmental implications are not closely scrutinised and the results are uncertain.

Notes

1. www.eastasiaforum.org/2014/08/09/after-joining-the-wto-whats-next-for-laos/. The ten sectors are the following: business services; courier and telecoms; construction; distribution; private education; environmental services; insurance; banking; private healthcare; tourism; and air transport services.
2. This phenomenon is known as the "Dutch disease", which occurs when capital inflows lead to real exchange-rate appreciation that negatively impacts the production and export of tradable goods.
3. Mining companies are often broken down into two categories: juniors and majors. The former are mining companies of a limited size and mostly involved in exploration activities. The latter are usually larger and involve more activities along the chain, including building and running mines.
4. CLMV countries include Cambodia, Lao PDR, Myanmar and Viet Nam.
5. An assessment based on interviews conducted as part of this Review.

References

ASEAN (2014), *ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains*, Jakarta.

Economist Intelligence Unit (EIU) (2015), *Country Report: Lao PDR*, June 2015, London.

Farole, T. and D. Winkler (2014), *Making Foreign Direct Investment Work for Sub-Saharan Africa: Local Spillovers and Competitiveness in Global Value Chains*, World Bank, Washington.

International Monetary Fund (IMF) (2015), Lao People's Democratic Republic. 2014 Article IV Consultation – Staff Report, Washington.

Kyophilavong, P. and K. Nozaki (2016), "Effect of FDI on Lao Economy and its Challenges", in *Progress Report on the Potentials on the Indochina Economic Zone*, ESRI.

Nolintha, V. (2015), The Effects of FDI on Economic Growth and Inequality in Laos, Reitaku University.

OECD (2016), *Economic Outlook for Southeast Asia, China and India 2016: Enhancing Regional Ties*, OECD Publishing, Paris, http://dx.doi.org/10.1787/saeo-2016-en.

OECD (2015a), *Policy Framework for Investment, 2015 Edition*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264208667-en.

OECD (2015b), *OECD Economic Surveys: Indonesia 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-idn-2015-en.

OECD (2013), *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, OECD Publishing, Paris, http://dx.doi.org/10.1787/saeo-2014-en

UNCTAD (2015), *World Investment Report 2015: Reforming International Investment Governance*, Geneva.

US Department of State (2015), *Investment Climate Assessment: Lao PDR*, Washington.

World Bank (2014), *Investment Climate Assessment 2014: Policy uncertainty in the midst of a natural resources boom*, Washington.

World Bank (2015), *Lao Economic Monitor: Towards Restoring Macroeconomic Stability and Building Inclusive Growth*, Washington.

World Economic Forum (2016), *The Global Competitiveness Report 2016-2017*, Geneva.

Chapter 2

The legal framework for investment in Lao PDR

This chapter provides an overview of Lao PDR's legal framework for investment. It examines the law-making process as well as the quality of the country's investment policies and the level of legal protection granted to both domestic and international investors. Particular attention is given to the Law on Investment Promotion and recommendations and its recent amendment. The chapter also looks into the rules for expropriation, the framework for protecting intellectual property rights and the legal regime for land property rights. The adjudication of commercial and investment disputes, including through arbitration, and Lao PDR's investment treaty practice, including its relation to ASEAN practice, are also addressed.

Summary

The investment policy and vision of the government is reflected in the laws, regulations and policies relating to the admission of investors, the rules governing established investment, and the protection of their property. Both domestic and foreign investors need to know that their rights and property will be respected. By enhancing investor confidence, sound investment protection guarantees are likely to increase both the level and the quality of investment, as well as its durability and contribution to economic development.

Laws and regulations in Lao PDR sometimes lack clarity and overlaps across various related regulations are commonly encountered. Laws are not always easily accessible and often lack official English translations. The lack of transparency in regulations and in administrative practices is often coupled with an uneven and inconsistent application of laws across administrative bodies and provinces. To the extent possible, it is essential to ensure that the legal and institutional infrastructure is built upon a general principle of rule of law. Any ambiguity in the legal system would also open the door for corruption.

The implementation of laws, including promptly adopting the implementing decrees, is the main challenge encountered in the ongoing reform process of Lao PDR. Even well-drafted laws will have little positive impact if not properly implemented. Likewise, draft laws and regulations are not sufficiently made available to the public for feedback. Recognising these challenges, the government passed a *Law on Laws*, also referred to as the *Law on Making Legislation,* in 2012. It provides that all laws must be available on the official gazette website, as well as providing for a clear hierarchy of the various regulatory instruments and clarifying which ones should prevail. Public consultation also became a legislative requirement, testifying to the government's commitment to improving the regulatory infrastructure. Drafting laws in a transparent and inclusive process helps ensure the buy-in of all stakeholders to the reform.

The government also suffers from a lack of capacity, particularly at provincial level, which impedes the effective application of investment regulations. Building more capacity within the government on technical matters is essential for modernising the legal and institutional infrastructure for investment.

The first FDI law was enacted in 1986. After successive amendments, the 2009 *Law on Investment Promotion* provided a single regulation governing both domestic and foreign investment under the same umbrella. Building upon improvements already achieved, the government has recently

amended its investment law to further align it with international good practices, the ASEAN Comprehensive Investment Agreement and WTO commitments. Strong attention will need to be given to the coherence of its provisions with other interacting laws and regulations. Effectively implementing the provisions of the *Law on Laws* would greatly help to ensure that the consistency of the overall legal framework is preserved.

The recent amendment of the *Law on Investment Promotion* provided an opportunity to take a clearer policy stance in favour of private sector development – creating the conditions for further transitioning towards a market-based economy. The new version of the law addresses some of the weaknesses of the earlier one but still does not provide enough legal predictability and security to investors or sufficiently strengthen the legal environment for investment. It remains to be seen how much clarity will be provided by the implementing decrees.

Good enforcement procedures enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. When procedures for enforcing contracts are overly bureaucratic and cumbersome or when contract disputes cannot be resolved in a timely and cost effective manner, companies may restrict their activities. Commercial and investment arbitration is not yet widely developed in Lao PDR. Although arbitration remains costly and therefore not easily accessible for smaller businesses, it is often favoured by the business community to bypass difficulties commonly faced when bringing dispute cases before domestic courts, given delays in the resolution of cases.

Recognising the shortcomings of the existing *Land Law* and its lack of implementation, the Land Administration Department, under the Ministry of Natural Resources and Environment, is currently revising the law to improve and streamline the land titling system and to reduce the number of land disputes. Although improving the existing legislation is undoubtedly much needed, amending the law will not be sufficient to overcome implementation challenges. Building institutional coherence and capacity to improve the management of the land titling and certificate system should remain the priority.

While still weak, intellectual property (IP) protection is steadily improving. Starting from a virtually non-existent regulatory framework, the authorities are making strong efforts to progressively bring their IP legislative and institutional framework in line with their international commitments. Establishing the Ministry of Science and Technology in 2011 was a positive step in this direction. There are no specialised IP courts yet and the issuance of the IP dispute decree, which will define administrative remedies, is still pending.

Lao PDR has a broad network of international investment agreements, both stand-alone treaties and investment chapters in broader free trade agreements. Like its ASEAN peers, Lao PDR's recent investment treaty policy has in many cases been driven by a new regional dynamic. In parallel with its multilateral approach, the government aims to build and adopt an increasingly informed and cautious approach to negotiating international investment agreements.

Policy recommendations

- The government should work towards building a strong and inclusive law-making process. The drafting of laws and decrees, including the new land law and IP implementing decrees, should follow a transparent, consultative process to ensure the buy-in of all stakeholders.
- The clarity and accessibility of the legal framework is key to building a favourable business climate. The government should further improve access to laws and regulations, avoid ambiguities in legal language that leave room for inconsistent interpretations and arbitrary administrative practices, and ensure that official translations of the law into English are made available to investors.
- For the ongoing reform process to be successful, it is essential to ensure that the enactment of new laws is promptly followed by the adoption of implementing decrees.
- The government suffers from a lack of capacity at all levels of government, particularly at provincial levels, which impedes the application of investment regulations. Training, capacity-building and awareness raising programmes in administrative bodies at central and provincial levels would help to close the capacity gap.
- Improving the mechanisms for enforcing contract and property rights and for settling disputes is a building-block of the continuing modernisation reform. The independence of the judiciary should be reinforced and alternative dispute resolution means, particularly commercial and investment arbitration, could be further developed.
- Lastly, the authorities could give further impetus to the reform efforts towards bringing the country further in line with its ASEAN commitments. In parallel, they should continue adopting a consistent investment treaty approach aligned with national development objectives and international commitments.

Regulatory reforms for Lao PDR's transition towards a market-based economy

A cornerstone of the enabling environment for investment, alongside investment facilitation, is the regulatory framework for investment. The investment policy and vision of the government is reflected in the laws, regulations and policies relating to the admission of investors, the rules once established and the protection of their property. The investment policy framework relates not only to the rules regulating domestic and foreign investment, but also, and increasingly, to the measures introduced to enhance the contribution of investment to sustainable development. Prospective investors take into consideration the transparency and predictability of policies, as well as guarantees of legal security. Both domestic and foreign investors need to know that their rights and property will be respected. By enhancing investor confidence, sound investment protection is thus likely to increase not only the levels, but also the quality, of investment, its durability and its contribution to economic development.

The pace of modernisation of economic legislation gathered momentum during the years preceding Lao PDR's accession to the WTO in 2013. Further regulatory reform is needed to create a regulatory environment that translates the government willingness to evolve from a centrally-controlled to a market-based economy and hence to attract more and better investment. A small, landlocked country, Lao PDR cannot afford to hobble its economy with weak regulatory infrastructure. Committed to attract better quality and job-intensive investment, the authorities are engaged in important modernisation efforts to create an enabling business environment.

Lao PDR enacted its first FDI law in 1986. The investment legislation was then amended three times in 1994, 2004 and 2009. With the 2009 *Law on Investment Promotion*, Lao PDR made an enormous leap forward which endowed it with a single regulation governing both domestic and foreign investment under the same umbrella, hence moving closer to the standards set in the ASEAN Comprehensive Investment Agreement (ACIA). The 2016 amendment to the law further improves some elements of the 2009 law.

In this ambitious endeavour, Lao PDR is grappling with tremendous challenges: the existing legal infrastructure is scattered across overlapping and inconsistent laws; and when modern pieces of legislation are enacted, their implementation often proves difficult. Administrative practices and mindsets hardly keep pace with the regulatory reforms initiated in the past years. To create the conditions for a successful transition towards a more liberal economy, Lao PDR will hence need to take a clear policy stance in favour of private sector development. When not justified for specific public policy reasons, restrictions to investment should be progressively reduced;

and basic guarantees of protection of property rights should be provided in an unambiguous manner. Fundamental rights, such as the right of appeal and enforcement of awards, also need to be promptly enhanced for Lao PDR to reposition itself as a safe investment destination.

Table 2.1 compares Lao PDR and its ASEAN peers in where they stand in introducing what are considered to be the key pillars of a healthy investment regulatory climate. It looks at the successive legal amendments undertaken by ASEAN member states, and identifies which countries have enacted a single law covering both domestic and foreign investment, compares the core protection provisions for investors and looks at whether countries have adopted a positive or a negative list approach to the entry of foreign investment. The availability of arbitration, as well as adherence to international investment treaties, are also included. This table gives a brief overview of how Lao PDR positions itself compared to its neighbours and of the areas that need to be further improved to bring the country closer to the standards set in ASEAN instruments.

Enhancing the rule of law in the law-making process

Investment implies a commitment of resources in the present for an uncertain return in the future. While commercial risk is a natural part of doing business, unforeseen policy changes can also have major implications for the viability of a project. Policy predictability is one of the most commonly cited concerns of investors in surveys in all countries. Regulatory risk can be mitigated by governments by providing greater certainty for investors through transparency and consultations when policy reforms are undertaken and in the way any potential disputes are handled. Investors care about regulatory risks. They are anticipated through higher hurdle rates for a project and translate into lower efficiency even if the investment goes ahead because of high expected returns. To the extent possible, it is hence essential to ensure that the legal and institutional infrastructure is built upon a general principle of rule of law (Box 2.1).

Table 2.1. **Comparison of ASEAN members' investment frameworks**

	BRN	KHM	LAO	IDN	MYS	MMR	PHL	SGP	THA	VNM
A single investment law covers domestic and foreign investments	No, but 2001 Investment Incentives Law	Yes	Yes	Yes	No	Yes	2 investment-related laws	No	2 investment-related laws	Yes
Recent amended the investment legislation		Ongoing	Ongoing	2007		2012, 2013, 2015	1987, 1991		2000	2005 -14
Provision on environmental impact, sustainable economic development, etc.	No	No	Yes	Yes	No	Yes		No		
Non-discrimination at post-establishment stage guaranteed in domestic legislation	No	Yes, except for land	Yes	Yes	No	No	Yes	Yes	No	Yes
Negative list approach	/	/	Yes, but unclear	Yes	/	Yes	Yes	/	Yes	Yes
Protection against expropriation	Yes, but not only investors	Yes, but incomplete	Yes	Yes	Yes	Yes	Yes	Yes	Yes, but incomplete	Yes
Guarantee of free transfer of funds provided by law	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Possible recourse to investment arbitration provided by law	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adherence to ICSID Convention	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Signed but not ratified	No
Adherence to New York Convention	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
BITs, FTAs, other IIAs in place	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: OECD compilation.

Box 2.1. **Elements of the rule of law**

1. The law must be accessible, intelligible and predictable.
2. Questions of legal right and liability should ordinarily be resolved by application of the law and not the exercise of discretion.
3. The law should apply equally to all, unless objective, clearly stated differences justify discrimination.
4. Ministers, officers of the courts and public officers at all levels must exercise the powers conferred on them in good faith, fairly, for the purpose for which the powers were conferred, without exceeding the limits of such powers and not unreasonably.
5. The law must afford adequate protection of fundamental human rights, as well as property rights.
6. Adjudicative procedures provided by the state should be fair and conducted without prohibitive cost or inordinate delay.
7. The state should comply with its obligations in international law as in national law.

Source: Adapted from Bingham (2010).

Recent reform momentum towards a more robust legal infrastructure

From independence in 1975 until the enactment of the 1991 Lao Constitution, there was no constitution and virtually no legislation. The regulatory architecture was mostly composed of decrees, orders issued at various levels of state authorities, with no clear hierarchy to ensure the readability and clarity of the overall framework. Overlapping and conflicting rules, procedures and regulations across levels of government, including between the central and provincial levels, tend to create administrative burdens for investors. Regardless of the administrative structure of the state, international experience shows that some central coordination is essential for successful regulatory governance.

In recent years, the authorities have become more aware of the need for a reliable legal framework to create a broader enabling environment for businesses. A Legal Master Plan was launched in 2009, with the support of UNDP and other international partners, to improve the formulation and implementation of laws and to raise awareness of the existing regulatory framework at all levels of government.

In the same effort to improve the quality of the regulatory framework, the National Assembly adopted the 2011-15 Legal Plan, whereby it committed to adopt 47 new laws and to amend 45 already existing laws (UNDP, 2015). This unprecedented impetus for regulatory modernisation and adoption of market-oriented legislation was prompted by the upcoming WTO accession in 2013. Lao commitments as an ASEAN Member State have also prompted this political momentum to move towards effective public governance. Although there is still a long way to go, the increasing awareness that an effective investment environment needs to be grounded in strong institutions and regulations is a very positive step to encourage investment and reduce the costs of doing business – offering the opportunity to leapfrog to an investment regime in line with international standards. The key prerequisites for investment policy include respect for the rule of law, quality regulation, transparency and openness and integrity. Building strong institutions and enacting well-drafted and coherent laws must go hand-in-hand to help maintain a predictable and transparent environment for investors.

Laws and regulations in Lao PDR often lack clarity, with frequent overlaps across various related regulations. Laws are not always easily accessible, and official English translations of existing laws are often missing. The lack of transparency in regulations and administrative practices results in policy uncertainty and is coupled with an uneven and inconsistent application of law across administrative bodies and regions.

Well aware of these challenges and in an effort to address this major impediment, the authorities passed a *Law on Laws* in 2012, also referred to as the *Law on Making Legislation,* providing that all laws must be available on the official gazette website. Article 80 of that law further stipulates that all pre-existing legislation must be published by the beginning of 2015, which was still not the case as of May 2017. The *Law on Laws* also provides for a clear hierarchy of the various regulatory instruments and clarifies which ones should prevail, by distinguishing between laws of general application and those of special application as well as between decisions, instructions and orders.

The Legislation Department of the Ministry of Justice oversees the law-making process and is responsible for the overall consistency of new laws with existing ones. This mandate proved insufficient to substantially improve the law-making process, so the Prime Minister decided in 2015 to set up a legal department within each ministry, in charge of ensuring the consistency across laws, instead of leaving this responsibility to the Ministry of Justice. Inter-ministerial co-ordination does not function well and line ministries tend to consider the review by the Ministry of Justice as a mere procedural requirement for the draft law to obtain the green light before

being presented to Parliament. To improve the law-making process and ensure better implementation of the *Law on Laws*, line ministries should be required to present their drafts to the Ministry of Justice sufficiently in advance and to take its comments on board before being allowed to present the draft to the Parliament or the Prime Minister Office. Likewise, for greater clarity, the government could consider introducing a sunset clause to automatically abolish redundant legislation.

By its own admission, the Ministry of Justice lacks sufficient resources and capacity to fulfil its mandate. The Legislation Department is often left with an impracticably short timescale to review draft laws. Concerns have also been expressed that civil servants have an increasing tendency to rely excessively on technical assistance provided by international institutions. While it is undoubtedly a positive step towards further integration for Lao PDR to strengthen its co-operation with such institutions, the government needs to do more than just adopting generic model laws. Taking ownership of the drafting process is crucial for successful regulatory reform that responds better to local needs. This again highlights the importance that must be given to building more capacity within the government on technical matters.

Likewise, all draft laws and regulations must be made available to the public for comment (Box 2.2). Introducing this legislative requirement is a very positive signal that the government is committed to improving the regulatory infrastructure. Observers have acknowledged encouraging steps in the preparation of more recent laws, which have followed a more transparent and inclusive process. Law drafting committees at the National Assembly have increasingly taken comments from government as well as non-government stakeholders on board.

An impact assessment regulation, issued in July 2014, requires posting draft laws 60 days prior to their enactment, together with an explanatory note and an impact assessment. The authorities have not started implementing this requirement and it remains to be seen to what extent they are endowed with sufficient powers and capacity to take concrete steps to create the conditions for a clear and predictable regulatory environment. As things stand, consultations with the private sector tend to take place once a consolidated draft is ready, which does not incentivise the authorities to fully take on board comments and suggestions from the business community.

Box 2.2. **Options for implementing regulatory transparency**

- ***Consultation with interested parties.*** The widespread use of consultations reflects a growing recognition that effective rules cannot rely solely on command and control – the individuals and organisations, including from civil society, who have a stake in the rules need to be recruited as partners in their implementation. Consultation is the first phase of this recruitment process. It can also generate information and ideas that would not otherwise be available to public officials. Consultation mechanisms are becoming more standardised and systematic. This effective access by improving predictability and outside awareness of consultation opportunities. There is a trend toward adapting forms of consultation to the stage in the regulatory process. Consultation tends to start earlier in the policy making process, is conducted in several stages and employs different mechanisms at different times. Problems have been noted as well. For example, consultation fatigue – where some organisations are overwhelmed by the volume of material on which their views are requested – has been noted in several countries.
- ***Legislative simplification and codification.*** There is increased use of legislative codification and restatement of laws and regulations to enhance clarity and identify and eliminate inconsistency.
- ***Plain language drafting.*** OECD work has documented that twenty-three member countries require the use of "plain language drafting" of laws and regulation. Sixteen member countries issue guidance materials and/or offer training programmes to help with clearer drafting.
- ***Registers of existing and proposed regulation.*** The adoption of centralised registers of laws and regulations enhances accessibility. OECD work documents that eighteen member countries stated in end-2000 that they published a consolidated register of all subordinate regulations currently in force and nine of these provided that enforceability depended on inclusion in the register. Many countries now also commit to publication of future regulatory plans.
- ***Electronic dissemination of regulatory material.*** Three quarters of OECD countries now make most or all primary legislation available via the Internet.
- ***Review of administrative decisions.*** Transparency in the implementation or enforcement of rules and regulations is as important as the transparency of the rules and regulations themselves. Clear criteria and transparent procedures for administrative decisions, including with respect to investment approval mechanisms, and their possible review can serve to bolster confidence in the regulatory framework for investment.

Source: OECD (2015).

Improvements in this area are crucial and should by no means be viewed as peripheral to broader economic reforms. Experience in other countries has shown that a fair, transparent, clear and predictable regulatory framework for investment is a critical determinant of investment decisions and their contribution to investment. It is especially important for small and medium-sized enterprises (SMEs) and foreign investors, who face more challenges in entering new segments of the economy and are likely to be less aware of regulatory changes, overlaps and loopholes. Uncertainty about the enforceability of lawful rights and obligations raises the cost of capital, thereby reducing investment. Any ambiguity in the legal system also allows scope for corrupt practices. When unclear regulations leave ample leeway to variable interpretations and to arbitrary administrative practices, investors may be more likely to seek to protect or advance their interests through bribery, and public officials may seek undue benefits.

Reform of the investment law presents an opportunity for a more consistent legal framework

The government has recently amended the 2009 *Law on Investment Promotion* to align it with international good practices, ACIA and WTO commitments, as well as to ensure more effective implementation. The success of this amendment will be key to position Lao PDR as a safe and attractive investment destination. The quality of investment policies directly influences the decisions of all investors, be they small or large, domestic or foreign. Property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all.

The 2009 *Law on Investment Promotion* crowned 20 years of successive revisions of the law but, despite undeniable improvements, still suffered from weaknesses that the amendment was intended to address. The experience from other countries shows that gradual regulatory modernisation can be an effective tool for investment climate improvements (Box 2.3). The amendment to the 2009 law was intended to allow Lao PDR to upgrade its legislation in order to fully comply with the standards contained in ACIA, so as to eventually achieve a common legal landscape with the ASEAN region.

With the implementation of the newly-amended law, strong attention needs to be given to the coherence of its provisions with other interacting laws and regulations. Provided that the provisions of the *Law on Laws* are applied, it would greatly help in ensuring that the consistency of the overall legal framework is preserved or even improved.

Box 2.3. **Viet Nam: Gradual improvements in the investment framework since the 1980s**

Viet Nam's experience in building its legal framework over almost three decades reflects how reforming the investment environment is a continuous and evolving process, and how substantial changes in investment laws have further encouraged foreign investment. As part of the *Doi Moi* (Renovation) reform process initiated in 1986, Viet Nam began an open-door policy and enacted the Law on Foreign Investment. As FDI became increasingly recognised as critical for Viet Nam's economic development, the government repeatedly revised the law, in 1990, 1992, 1996, 2000, 2003, and in 2005, with a new Investment Law, which substantially improved the investment environment, and lastly in 2014, with a law aiming to simplify the entry procedures for foreign investment.

The investment framework has gradually improved over the years, although improvements brought about by the successive amendments have sometimes been erratic. Registration procedures, tax policies, rights to transfer abroad capital and foreign exchange and access to land have been progressively relaxed, while the investment environment has been gradually brought in line with Viet Nam's international commitments (ASEAN in 1995, WTO in 2007 and numerous bilateral agreements). The authorities have made major adjustments towards further transparency and stronger protection for foreign investors. The most notable change brought about by the 2005 Investment Law was to regulate both domestic and foreign investment under the same legal umbrella and to state clearly, for the first time, a principle of non-discrimination, ensuring that all investors, both foreign and domestic, are treated equally. Other investment guarantees were also considerably improved: it recognised intellectual property rights, and ensured consistent prices, fees and taxes for all investors. The example of Viet Nam also shows the challenges faced when engaging in a fast-paced regulatory reform programme. The recent amendment of the Investment Law has in some regards weakened and watered-down the strong investment protection provisions that were contained in the former version of the law. Likewise, Viet Nam, despite these impressive improvements, is still facing challenges in the implementation of its regulations.

Despite persistent obstacles, these gradual and iterative reforms of the legal framework brought new waves of FDI into the country. Chien and Zhang (2012) show that the 2005 Investment Law substantially increased the amount of registered FDI capital. Viet Nam's experience also illustrates that major changes in the policy framework over time, such as introducing non-discrimination principles, offering legal stability, and improving investment guarantee measures, contributed to raising not only the amount but also the quality of FDI inflows into Viet Nam.

Source: Chien and Zhang (2012).

Stakeholders tend to agree that the main weakness of the 2009 *Law on Investment Promotion* was not to be found in the provisions of the law itself, but rather in its poor implementation. This has largely hampered the positive impact that was to be expected of the impressive legislative reforms undertaken in the past five years. It is difficult for businesses to comply with regulations whose application is subject to variable and sometimes arbitrary interpretation. If this issue is not addressed, then the newly-amended law, as good as it can be on paper, is likely to bring very little improvement to the existing investment framework. To maximise its chances of success, the amendment will need to be followed up with ambitious capacity and awareness building efforts across all levels of government. The legal division of the Investment Promotion Department, under the MPI, was in charge of drafting the amendment to the investment law. According to international observers, the extent to which it consulted and co-operated with line ministries to collect feedback and concurrent views is unclear. Without a holistic approach to modernising the legislation, risks are high that the revision will not necessarily bring the expected benefits.

The 2016 amendment to the Law on Investment Promotion

Until recent, investment policy in Lao PDR was translated into legal terms in the 2009 *Law on Investment Promotion* covering both domestic and foreign investment and reflecting an ambivalent policy stance. While it aimed to encourage all types of investment, it did not provide the means to achieve this goal. Core guarantees were missing and the entry of foreign investment was impeded by requirements whose rationale was unclear. The law was amended in 2016 and, as part of this process, the OECD and other international organisations provided suggestions to improve the clarity of core protection provisions. The following section considers how the amendment has altered the investor protection and dispute settlement provisions and where further amendments might be useful in the future.

In order to provide strong guarantees that investors will be treated fairly and without discrimination, the law must not only contain high standards of protection, but also have a clear temporal and material scope. Having clear, unambiguous provisions is essential to provide enough legal predictability and security to investors and to further strengthen the legal environment for investment. Particular attention should be given to the quality of the legal drafting, as well as to the availability of an official translation of the law into English.

Scope of the law

The definitional section of an investment law is crucial, as it determines the scope of the law, and hence the extent of the obligations, rights and guarantees that are provided in the law.

Lao PDR's investment law covers both domestic and foreign investment under the same umbrella, like an increasing majority of its ASEAN peers. Having domestic and foreign investment regulated by the same provisions is commonly considered as good practice as it limits the risk of being perceived as favouring either foreign or domestic investors. It is likely to send a positive signal that the government treats foreign and domestic investors equally, with an underlying principle of non-discrimination. But it also requires clear definitions of the typology of covered investments. Rules that apply only to foreign investors, such as profit repatriation, are provided together with provisions applying to domestic investors only, such as those applying in sectors that are not open to foreign investment, and with provisions applying to both foreign and domestic investors. The law has to clearly delimit categories of investments, in order to provide investors with greater legal predictability, stability and transparency. It is therefore crucial to clearly define "foreign" and "domestic" investment within the law.

The new law has brought further clarification to the definition of domestic companies by explicitly specifying that they must be registered in Lao PDR. It hence aligns with the most common practice, which is to use the place of incorporation of registration of a company to define its nationality. This specification is a substantial improvement compared to the previous law and will help to create an unambiguous and predictable legislative framework for investment. Having a clear typology of investment determines partly under what type of conditions foreign and domestic firms can invest and the scope of application of the list of sectors restricted to foreign investment. Some provisions, special benefits or incentives apply exclusively either to domestic or to foreign investors. Specific rights apply to foreign investors, such as access to international investment arbitration, while domestic investors often only have recourse to domestic courts to resolve investor-state disputes.

While the 2009 law covered direct and indirect investment, the new law has removed the mention of indirect investment. This omission may add further legal predictability as to the material scope of application of the provisions of the law.

Standards of protection for investment

The law gives investors guarantees that they are allowed to invest, manage business operations, hire employees and provides them with a right

of residence and free repatriation of capital. It also contains a provision protecting against unlawful expropriation, as well as a dispute settlement provision (Part X), but, in terms of core standards of protection, it contains only a few general provisions on investor protection.

The law provides for a list of core substantive rights guaranteed to investors, both foreign and domestic. While it does not explicitly provide for a principle of non-discrimination, Article 5 of Part I provides that the government should "ensure equality of investors before the laws of Lao PDR", and Article 22 provides that the "State protects […] equality of all domestic and foreign parties", which might be understood as providing an equivalent level of protection.

A more explicit reference to the principle of non-discrimination might further reassure foreign investors that they are operating in a non-discriminatory and enabling business environment. Affirming the non-discrimination principle in a law is common practice and the government could consider inserting an explicit reference to the principle in its investment legislation, which would apply at a post-establishment phase. It would signal a positive and open investment policy, without prejudice to the possibility for the state to preserve its sovereign right to implement any development policies, by providing exceptions to this principle and lists of restricted sectors.

Beyond substantive investors' rights, the law should, to the greatest possible extent, be easily understandable, with clear and unambiguous legal provisions. It should provide for a predictable and stable legal environment and be consistently and effectively implemented by the relevant bodies. Particular attention must be given to potential inconsistencies of the law with other related laws, as regular issues of inconsistencies and legal loopholes under the earlier law were reported by the private sector. Such confusion would have a detrimental impact on the overall investment climate perception. Provided that the *Law on Laws* is applied, these inconsistencies should progressively recede in the future.

The amendments recently made to the law are likely to progressively bring the domestic regulatory framework in line with the provisions of ACIA, although it is noted that ACIA explicitly provides newer ASEAN member states with a special and differential treatment, permitting them to execute their ACIA commitments in accordance with their stage of development.

Protection against expropriation

The protection against expropriation without fair compensation is one of the most crucial rights of investors. It should be included in the regulatory framework through provisions establishing transparent and predictable procedures. The protection against unlawful expropriation is provided in Article 23: "Forms of protection of Investment", although the article only covers protection against expropriation and not other forms of protection.

As in the 2009 law, the protection provision is stated in broad terms. It is not advisable to use vague terms when protecting against unlawful expropriation, as it can be interpreted in a very broad manner, thus covering indirect expropriation, or measures tantamount to an expropriation. The expropriation provision in the investment law could thus be further detailed, so as to avoid confusion on the scope of protection that it provides, especially with regards to indirect expropriation. Expropriation can take different forms. It can be direct, where an investment is nationalised or otherwise expropriated through formal transfer of title or outright physical seizure or it can occur through interference by a state in the use of that property or in the enjoyment of the benefits even where the property is not seized and the legal title to the property is not affected. The determination, in judicial and arbitral decisions, on whether governmental interference with the economic activity of an investor constitutes an indirect expropriation for which compensation should be paid is made on a case-by-case basis.

If the government wishes to protect against indirect forms of expropriation, the scope of the indirect expropriation should be defined in order to clearly designate the scope of protection Some recent laws provide that, except in rare circumstances, non-discriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute expropriation. While it is legitimate to preserve the non-discriminatory exercise of their regulatory power, the authorities should provide for explicit limits on their ability to expropriate.

It is important to ensure that the expropriation protection provision is consistent with international standards of protection, so as to avoid creating legal gaps between the levels of protection granted in these laws and the one provided through investment treaties as well as in ACIA.

Investors' obligations

The investment law contains, in Chapter 2 of Part VI, an extensive section that imposes obligations upon investors, which is more detailed than what is commonly encountered in investment laws. In addition to general obligations binding upon investors, Article 73 is fully dedicated to investors'

social obligations and Article 74 to environmental obligations. The incorporation of such well-delineated investor obligations places Lao PDR at the forefront of a more innovative legal practice that aims to strike a better balance between investors' rights and obligations. Few laws on investment contain such a set of obligations binding upon investors. Their inclusion brings the legislation closer to international standards for responsible business conduct, such as those contained in the OECD *Guidelines for Multinational Enterprises* (see Chapter 6 on responsible business conduct). Regardless of what is included in this provision, investors remain bound by other obligations, enshrined in other laws, such as the environmental law.

Dispute resolution

Part X provides for dispute settlement mechanisms. While it partly addresses the lack of clarity of the previous provisions, it retains some ambiguities with regards to the conditions upon which investors can have recourse to the different options available to solve investment disputes.

Four options are provided to resolve investment disputes: through amicable means, through "administrative dispute resolution", "dispute resolution by the Committee for economic dispute resolution or an international organisation to which Lao PDR is a party"; and "filling of a claim or litigation to the domestic courts or an international court to which Lao PDR is a party". The amended law has not addressed the lack of clarity underlying the term "dispute resolution related to investment". It is our understanding that it relates only to investor-state disputes, *i.e.* disputes between an investor, whether domestic or foreign, and the state authorities. It would be useful to clarify that this provision is not meant to cover disputes arising out of an investment between two private parties, nor commercial disputes. Likewise, it might be useful to clarify whether the options are all equally available to domestic and foreign investors, or whether some options are available only either to domestic or foreign investors.

Regardless of whether or not the authorities wish to open access to investor-state arbitration, it is essential to provide for clear and detailed provisions on dispute resolution, so as to avoid any difficulties of interpretation of the provision.

Dispute settlement mechanisms

According to representatives from the legal sector and government officials by the own admission, Lao PDR's judiciary is not endowed with sufficient capacity to efficiently deal with commercial disputes. It is crucial to further empower the domestic adjudication of disputes and to strengthen the independence of the judiciary.

Good enforcement procedures enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. When procedures for enforcing contracts are overly bureaucratic and cumbersome or when contract disputes cannot be resolved in a timely and cost effective manner, companies may restrict their activities. In the context of investment policy, investors also need mechanisms to enforce the obligations of the host state. Enabling the judicial and legal framework to resolve disputes efficiently and fairly, whether before courts or through arbitration, is an absolute priority to reinforce Lao PDR's investment climate.

As further developed in the section below, the government could also consider the possibility of providing access to arbitration mechanisms as an alternative mechanism to solve investment disputes. Although arbitration remains costly and therefore not easily accessible for smaller businesses, it is often favoured by the business community to bypass difficulties commonly faced when bringing dispute cases before domestic courts, given delays in resolving cases. In most countries, arbitration plays a primary role as an alternative dispute resolution mechanism, to settle disputes between foreign investors and host states. While it is not advisable to grant investors an automatic right to bring any investor-state dispute settlement (ISDS) case before international arbitration by providing a unilateral consent to arbitration in the investment law itself, the authorities could consider the option of merely opening the possibility for the parties to agree to arbitration, based on an agreement between the disputing parties. It would be a cautious approach, as it would show a pro-arbitration stance, often needed to reassure foreign investors, without overcommitting or surrendering too much regulatory leeway.

Dispute resolution before domestic courts

The court system has a fundamental role in enforcing contracts and settling disputes, both among private actors and between an investor and the state. Stakeholders and observers tend to agree that the judiciary suffers from a lack of independence and autonomy from the executive and complain that the reasoning behind judgments and the availability of an appeals mechanism are opaque. It is, for example, not possible to challenge administrative measures of expropriation in court. Meanwhile, according to private sector representatives, awards rendered by the Supreme Court, while they cannot be subject to appeal, can be informally contested before the National Assembly. At a last resort, complainants, if dissatisfied with the decision of the National Assembly, can bring their cases to the State Prosecutor, who can in turn overrule the decision taken by the National Assembly. This rather incongruous process raises a potential issue of a lack

of a clear delineation of responsibilities among the judiciary, the executive and the parliament. Moreover, although commercial courts have been established, in practice most judges adjudicating commercial disputes lack knowledge of the specificities of commercial law and amicable dispute settlement mechanisms, especially at local level, are still preferred by businesses.

As a result, the reputational risks of having to deal with the court system are very high, and investors tend to favour non-judicial means of dispute settlement. Alternative dispute resolution mechanisms, including arbitration, mediation and conciliation, are increasingly favoured by investors for resolving domestic commercial disputes. Foreign investors can also include provisions for international commercial arbitration in their contracts with Lao public agencies. Yet, the infrastructure for commercial arbitration is weak as well and choosing arbitration is by no means a guarantee to see one's rights efficiently enforced.

Resolving economic disputes domestically

The *Law on the Resolution of Economic Disputes*, passed in 2010, governs mediation and arbitration mechanisms that are implemented at the Economic Dispute Resolution Centre (EDRC) which was created within the Ministry of Justice in 1995. Prior to the EDRC, the MPI had an office in charge of settling investment disputes. By virtue of the law, EDRC uses arbitration and mediation means to settle economic disputes. It is composed of 16 arbitrators at central level, appointed by the Ministry of Justice, and is deployed in nine provinces. By the members of EDRC arbitrators' own admission, the allocation of tasks between central and provincial levels of EDRC is unclear and the functioning of EDRC suffers from serious capacity issues. The lack of a clear architecture within EDRC has partially resulted from a recent decentralisation process, by virtue of which the appointment of provincial arbitrators is now the responsibility of provincial authorities.

EDRC's mandate and status are quite unusual. While it claims to solve disputes through arbitration, it has none of the characteristics of an arbitration body. Firstly, it is fully integrated within the Ministry and has no autonomy. Secondly, it is mandatory to go to EDRC to solve economic disputes through arbitration before being allowed to go to courts or international arbitration. It is hence closer to a proto "first instance" adjudication body. Lastly, EDRC is not competent to deal with intellectual property and land disputes, and the material scope of economic disputes that must be settled before EDRC is largely unclear.

EDRC deals with disputes between domestic investors and between domestic and foreign investors. For disputes opposing investors against the

state, it is not clear in which circumstances they must be presented before the EDRC, and there seems to be no clear guidelines for EDRC arbitrators to have a clear understanding of whether both domestic and foreign investors have to bring their dispute cases against the state to the EDRC before going either to international arbitration or to domestic courts. This confusion over the scope of its own mandate can largely be explained by the fact that the dispute settlement provision of the law does not apply to big investment projects. In practice, investors comply with the dispute settlement provisions of contracts that they have concluded bilaterally with state authorities, and therefore do not abide by the legal requirement to bring their disputes before EDRC.

It is in theory mandatory to seek first amicable settlement of disputes before the administrative authority that has issued the contentious decision, and, at a second stage, to go to EDRC. Only then can investors go to domestic courts or arbitration, depending on whether they benefit from a contractual clause. Yet in practice, investors often bypass this process and bring their dispute cases directly to arbitration or to courts. A better regulatory and institutional infrastructure will help to sanction more efficiently the violation by businesses of their administrative obligations. Meanwhile, it is even more important to endow the EDRC with sufficient resources and a team of dynamic, well-trained professionals to encourage businesses to bring their disputes before it for arbitration and mediation.

Owing to these shortcomings, stakeholders all agree that the creation of private arbitration bodies is the way to go to improve the investment environment. The Lao National Chamber of Commerce and Industry (LNCCI) has proposed to the government to set up an arbitration body under its auspices to deal with domestic business arbitration. In the meantime, there is virtually no mechanism for domestic arbitration. In the event the LNCCI sets up an arbitration body, the Ministry of Justice would still be in charge of enforcing arbitral awards, and it remains to be seen whether it would actively support enforcement of such awards.

Establishing a dispute prevention mechanism

No dispute prevention mechanism exists in Lao PDR to prevent investment claims from escalating into international arbitration proceedings. Given the complexity of the current architecture and procedure for settling investment disputes, there is a strong case for establishing a formal dispute prevention and early alert mechanism and setting up an “Ombudsman” inter-ministerial team to forestall potentially very costly international arbitration proceedings that may stem from investor-state disputes.

Early alert mechanisms for preventing disputes are increasingly used in many countries, notably in Asia. Under such mechanisms, relevant government bodies would be required to share any information they have on potential emerging investment disputes to a designated co-ordinator within one ministry. This early warning mechanism to central authorities allows for early and coordinated action to be taken. Part of the mandate of the appointed team would typically involve centralising information on the legislation, contracts and international investment agreements applicable to the cases. It would also keep track of all commitments made by the state and provide guidelines for the negotiations of dispute settlement processes. Such initiatives could also be envisaged as a part of a broader effort to optimise the implementation of the *Law on Laws*, which requires a more coherent institutional coordination on investment regulations.

Investor-state dispute settlement

In the event of a dispute opposing a domestic investor and involving the MPI, there are no appeals mechanisms and the only available recourse is to contest the decision before the Ministry itself. It is not possible to challenge administrative decisions before an independent body or court. Foreign investors who are covered by the provisions of bilateral investment treaties (BITs) have recourse to international arbitration to solve their disputes against the state. Such cases are typically brought either before *ad hoc* international arbitral tribunals following the United Nations Commission on International Trade Law (UNCITRAL) procedural rules or, more commonly, before regional arbitration centres such as the Kuala Lumpur Regional Centre for Arbitration. On the state's side, the MPI supervises an *ad hoc* inter-ministerial committee in charge of leading the defence of Lao PDR in ISDS cases.

Lao PDR is a party to the *New York Convention on the Enforcement and Recognition of Foreign Arbitral Awards,* an internationally recognised instrument of international arbitration, requiring courts of contracting states to give effect to arbitration agreements and to recognise and enforce awards made in other states, subject to specific limited exceptions. Domestic courts have the obligation to enforce foreign arbitral awards as if they were domestic awards, with very few legal grounds on which to refuse such an enforcement (such as in case of non-arbitrability of the dispute matter). Yet, domestic courts too often do not abide by its provisions and tend to automatically review foreign arbitral awards. As a result, it is often difficult to obtain enforcement of an arbitral award obtained in a foreign jurisdiction. The enforcement of foreign arbitral awards therefore remains largely subject to uncertainties.

Since Lao PDR is one of the last ASEAN countries, with Myanmar and Viet Nam, not to have adhered to the 1965 *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, ICSID tribunals are not available for foreign investors. The authorities do not seem to be well aware of the implications and potential benefits of becoming a party to the ICSID Convention (Box 2.4). From an investor's view, the availability of ICSID arbitration could reduce the risk of investing in a given country. Since ICSID is a self-enforceable system, giving investors the option of recourse to ICSID arbitration could improve the perception of Lao PDR as a jurisdiction where investors can safely seek enforcement of arbitral awards.

Box 2.4. **Recognition and enforcement of arbitral awards**

For disputing parties it is important to know that decisions and awards of arbitral tribunals will be enforced. The international community has developed specific institutions and rules to enforce arbitration awards. Lao PDR is a party to the *New York Convention* and has not adhered to the *ICSID Convention*. Both agreements increase investor confidence that arbitral awards will be recognised and enforced effectively. The newly amended *Law on Investment Promotion* explicitly reaffirms that foreign or international arbitration awards would be recognised and enforced, in accordance with the provisions of the *New York Convention*.

The *New York Convention* is the leading international treaty applicable to commercial arbitration. It addresses the recognition and enforcement of foreign arbitral awards (*i.e.*, those made in a country other than Lao PDR) and for certain awards made in Lao PDR. The national courts of contracting parties to the *New York Convention* must generally recognise arbitration awards rendered in other contracting parties, subject to narrow exceptions, and enforce the awards in accordance with their rules of procedure. Since Lao PDR is a contracting party to the *New York Convention*, investors that have prevailed in arbitral proceedings know the conditions under which the awards will be recognised and enforced in Lao PDR. The *New York Convention* also facilitates the recognition and enforcement of domestic awards in third countries that are party to it.

The *ICSID Convention* addresses both the arbitral proceedings and the enforcement of awards rendered under these proceedings. The recognition and enforcement of ICSID awards is governed by the *ICSID Convention* itself rather than the *New York Convention*. The ICSID regime is thus more self-contained in this respect, and ICSID awards cannot be reviewed by national courts of the country in which their enforcement is sought, whereas the *New York Convention* permits national courts to refuse the enforcement of awards *i.a.* for reasons of public policy.

Access to land ownership

The Land Administration Department, in the Ministry of Natural Resources and Environment, is responsible for formulating and implementing land policy. It is composed of seven divisions: administration, state land, leases and concessions, legal, land disputes, registration and surveys. The institutional framework has changed significantly over time. Initially under the authority of Ministry of Finance, the Land Administration Department was then moved to the Prime Minister's Office, before being transferred to the Ministry of Natural Resources and Environment in 2012. These frequent changes may have resulted in a further lack of institutional memory and capacity within the land administration. Moreover, co-ordination between the Land Administration Department and the Land Allocation Department, which is responsible for issuing licences and certificates, is fraught with difficulties and land administrative measures are in practice often not compliant with the provisions of the land law.

Under the current regime, foreign investors can lease land for a maximum period of 50 years. In principle, investors can lease land if the land parcel is allocated by the government. Yet in practice, the government has not allocated any land parcel to foreign investors, who as a result access land through leaseholds directly concluded with private domestic owners. In parallel to the provisions of the *Land Law*, articles 15 and 16 of the newly amended *Law on Investment Promotion* provide for specific incentives related to land use.

A first land law was issued in 1997, before being revised in 2003. Recognising the shortcomings of the existing law and its lack of implementation, the Land Administration Department is currently revising the land law to improve and streamline the land titling system and to reduce the number of land disputes. It will also introduce two new categories of land, community land and communal land. According to the land authorities, the upcoming law also plans to substantially open the land regime to foreign investment, by allowing full ownership of land for foreign investors during the validity period of the investment certificate. The new legislation should also provide for *ex ante* and *ex post* environmental and social impact assessments for land acquisitions exceeding a certain area to ensure that land allocations follow a transparent and inclusive process. But while improving the existing legislation is undoubtedly needed, amending the law will not be sufficient to overcome implementation challenges. The absolute priority remains to build institutional coherence and capacity to improve the management of the land titling and certificate system.

Land use rights cannot be used as collateral. The authorities should consider abolishing this restriction which is very rarely encountered and

constitutes a major impediment to creating the conditions for a vibrant private sector development in Lao PDR. Land titles should allow land rights holders to use land as collateral to access credit.

Further implementing improvements to the land registration and titling system

A large share of land property is not formally registered, which seriously impedes business development opportunities, especially for SMEs. The vast majority of land rights are still transferred in informal markets. The poor record of land registries and the absence of a detailed cadastre foster the current deficiencies in identifying available land parcels. Approximately 30% of land is titled. The land titling system, managed by Land bureaus at provincial level, has been much criticised for discretionary practices. To address these shortcomings, land administration is currently benefitting from technical support from international partners, working closely with the authorities to undertake a survey of land parcels and to grand land titles. The land titling system is also undergoing a full computerisation programme, which is still at an early age. A comprehensive land titling project has been initiated by the Ministry of Natural Resources and Environment but will require substantial efforts.

In the absence of a clear and updated land cadastre and registration system, it is very often difficult to identify whether a land parcel is available or not. The land registers are not properly maintained, which lengthens the time to acquire land tenure rights, increases risks of corrupt practices and makes it difficult to collect taxes. Another consequence of the lack of updated and comprehensive registers is that land disputes are constantly increasing. The creation of specialised land courts would help to tackle this growing issue.

Although land administration is largely decentralised, the central government will have the responsibility to push the reform process forward and to ensure quick enactment of the draft land law to further secure land ownership. Among other reform efforts, it will be crucial to give strong emphasis to improving the land dispute resolution system. Full computerisation of the land titling system will also be needed. Land reform requires a full set of measures, including strengthening of the legal and institutional framework, improving the registration system, and a strong governmental commitment to project implementation (Box 2.5).

Box 2.5. **Thailand 20-year programme to title rural land**

In 1982, the Thai government began a 20-year project to title and register farmland throughout the kingdom. The aim was to enhance farmers' access to institutional credit and increase their productivity by giving them an incentive to make long-term investments. Just over 8.5 million titles were issued during the life of the project. Along with those issued outside the project, the number of registered titles increased from 4.5 million in 1984 to just over 18 million by September 2001. Studies conducted during the project show that it met both its objectives: titled farmers secured larger loans on better terms than untitled farmers, and the value of titled parcels rose appreciably.

The success in Thailand is attributed to several factors;

1. There was a clear vision for the project, a long-term plan to achieve it, and a commitment by the government and key stakeholders to project implementation.
2. A strong policy, legal, and institutional framework was in place for land administration.
3. The project built on earlier efforts to issue documents recognising holders' rights to their land.
4. Registration procedures developed by the Department of Lands were efficient and responsive to public demand.
5. The public had confidence in the land administration system and actively participated in the reform process.
6. The interests that can complicate projects in other countries – public notaries, private lawyers, and private surveyors – were not present.

Source: OECD (2006), Policy Framework for Investment: A Review of Good Practices, OECD, Paris (based on World Bank, World Development Report 2005).

Protection of intellectual property rights

Intellectual property (IP) protection in Lao PDR is weak but steadily improving. Starting from a virtually non-existent regulatory framework for intellectual property, the authorities are making strong efforts to progressively bring their IP legislative and institutional framework in line with their international commitments.

The government enacted in 2011 a new *Law on Intellectual Property* to bring the domestic framework in compliance with the World Intellectual Property Organization (WIPO) and WTO Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreements. A draft copyright law was

also prepared in 2005 but has never been passed, due to the fact that the current IP law contains substantial sections governing copyrights, thus making the need for a standalone copyright law less compelling. The 2011 law consolidates the responsibilities on IP policy under the Ministry of Science and Technology (MOST) and establishes a registration system which is not fully functional, as guiding decrees have yet to be passed. Lao PDR is also a member of the WIPO Convention, the Paris Convention of the Protection of Industrial Property, and has acceded to the Berne Convention on copyrights in 2012. It has committed to join the Hague Agreement but has not yet done so.

Despite major legislative reforms, challenges remain in the enforcement of IP rights

In 2011, a new ministry – MOST – was created by virtue of the new *Law on Intellectual Property* to lead the formulation and implementation of IP regulations. The ministry is responsible for issuing patents, copyrights and trademarks. The establishment of MOST is a very positive step towards creating a well-functioning institutional environment for protecting IP rights. Yet, substantial capacity-building efforts, within MOST and line governmental bodies, will be required to create the conditions for efficiently enforcing the new legislation. Lao PDR is not alone in this process. Other ASEAN states have gone through the same reform process and their experience can inform its current efforts (Box 2.6).

Within MOST, the department of intellectual property is composed of eight divisions: administration and cooperation, the intellectual property service centre, trademarks and geographical indications; patents; copyrights; varieties and plants; IP promotion and development; and lastly, dispute settlement. The dispute settlement division is in charge of issuing administrative sanctions, which is rather uncommon. The management of IP disputes seems to be still in its infancy and, pending the adoption of the IP dispute decree, the authorities are muddling through in establishing mechanisms for the resolution of IP disputes. This is crucial as judges in regular courts have very limited knowledge of IP issues, and the EDRC is not competent to deal with IP cases.

Box 2.6. **IP rights reform in Viet Nam**

Viet Nam has substantially improved its IP system over the past 15 years. The government started by developing an IP Rights Action Plan to bring its IP system in line with TRIPS commitments. IP regulations were first introduced in Viet Nam's legal framework with the entry into force of a new Civil Code in 1995, following which the number of patent applications by foreigners substantially increased. Introducing a new dedicated IP Law in 2005 was a milestone in the reform process and fully implemented the country's TRIPs obligations. As a direct consequence, the number of patent applications increased sharply. In parallel with reform efforts undertaken at a legislative level, the government initiated a "Modernisation of industrial property administration project", sponsored by Japan, as well as a number of sensitisation campaigns to raise awareness on the legal and institutional IP protection framework among the business community. Following these reforms, the number of IP assets, Vietnamese inventions and utility solutions applications in Viet Nam increased dramatically. Dedicated IP courts were created to deal with IP disputes, and capacity-building programmes were undertaken to train specialised IP officers.

Despite this successful reform process and concrete improvements, enforcement of IP regulations is still weak. Although the authorities have shown strong political will to fight IP rights infringements, there remains a problem of trademark counterfeiting and design infringement. Civil, criminal and customs procedures are still regarded as lengthy and poorly implemented. Viet Nam's case is an informative illustration of a successful legal reform process, but also of the imperative to give strong emphasis to enforcing implementation mechanisms, which is a prerequisite for policies and laws to have a real and positive impact.

Sources: www.wipo.int/export/sites/www/about-ip/en/studies/pdf/wipo_unu_07_vietnam.pdf; http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc_143762.pdf.

In the absence of specialised IP courts, and pending the issuance of the IP dispute decree, the mandate of the IP dispute resolution division, as well as its degree of independence, remain unclear. Administrative remedies are still to be defined in more detail in an upcoming decree. In the meantime, the lack of guidance makes it challenging to enforce IP rights and to sanction infringements. There is no system to formally register copyrights. Instead, an automatic protection is reportedly granted, as required by the Berne Convention and the TRIPS Agreement, when the work is created. IP holders can notify claims of copyrights to MOST, but this possibility does not appear to be often used in practice. It remains to be seen whether in practice this system makes it more difficult to produce evidence in judicial proceedings.

Box 2.7. **ASEAN Intellectual Property Rights Enforcement Plan**

Over the past few years, ASEAN has been working towards developing the IP system in the region through the ASEAN Working Group on Intellectual Property Cooperation which was established in 1996 pursuant to the ASEAN Framework Agreement on Intellectual Property Cooperation. It was signed by ASEAN Member States in Bangkok in 1995 and is mandated to develop, coordinate and implement all IP-related regional programmes and activities in ASEAN. Since 2004, its work has been based on the ASEAN Intellectual Property Rights Action Plan, 2004-10, and the Work Plan for ASEAN Cooperation on Copyrights. The Action Plan was formulated "(1) to help accelerate the pace and scope of IP asset creation, commercialization and protection; to improve the regional framework of policies and institutions relating to IP and IP rights, including the development and harmonization of enabling IP rights registration systems; to promote IP cooperation and dialogues within the region as well with the region's Dialogue Partners and organizations; to strengthen IP-related human and institutional capabilities in the region, including fostering greater public awareness of issues and implications, relating to IP and IP rights".

With the acceleration of ASEAN economic integration from 2020 to 2015, the Working Group prepared a new Work Plan as part of the Blueprint of the ASEAN Economic Community (AEC) to reflect the new objective of ASEAN. It builds on the Action Plan, 2004-10, the Work Plan on Copyrights, and the Work Plan under the AEC Blueprint in order to develop an ASEAN IP System that takes into account the different levels of capacity of the Member States, balances access to IP and protection of IP rights, and responds to the current needs and anticipates future demands of the global IP system.

The Action Plan is designed to meet the goals of the AEC by transforming ASEAN into an innovative and competitive region through the use of IP for their nationals and ensuring that the region remains an active player in the international IP Community (ASEAN Intellectual Property Rights Action Plan, 2011-15).

Source: www.aseanip.org/About-Us/ASEAN-IPR-Action-Plan-2011-2015.

The authorities should move ahead without further delay in adopting IP implementing decrees to accompany the important efforts undertaken to establish a comprehensive IP framework. In this endeavour, Lao PDR benefits from various capacity-building programmes, the most important being the Lao PDR–United States International and ASEAN Integration (LUNA) project, which supports the government in building-capacity and raising awareness on IP enforcement. The LUNA project also supports the country in formulating IP laws and policies that are aligned with Lao PDR's ASEAN and TRIPS commitments. Other international partners, including WIPO, ASEAN and Japan, have been very active in organising IP-related

awareness and capacity-building events. Further work is necessary to improve the co-ordination of the IP authorities with line ministries.

At a regional level, Lao PDR is bound by the ASEAN Framework Agreement on Intellectual Property Cooperation and is a member of several regional economic integration treaties that affect the regime for IPs, such as the ASEAN Trade in Goods Agreement. The ASEAN Intellectual Property Rights Enforcement Plan, should continue to support Lao PDR's efforts to build a robust policy framework for the protection of IP rights (Box 2.7).

Intellectual property can have significant value, and hence good registration systems and efficient implementation are crucial. Most importantly, the protection granted to IP needs to strike a balance between the need to foster innovation and competitive markets and society's interests in having new products priced affordably (Box 2.8).

Box 2.8. **The benefits of IP rights in developing countries: The shifting debate**

Traditionally, a limited number of developed countries in which a high proportion of the world's R&D was concentrated were the main "demandeurs" of strong intellectual property rights internationally. Four recent developments are helping to broaden acceptance of the benefits of intellectual property rights. First, more firms in more developing countries are now producing innovative products and thus have a direct stake in protecting intellectual property rights. In Brazil and the Philippines short-duration patents have helped domestic firms adapt foreign technology to local conditions, while in Ghana, Kuwait, and Morocco local software firms are expanding into the international market. India's vibrant music and film industry is in part the result of copyright protection, while in Sri Lanka laws protecting designs from pirates have allowed manufacturers of quality ceramics to increase exports. Second, a growing number of developing countries are seeking to attract FDI, including in industries where proprietary technologies are important. But foreign firms are reluctant to transfer their most advanced technology, or to invest in production facilities, until they are confident their rights will be protected. Third, there is growing recognition that consumers in even the poorest countries can suffer from the sale of counterfeit goods, as examples ranging from falsely branded pesticides in Kenya to the sale of poisoned meat in China attest. Consumers usually suffer the most when laws protecting trademarks and brand names are not vigorously enforced. Fourth, there is a trend toward addressing intellectual property issues one by one, helping to identify areas of agreement and find common ground on points of difference.

International investment agreements

International investment agreements (IIAs) are an important element of the investment policy framework which complement the domestic framework. IIAs, entered into between two or more countries, can offer covered foreign investors substantive and procedural protection for their investments in host states, help to liberalise restrictions on investment flows and provide mechanisms for resolving disputes.

Lao PDR has a broad network of international investment agreements, both stand-alone treaties and investment chapters in broader free trade agreements. Investment treaties typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to ISDS mechanisms to enforce those provisions. Increasingly, treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment.

The International Investment Cooperation Division of the Investment Promotion Department, within MPI, has taken over the mandate previously attributed to the Ministry of Foreign Affairs and since 2011 has been in charge of negotiating and concluding BITs. In addition to over 20 BITs in force, Lao PDR is also a party to an increasing number of regional and multilateral trade and investment agreements (Box 2.9).

Like its ASEAN peers, Lao PDR's recent investment treaty policy has in many cases been driven by a new regional dynamic: since the conclusion of ACIA in 2009, the group of ASEAN Member States has signed agreements with Australia and New Zealand (2009), Korea (2009), China (2009), and India (2014).[1] ASEAN is currently also negotiating on the inclusion of an investment chapter for the existing Economic Partnership Agreement with Japan and Regional Comprehensive Economic Partnership (RCEP).[2]

The section below gives an overview of selected provisions in Lao PDR's IIAs on the basis of a sample of publicly available treaties. The elements discussed can inform the ongoing preparation of a new model BIT, to build a more consistent and informed approach to negotiating investment treaties. In parallel with the drafting of a new model treaty, the authorities are adopting an increasingly informed and cautious approach to negotiating IIAs. The review of the substantive and procedural provisions in the country's investment treaties shows that the language of key treaty provisions has evolved, particularly since the advent of the new regional ASEAN treaty policy in 2009. Some of these treaties reflect more specific language on key treaty provisions to clarify government intent. Regional and multilateral approaches offer an opportunity to create an integrated

investment region in ASEAN and to establish common rules on investment protection and liberalisation. At the same time, additional commitments in agreements covering investment relations already subject to bilateral or other multilateral treaties may jeopardise the consistent implementation of Lao PDR's treaty policy.

Box 2.9. **International Investment Agreements signed by Lao PDR**

Bilateral investment agreements

Countries	Status	Date of signature
Australia	In force	1994
Cambodia	Signed	2008
China	In force	1993
Cuba	In force	1997
Denmark	In force	1998
France	In force	1989
Germany	In force	1996
India	In force	2000
Indonesia	In force	1994
Japan	In force	2008
Kuwait	Signed	2008
Malaysia	Signed	1992
Mongolia	In force	1994
North Korea	Signed	1997
Netherland	Signed	2003
Pakistan	Signed	2004
Philippines	Signed	2007
South Korea	In force	1996
Russia	In force	1996
Singapore	In force	1997
Sweden	In force	1996
Switzerland	In force	1996
Thailand	In force	1990
UK	In force	1995
Viet Nam	In force	1996
Myanmar	Signed	2003
Belarus	Signed	2013

Multilateral investment agreements

Contracting parties	Date of signature
ACIA	26-02-2009
ASEAN - China	15-08-2009
ASEAN - India	12-11-2014
ASEAN - Korea	02-06-2009
ASEAN - Australia/New Zealand	27-02-2009

Source: http://investmentpolicyhub.unctad.org/IIA/CountryBits/114.

Further specify investment protection provisions to better reflect government intent

International practice shows that investment protection standards in older IIAs have often been relatively vague. Where they provide for arbitration, this gives investment arbitrators broad discretion to interpret and thereby determine the scope of protection they provide. While Lao PDR's investment treaty practice since 2009 in the ASEAN framework reflects more specific treaty language, its older treaties, which are still in force, are often vague. The 2013 treaty with Belarus also appears to lack many of the innovations that have emerged in recent years.

More specific language in investment protection provisions would lead to increased predictability and thereby benefit both investors and governments. The specifications also reflect policy choices. In some cases, the specifications may affect the degree of protection for covered foreign investors. Policy-makers need to carefully consider the costs and benefits of these choices, and their potential impact on foreign investors and domestic investors, as well as on the host state's legitimate regulatory interests and its exposure to investment claims (Box 2.10).

Box 2.10. **Public scrutiny and reform of international investment agreements**

IIAs have come under increasing scrutiny by a variety of stakeholders, including civil society and academia, but also by contracting parties to IIAs themselves. Critics argue that international investment agreements unduly restrict governments' "right to regulate" and that arbitral proceedings are subject to important flaws. In this process, a number of core assumptions have been challenged. Econometric studies, for example, have failed to demonstrate conclusively that IIAs actually lead to increased FDI flows – a policy goal commonly associated with the investment protection regime (Sauvant and Sachs, 2009). Beyond investment protection, IIAs are increasingly being used to liberalise investment policy. Studies have had more success in linking market access provisions in IIAs to increased inflows of FDI (Berger *et al*., 2013; Lesher and Miroudot, 2006).

Furthermore, while it has been contended that IIAs advance the international rule of law and good governance in host states by providing mechanisms to hold governments accountable, critics argue that opaque legal proceedings and potential conflicts of interest of arbitrators are contrary to rule of law standards (Van Harten, 2008). Moreover, the availability of international investment arbitration to investors has been seen by some as an instrument that could circumvent, and thereby weaken domestic legal and governance institutions instead of strengthening them (Ginsburg, 2005). Many governments are engaged in review of their investment treaty policy and the field has been marked by significant reforms in recent years.

Direct and indirect expropriation

Lao PDR's IIAs require host states not to expropriate unless the measures are taken in the public interest, on a non-discriminatory basis and under due process of law, with prompt, adequate and effective compensation.[3] The relevant provisions typically address the determination and modalities of payment of compensation as well. Lao PDR's treaties distinguish and cover both direct and indirect expropriation. Because most policy issues relating to expropriation arise with regard to indirect expropriation, this section focuses on Lao PDR's policy in that area.

Most Lao PDR IIAs explicitly cover indirect expropriation, but they often do not clarify the circumstances under which regulatory measures do not amount to expropriation and where therefore no compensation has to be paid. This gives arbitrators discretion to draw the line between indirect expropriations that entitle the covered investor to compensation, and legitimate regulation that has a significant economic impact on the investor without obligating the government to pay compensation. Under treaties that refer only generally to indirect expropriation, ISDS tribunals have used varying approaches to determine whether an indirect expropriation has occurred (UNCTAD, 2012).

Beginning with ACIA in 2009, some treaties with Lao involvement started to include specifications on indirect expropriation, to ensure that non-discriminatory measures, designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an expropriation.[4] Such clarifications are also included in the ASEAN agreement with Australia and New Zealand, and in the agreement signed with India; it is also referred to in the Work Programme for the ASEAN agreement with Korea.[5]

Fair and equitable treatment and the international minimum standard of treatment of aliens

Fair and equitable treatment (FET) is another standard at the centre of investment treaty claims and treaty policy. Since 1997, investors worldwide have invoked the standard in 341 claims and tribunals have found a breach in 129 of the cases.[6] All Lao IIAs reviewed grant FET to covered investors. These treaties often merely state that foreign investors shall be accorded FET without providing further specification. Provisions providing generally for fair and equitable treatment have been considered or applied by tribunals in a broad range of claims. Some interpretations of FET are widely seen as having a significant impact on the right to regulate.

There is a growing trend to define fair and equitable treatment provisions, both in Lao PDR and internationally, to give more direction to arbitrators by clarifying the original intent of the contracting parties. Two approaches are outlined in Box 2.11. Given the centrality of FET to many investor claims, clarification of government intent could improve predictability for both governments and investors, and Lao PDR might wish to reflect the more specific language found in recent treaties to its older treaties as well.

Box 2.11. **Two approaches to specifying and limiting the FET provision**

Two important approaches to further specifying the scope of fair and equitable treatment have emerged:

- Limitation to the minimum standard of treatment under customary international law (MST): This approach has been used in a number of major recent treaties in Asia and the Americas. ASEAN-Korea IIA (Art. 5), ASEAN-India IIA (Art. 7) and the ASEAN IIA with Australia and New Zealand (Art. 6) A FET provision limited to MST has been repeatedly interpreted under NAFTA. It has been interpreted more narrowly than FET provisions under other treaties and NAFTA governments have had much greater success than other governments in defending FET claims (UNCTAD, 2012: 61). In addition to the limitation to MST, the Trans-Pacific Partnership agreement (TPP), which is a largely built on US practice, specifies that the mere fact that government action is not consistent with an investor's expectation does not constitute a breach of FET (Art. 9.6(4). Art. 9.6(3) and (5)) contain further specifications.
- Defined lists of elements of FET: The EU's proposal for the Transatlantic Trade and Investment Partnership (TTIP), which is reflected in the investment chapter of the EU-Viet Nam free trade agreement (FTA) and the Comprehensive Economic and Trade Agreement (CETA), contains a defined list of elements of the FET provision. The FET provision lists the elements that can constitute a breach of the standard, namely denial of justice, fundamental breach of due process, targeted discrimination on manifestly wrongful grounds, and abusive treatment of investors. While it is a closed list, this approach is broader than some interpretations of MST. Under this emerging EU policy, the parties may agree to add further elements to the list. The article also provides that the tribunal "may take into account" (or "will take into account", in EU-Viet Nam FTA) specific representations that created legitimate expectations. Other defined list approaches are also used. For example, the ASEAN-China Investment Agreement (2009) limits the application of its FET provision to cases of denial of justice (Art. 7).

Both options are more specific than the broad language of treaties that only refer to "fair and equitable" treatment. This does not mean, however, that issues of interpretation might not arise. The content of the minimum standard of treatment, for example, is subject to important debates as are a number of elements in the defined EU lists.

Sustainable development and responsible business conduct considerations

A new emphasis in recent treaty making has been on sustainable development and responsible business conduct (RBC) considerations.[7] To a very limited extent, some of these innovations are also found in Lao PDR's existing investment treaties. While specific investor obligations are so far not encountered in treaty practice, treaties often make investment protection conditional on compliance with host state law. Lao IIAs use different ways to ensure that only investments that do not violate host state law are covered and protected. These include making legality a condition for application of the treaties or by defining covered investments as those made in accordance with host state law. Such requirements serve as a filter mechanism and can potentially incentivise investors to be more mindful of their obligations under host state law.

To seek to protect certain types of regulation from challenge, some Lao IIAs have used other tools, often apparently inspired from international trade law, such as general exceptions clauses. Except in the treaty with Japan, they appear to be only included in the ASEAN agreements since 2009. The rationale for these clauses is to ensure that the host state will not be prevented from implementing measures that pursue specific regulatory goals providing certain requirements are satisfied. Unlike clarifications limited to a particular provision, like for indirect expropriation addressed above, these provisions can apply to protect measures that satisfy their criteria from challenge under most if not all treaty provisions. These general exceptions clauses are in a few cases also complemented by more targeted provisions relating to measures addressing security issues, the stability of the financial system, or efforts to safeguard the balance-of-payments.[8]

Regulation of investor-state dispute settlement in Lao agreements

Starting in the 1990s, mechanisms for covered investors to bring claims directly against host governments – ISDS mechanisms – have become a frequent feature of investment treaties. OECD research shows that around 96% of the global IIA stock provides access to ISDS (Pohl *et al*., 2012). All of the investment treaties to which Lao PDR is a party – all signed in or after 1989 –contain ISDS provisions. While it is difficult to establish a precise number and status of investment claims due to the confidentiality of certain ISDS proceedings, it appears that there have been only two such claims against Lao PDR. One claim was settled and the other is still pending.[9] There are no known claims by Lao investors against foreign states.

Reconsidering policy rationales for different levels of treatment

Treatment of domestic and foreign investors.
In general, Lao PDR should seek to guarantee a sound investment climate for both domestic and foreign investors. Parts of Lao PDR's legal framework applicable to investment protection, such as its *Law on Investment Promotion*, apply to both domestic and foreign investors. Lao PDR's legal framework for investment also contains many provisions that exclusively cover only some foreign investors, such as IIAs. Lao PDR should consider whether distortions to efficient investment decisions may occur because of more favourable regulatory conditions for certain investors based on nationality. At the same time, many governments see the value or the need to provide certain extra incentives and guarantees to attract foreign investment in a highly competitive market for that investment. The balance between these interests is a delicate one and may evolve over time.

Harmonisation of domestic legislation and investment treaties.
Different levels of treatment may also exist between protection offered in the domestic legal system and investment treaties. On the interaction between domestic legislation and investment treaties, the *Law on Laws* gives some useful guidance, providing that legislation being developed shall be consistent with higher legislation. Moreover, if the provisions of existing legislation and newly adopted legislation are inconsistent with the provisions of international conventions or treaties, the provisions of the international convention or treaty prevail and the provisions of existing or newly adopted legislation shall be revised in due time (Art. 9). This indicates that Lao PDR intends to foster harmonisation of its investment policies at different levels, in line with commitments under ACIA.

Increasing complexity of investment obligations for foreign investors.
Different levels of investment protection and liberalisation in Lao PDR's various investment treaties also raise policy issues. Lao PDR still has BITs in force with countries whose investors can invoke ACIA and other ASEAN agreements. The impact of treaty policy innovations reflected in these ASEAN agreements can be negated because covered investors can circumvent them by bringing a claim based on the bilateral, potentially more favourable, treaty. Multi-layering of investment provisions may hamper the effective implementation of new policies. Multiple layers of investment protection reflecting different treaty policies would also jeopardise the establishment of harmonised investment policy across ASEAN member states, a policy goal set forth in the ACIA.

Notes

1. The dates noted after the treaties indicate their year of signature.
2. The agreement is negotiated between the ASEAN Member States, and the countries of the ASEAN Plus agreements (Australia, China, India, Japan, Korea, and New Zealand).
3. In line with the French model BIT, the French-Lao IIA, Art. 5(2) adds that an expropriation is only lawful if it does not violate a specific commitment of the state ("ni contraires a un engagement particulier").
4. See ACIA, Annex 2, para. 4.
5. The Work Programme contains a list of issues that the contracting parties agreed to negotiate upon, including an annex on expropriation, which would typically contain such clarification.
6. The numbers are based on the UNCTAD ISDS database (available at: investmentpolicyhub.unctad.org/ISDS/), which refers to 668 cases. Data on alleged breaches is available for 425 of them.
7. RBC principles and standards set out the expectation that all businesses should avoid and address negative impacts of their operations, while also making efforts to positively contribute to sustainable development of the countries in which they operate (see Chapter 6 on responsible business conduct).
8. Examples include clauses on security issues (ACIA, Art. 18; ASEAN-India, Art. 22; ASEAN-Korea, Art. 21), the stability of the financial system (e.g. Japan-Lao IIA) and – these provisions are widespread in the ASEAN IIAs – measures to safeguard the balance-of-payments (e.g. ACIA, Art. 16; ASEAN-China, Art. 11; ASEAN-India, Art. 12; ASEAN-Korea, Art. 11; AANZFTA, Chapter 15).
9. The numbers are based on the UNCTAD ISDS database.

References

Berger, A., M. Busse, P. Nunnenkamp and M. Roy (2013). "Do Trade and Investment Agreements Lead to More FDI? Accounting for Key Provisions Inside the Black Box", *International Economics and Economic Policy*, Vol. 10, No. 2, pp. 247-275, http://link.springer.com/article/10.1007%2Fs10368-012-0207-6.

Bingham, T. (2010), *The Rule of Law*, Penguin Books.

Chien, N. D. and K. Zhang (2012), "FDI of Viet Nam; two-way linkages between FDI and GDP, competition among provinces and effects of laws", in iBusiness, 2012, No. 4: 157-163.

Gaukrodger, D. and K. Gordon (2012), "Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community", *OECD Working Papers on International Investment 2012/03,* OECD Publishing, Paris, www.oecd.org/investment/investment-policy/WP-2012_3.pdf.

Ginsburg, T. (2005), "International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance", *Illinois Law and Economics Working Papers Series*, No. LE06-027, October.

Lesher, M. and S. Miroudot (2006), "Analysis of the Economic Impact of Investment Provisions in Regional Trade Agreements", *OECD Trade Policy Papers*, No. 36, OECD Publishing, Paris, http://dx.doi.org/10.1787/322248021805.

OECD (2015), *Policy Framework for Investment, 2015 Edition*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264208667-en

OECD (2006), *Policy Framework for Investment: A Review of Good Practices*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264025875-en

OECD (2008), *Freedom of Investment, National Security and 'Strategic' Industries: Progress Report by the OECD Investment Committee*, Progress Report published following the 7th Roundtable on Freedom of Investment, National Security and 'Strategic' Industries, Paris, March 26. www.oecd.org/daf/inv/investment-policy/40473798.pdf.

Pohl, J., K. Mashigo and A. Nohen (2012), "Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey", *OECD Working Papers on International Investment*, 2012/02, OECD Publishing, Paris. http://dx.doi.org/10.1787/5k8xb71nf628-en.

Sauvant, K. P. and L. E. Sachs (eds.) (2009), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*, Oxford University Press.

UNCTAD (2012), "Expropriation", Series on Issues in International Investment Agreements II, http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf.

UNDP (2015), *The law-making process in Lao PDR - A baseline study*.

Van Harten, G. (2008), *Investment Treaty Arbitration and Public Law*, Oxford University Press.

Chapter 3

Regulatory restrictions on FDI in Lao PDR

This chapter provides an overview of the Lao People's Democratic Republic's (Lao PDR) framework for the entry and regulation of investment and reviews existing regulatory restrictions to foreign direct investment. It looks at key policy reforms covering foreign investment and benchmarks the remaining restrictions against those in other countries.

Summary

Investment is a crucial ingredient for economic growth and sustainable development. Although raising investment levels is not a goal in itself – investment may sometimes have negative effects on economic welfare or on the environment – under the right conditions it can raise overall output both through factor accumulation and by introducing new techniques and processes which boost productivity and ultimately the standard of living. Domestic investments usually dominate, but FDI inflows can provide additional advantages beyond their potential contribution to the capital stock by serving as a conduit for productivity gains through greater competition and the local diffusion of technology and expertise (OECD, 2015).

Regulatory restrictions on FDI, as with any other policy favouring some firms over others, may therefore involve some important costs to the economy, notably in terms of a lower level of FDI and lower productivity.[1] For this reason, exceptions to the non-discrimination principle of investment policy need to be evaluated to determine whether the original motivation behind an exception (*e.g.* protection of the domestic infant industry or national security concerns) remains valid, supported by an evaluation of the costs and benefits, including an assessment of the proportionality of the measure. Consideration of the costs and benefits is especially important in service sectors that support a wide range of economic activities across the economy.

While no government accords national treatment to foreign-owned enterprises established in their territories across the board – this is the case even in OECD member countries, although restrictions on foreign investment tend to be, on average, lower than in other parts of the world – countries have in general reduced the number and scope of discriminatory measures affecting foreign investors over time (Kalinova *et al*., 2010).

Lao PDR is relatively less restrictive to foreign investment than many economies in region, but is still more so than in neighbouring Cambodia and Viet Nam. For a landlocked country with a small domestic market, this may entail a relatively more important hurdle for investors. Until recently, Lao PDR's restrictiveness resulted partly from the stringency of some sector-specific restrictions, as well as from a discriminatory minimum capital requirement for foreign investors applying across all economic sectors. This latter restriction has now been removed with the adoption of the newly-amended law, in line with OECD advice during the review process. The sectoral distribution of remaining restrictions also deviates somewhat from what is usually observed in OECD and ASEAN economies.

The investment regime has also historically lacked transparency and predictability for investors with regards to market access rules and conditions. The expectation is that this will change with the government's recent effort to reformulate and improve its legal and regulatory regime. Currently, regulatory restrictions on foreign investment are spread among several laws and regulations, making it difficult to ascertain whether potential investors are prohibited or restricted in any way from investing.

The newly-amended *Law on Investment Promotion* continues to use a generic statement (a "catch-all" type of provision) to regulate areas where investment (both domestic and foreign) may be restricted, which may potentially lead to discretionary abuse by the authorities if not accompanied by appropriate delimitations and implementation guidance. Previously, the *Decree on the Implementation of the Investment Promotion Law* made reference to a negative list (*i.e.* a list of sectors or activities in which investments are forbidden or restricted), but it was not clear if such a negative list referred to one yet to be issued or to the list of controlled businesses mentioned in the *Law Investment Promotion* of 2009. The latter was more likely the case, but uncertainty remained with regards to the scope and validity of publicly available information.

The amended law is expected to bring some clarification to this matter by explicitly requiring the government to set the list of controlled businesses and by providing some guidance on the types of activities that may be considered a controlled business. In the past the overall transparency of the framework was also greatly reduced by the lack of online access to important regulations and policy documents, most notably in English. This will need to be addressed to support the implementation of the newly amended framework.

As highlighted in the previous chapter, the amendment of the *Law on Investment Promotion* has provided a timely opportunity to take a clearer policy stance in favour of private sector development, so as to create the conditions for further transitioning towards a market-based economy. The law reform is also an opportunity to reassess the pertinence of existing restrictions on FDI and to address the previous framework's limited transparency and predictability.

Policy recommendations:

- Reassess existing discriminatory restrictions to foreign investment against their public policy objectives and, where relevant, streamline or remove them. Where such discriminatory policies are deemed necessary, ensure that they are not greater than needed to

address specific risks and concerns and regularly assess them against their intended objectives.

- Adopt a negative list approach to list all existing exceptions to national treatment in a regulation, to facilitate its revision over time and to enhance the clarity and predictability of the investment regime for foreign and domestic investors.

Lao PDR is relatively less restrictive than many regional peers

The most common restriction on foreign investment worldwide is the limit on foreign equity ownership. Governments usually apply this measure only to certain sectors to protect local enterprises from the full onslaught of foreign competition or to encourage technology transfer while allowing local enterprises to share in the economic rents in the sector.

Box 3.1. **Calculating the OECD FDI Regulatory Restrictiveness Index**

The OECD FDI Regulatory Restrictiveness Index covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted,
- the screening and approval procedures applied to inward foreign direct investment;
- restrictions on key foreign personnel; and
- other restrictions such as on land ownership, corporate organisation (*e.g.* branching).

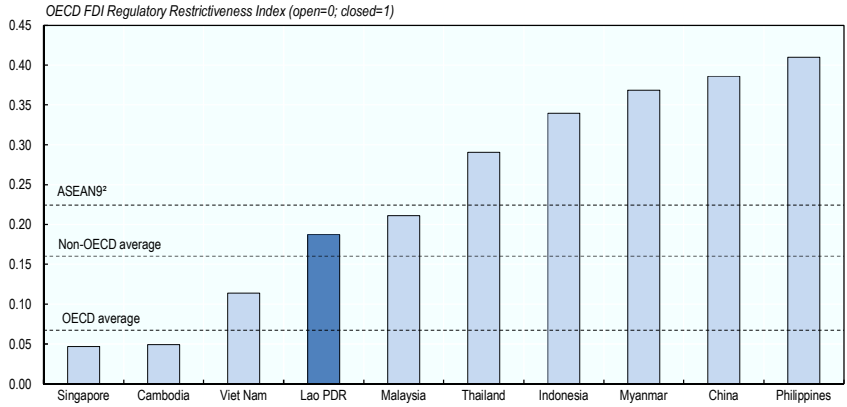
Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI, typically listed in countries' lists of reservations under FTAs or, for OECD countries, under the list of exceptions to national treatment. The FDI Index does not assess actual enforcement and implementation procedures. The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. Preferential treatment for special-economic zones and export-oriented investors is also not factored into the FDI Index score.

Source: For more information on the methodology, see Kalinova, Palerm and Thomsen (2010). For the latest scores, see www.oecd.org/investment/index.

In Lao PDR, foreign equity restrictions apply across a number of sectors, including in a few manufacturing activities and some services, such as construction, wholesale and retail distribution, and hotels and restaurants, (see Annex 3.A1 for a list of regulatory restrictions to foreign investment). Together with a few horizontal restrictions which apply across all sectors, this contributes to making the regulatory regime for foreign investors in Lao PDR relatively more restrictive than in many OECD and non-OECD countries, according to the OECD *FDI Regulatory Restrictiveness Index* (Box 3.1), despite still comparing favourably against the average of ASEAN9 countries (excluding Brunei Darussalam) (Figure 3.1). But compared to the other CLMV countries, the relative stringency of Lao PDR's regime is not negligible, particularly if one considers it is a landlocked country with a small domestic market.

Figure 3.1. **Lao PDR is restrictive by global standards but relatively open in Southeast Asia**



Source: OECD FDI Regulatory Restrictiveness Index database, www.oecd.org/investment/fdiindex.htm.

Notes: Data refer to regulatory restrictions on FDI as of end-2016. Lao PDR (2017) reflects only the regulatory changes brought by the amendments to the *Law on Investment Promotion*, notably the removal of minimum capital requirement for foreign investors and the reduction in the land lease period for concessions business. ASEAN9 refers to the average scores of the nine ASEAN member states covered, excluding Brunei Darussalam. Data for Cambodia (2016), Singapore (2013) and Thailand (2013) are preliminary.

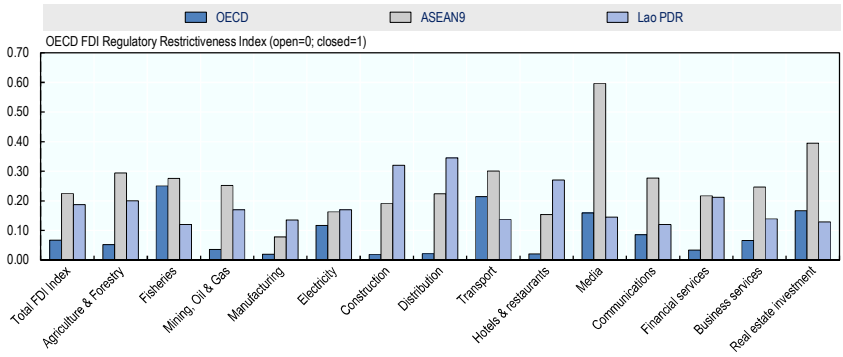
The sectoral distribution of Lao PDR's regulatory restrictions on FDI also deviates from the average pattern observed in ASEAN9 economies (Figure 3.2). While the statutory degree of openness to FDI in a few service sectors (*e.g.* media and communications) is somewhat greater than the ASEAN9 average, in other sectors it remains largely more restrictive (*e.g.*

construction, hotels and restaurants). This sectoral divergence may possibly reflect the relatively greater importance of tourism and construction-related activities for the Lao economy, both in terms of employment and economic output, and also the importance of domestic interest groups in these sectors.

Whatever the basis for restrictions, any measure should be periodically evaluated to ensure that it continues to meet the public interest. While concerns for national security, public order, the natural environment, national culture and social inclusion are legitimate, discriminatory investment policies may not always be optimal for tackling identified risks. Alternative non-discriminatory measures (*e.g.*, social and environmental regulations) may be available and adequate to address the identified risks to the national interest. Governments ultimately remain the regulatory authority in their jurisdictions and can deploy laws and regulations to regulate investments and address specific concerns.

Lao PDR may therefore wish to reassess the existing discriminatory restrictions on foreign investment so as to determine whether the original motivation behind such measures remains valid, supported by an evaluation of the costs and benefits, including an assessment of the proportionality of the measure. Broad consideration of the costs and benefits is especially important in service sectors that support a wide range of economic activities across the economy.

Figure 3.2. **FDI restrictions by sector, Lao PDR vs ASEAN9**



Notes: Data refer to regulatory restrictions on FDI as of end-2016. Lao PDR (2017) reflects only the regulatory changes brought by the amendments to the *Law on Investment Promotion*, notably the removal of minimum capital requirement for foreign investors and the reduction in the land lease period for concessions business. ASEAN9 refers to the average scores of the nine ASEAN member states covered, excluding Brunei Darussalam. Data for Cambodia (2016), Singapore (2013) and Thailand (2013) are preliminary.

Source: OECD FDI Regulatory Restrictiveness Index database, www.oecd.org/investment/fdiindex.htm.

Some regulatory restrictions on FDI in Lao PDR are uncommon

Lao PDR's sectoral distribution of regulatory restrictions also reflects, to some extent, the stringency of some rather uncommon measures in place until recently, such as: a relatively restrictive environment for foreign investors in the distribution sector, despite some important liberalisation measures implemented in 2015; the application of a minimum capital requirement for foreign investors in general business activities, which was removed in the newly-amended *Law on Investment Promotion* which came into force in April 2017; and the limit of foreign investment to 20% in listed companies across sectors. While the latter measure may currently have only a limited effect on foreign investment because very few companies are listed on the Lao stock exchange (see Chapter 4 on corporate governance), the potential effect of FDI restrictions in the distribution sector and the minimum capital requirement (previously applied), in contrast, may have broader economic implications.

Foreign investment in wholesale and retail distribution is now allowed but with conditions

While FDI restrictions in the wholesale and retail distribution sector may serve to protect traditional small and medium-scale domestic investors – normally an important source of employment – consumers may sometimes pay a heavy price. In some cases, such as in India, restrictions on the entry of foreign investors in the retail sector have been found to be associated with higher prices for consumers (Lakatos and Fukui, 2013). This partly motivated the Indian government to pass the recent reforms to allow greater foreign participation in the sector.[2] The government assessed that the previous restrictions prevented greater levels of investment in retail chain logistics, particularly in the cold-chain infrastructure for food products, which contributed to excessively high food and consumer goods prices in the outskirts of main economic centres, and also worked as an impediment for farmers to reach markets offering better prices due to the presence of relatively inefficient intermediaries (Government of India, 2010).

The fragmented environment where medium and small-scale investors operate is sometimes prone to a number of important supply chain inefficiencies that can translate into higher costs (Dasgupta, 2011). In this regard, foreign investors can deploy capital and know-how that may help to reduce transaction and information costs and improve the efficiency of the entire wholesale and retail business supply chain, including of farmers in the food market, potentially translating into more consumer choice and lower prices.

In Lao PDR, until June 2015, investment in the retail business was reserved to Lao citizens and foreign investment in wholesale distribution was only permitted through joint ventures with domestic investors. From a broad geographical perspective, foreign equity ownership restrictions in the distribution sector are becoming more rare, albeit relatively more common in Asia. Out of the 64 economies included in the OECD *FDI Regulatory Restrictiveness Index*[3], only 13 countries maintained such measures in place as of 2014, roughly half of them in Asia.

Since 2015, foreign investors have been allowed to operate wholesale and retail businesses in Lao PDR under certain conditions. Regulatory approval is required for the location of the business, although it is unclear if it applies to both wholesale and retail or only retail outlets and what are the criteria for approval. A minimum capital requirement of at least Laotian Kip (LAK) 4 billion (about USD 490 130) also applies for business with foreign shareholding. Local equity participation is also required in some projects as follows:

- A 100% foreign shareholding is allowed if registered capital is at least LAK 20 billion (around USD 2.5 million);
- Foreign ownership of up to 70% is allowed if registered capital is between LAK 10 billion (around USD 1.3 billion) and LAK 20 billion;
- Foreign ownership of up to 50% is allowed if registered capital is between LAK 4 billion and LAK 10 billion;

Moreover, the operation of wholesale and retail businesses must also be in accordance with the Decision on Shopping Centres and Department Stores issued in September 2015. The decision regulates the establishment, management and level of foreign equity ownership allowed in the sector (see Annex 3.A1).

Discriminatory minimum capital requirement has been removed

The 2009 *Law on Investment Promotion* provided for the regulation of three types of investments: general business activities, concessions and investment in special and specific economic zones. Minimum capital requirements were explicitly delimited for investments in concessions and general business activities, although to different extents. This has been partly reformed with the amendments passed by the National Assembly in late 2016, which abolished the requirement for general businesses.

In the case of concessions[4], the minimum capital requirement continues to apply without discrimination between domestic and foreign investors: "Registered capital for concession business shall not be less than thirty

(30%) percent of total capital. Registered capital for concession business shall be clearly expressed in assets and the asset value during the operation shall not be less than the registered capital" (Art. 52). The registered capital refers to equity capital paid-in by investors and the total capital refers to long-term debt and retained earnings in addition to the registered capital (DFDL, 2015).

Although not a discriminatory measure, the minimum 30% "registered capital" requirement for concessions restricts the leverage level that a concession business may undertake. While this may act to prevent the concession from assuming too much risk, it may sometimes be counter-productive by raising the cost of capital for the concessionaire and thereby the returns required from the business. In the case of infrastructure projects delivered through project finance, for instance, this may be excessively protective. Often the project company operates with rather high leverage levels, sometimes over 80% and, thus, above the level permitted for concessions in Lao PDR.

In the case of general business activities, recent amendments to the *Law on Investment Promotion* have removed the previous minimum capital requirement which discriminated against foreign investors. This is a welcome improvement to the regulatory framework. Lao PDR was among a handful number of countries that discriminated between domestic and foreign investors in the application of minimum capital requirement policies. As per Article 17 of the 2009 *Law on Investment Promotion*, "the total capital of the foreign investor in general business shall not be less than one billion kips)", or roughly USD 124 000.[5]

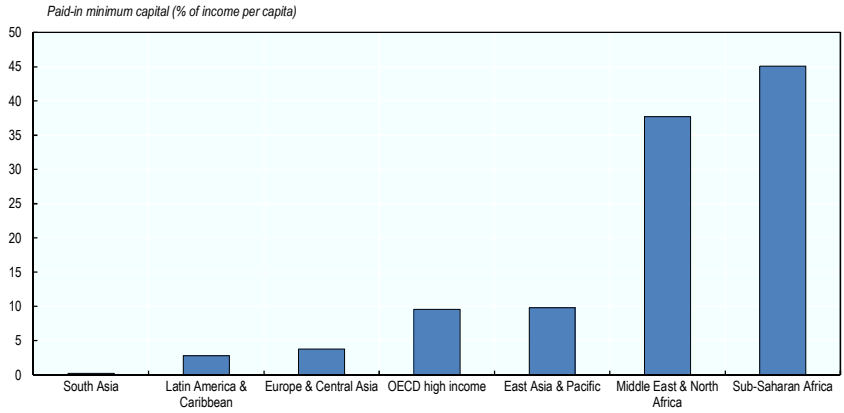
The *Decree on the Implementation of the 2009 Law on Investment Promotion* further clarified the different procedures for the registered capital to be paid-in by economic sector (Article 4).[6] The investor was required to pay the registered capital through a commercial bank established in Lao PDR and to obtain a certification of such capital payment with the Bank of Lao PDR within 10 working days from the date the enterprise registration certificate was obtained. Appropriately, financial institutions were, and will continue to be, subject to specific regulations of the Bank of the Lao PDR (DFDL, 2015). Additional conditions on capital requirements also existed for foreign investors in infrastructure projects wishing to acquire land use rights (Article 50).

The use of minimum capital requirements[7] for general business activities, whether or not discriminatory, has declined considerably worldwide over the past decade. According to the World Bank (2014a), 39 economies eliminated capital requirements in the preceding seven years, and many others never had them in the first place. Despite this, non-

discriminatory minimum capital requirements remain a reality in many countries. Out of the 189 economies included in the World Bank's *Doing Business* 2016, 68 economies still applied minimum capital requirement without discrimination (World Bank, 2015a).

Even in regions where minimum capital requirements still exist, the amount required has been significantly reduced. At the same time, minimum capital requirements which are higher for foreign investors are largely an exception in international practice (Figure 3.3). According to the World Bank's *Investing across Borders* database, across all regions only nine countries (out of the 98 covered) discriminate between foreign and domestic investors in this regard, four of which are from the East Asia and Pacific region. Lao PDR is not considered in the database.

Figure 3.3. **Few countries discriminate against foreign investors**

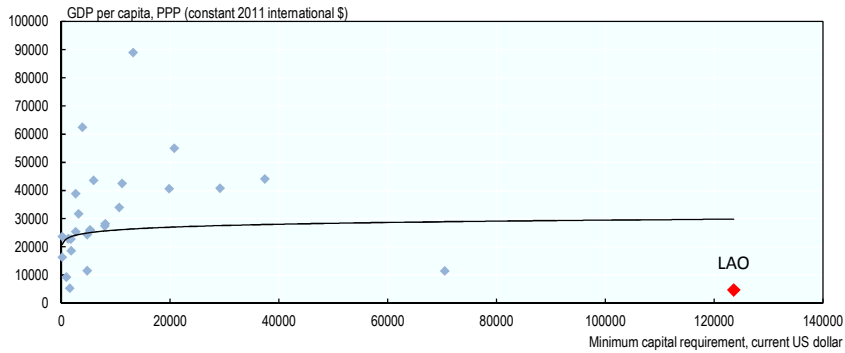


Note: The original data refer to a sample of 98 countries. Out of 56 countries where minimum capital requirements apply, only 9 countries discriminate against foreign investors in this regard.

Source: World Bank's Investing Across Borders database.

Another striking feature of Lao PDR's minimum capital requirement policy was its stringency. The minimum capital requirement of one billion kips (roughly USD 124 000) applicable to foreign investors in general business was substantially greater than capital requirements applied in OECD countries and large emerging economies (Figure 3.4). Lao PDR also clearly stood out as an outlier in this respect compared to countries at similar income levels adjusted for purchasing power. The comparison is based on minimum capital required for limited liability companies. But, to a large extent, it also holds true in comparison to minimum capital required from public stock companies in the countries observed.

Figure 3.4. **Lao PDR's minimum capital requirements in international comparison**



Notes: data refer to minimum capital requirement for limited liability companies and is converted at current exchange rates as of 21-04-2015. There are 25 countries within the OECD *Services Trade Restrictiveness* database that reported applying minimum capital requirements for investment in limited liability companies.

Source: OECD Services Trade Restrictiveness database and World Bank's World Development Indicators.

Beyond the limitation of minimum capital requirements in achieving their intended objectives (Box 3.2), they may also deter entrepreneurial activity. This is more likely to affect non-capital intensive industries, and particularly SMEs. Small entrepreneurial companies are common in many service sectors, including more knowledge-intensive activities, and the discriminatory minimum capital requirement imposed in Lao PDR could potentially have led foreign investors to pass on certain investment opportunities or decide to locate elsewhere. In sectors where barriers to entry are relatively low and investors and labour are largely mobile, any particular barrier to investment may hamper the country's competitiveness.

Beyond the relative stringency of the minimum capital requirement imposed on foreign investors, the drafting of the provisions governing its application was also problematic. The 2009 Law on Investment Promotion and its implementing decree lacked adequate precision for a clear understanding of their scope of application. For instance, both referred on numerous occasions to two concepts of capital (total capital and registered capital), which were not properly defined in the legislation. Article 17 of the 2009 Law established that "the total capital of the foreign investor in general business shall not be less than one billion kips". Article 3 of the implementing decree further extended the application to "registered capital" by stipulating that "Foreign investors wishing to invest in any general business […] shall have the minimum total capital and registered capital of not less than one million kip".

Box 3.2. **Minimum capital requirements often fail to achieve their objectives**

The early rationale for countries to adopt minimum capital requirements was to protect consumers and creditors from risky and potentially insolvent business (World Bank, 2014a). By requiring investors to lock-in upfront a minimum amount of capital, investors were expected to be more cautious about undertaking riskier commercial opportunities. Evidence points to a number of shortcomings of minimum capital requirements, notably to the detriment of entrepreneurial activity and companies' growth, with some notable exceptions such for financial services (*e.g.* banking and insurance).

Minimum paid-in capital requirements, as often stipulated by the commercial code or company law, do not take into account firms' differences in economic activities, size or risks, thereby offering only a limited recourse to address varying probabilities of default. Creditors prefer to rely on objective assessments of companies' commercial risks based on analysis of financial statements, business plans and references, instead of legally-imposed capital requirements, as many other factors can affect a firms' possibility of facing insolvency. Moreover, such requirements are particularly inefficient if firms are allowed to withdraw deposited funds soon after incorporation (World Bank, 2014a). In this situation, they act merely as barriers to entrepreneurship and may even hinder firms' financial sustainability, as the funds tied up for such purposes could be used in other critical activities for the company's sustainable growth and solvency.

Contrary to initial expectations, evidence has shown that minimum capital requirements do not help the recovery of investments as they are negatively associated with creditor recovery rates (World Bank, 2014a). Credit recovery rates tend to be higher in economies without minimum capital requirements, which suggest that other alternative measures (*e.g.*, efficient credit and collateral registries and enhanced corporate governance standards) are potentially more efficient in addressing such concerns. Moreover, minimum capital requirements have been found to be associated with higher levels of informality, and with firms operating without formal registration for a longer period. They also tend to diminish firms' growth potential (World Bank, 2014a).

Only the *Law on Enterprise* provided some clarity on what constituted registered capital, referring to equity capital paid-in by investors, but no legal definition was given to total capital, although it has been commonly understood to refer to long-term debt and retained earnings as well as registered capital (DFDL, 2015). Further uncertainties remained concerning definitions relating to capital requirements applicable to concession and joint

ventures businesses. While such inconsistencies or lack of clarity are potentially less of a concern for investors more familiar with the practices in Lao PDR, they make the regime more opaque for potential new investors.

The legal and regulatory regime covering market access lacks transparency and predictability

Regulatory restrictions on foreign investment are spread among several laws and regulations in Lao PDR, making it difficult to ascertain whether potential investors would be prohibited or restricted in any way from investing. The 2009 *Law on Investment Promotion* limited itself to a generic statement on areas where investment (both domestic and foreign) may be restricted: "The Government promotes the investment in all sectors, business operations and in areas throughout the country except for areas and business operations which are considered detrimental to national security, the natural environment, at present and in long-term, public health and national culture" (Art. 4). Both the law and the *Decree on the Implementation of the Investment Promotion Law* did not provide any guidance or rules for implementing such a provision. Such catch-all provisions risked leading to discretionary abuse by the authorities if not accompanied by appropriate limits and guidance for its implementation.

The newly-amended *Law on Investment Promotion* continues to use a generic statement to regulate areas where investment (both domestic and foreign) may be restricted. But it is expected to bring some clarification to this matter by explicitly requiring the government to set the list of controlled businesses and by providing some guidance on the types of activities that may be considered as controlled business.

Previously, the *Decree on the Implementation of the Investment Promotion Law* made reference to a negative list (*i.e.* a list of sectors or activities in which investments are forbidden or restricted), but it was not clear if this referred to one yet to be issued or to the list of controlled businesses mentioned in the *Law Investment Promotion* of 2009. The latter was more likely the case because *the Law on Enterprises* of 2005 and amendments of 2013 also referred to a list of controlled businesses, and defined them as "the list of business types that are highly sensitive to national stability, social order, and fine national traditions and to the environment, which require the permission of, and inspection by, the relevant authorities prior to the registration of the enterprise" (Art. 2).

Pursuant to the 2005 *Law on Enterprises*, the Prime Minister issued Decree No. 68 of 2008 delimiting the list of controlled businesses. The list shed limited clarity on the investment regime. To begin with, it only provided for a list of sectors and activities (rather comprehensive) for which a prior

approval is needed from the relevant sectoral agencies for the investor to be able to register an enterprise as per the procedures established in the *Law on Enterprises*. The list did not cover any prohibited activity, only conditional business activities. It made no reference to any of the conditions or restrictions that apply for investments in these sectors, nor did it provide any guidance on the criteria and procedures applicable to such approval requirements. As such, it failed to support a more transparent implementation of the regime. The sector coverage was also relatively comprehensive, ranging from fishery and forestry to mining and quarrying, electricity, water and sewage, transport, media, telecommunications and financial services.

The decree also did not distinguish between the restrictions and conditions which may apply only to foreign investors and those that may apply to all investors. Another uncertainty arose with regard to whether it was up-to-date since the Decree No 68/PM dates from 2008, before the enactment of the 2009 *Law on Investment Promotion* and the implementing regulation. Several implementing regulations and lower order legal instruments, as well as policy documents, which may contain important regulatory measures for both domestic and foreign investors, were also not readily accessible online and even less available in English.

The government's current efforts to reformulate its investment regime, including with the amendment of the *Law on Investment Promotion*, provides a timely opportunity for the government to address the various shortcomings of the framework highlighted above. Among other things, the government may wish to adopt a more intelligible negative list, listing all the market access conditions or restrictions applicable to domestic or foreign investors. The use of a negative list to regulate the sectors or activities where foreign investment is restricted, prohibited or subject to discriminatory conditions compared to domestic investors has been increasingly considered best practice worldwide. It can serve as an instrument of transparency, predictability and commitment to openness to foreign investment by the host country. It is also good practice for the negative list to be placed in a document of lower legal value to facilitate any necessary revision overtime.

Notes

1. Alesina *et al*. (2005); Arnold, Javorcik and Mattoo (2011); Arnold *et al*. (2011); Fernandes and Paunov (2012); Duggan *et al*. (2013); Nordas and Kim (2013).
2. The government allowed 100% foreign investment into single-brand retailing in 2012 and 51% in multi-brand retailing in 2013 with conditions.
3. The number of countries includes also the ASEAN9 countries for which scores remain preliminary as these have not been subject to an OECD Investment Policy Review.
4. Article 15 of the Law defines concessions as "investment activities authorized by the Government to utilize ownership and other rights of the Government in conformity with regulations, for the purpose of developing and conducting business operations; these include rights on land concession, minerals, electric power, airlines, telecommunication, insurance and financial institutions."
5. USD 124 000, as per the current exchange rate as of 29 February 2016: 1 USD equals to 8090 LAK.
6. For agricultural businesses, 40% of the registered capital must be contributed within 90 days from the date the enterprise registration certificate is obtained, and the remainder within one year; for the manufacturing sector, 60% of the registered capital needs to be paid-in within 90 days, and the rest within one year; for commerce and other services, 80% needs to be registered within 90 days, and the remainder within one year; for concessional activities, 20% of the registered capital must be paid-in within 90 days and the rest within one year. According to one legal practitioner, investors in non-agricultural concessionary activities are required to register 20% of their capital within 90 days, and the remaining part within two years (DFDL, 2015).
7. "What is a minimum capital requirement? It is the share capital that must be deposited by shareholders before starting business operations. For the Doing Business starting a business indicator the paid-in minimum capital is usually the amount that an entrepreneur needs to deposit in a commercial bank or with a notary when, or shortly after, incorporating a business, even if the deposited amount can be withdrawn soon after a company is created"(World Bank, 2014a).

References

Alesina, A., Ardagna, S., Nicoletti, G. and Fabio Schiantarelli (2005), Regulation and investment, *Journal of the European Economic Association 3(4): 791-825*.

Arnold, J., Javorcik, B.S., Lipscomb, M., Mattoo, A. (2012), Services Reform and Manufacturing Performance: Evidence from India, *World Bank Policy Research Working Paper No. 5948*, January.

Arnold, J., Javorcik, B.S., Mattoo, A. (2011), Does services liberalization benefit manufacturing firms? Evidence from the Czech Republic, *Journal of International Economics No. 85*, pp. 136-146

Dasgupta, N. (2011), FDI in retailing and inflation: the case of India, *Columbia FDI Perspectives No. 52*, December.

DFDL (2014), *Real estate investment guide: Bangladesh, Cambodia, Indonesia, Lao PDR, Myanmar, Singapore, Thailand, Viet Nam*, February.

DFDL (2015), *Foreign investment issues in Lao PDR*, Vientiane, March 24.

DFDL (2015), *Lao wholesale and retail sectors now open to foreign investors*, Legal and Tax Update, August 10.

Duggan, V., S. Rahardja and G. Varela (2013), Service sector reform and manufacturing productivity: evidence from Indonesia, *World Bank Policy Research Paper No. 6349*, January.

Fernandes, A.M. and Paunov, C. (2011), Foreign direct investment in services and manufacturing productivity: Evidence for Chile, *Journal of Development Economics No 97*, pp. 305-321.

Government of India (2010), *Issue of Discussion Paper on Foreign Direct Investment (FDI) In Multi-Brand Retail Trading*, Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, July.

IISD (2007), Environmental Impacts of Trade Liberalization in the Wood and Wood Products Sector of the Lao PDR, *Rapid Trade and Environment Assessment (RTEA, Background Research Paper*, December.

International Monetary Fund (2015), *Lao People's Democratic Republic*, IMF Country Report No. 15/45, February 2015, Washington DC.

Kalinova, B., A. Palerm and S. Thomsen (2010), "OECD's FDI Restrictiveness Index: 2010 Update", *OECD Working Papers on*

International Investment, No. 2010/03, OECD Publishing, Paris, http://dx.doi.org/10.1787/5km91p02zj7g-en.

Lakatos, C. and Tani Fukui (2013), Liberalization of Retail Services in India: a CGE Model, USITC Economics Working Paper No. 2013-03A, March.

Nordås, H. and Y. Kim (2013), "The Role of Services for Competitiveness in Manufacturing", *OECD Trade Policy Papers*, No. 148, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k484xb7cx6b-en.

OECD (2015), *The Future of Productivity*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264248533-en.

OECD (2009), *Guidelines for Recipient Country Investment Policies Relating to National Security*: *Recommendation adopted by the OECD Council on 25 May 2009*, www.oecd.org/daf/inv/investment-policy/43384486.pdf.

United States Department of State (2015), *Laos Investment Climate Statement*, June 2015, Washington DC.

World Bank (2014a), *Why are minimum capital requirements a concern for entrepreneurs?,* World Bank Doing Business 2014, Washington D.C.

World Bank (2015a), *ASEAN Services Integration Report,* Washington D.C.

ANNEX 3.A1

Regulatory restrictions on foreign investment in Lao PDR*

Sector	Description of the restriction	Legal authority / source of information
Horizontal measures		
Land ownership	Foreign investors are not allowed to own land use rights but may lease land or receive grant concession of land for investment purpose. The period of the lease is between 35- 50 years and can be extended for another 25 years to a maximum of 75 years, for agriculture, mining and energy. SEZs may lease for up to 99 years [the lease period has been reduced to 50 years by the newly-amended Law on Investment Promotion].	Land Law No: 04/NA, Art: 3, 64, 65, 66 and 67, 20 October 2003; Law on Investment Promotion No. 02/NA, Art. 17, 8 July 2009
Discriminatory minimum capital requirement	A foreign investor who invests in the general activities shall have the total capital amounted to not less than one billion Kip [this restriction has been removed by the newly-amended Law on Investment Promotion]. Specific capital requirements apply for foreign investors in other sectors, notably banking, insurance and distribution business.	Law on Investment Promotion No. 02/NA, Art. 17, Dated: 8 July 2009
Foreign ownership restriction	Foreign investors are entitled to purchase securities, but individual foreign investors are not allowed to hold more than 10% of the total shares of a single listed company. A group of foreign investors together are not allowed to hold more than 49% of the total shares of a single listed company. In January 2012, the Lao Securities and Exchange Commission announced that it was increasing the percentage of shares that foreign investors can hold in publicly listed companies from 10% to 20%.	Law on Securities No. 21, National Assembly 10/12/2012

* The list of measures may not be comprehensive, as there is only a limited number of laws and implementing decrees available online, and even fewer available in English. In a number of cases, definitions of terms used – even of basic critical legal terms as the proper definition of foreign investors – are vague and allow for considerable discretion by the authorities in their application.

Sector	Description of the restriction	Legal authority / source of information
Foreign ownership restriction (sectoral)		
Fisheries	Operation of fish/aquaculture hatcheries in the Mekong River and its tributaries in Lao PDR is reserved for citizens and companies wholly-owned by Lao citizens. No foreigner is authorised to undertake fishing activity for commercial purposes in Lao PDR	Law on Fisheries No. No. 03/NA, Art. 30-32, Dated: 9 August 2009.
Manufacturing: Food and other	Manufacturing activities: Production, processing and preserving of meat and meat products (cattle, pigs, sheep, horse); Fish processing and storing; Fruit and vegetable process; Manufacture of animal and vegetable oil; Manufacture of dolls and manufacturing of game and toys; Authentic Lao musical instruments; Lao traditional textiles; Manufacture of veneer sheets, plywood, lamina board, particle board and other panel boards; Manufacturing of pesticides; Manufacture of ice cream and ice manufacturing; Mill; Flour and flour product; Feedstuff; Bakery products; Lao local noodles products; Non-alcoholic beverage, soft drink, pure water drinking. Reserved exclusively for Lao citizens, to promote the domestic production and exportation. Subject to joint venture with domestic investors and/or export 100%. The establishment of the new wood processing factory is not permitted, except the case of utilising raw material (wood) from the reforestation or forest plantation. No new wood processing factory is to be licensed, but investment is promoted if planted wood is used.	PM Decree Nº 46/2001 Decree on Endorsement and Declaration of the Forestry Strategy to the Year 2020 of the Lao PDR No. 229/PM, 9 August 2005. Schedule to the ASEAN Comprehensive Investment Agreement: Policy of the Ministry of Agriculture and Forestry, order of the Ministry of Agriculture and Forestry, No.2050/MAF99 (20/12/1999); The measures stipulated in the article 24, 31and 32 of the Law on wildlife No. 07/NA, 24/12/2007 are applied only Lao national.; Industrial Processing Law 2001; Ministry of Agriculture and Forestry; Handicraft Law; The provision of the Law on Forest No. 06/NA, (24/12/2007); articles: 41, 42, 68, 86, 8,d 88; Food Law No. 04/NA, art. 38, (15/05/ 2004).

Sector	Description of the restriction	Legal authority / source of information
Electricity: generation and distribution	Article 10. Investment in Operations Relating to Electricity: The State promotes investment in operations relating to electricity, with an emphasis upon hydropower in order to utilise the [electricity generating] potential of water sources that are natural resources. Investment in operations relating to electricity may be undertaken by different types of enterprises as follows: The State invests by itself; The State invests with other domestic or foreign parties; Domestic cooperative or private investment.[...] Enterprises engaged in operations relating to electricity may undertake their operations in the following forms: Build, operate and transfer (BOT); Build, operate, own and transfer (BOOT); Build, transfer and finance (BTF); The State engages in the undertaking by assigning the State electricity company to be its representative; Investment in some other form. Article 12. Concession Procedures: An electricity enterprise shall request a concession [...] The government of the Lao People's Democratic Republic will participate in the shareholding when there is a concession for an electricity enterprise.	Law on Electricity No. 02/97/NA, Art. 10, 12, Dated: 12 April 1997. Law on Electricity No 03/NA, dated 20 December 2011.
Construction	A foreign private sector party may invest up to 100% in a concession investment if the registered capital is more than LAK240 billion (USD30 million). Where the registered capital is less than USD30 million, the foreign private sector party may only invest up to 49%; the Prime Minister via a decree may exempt this limitation (MPWT, 2014).	Presentation by Mr. Saysana Saphakdy, Ministry of Public Works and Transport of Lao PDR (2014), "Lao Roads Public Private Partnership: A pilot PPP in Lao PDR : National Road No. 13" , UNESCAP *Event on "Public-Private Partnerships (PPPs) for Infrastructure Development in Lao PDR"* September, Vientiane; Law on Construction No. 05/NA 26 November 2009.

Sector	Description of the restriction	Legal authority / source of information
Hotels and restaurants	Article 64. Establishment and Operation of Tourism Business Domestic individuals and legal entities intending to establish an enterprise to operate a tourism business shall comply with the following main requirements: [...] Legal Entities: Domestic legal entities that are business units: Shall possess lawful business licenses; Must have an office in the Lao PDR; Shall have performed obligations owed to the State in accordance with the laws and regulations. Other legal entities shall get special permission from concerned authorities. Foreign individuals or organisations have the right to establish an enterprise to conduct tourism business activities in the Lao PDR, mainly: hotels, resorts, restaurants, [and] tourism sites. For the business of transnational guided tours, the State permits foreign legal entities to jointly invest with domestic investors. Foreign individuals or organisations shall not be permitted to conduct certain tourism business reserved for Lao citizens, [such as]: the tour guide profession, the business of domestic guided tours, the tour business in a specific area, guesthouses, and daily room services. Detailed regulations on [obtaining] permission for investment and establishment of tourism enterprises in the Lao PDR by foreign individuals or legal entities are separately stipulated. Guesthouse means a place of temporary accommodation consisting of a maximum of fourteen rooms but not less than five rooms, which provides, in exchange for fees, comfortable facilities, appropriate consumer equipment, and good standard of services with the purpose of providing temporary accommodations to travellers. Daily room service means a place of temporary accommodation, consisting of a maximum of four rooms, which shall have necessary facilities for travellers.	Law on Tourism No. 10/NA, Art. 64, 9 /11/2005

Sector	Description of the restriction	Legal authority / source of information
Insurance	Article 28 (amended). Types of Investment: A domestic insurer and insurance broker wishing to operate as a joint-venture insurance company with a foreign investor is eligible to operate under the types of investment as defined in the Law on Investment Promotion and Law on Enterprise. Article 29 (amended). Application for the Establishment and Operation of a Foreign Owned Insurance Company: Any foreign insurance company and insurance broker wishing to establish and operate an insurance business in Lao PDR shall submit completed application documents through the one-stop service for approval as defined in the Law on Investment Promotion Article 30 (amended). Conditions for the Establishment of a Foreign Representative Office: The establishment of a representative office of a foreign insurance company shall have the following conditions: 1. It has experience in operating insurance business for at least five years; 2. It has maintained good cooperation with the concerned authorities.	Law on Insurance (amended) No. 06/NA, Art. 28-33, 21 December 2011 World Bank (2015), ASEAN Services Integration Report, Washington D.C. Law on Insurance No. 11/90/SPA, dated 29 November 1990 (repealed)
Financial services (other than banking and insurance)	Article 34. Securities companies established by foreign investors - Foreign investors are allowed to establish a joint venture securities company with domestic investors. The share of capital contributed by foreign investors in a joint venture shall not exceed 51% of total outstanding shares.	Decree on Securities and Securities Market 2010

Sector	Description of the restriction	Legal authority / source of information
Accounting and audit	Article 41 Requirements for Accounting Firm Practicing License: An individual wishing to obtain an accounting firm practicing license shall meet the following requirements: 1. Be a certified public accountant; 2. Be member of the Chamber of Professional Accountants and Auditors; 3. Not be an officer, owner, shareholder or staff of any enterprise; 4. Be free of embezzlement or other intentional infringements on finance or accounting; 5. Have more than three technical staff that have acquired a high level education degree in accounting and finance. Article 43 Requirements for Audit Firm Practicing License: An individual and legal entity wishing to obtain audit firm practicing license shall meet the following requirements: 1. Be a certified public accountant or a foreign audit firm; 2. Be member of the Chamber of Professional Accountants and Auditors; 3. Not be an officer, owner, shareholder or staff of any enterprise; 4. Be free of embezzlement or other intentional infringements on finance or accounting; 5. Have at least two certified public accountants and, in case of sole proprietorship enterprise, have technical staffs that have acquired at least a high level education degree. 6. Have a certified public accountant as shareholder of least three fifths of total shares and act as manager. In case there are more than two shareholders, have technical staffs that have acquired at least a high level education degree.	Law On Independent Audit No. 51/NA, Art. 41, 43 (22/07/2014).

Sector	Description of the restriction	Legal authority / source of information
Local incorporation requirement		
Mining and quarrying	Article 5. (Revised) State Policy on Minerals: The State's policy, as changed from time to time, is to carefully screen domestic and foreign enterprises for investment in the minerals and mining industry, based on technical and financial capability. Article 29. Forms of Investment in Mineral Business: Forms of investment in mineral business include Individual enterprise, Partnership and Company as provided in Article 10 of the Enterprise Law. Article 52. Small -scale Mining: Small-scale mining means[...] digging, drilling, blasting, and sorting of minerals from the surface, underground or underwater where it is not appropriate for industrial mining, within an area not to exceed ten hectares. Small- scale mining shall be permitted only for Lao entities[...] Article 53. Extraction of Industrial Minerals and Rocks: Industrial minerals and rocks are non-metallic minerals including limestone, marble, silicate sand, sulphur, phosphates, basalt, granite, [...]. includes extraction by excavation, drilling, cutting, and blasting. Article 54. Granting of Industrial Minerals and Rocks Exploitation Permit: [...] The exploitation of industrial minerals and rocks is permitted only to be undertaken only by Lao legal entities. Article 69. Equity Participation by the Government After the investor has completed exploration and presented a detailed feasibility study report, the Government has the right to undertake an equity share in such mineral business.	Law on Minerals No. 02/NA, Art. 5, 52, 69. Dated: 20 December 2011
Air transport	Article 9. Nationality and Registration of Aircraft Any aircraft that intends to fly within the airspace of the Lao PDR shall be registered and shall have nationality and registration marks in accordance with the laws of the Lao PDR or of the concerned State. Article 10. Registration Conditions - Aircraft registration in the Lao PDR must be carried out in accordance with the following conditions: 1. The individual registering the aircraft shall be its owner or another individual who has the right to operate such aircraft. This could be, but is not limited to, the following: The government of the Lao PDR; A Lao citizen; An alien, foreign individual or apatrid who has a principal place of business or permanent residence in the Lao PDR; An enterprise, company or association established in accordance with Lao laws and regulations.	Civil Aviation Law 2005

Sector	Description of the restriction	Legal authority / source of information
Some media services	"A new Prime Ministerial Decree permits foreign media to report and set up offices in Laos, but requires the content of their reports to be reviewed by the Lao authorities before being printed or broadcast. The six-page decree issued on November 24, 2015, defines the principles, regulations and measures for managing and following up the collection of information and reporting by foreign media organisations, embassies and international organisations in Laos. A foreign media organisation must set up an office in Laos within 3 months after having an application approved by the government."	Vientiane Times (2016), *Decree outlines conditions for foreign media in Laos,* January 6.
Distribution (foreign equity restriction and discriminatory minimum capital requirement)		
Since June 2015 foreign individuals and legal entities have been allowed to operate wholesale and retail businesses in the Lao PDR. But investment is permitted under several conditions: The operation of wholesale and retail businesses must be in accordance with the Decision on Shopping Centres and Supermarkets. Regulatory approval is required for the location of the business, but it remains to be clarified if it applies to both wholesale and retail or only retail outlets. A minimum capital requirement of at least LAK 4 billion (about USD 490 130) apply for business with foreign shareholding. Local equity participation requirements also applies as per the following: A 100% foreign shareholding is allowed if registered capital is at least LAK 20 billion (around USD 2,453,200); Foreign ownership of up to 70% is allowed if registered capital is between LAK 10 billion (around USD 1,325,320) and LAK 20 billion; Foreign ownership of up to 50% is allowed if registered capital is between LAK 4 billion and LAK 10 billion;		Decision No. 1005/MOIC on Wholesale and Retail Businesses issued on 25 May 2015 and its additional instructions (No. 0515/MOIC.DTD, 17 June 2015) DFDL (2015), *Lao wholesale and retail sectors now open to foreign investors*, Legal and Tax Update, August 10; Decision No. 1950/MOIC.DIT on Shopping Centers and Department Stores, dated 22 September 2015; Decision 0977/MOIC.DTD on Wholesale and Retail Business, dated 18 May 2012 (repealed).

Real-estate investment	
Article 58: Land use rights as an investment incentive: Foreign investors with registered investment capital of USD 500 000 and above are entitled to land use right. The Government will allocate land to investors for duration consistent with the investment duration and based on the consent of local authorities according to prevailing regulations to build facilities for residential or business purpose. Otherwise, foreigners can only buy property on a leasehold basis and for a maximum of 30 years renewable up to 75 years. Article 64: Rights to Invest: [...] 10. To receive benefits from the lease or concession such as the right to use and to use this right as a collateral with another person or financial institutions or to allow the joint-venture, to sublease, to sell and to transfer the Land use rights in accordance with the terms of the lease or concession in the contract and other conditions according to the laws; 11. A right holder of the land use or concession has the right to use land in accordance to the terms of leasing contract or concession agreement; and owns property such as buildings or any constructions on that piece of land and to transfer the rights to local people or foreigners Article 48 (Decree). Land use right incentive: The land use right incentive in accordance with Article 58 of the Law on Investment Promotion refers to the authorization granted to foreign investors to purchase land use rights from the state for a maximum area not exceeding 800 square meters for the purpose of building for habitation or enterprise offices, except for the land the investors rent or have as concession from the government or rent from Lao citizens to conduct business activities in conformity with laws and regulations. Article 52 (Decree). Right and interest of foreign investors who have acquired land use right: Foreign investors who have acquired land use right have the following benefits: 1. Use the land based on the approved purpose and within the timeframe defined in the concession agreement or in a specific law and regulation of Lao PDR [...]; 2. Transfer land use right ownership to other investors who fulfil all required conditions as set out in Article 50 of this Decree shall be certified by the planning and investment or the industry and commerce sector [...] 3. Use of land use right ownership as collateral to secure repayment of loan for banks or financial institution entity in Lao PDR; 4. Transfer or sell premises under the investor's ownership to other individuals or legal entities in accordance with the laws and regulations of Lao PDR. The Decision No. 1950/MOIC.DIT on Shopping Centres and Department Stores establishes the rules for foreign investment : A foreign investor can hold 100 % of the shares as long as the total cost of investment is a minimum of 160 billion LAK (USD 20 million); In a project where the total cost of investment is between 80 billion LAK (USD 10 million) and 160 billion LAK (USD 20 million), a foreign investor may hold a maximum 70 % of the shares; Where the total cost of investment is between 8 billion LAK (USD 1 million) and 80 billion LAK (USD 10 million), a foreign investor may hold a maximum 51 % of the shares; If the total cost of investment is less than 8 billion LAK (USD 1 million) and involves a minimart or an independent store, the business is entirely reserved to Lao citizens.	Law on Investment Promotion No. 02/NA, dated: 8 July 2009. Decree on the Implementation of Investment Promotion Law No. 119/PM, dated: 20 April 2011. Decision No. 1950/MOIC.DIT, 22 September 2015 on Shopping Centres and Department Stores

Chapter 4

Corporate governance in Lao PDR

This chapter provides an overview corporate governance framework in the Lao People's Democratic Republic (Lao PDR). It addresses ongoing reforms to the ownership and governance of state-owned enterprises and challenges in expanding the capital market.

Summary

Corporate governance concerns the structure framing the relationships among a company's executive management, board of directors, shareholders, and stakeholders. From the perspective of modernising legal and regulatory frameworks for investment, effective corporate governance critically affects individual firm behaviour as well as broader macroeconomic activity. For emerging market economies, improving corporate governance can reinforce property rights, reduce transaction costs, and lower the cost of capital, which together can improve investor confidence. The Asian financial crisis in 1997 acted as a significant catalyst for improving corporate governance frameworks in Asia with the aim of building well-functioning and stable financial markets.

While the Lao authorities have made progress in recent years in the area of corporate governance, the overall legal and regulatory corporate governance framework remains challenging, with scattered inconsistencies and at times limited awareness by market participants. This section evaluates the current and evolving institutional framework for corporate governance in Lao PDR, using as a benchmark the *G20/OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State-owned Enterprises* (Box 4.1).[1]

Developing a corporate governance framework

Since 1986, Lao PDR has undertaken important reforms in its transition to a market economy. Under the New Economic Mechanism, reforms included liberalising domestic and foreign trade, privatising state-owned enterprises (SOEs), and devolving powers to regional and local governments. After 30 years of reforms, a number of challenges continue to face the development of a sound business environment: access to finance for firms remains challenging; the responsibilities of boards are not always clearly stated; financial disclosure remains weak; and financial reports are often not submitted in English or in a timely manner. To address some of these challenges, the Lao authorities have taken steps in recent years to establish the legal and regulatory framework for corporate governance (Table 4.1). The *Law on Enterprises* of 2013, which was passed as part of a legislative reform process in preparation for the ASEAN Economic Community in 2015, applies to all companies in Lao PDR and helps to establish a level playing field by subjecting SOEs to the same rules as private companies.

Box 4.1. **OECD principles and guidelines on corporate governance**

Good corporate governance is not an end in itself. It is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment. Access to equity capital is particularly important for future oriented growth companies and to balance any increase in leveraging. The *G20/OECD Principles of Corporate Governance* (the *Principles*) therefore support investment as a powerful driver of growth.

The *Principles* were originally developed by the OECD in 1999 and updated in 2004 and 2015. The latest review was carried out under the auspices of the OECD Corporate Governance Committee with all G20 countries invited to participate in the review on an equal footing with the OECD Member countries. The *Principles* provide guidance through recommendations and annotations across six chapters:

i. Ensuring the basis for an effective corporate governance framework

ii. The rights and equitable treatment of shareholders and key ownership functions

iii. Institutional investors, stock markets and other intermediaries

iv. The role of stakeholders in corporate governance

v. Disclosure and transparency

vi. The responsibilities of the board

The *Principles* have a proven record as the international reference point and as an effective tool for implementation. They have been adopted as one of the Financial Stability Board's (FSB) Key Standards for Sound Financial Systems serving FSB, G20 and OECD members. They have also been used by the World Bank Group in more than 60 country reviews worldwide. They serve as the basis for the Guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision, the OECD Guidelines on Insurer and Pension Fund Governance and as a reference for reform in individual countries.

Complementing the *Principles*, the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and with accountability. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. They were first developed in 2005 and have been updated in 2015 to reflect a decade of implementation experience and to address new issues that have arisen concerning SOEs in the domestic and international context.

The *Law on Enterprises* stipulates that a limited company with assets more than LAK 50 billion (USD 6.25 million) must have a board of directors and an auditor. The voting for the selection or removal of a board director may be executed by either cumulative or straight voting, and proxy voting is allowed. Lao companies use a one-tier board system. Shareholders must be given notice of at least five working days before holding a shareholders meeting. External audit is carried out through auditors elected at the shareholders meeting.

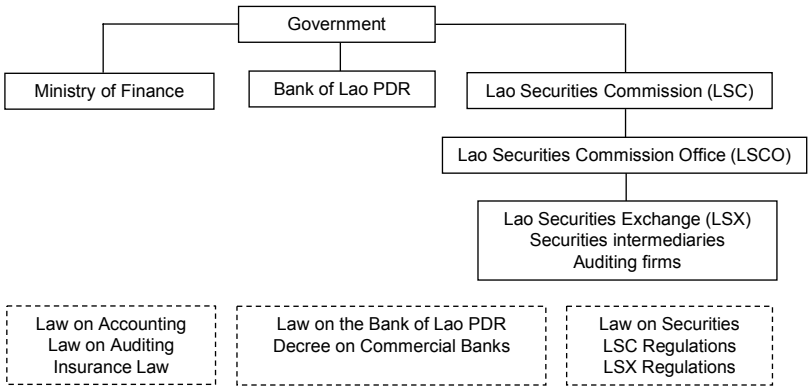
Table 4.1. **Main laws and regulations relating to corporate governance in Lao PDR**

Name	Effective	Purpose	Notes
Law on Enterprises, No. 46/NA, 26 December 2013	September 2014	Companies Law	Replaced Law on Enterprises of 2005
Law on Securities, No. 21/NA, 10 December 2012	March 2013	Securities Law	Upgraded from Decree on Securities and Securities Exchange of 2010
Law on Accounting, No.47/NA, 26 December 2013	July 2014	Accounting Law	Replaced Law on Accounting of 2007
Stock Listing Regulations of the Lao Securities Exchange (LSX)	November 2015	Rules governing the issuance of and trading in equity and debts securities of listed companies	Pursuant to Regulation on Stock Issuance, No. 018/LSCO, 27 July 2015

The *Law on Accounting* of 2013, which became effective in July 2014, permits entities to use the International Financial Reporting System to prepare and maintain their financial records, subsequent to approval from the Ministry of Finance. Previously, private entities doing business in Lao PDR had to use Lao Accounting Standards.

As for the institutional framework, the Lao Securities Commission Office (LSCO), which was established in 2009, oversees the Lao Securities Exchange and is governed by the *Law on Securities* of 2012 (Figure 4.1). LSCO has 48 staff members and reports to the 13 members of the Lao Securities Commission (LSC). LSC is chaired by the Deputy Prime Minister of Lao PDR and has two Vice Chairmen (the Governor of the Bank of Lao PDR and the Minister of Finance) as well as nine Commissioners from selected Ministries and National Committees. To complement and facilitate implementation of the Law on Securities, LSC has issued a number of decrees, decisions, manuals and guidelines.

Figure 4.1. **Financial Supervisory Structure in Lao PDR**



Source: LSCO.

As part of the effort to strengthen the corporate governance of listed firms, an updated Stock Listing Regulation was released by the Lao Securities Exchange in November 2015. As outlined in Section 4 Article 13, requirements for the initial listing of stock include disclosure of financial and non-financial elements. Financial elements relate to: *i*) operating history (three or more years needed since incorporation), *ii*) size of the company (capital of LAK 8 billion or approximately USD 1 million), *iii*) stock distribution (at least 100 minority shareholders and more than 10% of shares owned by minority shareholders), and *iv*) business performance (sales revenue of at least LAK 24 billion or approximately USD 3 million). Other requirements relate to the quality of corporate disclosure, corporate governance and other matters deemed "necessary for the promotion of the public interest and the protection of investors."

Even considering these reforms, some important gaps remain. In practice, financial and non-financial disclosure remains weak: company reports are commonly challenging to access online or in English; many of the skills required to implement and create a culture of good corporate governance, including accounting and auditing skills, are in high demand; and enforcement of the law remains inconsistent. The existence of a large number of government decrees leads to limited awareness by market participants.

Ongoing reforms to the ownership and governance of SOEs

As a part of the transition toward a market economy, the Lao government began privatising SOEs in 1986. In line with this programme, the central government devolved significant economic powers to regional governments and reduced the number of central ministries and ministry-equivalent organisations. In 1989, there were reportedly 640 SOEs, 200 of which were controlled at the central level (Quang, 1999). This number has been steadily reduced through closures, leases, mergers and sell-offs. As of October 2015, there were reportedly 130 fully state-owned enterprises in Lao PDR. Approximately 55 of these SOEs operate at the central level, 42 of which are under the responsibility of the Ministry of Finance.

The *Law on Enterprises* defines two types of SOEs: (1) state enterprises, which are established by the state and have a capital contribution from the state of more than 50% of the total capital, and (2) mixed enterprises, which are invested jointly by the state and another party (*e.g.* domestic or foreign investor). The fundamental principles for the business operations of SOEs outlined in the Law are: *i*) strict compliance with the Lao People's Revolutionary Party's guideline and policy and the government's social economic development plan, *ii*) independent business operations based on commercial principles, *iii*) a transparent and modern management system subject to internal and external audits, and *iv*) full participation of the entire organisation, in view of contributing to improving the efficiency of business operations.

By some estimates, SOEs in Lao PDR currently account for only 1% of total employment. This finding should be tempered by the fact that a number of activities that might in other economies be carried out by SOEs are either performed within the general government sector or by companies that, while not classified as SOEs, are closely related to the government. Moreover, SOEs continue to play a significant role in the overall economy and remain particularly prominent in key sectors such as finance, telecommunications, energy, and mining. According to the National Committee for Business Development of Lao PDR, state enterprises had assets of USD 11.7 billion, revenues of USD 2.8 billion and profits of USD 119 million in 2015.

A number of international observers have described the variant of capitalism in Lao PDR as "frontier capitalism" (Andriesse, 2014). Indeed, the interventionist role of the state in the economy and the state-mediated financial system have led to a situation in which well-connected companies, either under government patronage or having partial government ownership, have flourished. Consortia of SOEs and foreign companies have also particularly benefitted from this model, promoting significant levels of economic growth.

To improve the governance and efficiency of SOEs, the government has encouraged a number of SOEs to partner with foreign firms, either through joint ventures or by inviting strategic partners into their shareholdings. In 2005, the Danish beer company Carlsberg took a 50% stake in Lao Brewery, with the Lao government retaining the other 50%. In 2011, Russia's Vimpelcom, which operates the Beeline brand, acquired a 78% stake in Millicom Lao, a leading mobile telecom operator, leading to the creation of Vimpelcom Lao. In 2012, Compagnie Financère de la BRED, a subsidiary of the French bank BRED Banque Populaire, took a 10% stake in Banque pour le Commerce Extérieur Lao (BCEL), a listed company that is 70% owned by the Lao government. In 2014, BCEL established a joint venture with Fudian Bank, a Chinese bank, to establish the Lao China Bank with an initial registered capital of USD 37 million.

The Lao government has expressed its commitment to continue to reform the SOE sector by reducing the number of fully state-owned enterprises from 130 to approximately 30, largely through attracting foreign ownership. SOEs with sound financial performance will be encouraged to list on the stock market. The stated objectives of the reforms are to: *i*) strengthen state sector performance, *ii*) maximise public resource use, *iii*) enhance revenue contribution to the state budget and *iv*) improve the quality of utility sector services. Yet efforts to establish separation between ownership and regulation have been limited. There is currently no clear state ownership policy in Lao PDR. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, revised in 2015, provide the Lao authorities with an internationally-recognised benchmark for evaluating the corporate governance framework pertaining to SOEs and designing reforms.

Challenges remain in expanding the capital market

Lao PDR's capital market remains relatively small within the region. In 2006, the government announced the decision to establish a securities exchange, and the Lao Securities Exchange (LSX) began operations in January 2011. Electricité du Laos-Generation Public Company (EDL-Gen) and BCEL, both of which are majority state-owned, were the first two companies to list in 2011. As of May 2016, LSX has five listed companies (Table 4.2). EDL-Gen accounts for over 80% of the market capitalisation of LSX. The two shareholders of LSX are the Bank of Lao PDR (51%), and Korea Exchange (49%).

Table 4.2. **Listed firms on the Lao Securities Exchange,**

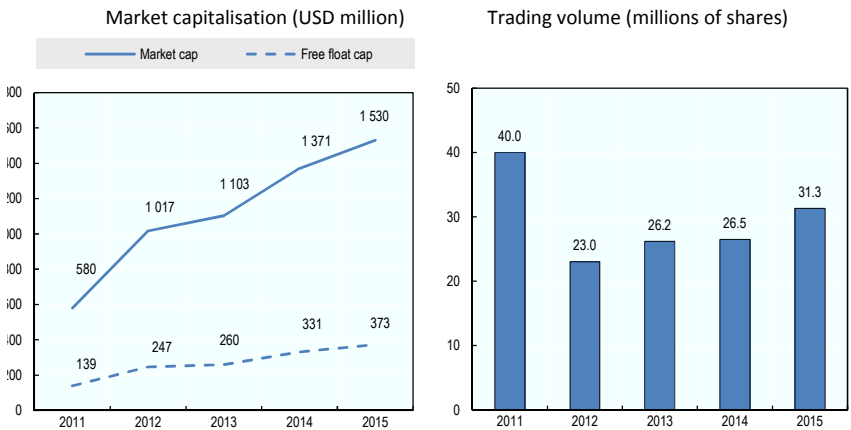
Name	Issue name	Sector	Free float	Share price (USD) as of 20/05/2016	Market capitalisation (USD)
EDL-Generation Public Company	EDL-Gen	Energy	25%	0.70	1 179 752 820
Banque Pour Le Commerce Exterieur Lao Public	BCEL	Finance	20%	0.65	88 374 194
Lao World Public Company	LWPC	Real Estate	10%	0.85	33 643 552
Petroleum Trading Lao Public Company	PTL	Energy	25.53%	0.32	76 753 937
Souvanny Home Center Public Company	SVN	Construction Materials	15.15%	0.41	67 109 625

Source: LSX (May 2016).

Since its establishment, LSX has experienced modest levels of activity (Figure 4.2). Between 2011 and 2015, LSX's market capitalisation rose from USD 580 million to USD 1.53 billion, or approximately 12% of GDP. Over this same period, the number of investor accounts grew to 11 899, of which around 20% are foreign. In 2015, the average daily trading value was approximately USD 100 000, with 86% of this value accounted for by foreign traders, meanwhile the total trading volume fell from approximately 40 million shares in 2011 to 31 million shares in 2015. In 2012, the government increased the proportion of shares that foreigners can hold in a listed company from 10% to 20%. Overall, capital market development in Lao PDR remains at an early stage of development.

While there is no corporate debt market in Lao PDR, the government's first sovereign cross-border bond issuance in the Thai debt market in 2013 marked an important step toward facilitating cross-border bond issuance by Lao companies, particularly SOEs with revenues in Thai baht (THB). By the end of 2015, the Lao government issued four batches of bonds, the last of which was a THB 12 billion triple-tranche issue and the first to be rated. To develop debt and equity markets in Lao PDR and enabling Lao companies to access regional capital markets to fund long-term investment, the implementation of sound corporate governance practices by Lao firms is critical.

Figure 4.2. **LSX market capitalisation and trading volume, 2011-15**



Source: LSX (May 2016).

Observers have identified a number of challenges facing the development of a vibrant capital market in Lao PDR. Notably, the disclosure of financial and non-financial information by firms is commonly perceived as partial and untimely by investors. It is often challenging to obtain detailed corporate information on company websites or through investor relations contacts. In one case, the short period of time between the announcement of stock market listing and the initial public offering (IPO) made it difficult for investors to review the company prospectus, leading to troubles in the IPO process. Also, the small size of the market and low level of liquidity are important factors deterring investors, and the short hours of operation of LSX (only three hours each weekday) have been cited as presenting challenges for some traders.

Institutional investors and other intermediaries have been slow to establish in the Lao securities market. Securities companies, providing financial advice, brokerage services and underwriting for securities issuance, have not yet developed a substantial revenue base. There are currently four active securities companies in Lao PDR (Lanexang Securities Public Company, BCEL-KT Securities Company Limited, Lao-China Securities Company Limited, APM Lao Securities Company Limited) and one foreign representative office (Capital Nomura Securities), though not all of these have functioning websites. Although there are more than 50 accounting firms in Lao PDR (including all of the Big Four), most of them focus on accounting services and do not conduct audits.

The Lao government has expressed its ambition to expand the capital market. The Strategic Plan on Capital Market Development for 2016-25 states the aim of having 25 listed companies by 2020 and 60 listed companies by 2025. Awareness raising activities with companies and other stakeholders on the benefits of capital market access is a key component of this strategy. The Lao authorities have also expressed future plans to: *i*) explore the bond market, *ii*) introduce mutual funds, *iii*) extend trading hours beyond the current morning session, and *iv*) launch a new exchange for small and medium-sized enterprises. To enhance the relationship with regional and foreign investors LSX has signed memoranda of understanding with the Hanoi Stock Exchange, the Ho Chi Minh Stock Exchange and the Stock Exchange of Thailand. Looking ahead, LSX aims to become a member of the World Federation of Exchanges and the ASEAN Trading Link.

Note

1. The *G20/OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State-owned Enterprises* were both revised in 2015, taking in account recent developments in financial markets and the corporate sector. The *Principles* were endorsed by the G20 in 2015.

References

Andriesse, E. (2014), "Regional Varieties of Capitalism in Southeast Asia," February 2014, Working Paper No. 175, Murdoch University, Perth.

Dalaloy, Vathana, *Presentation on Lao PDR Perspectives on Capital Market Development,* Asia-Pacific Outreach Meeting on Sustainable Development Financing, June 2014, Jakarta.

Quang, T. & Thavisay, C. (1999). *Privatization and Human Resource Development Issue: A Preliminary Study of State-Owned Enterprises in the Lao People's Democratic Republic*, Research and Practice in Human Resource Management, 7(1), 101-123.

Siackhachanh, A. Noy (2012), *Strengthening the Financial System and Mobilizing Savings to Support More Balanced Growth in ASEAN+3*, ADB Working Paper Series on Regional Economic Integration, March 2012, Manila, Philippines.

Songvilay, L. and Vanthana Nolintha (2011), *Securities Market in Lao PDR: Challenges for Security Market Development at Early Stage*, National Economic Research Institute, 2011, Vientiane.

World Bank (2009), *Report on the Observance of Standards and Codes: Accounting and Auditing*, January 2009, Washington DC.

Chapter 5

Investment promotion and facilitation in Lao PDR

This chapter provides an assessment of the investment promotion and facilitation framework in the Lao People's Democratic Republic (Lao PDR). It examines existing strategies and institutions governing investment promotion and facilitation with a particular focus on the Investment Promotion Department. It highlights key reforms and remaining challenges to improve the business environment and attract foreign investment to diversify the economy, including in special economic zones. It also provides recommendations on the investment incentives regime as well as on measures to encourage business linkages with small and medium-sized enterprises and other policies to maximise investment spillovers.

Summary

Investment promotion and facilitation measures can be powerful means to attract investment and maximise its contribution to development. Effective investment promotion and facilitation is not only about promoting a country as an investment destination and making it easy for investors to establish or expand their existing investments, it is also about ensuring that these investments create linkages with domestic companies and contribute to skills transfer.

The landscape for investment promotion and facilitation in Lao PDR is dictated by the different existing routes to invest in the country. Different entry points exist, with little co-ordination, which affects the results in terms of improving the business environment and attracting foreign investment. Tax incentives for investment are generous and special economic zone development has taken an important role in the government's investment promotion objectives. FDI in Lao PDR has mostly been geared to natural resource sectors and the government is putting increasing emphasis on diversifying the economic sectors for FDI and attracting quality investments that generate spillovers and linkages with the local economy.

Policy recommendations

- In line with the newly-amended *Law on Investment Promotion*, develop an investment promotion strategy that supports Lao PDR's economic diversification objectives and reinforces the role of the IPD as the national investment promotion agency – including by separating more structurally its regulatory and promotion functions. FDI attraction measures should be better co-ordinated across government, notably between the Investment Promotion Department and the Secretariat of the National Committee for Special Economic Zones, to ensure consistent messages are provided and activities serve overall development objectives.

- To support inclusive growth, create a more favourable business environment for all firms, including SMEs. A taskforce of ministries and stakeholders, supported at the highest level of government, should be set up to identify and eliminate all unnecessary licences and administrative obstacles to start and operate a business. Client charters with clear deadlines and fees for licensing should be prepared and relevant ministries should sign memorandums of understanding to ensure deadlines are systematically met. While the development of the multiple one-

stop-shops should not be a top priority of the government, increased dialogue with the private sector should be more systematic including through aftercare and policy advocacy and by revamping the Lao Business Forum.

- Make existing tax incentives for investment more transparent and rules-based, to ensure that all companies operate on an equal footing and know exactly what to expect and under which conditions. The tax incentives regime should be redesigned, after a thorough cost-benefit analysis, to increase revenue collection to secure the necessary resources for the state to invest in education and skills development – a critical aspect of Lao PDR's investment climate and economic development.

- Enhance the development impact of FDI by encouraging linkages with domestic firms, notably with increased industry-specific capacity-building activities to help SMEs acquire absorptive capacities and the facilitation of information exchanges between foreign and domestic firms through supplier databases and matchmaking events. In its FDI attraction measures, the government could also focus on foreign investors that are more inclined to source locally and to contribute to industrial cluster creation. Inter-agency co-ordination will be key in all these activities as well as the private sector contribution. While the government will need to tackle the issue of low labour productivity, businesses should be increasingly involved in the human resource development strategy design and be further encouraged to upgrade employees' skills.

Institutional framework for investment promotion and facilitation

Overall setting

The Ministry of Planning and Investment (MPI) – particularly its Investment Promotion Department – is officially competent for all matters that relate to investment in Lao PDR but other ministries play a key role in many regards. The Ministry of Industry and Commerce (MOIC) grants licences for some investments in general activities, and the National Committee for Special Economic Zones (NCSEZ) has been responsible for approving projects in SEZs, which should be transferred under the MPI according to the newly amended *Law on Investment Promotion.* The law provides for two types of investments: i) general activities and ii) concession investment. The former is divided into two sub-categories: business activities under the controlled business list and business activities outside

the controlled business list. The latter activities are regulated by the *Enterprise Law* and fall under the responsibility of the MOIC.

Each type of investment has a different process for obtaining the appropriate licences to start a business, which are detailed in the law (see section on facilitating investment below). As a consequence, the MOIC and the MPI are, to varying degrees, involved in what constitute the core functions of investment promotion and facilitation. Sectoral ministries, such as the Ministry of Energy and Mines, also play an important role, particularly for investments in concession activities. Provinces are involved through their Provincial Departments for Planning and Investment and are mostly active in investment facilitation, notably through public-private dialogues.

The Committee for Investment Promotion (CIP) has been the governing body responsible for providing strategic orientations and co-ordinating investment promotion measures in Lao PDR under the 2009 *Law on Investment Promotion*. It is chaired by the Minister of Planning and Investment and meets twice a year. Its members include officials from the ministries/departments of industry and commerce, finance, public security, labour and social welfare, foreign affairs, agriculture and forestry, energy and mines, public works and transport, telecommunications and post, education, public health, water resources and environment, sciences and technology, national tourism, national land management, national defence, information and culture, justice and banking. The IPD acts as the CIP's secretariat. The CIP's exact role and functions are detailed under the Decree on the Implementation of the *Law on Investment Promotion*. The same committees also exist at provincial level and are chaired by the governor.

The 2016 amendment of the *Law on Investment Promotion* provides for the establishment of an Investment Promotion and Supervision Committee, a similar but higher-level inter-ministerial co-ordinating committee headed by the Deputy Prime Minister and overseeing investments in controlled activities, concessions and SEZs. This measure testifies to the authorities' willingness to consider investment through a coherent and whole-of-government approach and is a reflection of the process that has led to this *Investment Policy Review*.

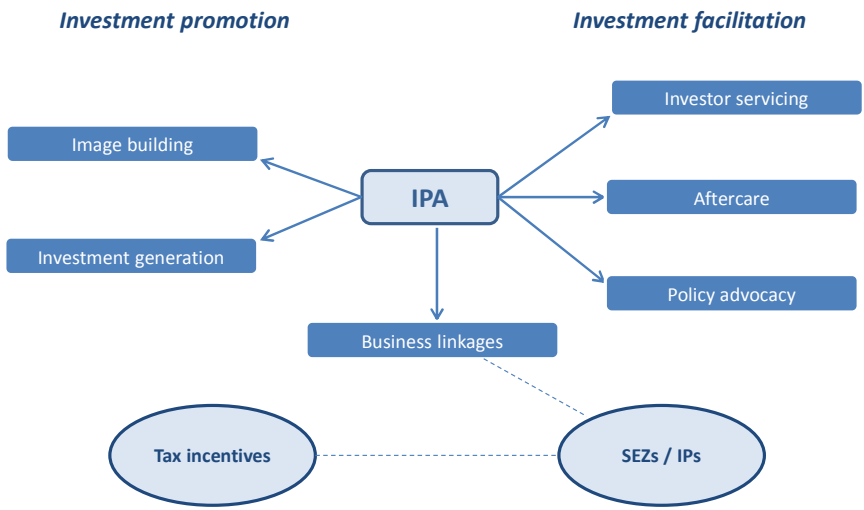
Recognising the importance of investment for economic development, most countries have established investment promotion agencies (IPAs) dedicated to promoting and facilitating investment. It is estimated that over 170 national and 260 subnational IPAs have been created worldwide (OECD, 2015a). IPAs can be independent, semi-autonomous or part of a ministry. Although large differences exist across countries, IPAs are usually major players in the implementation of five key functions:

- *image building* consists of fostering the positive image of the host country and branding it as a profitable investment destination;
- *investment generation* deals with direct marketing techniques targeting specific industries, activities, companies and markets, in line with national priorities;
- *investor servicing* is about providing support to prospective investors in order to facilitate their establishment phase;
- *aftercare* aims to retain established companies and encourage reinvestments by proactively responding to investors' needs and challenges after their establishment; and
- *policy advocacy* includes identifying bottlenecks in the investment climate and providing recommendations to government in order to address them.

While the first two functions relate more to investment promotion, the latter three are usually associated with investment facilitation (Figure 5.1). Some IPAs also perform other functions, such as encouraging business linkages between foreign affiliates and domestic companies, which is a combination of investment promotion and facilitation but also a measure to enhance the development impact of FDI (see section on business linkages below). Governments usually supplement their investment promotion and facilitation strategy by providing tax incentives to attract foreign investors and by creating special economic zones or industrial parks to facilitate their establishment in dedicated sites where basic facilities and additional tax incentives are often provided.

Investment, including FDI, is recognised as a key engine of growth and job creation in Lao PDR, but investment promotion and facilitation activities, as described above, are still at early stages of development. They seem to be mostly conducted as "side-activities" by government entities in charge of regulating investment policy and business related matters. This mostly affects the MPI/IPD but also the MOIC and, to a lesser extent, the NCSEZ. In other words, those ministries/departments responsible for promotion and facilitation have much broader mandates that include designing and reforming laws and regulations, negotiating international agreements, screening incoming projects, granting investment licences and registering companies, regulating and monitoring existing investments as well as negotiating contracts and incentives packages with investors.

Figure 5.1. **Core investment promotion and facilitation measures**



The investment promotion agency: IPD

Against this background, the Investment Promotion Department (IPD) is the dedicated IPA established in 2004 under the *Law on the Promotion and Management of Foreign Investment*, before being renamed as IPD in 2007 and is currently governed by the *Law on Investment Promotion*. As one of the 12 departments of the MPI, the IPD is fully government funded and hence not an autonomous body and with little room for manoeuvre in comparison to most IPAs worldwide. The IPD is made up of seven divisions: administration; investment promotion; project screening; legal affairs; planning and project monitoring; one-stop services; and international investment co-operation.

The mandate of the IPD encompasses both promotional and regulatory/administrative functions, including promoting Lao PDR as an investment destination, offering investment incentives, screening investment proposals, collecting investment data and monitoring investment operations. In practice, as described above, most of the IPD's work seems to be regulatory (screening and regulating companies) more than purely promotional (marketing the country and attracting investors) – see Box 5.1. It is also highly focused on FDI in concessions, as it is in charge of approving these types of investments. The IPD's Investment Promotion Division – the sole in charge of the latter tasks – employ only six staff members.

Box 5.1. **Main functions of the IPD**

The main functions of the IPD include the following:

- Examine, report, consider, approve or reject investment activities;
- Examine, report, consider, approve or reject amendment, transfer of shares, renewal, modifications, changes, suspension or cancellation of investment activities or the memorandum of understanding, project development agreement and other concession agreements;
- Consider approval of project lists or investment calling activities;
- Sign concession registration certificate or other authorisation;
- Sign any legal document such as an MOU, project development agreement and other concession agreements as assigned by the government;
- Monitor, inspect, assess, encourage and provide guidance to business corporation to properly conduct business activities in accordance with the agreement, the laws and regulations of Lao PDR;
- Monitor and inspect the promotion and management of the process of issuing investment licence by the Committee for Investment Promotion (CIP) at each level;
- Notify the suspension or cancellation of concession registration certificate or other authorisations that violate the Law, regulations, MOU, project development agreement or concession agreement.
- Convene concluding meetings, evaluate and draw lessons from the implementing the one-stop service, promotion work and investment management on a quarterly, semi-annual and annual basis;
- Approve rewarding and disciplinary sanctions for officials of the one-stop service office of the planning and investment sector; and
- Perform other tasks as assigned by the government.

Source: IPD.

Promoting SEZs

As in many other countries, Lao PDR has started developing special economic zones as part of its strategy to attract foreign investment and, as such, contribute to economic development. The first zone was created in Savannakhet in 2002 following which the National Committee for Special Economic Zones (NCSEZ) was established by decree in 2010. It is chaired by the vice prime minister and includes relevant ministers, vice-ministers and high-level officials as well as governors of provinces where SEZs are located. The Secretariat to the Committee is the specialised agency mandated to assist the NCSEZ in implementing activities. It was attached to the Prime Minister's Office under the 2009 *Law on Investment Promotion* with a mandate to assist the NCSEZ to liaise with both local and foreign parties regarding SEZ activities, and to ensure the regular administration and management of the NCSEZ. Under the 2016 amendment of the law, the responsibility of SEZ investments has been brought under MPI. This decision, in line with the recommendation of an earlier draft of this *Investment Policy Review*, should allow for a well-integrated investment promotion and facilitation strategy and better co-ordinated activities.

It remains to be seen how the new institutional set-up for SEZ promotion and management will be implemented and to what extent the functions of the NCSEZ will be transferred to the MPI, which included:

- Lead and manage the SEZs countrywide (special economic zones, export-oriented industrial zones, industrial zones and parks, goods transit centres, tourist towns, free-tax zones, border areas, new township zones and other zones);
- Consider and approve the policies and legal acts pertaining to the development and management of SEZ activities in the whole country;
- Formulate the strategic plan for development of SEZs in the whole country;
- Advertise, disseminate and attract investments for developing SEZs;
- Research, look for funding sources, and ensure the management of the fund from both local and foreign parties for the purpose of developing SEZs; and
- Provide advice, suggestions; encourage, follow-up, control, facilitate and resolve all problems arising in SEZs in order to allow it to perform development activities; and manage SEZs so as to ensure maximum economic and social efficiency, justice, social

order, peace, safety, security, environmental protection, sustainable development, etc.

The authorities define an SEZ as an area that provides facilities for business operation and that makes social and economic infrastructure available. SEZs can include specific economic zones, which are targeted at specific sectors including manufacturing, export production, tourism and duty-free trade. SEZs have been developed to achieve the targets of the National Socio-Economic Development Plan 2011-15, but they remain a relatively new concept in Lao PDR. Since 2002, ten zones have been created, although the private sector reports that only two are fully operational.

A Development Strategy for Special and Specific Economic Zones in Lao PDR, 2011-20, was developed in 2012 to provide more concrete guidance on SEZ development and management. One of its immediate results is the preparation by the government of a new SEZ law to upgrade Decree No 443/PM so as to ensure that SEZs have their own regulatory framework. Until recently, SEZs were governed by the 2009 *Law on Investment Promotion*. Having distinct legal foundations for SEZs and non-SEZ investments reflects good practice.

Marketing Lao PDR and attracting the right investors

Investment promotion measures

The *Law on Investment Promotion* provides little information on the five core functions of investment promotion described above. Instead, it defines investment promotion as the following: formulating policies that create a favourable investment environment; providing incentives to investors, mostly tax incentives but also those related to land; and providing information. Providing information to prospective investors should not be perceived as an incentive, as it is a core function of IPAs. Correcting market failures related to information gaps is one of the main *raisons-d'être* of IPAs worldwide. The importance of proactive promotion, other than providing incentives, should not be underestimated, as some studies have linked greater investment promotion with higher FDI flows, on top of the influence of the country's investment climate and market size (Morrisset, 2003).

While the IPD is active in image building, it does little investment generation. Image building is a function of almost all IPAs by drawing attention to profitable investment opportunities in the host economy and involves marketing the country as an investment destination by creating a positive image of it while also overcoming potentially negative perceptions (OECD, 2011). Typical promotional activities include advertising, public relations campaigns, dissemination of brochures, participation in fairs and

fora, and developing the IPA website which is of particular importance, as it often contributes to building the first impression of prospective investors about the host economy. It also constitutes an easy means for the IPA to centralise all the information relevant to foreign investors at a reasonable cost. The IPD's website is relatively clear and well-structured and provides the basic information a prospective investor is usually looking for, including: the IPD's role and contact information; all relevant laws and regulations; clear information on the different forms of investment and related procedures to start a business; links to relevant ministries' websites; and some FDI statistics and information on the economy.

IPD's website focuses very much on procedural and administrative aspects, however, and could more strenuously showcase investment opportunities by, for example, providing additional factual and quantitative details on key economic sectors to better allow investors to take an informed decision. It could also include a list of all services that the IPD can provide to prospective and existing investors, and provide information on relevant existing support programmes and measures – including but not exclusively incentives. In this regard, less emphasis should be put on providing tax incentives, as this should not appear as the only motive to invest in Lao PDR but as one reason among many others. In this light, the website could also highlight the reforms taken by the government to improve the investment environment. Some IPAs also include success stories and testimonies from existing foreign investors, which is an effective technique to raise the country's profile as an investment location and build investor confidence. An informative and regularly updated website will contribute to placing Lao PDR on the radar screens of international investors.

The government does not have a well-defined, inward investment promotion strategy. As a consequence, the IPD does little proactive investor targeting and lead generation. These activities require IPAs to align themselves with national priorities to identify potential sectors and investors, and use direct marketing techniques to approach them. Investment generation is a complex function that involves sophisticated institutional capacities, as in addition to a thorough sector-specific knowledge, it requires a good understanding of MNEs' internationalisation strategies (OECD, 2011; 2015a). In other words, the IPA's staff members have to be able to grasp companies' investment location decision processes and identify their requirements long before their investment decision is taken, so as to effectively respond to their needs and enquiries during their investigation phase, and influence their decision making.

The IPD should focus its promotional efforts on industries where a locational advantage can be developed rather than on industries for which Lao PDR already has a natural advantage. Lao PDR has been quite

successful in attracting FDI in the past few years, but flows have been largely concentrated in mining and hydropower (see Chapter 1 on trends in foreign investment and trade). Recognising the need to diversify the economy and the role that investment promotion can play, the IPD plans to concentrate its FDI attraction efforts on more targeted sectors. Specific industries are not yet clearly identified but they include food-processing, value-added manufacturing and tourism. It is also the government's objective to attract quality investment; in other words investments that generate jobs, create value-added and meet certain social and environmental criteria (see Chapter 6 on responsible business conduct).

The IPD is also focusing its efforts on a limited number of countries and has established offices in key partner countries, namely China, France, Japan, Russia, Thailand and Viet Nam. Using diplomatic missions in countries that headquarter MNEs with the highest probability to invest constitutes an efficient way to support inward investment attraction while maximising resources. The IPD and other government representatives, such as the MOIC and the NCSEZ, are also taking advantage of bilateral or regional events, such as the ASEAN-Korea, ASEAN-China and Asia-Japan investment fora, to advertise investment opportunities in Lao PDR. Although not necessarily in a co-ordinated manner, the IPD and the NCSEZ Secretariat both organise missions abroad and arrange business delegation visits.

Although opening overseas offices and participating in international exhibitions relate more to promotional activities than direct marketing, narrowing down the scope of countries and sectors targeted for FDI attraction constitutes a good first step towards more active and targeted investment generation. In this light and with a view to meet the country's objective of attracting quality investors, the IPD will need to build internal capacities so as to be able to conduct proper investment generation. A clear strategy will also need to guide the agency's activities, as there is a risk associated with targeting specific sectors or "picking winners" if these decisions are made based on political agendas rather than on carefully crafted economic rationales.

Institutional and strategic considerations

The IPD is well placed to conduct those activities, but in order to be able to perform them and build the related capacities, the *Law on Investment Promotion*'s implementing decrees should give a clear mandate to the IPD to conduct proper investment promotion. It could describe in general terms the key functions it should perform (*i.e.* image building, investment generation, investment facilitation, aftercare, policy advocacy) instead of overly focusing on its regulatory role, as is the case in the previous version of the law. Without a solid legal framework, the IPD's organisational position can

be unclear, potentially resulting in duplication of initiatives and other inefficiencies.

The IPD is the government's focal point for investment policymaking, in charge of drafting investment laws and negotiating international investment agreements. This tendency of mixing policy and promotion also occurs elsewhere in Southeast Asia but is not a common practice in IPAs worldwide. Some studies show that those IPAs focusing exclusively on investment promotion achieve significantly higher results in attracting investors than those which carry out both regulatory/administrative and promotional activities (World Bank, 2011). Furthermore, giving IPD responsibility for investment approvals only in concession activities might not be an appropriate incentive to actively promote FDI in all sectors of the economy.

More resources should be given to the promotional functions of the IPD and, in this context, a clear structural delineation between its regulatory and promotional functions should be carried out. A more radical alternative would be to divide the IPD into two departments within the MPI – one in charge of regulating investment and reviewing investment applications, and the other responsible for FDI promotion and facilitation. If this option is considered, the promotion part of the IPD could increasingly take more autonomy from the MPI. In most countries, the ministry in charge of investment is responsible for investment policy making and, if appropriate, other regulatory aspects such as reviewing investment proposals and monitoring companies' projects. Meanwhile, the IPA is more autonomous from the ministry, sometimes with private sector participation, seeking to find a balance between following the government's strategic orientations and representing the views of investors. Successful IPAs are characterised by high political visibility and strong private sector participation.

The government also needs to prepare a coherent inward investment promotion strategy, with clear objectives, activities and monitoring indicators, which targets specific activities in line with national economic development priorities – such as those outlined in the National Socio-Economic Development Plan The content of the investment promotion strategy revolves around the question of what to promote and depends on the balance between the country's business competitiveness and attractiveness for investment opportunities on the one hand, and the perceptions and intentions of investors on the other (OECD, 2015a). Decisions on what to promote are usually embedded in policies and can vary over time as global demand and markets change, and as different policymakers use different angles as to what strengths to promote. This strategy should be developed by the MPI in collaboration with the MOIC and in partnership with the relevant sectoral ministries and agencies.

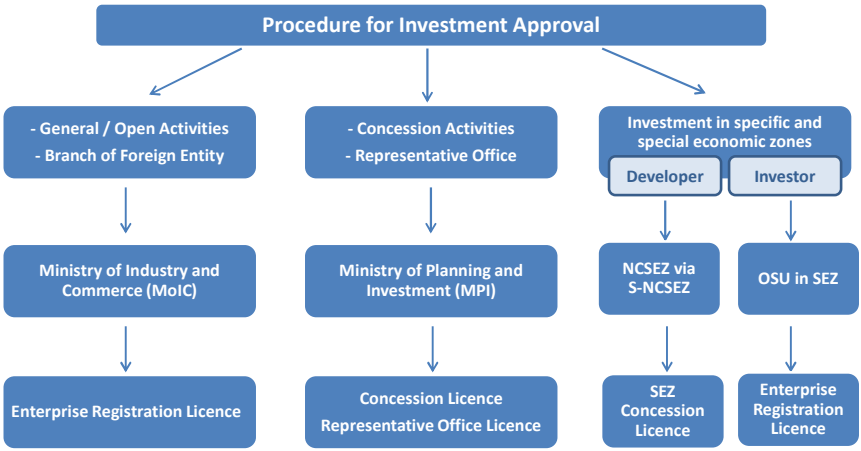
Facilitating investment and reinvestment

Investment facilitation starts when an investor shows interest in a location and depends on how enquiries are handled by the relevant authorities – usually the IPA. It includes all the support that can be provided by the authorities once the investor has decided to invest – many countries have established one-stop-shops to ease the business creation stage. Facilitating the expansion of existing investors and helping them overcome the challenges they face in operating their business is at least as important as facilitating new investments. Aftercare measures can be influential in companies' decisions to reinvest and policy advocacy is a powerful instrument to bolster reforms and enhance the business environment by leveraging the private sector's feedback.

Starting a business

Under the previous *Law on Investment Promotion*, in force until early 2017, there were three types of investments in Lao PDR, each having a different process for investment approval procedures (Figure 5.2). Licences for general business activities were delivered by the MOIC while concession licences could be obtained at the IPD (MPI). Licences for SEZ activities were either issued by the zone's one-stop shop unit (OSU) for an investment in a SEZ or by the NSCEZ for the development of new SEZs.

Figure 5.2. **Investment approval procedures in Lao PDR under the 2009 *Law on Investment Promotion***



Source: IPD.

The three-tier system for investment procedures, resulting in three distinct entry points for investors, brought a certain degree of confusion to investors, especially when incoherent or conflicting messages were delivered. The 2009 *Law on Investment Promotion* did not use sufficiently clear language (*e.g.* on roles and responsibilities among government agencies, deadlines and criteria for granting licences) and some provisions were thus subject to interpretation. This created unpredictability and could consequently leave too much space for discretionary decisions. The law also seemed not to be consistently applied, according to feedback from private sector representatives. The process of registering a company was said to vary dramatically among investors, depending on the sector or the nature of the project, and could take up to six months in some cases, notably due to the lack of co-ordination between the different institutions involved. Long and complex procedures seem to particularly affect wholly-owned foreign businesses, especially SMEs.

This tendency is confirmed by the country's position in the World Bank *Doing Business* survey, where it is ranked 139th out of 190 countries in 2017, a slight decline from 2016, and still the second weakest in the region (Table 5.1). In terms of 'starting a business', it has an even lower ranking, at the 160th position – again the second to last within the region. While this does not portray a comprehensive image of the business environment in Lao PDR, it illustrates the necessity to address certain shortcomings to ease the establishment of new companies.

Table 5.1. **Doing Business in Lao PDR and neighbouring countries, 2017**

(ranking out of 190 countries)

	Lao PDR	Cambodia	China	Myanmar	Thailand	Viet Nam
Ease of doing business	**139**	131	78	170	46	82
Starting a business	**160**	180	127	146	78	121

Source: World Bank.

The government recognises the constant need to improve the business environment so that the private sector can effectively contribute to economic growth. Long delays and costly procedures to establish a new business entity are one of the obstacles to new investment and entrepreneurial activity. Many countries have established one-stop shops to facilitate the establishment phase of investors by providing a single entry window, where all necessary administrative requirements to start a business can be dealt

with. It often requires hosting officials from other ministries under the same roof (such as tax and immigration), so that relevant licences can be granted. Effective one-stop-shops with single-point authority can be a critical factor in investment decisions, especially if they lower the investor's transaction costs. But they can also be costly and, if not efficient, more burdensome than helpful for investors.

The three different entry points for investors in Lao PDR have been defined as one-stop-shops by the government. Consequently, three distinct one-stop-shops have coexisted in the country, which contradicts the definition of a one-stop shop. According to the old law, the division of tasks and responsibilities was supposed to be quite simple and straightforward. The newly amended *Law on Investment Promotion* has reduced the number of entry points for investors from three to two. As described above, only two forms of investments exist under the new law but the responsibility is still divided between the MOIC and the MPI. It is hoped that implementing decrees will reduce the currently high level of confusion on which one-stop shop to go to for non-SEZ investments, whether MPI or MOIC.

For investments in general activities, investors are supposed to obtain their business licence from the MOIC within 10 working days for activities not included on the list of "controlled businesses" and within 13 working days for those that are included in the list. While deadlines are usually met in the former case, the private sector reports that it is almost never the case in the latter. Line ministries need to be consulted to approve the business licences in these controlled businesses, which constitute the majority of economic activities. According to investors, deadlines vary substantially from one project to another, depending on the sector, the nature and location of the project. They are also subject to negotiable fees, making the whole process highly unpredictable and non-transparent. Obtaining a business licence can take six months, sometimes even a year. In some cases, projects are even refused by line ministries with no clear justification. Most investors liaise with the relevant line ministries directly to increase their chances to speed up the process, which renders the one-stop shop unnecessary and unsuccessful.

In addition, the MOIC's one-stop shop is only mandated to issue business licences. Investors need to apply for additional approvals from other ministries, including the tax payer identification number from the Ministry of Finance, the company seal (as well as the business visa and identity card for foreign investors) from the Ministry of Public Security, and the operating licence from the relevant ministry where required. This also contradicts the definition of a one-stop shop. An assessment supported by the Asian Development Bank (ADB) found that on average investors need to go 21 times to a government authority – sometimes several times to the

same – to receive the relevant approvals to start a business under the general activities' category.

For investments in concessions, a number of documents need to be prepared by investors before their application is considered and screened by the MPI/IPD. This process is reported to be multi-layered and complex. The timeframes are also not clearly defined, which leaves space for discretion and unpredictability (see Chapter 2 on the legal framework for investment). Similarly to general activities, an investor needs to go to many different ministries to get the relevant licences and approvals. The ADB assessment found that on average an investor needs to go 17 times to a public administration before being able to start its business in a concession activity.

It is clear that both entry points for investors at MOIC and MPI/IPD are not proper one-stop shops, but given the economic and institutional context of Lao PDR, it might not be an opportune decision to dedicate too much efforts and resources to building effective one-stop shops. As indicated above, if they are to function efficiently, one-stop shops are costly and complex instruments. And if they are not functioning efficiently, they are more likely to add another layer of bureaucracy to the establishment phase of a new investor.

Alternatively, the government should focus rather on facilitating the environment to start a business by strengthening the capacities of the administration, enhancing the transparency in decision-making and streamlining unnecessary licences and approvals. Clear timelines and rates need to be provided to investors, and the relevant government departments have to be held accountable to respect them. The MOIC and the MPI/IPD should enter into agreements with the relevant line ministers to establish performance standards with predefined deadlines to issue each relevant approval or administrative requirement. Complying with these deadlines should be made mandatory, responsibilities should be clearly defined and performance closely monitored. The decisions to grant or refuse a business licence should be transparent and made publicly available, with a right of appeal for those investors who have seen their licence rejected.

The government could consider establishing a whole-of-government taskforce mandated to map all necessary licences and administrative procedures to do business in Lao PDR and identify those that should be streamlined. International good practices show that countries that have successfully enhanced their business environment have driven reform from the highest-level of government with strong political support; have involved all relevant stakeholders, both public and private, from the beginning of the process; and have established a dedicated taskforce to suggest and monitor reforms (Box 5.2).

Box 5.2. **Driving doing business reforms: the example of Rwanda**

In view of improving Rwanda's business environment, a Doing Business Steering Committee with representatives from various ministries was created in early 2009 to lead the reform efforts at cabinet level, with a taskforce made up of different working groups on six business related topics (business entry, licensing reform, legislative changes, taxes and trade logistics, construction permits and property registration). This structure was then reinforced with an operational team, the Doing Business Unit, located within the country's investment promotion agency (Rwanda Development Board). This unit – still active – is responsible for identifying the policy changes that are necessary to positively affect those indicators used in the *Doing Business* ranking. It is in charge of liaising with the working groups, ensuring co-ordination within the government and between the government and donors providing technical support, and monitoring progress through internal indicators. The Steering Committee then approves the unit's reform proposals and submits them to the cabinet.

As a result of this proactive attitude, Rwanda moved from the 158th place in 2007 to the 55th place in 2015 in the *Doing Business* ranking. Several conditions need to be met, including at institutional level, to make such reform processes happen. Strong political will and support is necessary for the proposed changes to be actually turned into concrete reforms. In addition to directly reporting to the Steering Committee, the Rwandan Doing Business Unit also reports to the Prime Minister and keeps the Office of the President regularly informed on progress. Moreover, involvement of various stakeholders is crucial. While private sector representatives are included in the Steering Committee's working groups, the Doing Business Unit systematically informs the private sector about ongoing reforms and has established links with the Parliament and the Judiciary. Civil society organisations and development partners have also been involved.

Source : World Bank (2013), Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises, Washington

The role of the IPD, as the national IPA, should be limited to providing clear and useful information on the establishment requirements to prospective investors. A core mandate of investment facilitation includes filling information gaps created by market failures or distortions. Investment facilitation can thus provide investors with much needed clarity vis-à-vis public administration and policies. The IPD should also make itself available to handhold all interested investors while they navigate the various regulatory and administrative requirements, whether for general or concession activities. Implementing decrees of the new law could empower the IPD with a clearer and more focused mandate to facilitate new investors' establishment.

Aftercare and policy advocacy

In their continuous efforts to provide a friendlier investment climate, governments should maintain regular dialogue with the private sector in order to involve them in policy design and to collect feedback on recurrent issues affecting their operations. Aftercare activities have a potentially high impact on retaining investors and encouraging reinvestments. It is also a more resource-efficient function than investment generation, as it is less costly to win reinvestments through aftercare than to generate investments from new firms (UNCTAD, 2007). Identifying redundant problems faced by investors through aftercare also contributes to the IPA's policy advocacy role and can encourage new investors through word of mouth endorsements by satisfied investors already on the ground.

As a policymaking and regulatory department under the MPI, the IPD is naturally involved in policy advocacy. It is leading the government's national investment policy agenda and is thus directly influencing changes in regulations, laws, government policies and their administration. A more autonomous IPA is usually better placed to find a balanced approach between the government's public policy objectives and the private sector's corporate interests. The question is thus to what extent it uses the private sector's feedback to feed into its policymaking and advocacy function. This depends on the quality of aftercare measures and public-private dialogue.

The government's major aftercare platform is the Lao Business Forum, which is supposed to gather government officials and representatives of the private sector, both domestic and foreign, to discuss options to improve the business environment. It was established in 2005 with the support of the International Finance Corporation (IFC) based on the success of other public-private dialogue models such as those in Cambodia and Viet Nam. The LBF's secretariat is hosted at the Lao National Chamber of Commerce and Industry (LNCCI), the largest and most representative chamber in Lao PDR. The forum used to be held annually but has stopped doing so for several years, especially since the IFC pulled out some years ago. The Forum is composed of ten specialised working groups: taxes, labour, tourism, agri-business, mining, hydropower, logistics/transport, ICT, banking and manufacturing.

Similar public-private dialogue mechanisms exist at provincial level, with the support of the German development co-operation institute (GIZ), but their outcomes are limited. The Forum, when operational, was perceived by the private sector as a successful initiative, allowing a constructive dialogue with the government on existing challenges and potential solutions. An efficient public-private dialogue platform is an important element of a successful aftercare programme and the authorities would be well inspired to

revamp the Forum and give it high political support to make it a useful and effective platform to address investment climate issues.

Beyond the Forum, other measures need to be put in place to retain investors and encourage them to expand their activities. Most well developed IPAs devote a considerable amount of time to working with their existing company portfolio to try to identify potentially new business opportunities for them to consider.[1] In this light, the IPD could consider conducting more systematic and proactive aftercare activities with key investors. This involves responsiveness and effectiveness when concerns are reported to the IPD by investors, but also regular consultations to identify and enquire on recurrent problems they face. In doing so, IPD should limit its efforts to a selective number of companies, based on: *(i)* their propensity to reinvest in Lao PDR; *(ii)* the developmental impact of their investment (notably in terms of job creation and linkages with domestic companies); and *(iii)* the economic sectors in which they operate – focusing on the priority sectors for investment promotion.

Aftercare also provides opportunities for the IPD to strengthen foreign investors' links to local suppliers and encourage them to increase their roles in MNE supply chains (see section on business linkages below). Conversely, evidence shows that long-lasting foreign investors, by knowing the local context better, are more inclined to use domestic suppliers instead of sourcing internationally (Farole and Winkler, 2014). Aftercare thus supports the double purpose of better anchoring foreign investors in the local economy and enhancing their positive spillovers.

Through its aftercare activities, the IPD may also consider working with existing investors to promote responsible business conduct which means in the first instance that businesses should comply with laws, such as those on the respect for human rights, environmental protection, labour relations and financial accountability. Businesses should also strive to go beyond legal obligations and respond to other expectations in society, such as those communicated by international organisations and RBC standards, customers and employees, by trade unions and the local community or through the press (see Chapter 6 on responsible business conduct).

Using tax incentives more cautiously

Although analysis tends to indicate a limited investment response to a lower tax burden relative to revenue forgone, tax incentives are routinely chosen by governments to stimulate investment in general, and FDI in particular. The rationale behind this widespread practice is obvious, particularly in the context of developing countries. It is easier to provide tax incentives than to correct deficiencies in, for example, infrastructure or

skilled labour. Tax incentives do not require an actual expenditure of funds or cash subsidies to investors and can often be politically easier to provide than public funds – although local firms sometimes complain about preferential treatment accorded to foreign firms.

Overview of incentives in Lao PDR

The general profit tax rate in Lao PDR is 24%, with the exception of companies listed on the stock market (19%) and those engaged in the manufacturing, import and sale of tobacco products (26%) (DFDL, 2013; KPMG, 2015). Additional exceptions exist for companies that have a concession agreement with the government, which can thus benefit from a reduced profit tax rate as established in the agreement (see below).

The government offers a wide range of tax incentives, mostly tax holidays, to investors. Under the 2009 *Law on Investment Promotion* (articles 49-55 under Part IV-Chapter 1: "Customs Duty and Tax Incentive") and the *Decree on the Implementation of the Law on Investment Promotion* (articles 31-46 under Part 8: "Incentives related to Duties and Taxes"), tax holidays were granted to investors operating in agriculture, industry, handicraft and services sectors and based on the investors' activities and their geographic location. The latter were determined by geographic conditions and the availability of infrastructure (Zone 1 areas have very little or no infrastructure to support investment; Zone 2 has a moderate level of infrastructure; and Zone 3 has good infrastructure). The detailed lists of the specific promoted activities and zones can be found respectively in Annex 1 and Annex 2 of the implementing decree of the former law. On this basis, a certain period of tax exemption was granted according to the level and zone in which the investment took place.

The newly amended Law on Investment Promotion follows a similar scheme for investment incentives, which are categorised by business activities and by zones. The business activities benefitting from incentives are better specified in the new law and many of them focus on sectors or activities supporting economic development (e.g. modern technology, micro-finance), social progress (e.g. health, education, human resource development) or sustainable development (e.g. efficient use of natural resources, environmental-friendly agriculture). If well implemented, this constitutes an improvement over the 2009 law thanks to a better targeted approach in line with the government's stated goal of attracting quality investments.

The zone categorisation is also slightly different in the newly amended law: Zone 1 areas are poor or remote and have little or no infrastructure to support investment; Zone 2 areas have favourable infrastructure to support investment; and Zone 3 is dedicated to SEZs. As was the case in the old law,

a certain period of tax exemption is granted according to the level and zone in which the investment takes place. Having a specific incentive scheme for SEZs in the investment law could constitute an improvement from the 2009 version if a standardised approach is adopted. Previously, each SEZ had a different set of investment incentives, usually highlighted in the zone's own regulation. Companies investing in SEZs were granted a temporary profit tax exemption (*e.g.* from 2 to 10 years in Savan-Seno) while income and value-added taxes are negotiated between the SEZ Management and Economic Boards and the NCSEZ (ECCIL, 2013).

In the new law, incentives are also conditioned on one of the following: a minimum investment of 200 million Kip; the employment of at least 30 Lao skilled employees; or the employment of at least 50 Lao employees (regardless of their skills). Similarly to the old law, it provides for additional incentives, including exemptions from import and export duties and exemptions from land lease or concession fees in certain cases.

As explained above, investments in concessions are subject to specific profit tax rates and incentives packages negotiated on a case-by-case basis between the government and the investor. Investments falling under this category constitute the largest projects driving GDP growth and the bulk of sectors for FDI. They include mining, hydropower, telecommunications, transport, agriculture, forestry and certain tourism-related projects. This means that much of the economy is not subject to 24% profit tax rate but subject to incentives packages negotiated on a case-by-case basis and without making the details of the agreements publicly available (IISD, 2011).

Transparency and predictability of the incentives regime

Although they are relatively clearly specified in the newly amended *Law on Investment Promotion*, the large number of existing tax incentives and their dual categorisation by business activities and zones makes the current regime potentially confusing for investors and complex for the administration to manage. Incentives in SEZs are governed by separate legislation and investments in concession activities do not benefit from clear and standard granting criteria since they are negotiated on a case-by-case basis.

In the case of concession agreements, the government and the investor negotiate a master list that includes all incentives granted to the latter and the conditions under which they apply. The MPI and the Ministry of Finance, together with the line ministries involved (*e.g.* mining, electricity, forestry), are usually part of the taskforce negotiating on behalf of the government but it is not clear who is the lead ministry and how decisions are taken. It is reported that master lists are sometimes very vague and that the

tax administration often experiences difficulties to implement their provisions. A complex and unclear incentives system not only makes it less predictable for investors but also makes it more difficult for the authorities to administer.

It would be advisable to ensure that granting/qualification for tax incentives is automatic, according to predetermined, uniform and clearly declared criteria. The current incentives regime for investments in concession activities, which is negotiated on a case-by-case basis while involving multiple government bodies, leaves too much space for discretion. Excessive administrative discretion in the hands of tax officials can be problematic for various reasons: it can create unnecessary and counterproductive market distortions (by favouring some firms over others); it can increase the risk of corruption and undermine good governance objectives fundamental to securing an attractive investment environment; and it can also give more bargaining power to investors during the negotiation phase and create opportunities for rent-seeking. It is important that the investment environment, including the incentives policy, provide readability and predictability, where all investors can expect to be treated fairly and equally (OECD, 2015b).

In the same vein, the government should ensure that all tax incentives for investment are ratified through the National Assembly. Currently, overall tax incentives are included in the investment law, but detailed provisions and procedures are yet to be provided in implementation decrees and separate legislation. Others, such as those negotiated by the MPI for concession investments, are provided through executive decrees or agreements. When not adequately scrutinised by the law making body, tax incentives do not provide sufficient transparency.[2] Parliamentary oversight, or its equivalent, is fundamental to transparency and accountability in the governance of tax incentives. This ensures incentives are subject to scrutiny on their intended purpose and their costs as well as benefits to the country (OECD, 2015b).

Consequently, all tax incentives, along with their eligibility criteria, should be consolidated in the main body of tax law. This good practice principle would not only increase the transparency of the system but also provide more means for the revenue authority to effectively administer the tax incentives regime. The investment law can include a reference to the tax law where incentives are detailed. A well-functioning mechanism of greater co-ordination between different levels of government would also improve the transparency of the tax system. Effective co-ordination of tax policy makers with various authorities that are mandated to promote investment, including at local government levels, is critical. One feature of those countries that have been successful in designing tax policy attractive to

investment is that they have generally adopted a whole-of-government approach to ensure consistency between tax policy, broader national and sub-national development objectives and the overall investment attraction strategy.

Nature of incentives

Most incentives provided in Lao PDR are in the form of tax holidays. They aim to incentivise investors to locate in remote areas but fail to do so in practice. Incentives rarely influence investors' location decisions since, as reported by the authorities, most companies invest in urban areas and are hence not eligible for important tax holidays. The government might nevertheless wish to take this opportunity to reconsider this policy, as tax holidays are often an inefficient form of tax incentive (OECD, 2015b). They are the most subject to tax planning activities by MNEs, which are being somehow encouraged to close their business at the end of a tax holiday period to simultaneously open a new firm entitled to new incentives, or to use transfer pricing across subsidiaries to shift profits into holiday companies (Box 5.3). In addition, the law stipulates that the tax exemption period can start on the first profit-making year, which can lead to excessively long period of activities without paying the corporate tax.

Cost and benefits of incentives

No publicly available study on the costs and benefits of tax incentives for investment exists in Lao PDR and, as a result, the government is not aware of either the exact revenue forgone due to incentives or the extent to which this regime contributes to attracting investment into the country. The government should conduct a thorough analysis of the effectiveness and cost-efficiency of its tax incentives to distinguish between beneficial and wasteful tax incentive programmes. It is highly advisable to set up an inter-ministerial taskforce composed of at least the MPI, the MOIC and the Ministry of Finance in order to thoroughly analyse the costs and benefits of existing tax incentives for investment. The government should also conduct such evaluations systematically *ex post*, to assess the extent to which and the cost at which tax incentives meet their intended objectives. The authorities seem aware that there is a need for serious cost-benefit analysis but lack the capacity to conduct it. Table 5.2 provides more details on the benefits and costs that should be considered when conducting a cost-benefit analysis of a given tax incentives programme.

Box 5.3. **Advantages and disadvantages of tax holidays**

- All returns over the holiday period on investment – including returns covering initial investment costs as well as normal profits – are earned tax-free.
- The most open to tax planning, leading to significant revenue leakages – considerably higher than the revenue that would have been forgone from a legitimate activity. Tax holidays invite opportunities for tax avoidance, for instance by using transfer pricing to shift profits into holiday companies. Enterprises can manipulate the cost of inputs because of the difficulty in establishing the true, "arm's-length" market value of inputs purchased from a related entity. Thus, income and deductions can be shifted across entities with different tax treatments either domestically or internationally. As a result, tax revenues can be significantly eroded. Another way to erode profit is through fictitious foreign-ownership (e.g. a domestic company incorporates offshore and reinvests home as if it were foreign-owned).
- Encourage the artificial collapsing and establishment of firms to extend the length of the holiday period. Usually tax holidays are granted to new firms only, so an incentive exists for an old firm to re-establish itself as a new one towards the end of the holiday period to qualify for further tax benefits.
- Most attractive for footloose industries. "Fly-by-night" or short-term investment is in a favourable situation in a tax holiday environment compared to long-term investment. Since tax holidays benefit the industries that start making profits during the holiday period a favourable tax bias exists for short-term projects and short-term assets.
- Tax holidays (or other favourable corporate tax treatment) targeted at export activities could be inconsistent with World Trade Organization (WTO) rules, except for the lowest income countries.
- The impact of the holiday may be diluted once profits are repatriated if the home country operates a worldwide system of taxation. Any reduction in liability in the host country will be offset by increased liability in the home country. However, in practice, concerned firms are quite successful in avoiding such payments by delaying repatriation and/or routing it through third countries. They therefore still benefit from tax holidays.
- Could actually discourage some investment. To maximise depreciation allowances a firm might postpone the investment until later in the holiday period when full deductions may be claimed.

Table 5.2. **Elements to consider in a cost-benefit analysis**

Benefits	Costs
Direct impact by the incentives-motivated investment	Primary revenue forgone due to tax incentives
Indirect and induced impact due to inter-industry transactions and changes in income and consumption	Revenue leakages due to unintended and unforeseen tax-planning opportunities
Positive externalities, such as technology and know-how transfers by incentives-induced FDI	Costs incurred by taxpayers in order to comply with a given tax incentives regime
Social and environmental benefits where tax incentives serve to correct market imperfections	The administrative costs from running the tax incentives programmes due to the complexity introduced to the legislative and regulatory framework
	The costs to the economy of creating an uneven-playing-field where domestic firms are not entitled to the same tax incentives as their foreign competitors

The results of cost-benefit analysis should feed into a revised tax incentives strategy, gradually reducing tax holidays to focus on less costly forms of incentives such as tax credits and tax allowances. Streamlining tax incentives for investment would help to broaden the tax base – as also recommended by the International Monetary Fund and the World Bank Group – and devote more government resources to areas reinforcing overall competitiveness and making growth more inclusive and sustainable, such as education, health and infrastructure.

Enhancing the development impact of FDI through business linkages

Better understanding FDI spillovers and linkages

FDI spillovers encompass various long-lasting, structural benefits that foreign investments can bring to the host country, be they on the quality of the workforce, the competitive environment in the economy, or the creation of supply chain linkages with domestic firms. Business linkages between foreign and local companies are the channel through which FDI spillovers can be maximised, owing to the productivity gains resulting from the transfer of knowledge and technology from foreign affiliates to domestic companies and workers (Farole and Winkler, 2014; UNCTAD, 2010). Determinants of FDI spillovers can be divided into three broad categories as follows:

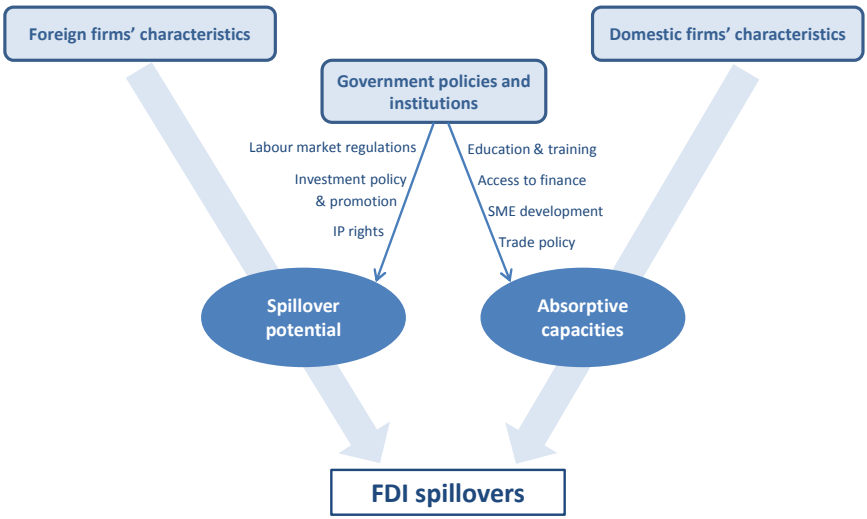
- foreign companies' characteristics – including their global production strategy, the degree and structure of foreign ownership, the entry mode (whether greenfield or mergers and acquisitions), and the determinants of FDI (whether resource, efficiency, market or asset-seeking);

- domestic companies' characteristics – notably their size, their geographic location, the sectors in which they operate, their capacities to overcome the technology and productivity gap, and the availability of adequate skills; and

- host country's institutions and policies – such as labour market regulations, intellectual property rights, access to finance, education and training facilities, investment and trade policies and promotion as well as SME development policy.

While foreign companies will generate spillovers depending on the spillover potential of the particular type of foreign investment in the host economy, domestic firms will benefit if they have sufficient absorptive capacities. To a certain extent, host countries can influence these two transmission channels – foreign firms' spillover potential and domestic firms' absorptive capacities – with adequate policies and institutions (Figure 5.3).

Figure 5.3. **Determinants of FDI spillovers**



Source: Authors adapted from Farole and Winkler (2014); and Paus and Gallagher (2008).

Business linkages occur along the supply chain and can be either backward or forward. Backward linkages refer to upstream sectors and occur when domestic firms become suppliers or subcontractors of MNEs. Forward linkages arise in downstream sectors, when the MNEs' goods and services are used as inputs in local companies' operations or activities. Low-income host countries tend to focus initially on promoting the former as they can more easily foster the potential of local SMEs. Creating linkages also serves the purpose of investment attraction and retention, as it allows foreign investors to be more firmly anchored in the local economy, to adopt a longer-term investment strategy and to be inclined to reinvest or expand activities.

Few linkages between foreign affiliates and local firms currently exist in Lao PDR (see Chapter 1 on trends in foreign investment and trade). Business linkages are determined by a number of external factors and do not necessarily occur automatically but, as highlighted in Figure 5.3, require adequate government institutions, policies and measures. Business linkages depend first and foremost on the availability and capacity of domestic companies. Creating a business environment that is favourable for both domestic and foreign firms, supplemented by SME development policies and programmes to maximise their absorptive capacities, is an important first step. Other, more proactive, measures can also be taken by the government to encourage linkages and interactions between MNEs and SMEs – and attract FDI with a higher spillover potential. The role of SEZs and progressive cluster development is also key to transform the economy. Lastly, education and training policies and institutions to develop human resources is essential to ensure FDI activities benefit the rest of the economy. These different points are analysed below.

Promoting backward linkages in Lao PDR

Supporting SMEs and building absorptive capacities

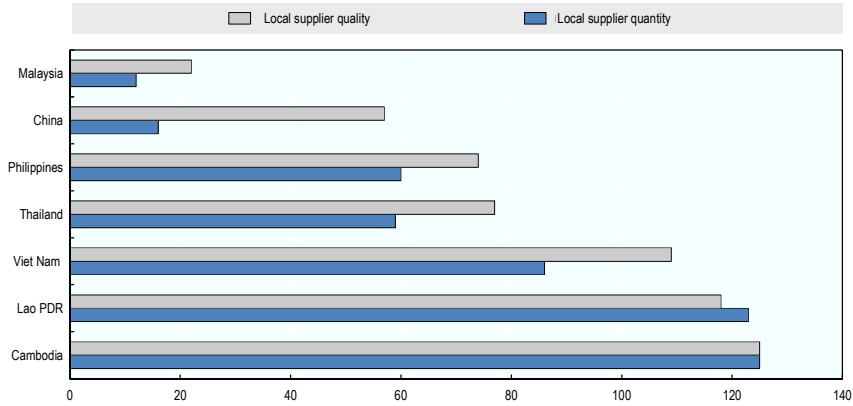
Linkage creation opportunities mainly depend on the availability of an adequate domestic supply-side capacity. The extent to which SMEs are capable of responding to the needs of MNEs determines their ability to serve as domestic suppliers. Those that strive to become suppliers of world-class corporations frequently face challenges related to their size, their own organisational capacity (*i.e.* qualified human capital, quality control and international certifications), external conditions in the economy that are particularly constraining for small firms (such as access to finance), and the high cost of upgrading production processes to meet the needs of MNEs.

Lao PDR is ranked respectively 123rd out of 138 economies for the quantity of local suppliers and 118th for their quality on the World Economic

Forum *Global Competitiveness Index 2016-17*. These figures are relatively weak compared to most of its neighbouring and regional peers, with the exception of Cambodia (Figure 5.4).

According to GIZ, SMEs in Lao PDR represented over 96% of total companies and provided 63% of jobs in 2013. Most SMEs operate in the agriculture and agro-processing sectors but the garment sector is also well represented. The SME sector in Lao PDR is still in the early stage of development, and performance and productivity of SMEs are low compared to large firms or to those in other ASEAN countries (ERIA and OECD, 2014; GIZ, 2014). Most Lao SMEs are family businesses producing low-end products with little value-added. Labour productivity is lower than in neighbouring countries (Kyophilavong, 2008).

Figure 5.4. **Ranking of local suppliers in Lao PDR and regional peers, 2016**



Note: Rankings are out of 138 economies and based on the responses of business leaders to the World Economic Forum's Executive Opinion Survey.

Source: World Economic Forum (2016), Global Competitiveness Report 2016-2017, Geneva.

As a consequence, the vast majority of Lao SMEs serve the domestic market, not only because of their low productivity but also because of the low quality of their products and their lack of knowledge about foreign markets. A notable exception is the garment sector, where Lao SMEs are more competitive thanks to lower wage rates than neighbouring counties (notably Cambodia and Viet Nam) and have developed as supporting industries of export-oriented FDI. Faced with low productivity, garment SMEs in Lao PDR increasingly face difficulties to innovate, expand markets, find business partners and access finance without appropriate

government support (Kyophilavong, 2008). These difficulties are essentially the same as those faced by all Lao SMEs and include limited access to financial resources, asymmetric information, lack of labour skills and a poor overall business environment (Vixathep, 2014)

The main government agency supporting SMEs in Lao PDR is the SME Promotion and Development Office (SMEPDO), which was established in 2004 under the MOIC. SME promotion was included in the Seventh NSEDP (2011-15) and an SME Development Plan 2011-15 was prepared, focusing on the following objectives: (*i*) improving the regulatory environment and public administration of economic activities; (*ii*) improving access to finance; (*iii*) training new entrepreneurs; (*iv*) increasing the provision of support and business development services (BDS); (*v*) enhancing business linkages between large enterprises and SMEs; (*vi*) promoting the growth of productivity for upgrading the quality of SME products and services; and (*vii*) enhancing access to markets and expanding markets for SMEs. The SME Development Plan (2016-20) focuses on productivity, access to finance, BDS (training in particular), new entrepreneur creation and access to markets.

A *Law on SME Promotion* was enacted in 2011 to support the implementation of SMEPDO's activities. Some of its actions have had some effect, such as BDS to provide SMEs with information, training and consultation services on accounting, finance, law and marketing, as well as the establishment of the "Lao PDR Trade Portal" to help their market expansion. However, the *ASEAN SME Policy Index* 2014 undertaken in collaboration with the OECD finds that "even if the result shows quite a strong institutional framework, the funding and human resources in institutions in Lao PDR are not sufficient for the promotion of SMEs" (ERIA and OECD, 2014: p.217). SMEPDO receives some support from international organisations and development partners but relies heavily on aid and does not receive sufficient attention from the government. The LNCCI confirms this assessment and perceives the absence of a robust and well-funded government agency dedicated to SME promotion and development as a major weakness in the overall business environment.

Access to finance is an important challenge for all SMEs around the world and Lao PDR is no exception. Improving access to finance for SMEs was among the government's top priorities in the previous SME Development Plan and remains so in the present one. The SME Promotion and Development Fund was established by decree with the support of the Asian Development Bank and the World Bank. Under the *Law on SME Promotion*, it has been reinforced and renamed as the SME Promotion Fund. Its purpose is to centralise funds from different sources (such as the national budget, grants and loans) to provide credits to SMEs as well as to finance SME capacity building projects.

Box 5.4. **Chile's world class supplier development programme**

Chile is a major player in the mining industry and the largest copper producer globally. Many of the world's largest mining companies, including Anglo-American, Barrick Gold, BHP Billiton and Rio Tinto, are present in Chile, along with other smaller foreign-owned enterprises. Foreign investments in mining and quarrying represent approximately 40% of Chile's FDI stock.

In 2008, BHP Billiton established the World Class Supplier Development Programme to provide local suppliers with an opportunity to offer innovative solutions to challenges faced by mining companies in Chile. Since then, other companies, such as Codelco, joined the programme, which aims to create 250 world-class suppliers in Chile by 2020. The project defines "world class" suppliers as those that are recognised in Chile and abroad, export 30% or more of their services, and have innovative and technologically advanced services. A review of current Chilean suppliers in the mining industry found that 98% of firms were either simple users or adaptors of existing technology and very few were highly innovative in their operations. The aim of the project is to move Chilean suppliers into higher technological areas by 2020. The World Class Suppliers' model encourages mining companies to identify areas where innovative solutions could assist operational efficiency across its operations, and identify local suppliers who have the capacity to work on the problem. Each prioritised challenge is weighted as deemed appropriate and advertised to suppliers.

Although a private sector-led initiative, the project is coordinated by *Fundacion Chile*, a nonprofit corporation that aims to support technology transfer and innovation, and increase the competitiveness of Chilean firms across the economy, but does not provide funding for the projects themselves. *Fundacion Chile* has also produced a guide for mining companies undertaking World Class Supplier projects and a detailed handbook is also in development. The guide includes practical advice for companies in the operationalization of the project.

By early 2012, more than 60 suppliers were participating in the programme. It is noteworthy that after four years, there are 60 suppliers working with two of the world's largest mining firms, using a methodology that was specially designed and successfully tested to identify specific demands and to select and support the potential suppliers. This process has required the collaboration of the mining firm's operations teams, both in the production and procurement processes. The programme is a valuable achievement in terms of collaboration among different stakeholders.

Source : OECD (2013a); and Farole and Winkler (2014)

Building absorptive capacity of domestic companies to enhance FDI-SME linkages requires not only a horizontal approach to SME development but also industry-specific capacity building to help them achieve

technological upgrading and meet quality standards. Lao SMEs are heterogeneous and the potential to become a supplier to a foreign affiliate varies immensely across companies. While it is important to help SMEs to meet international quality standards, such as ISO certification, it might be more important to help them meet industry-specific standards, as the latter are more inclined to help SMEs integrate international supply chains (Farole and Winkler, 2014). Technical support and training also need to involve industry associations and MNEs themselves, which can play a key role in both the design and the delivery of such training, and ensure their relevance (see below section on addressing skills gaps).

The government could draw on the experience of countries that have designed successful industry-specific programmes together with the private sector in key economic sectors. These could include mining, as illustrated by the case of Chile (Box 5.4), hydropower, garment, tourism, forestry or agro-processing. While resource-seeking FDI is less likely to generate spillovers (see above and Chapter 1 on trends in foreign investment and trade), targeted linkage programmes can help maximise their impact on the local economy.

Filling information gaps

MNEs do not necessarily engage in linkages with domestic suppliers automatically – even when local SMEs are competitive enough and technology-ready. Many MNEs are bound by international contracting arrangements that tie them to international suppliers, offsetting the effectiveness of public policies to promote linkages. In some other cases, MNEs rely on their usual overseas business partners for convenience or because of lack of information and do not make the effort to look for local firms that can act as suppliers. In this case, the government can bridge information gaps with targeted measures to facilitate exchange of information. Governments can, on the one hand, inform MNEs about potential local suppliers and their expertise, and, on the other, inform SMEs on foreign investors' needs in terms of products and services, standards and delivery expectations.

The IPD, by directly interacting with foreign investors on a regular basis, is particularly well-positioned to understand their supply needs and requirements. The IPD started organising, in collaboration with the LNCCI, roundtables for foreign investors and local firms with a view to create linkages, but these events need to be further developed before they bear fruit. Fully integrating linkage promotion in its mandate and as part of its facilitation and aftercare activities – for which regular interactions with

MNEs are maintained – could be an appropriate first step. Emphasis should be given to two particular measures:

- *Information dissemination*: the IPD could compile a database of domestic suppliers, in co-ordination with relevant stakeholders such as the LNCCI, the MOIC or other relevant line ministries. This database should respond to MNEs' most common requirements in terms of products and services. Supplier databases should be regularly updated and made available online for foreign investors to access easily and reduce their transaction costs. Databases should be industry-specific and, as a first step, the IPD could focus on existing Lao SMEs in those sectors and industries prioritised for FDI attraction.

- *Matchmaking*: the IPD could organise more systematically, in collaboration with the LNCCI and industry associations, matchmaking meetings between foreign investors and SMEs that could act as suppliers or local partners. These meetings could take the form of large promotional exhibitions or of industry-specific roundtables at a smaller scale. The IPD's role in these undertakings should be proactive, constructive and neutral, as linkage promotion activities can only function in an environment of trust. Relevant government stakeholders, such as MOIC and SMEPDO also need to be involved in these activities.

While information exchange facilitation is typically a function that can be led by IPAs, experience worldwide show that successful linkage programmes require strong inter-agency co-ordination and a genuine engagement from the private sector.

Carefully using local content requirements

As linkages between foreign investors and domestic firms do not occur automatically, countries, especially in the developing world, are increasingly tempted to apply local content requirement policies. These consist of regulatory interventions that can take the form of quantitative targets for local sourcing or procurement procedures that give preference to domestic suppliers (Tordo *et. al.*, 2013). Policies that force foreign investors to buy intermediate inputs in a specific industry from domestic suppliers nevertheless contain a certain degree of risk. They might prove useful only if they are tightly circumscribed to specific industries that have a competitive domestic supply side capable of supplying the targeted foreign investors.

In most cases, local content requirements will raise the targeted industry's production costs – assuming that without these requirements, each investor would be allowed to choose from the most cost-effective source, whether domestic or foreign. As such, a local content requirement is a regulatory intervention constraining firms to choose a less efficient supplier, which will lead to increase prices and thus reduce the competitiveness of the targeted industry across the economy (Stone *et al.*, 2015). Final consumers and non-targeted domestic sectors will consequently reduce their consumption of these particular goods and, in turn, import more of the comparatively cheaper products. Stone *et al.* (2015) also find that the industries under local content requirements tend to increase their share of imported inputs, which is counterproductive *vis-à-vis* their intended public policy objective.

If it is still the Lao government's aspiration to apply local content requirements on foreign investors, domestic supply-side capabilities and potential costs and benefits of such policies need to be carefully evaluated. Local content requirements should be clearly defined, associated with the granting of concessions (*e.g.* in the case of the extractives sector) or of incentives, and allow for a certain degree of flexibility (Farole and Winkler, 2014). The local procurement policy in Ghana's mining sector is a good example of striking a balance between imposing obligations on investors and leaving some flexibility on how to implement them.

Given that domestic firms generally show a low level of competitiveness in Lao PDR, local content requirements are likely to have unintended consequences that would go against national interests and FDI attraction objectives. Alternative policy options should be preferred, including those presented in this chapter that aim to build SMEs' absorptive capacities, establish dynamic linkage programmes, use FDI to build industry clusters, and revisit education policies to upgrade local skills.

Implications for investment promotion

Investment attraction considerations

Given the government's priority to attract quality investors, one might expect that it is not only willing to attract job-creating FDI but also to attract investment that will generate spillovers on the rest of the economy. In this light, the different determinants of FDI spillovers presented above (*i.e.* foreign and domestic firms' characteristics, and government policies and institutions) have implications for the government's FDI attraction strategy. For example, as pointed out previously, market-seeking FDI is more likely to generate linkages than resource-seeking and efficiency-seeking FDI (Farole and Winkler, 2014). This is a particularly challenging consideration, as Lao PDR has a limited market size but is very well endowed with natural resources.

In order to set pragmatic targets, the government first needs to recognise that FDI spillovers and linkages might remain limited, at least in the short run. Promotion efforts should target investors with a tradition of working with and supporting local suppliers; market-seeking FDI with a long-lasting interest in the ASEAN Economic Community; export-oriented investors that export to mature markets; and MNEs that operate in industries and activities that can rely on local inputs (Farole and Winkler, 2014). In the case of mining investments, the government could consider making the preparation of a local linkage strategy a part of the package that has to be proposed by the investors to be awarded a concession or exploration licence.

The role of SEZs and cluster development

Many governments opt for SEZs to attract investors, create jobs and increase export earnings. Common features include a geographically defined area, streamlined procedures – such as for customs, special regulations, tax holidays – which are often governed by a single administrative authority (OECD, 2015b). A zone-based strategy may be effective in attracting investors in the short-run by offering adequate infrastructure, services and duty-free access for capital goods and other inputs. Economic activities within SEZs, allowing for import and export cost reduction measures, nevertheless tend to generate weak linkages with domestic firms if not firmly embedded in a wider development agenda, including appropriate connectivity to the rest of the economy and reduced barriers to investment.

It is critical that local companies are allowed to participate in the activities within the SEZs, especially manufacturing activities. SEZs are usually primarily targeting foreign investors and may have obstacles to domestic firm participation. Yet, if the government is willing to promote linkages, it needs to create a conducive environment for both foreign and domestic companies and not target exclusively the former while jeopardising the productivity of domestic SMEs – for example through a particular incentives scheme. Promoting zones where foreign and Lao companies operate on a level playing field will facilitate FDI integration through geographic proximity and networks (Farole and Winkler, 2014). In the long run, should a particular zone prove successful, the public objective should be to extend its regime and benefit to the rest of the economy (OECD, 2007).

Both OECD and non-OECD countries are increasingly following a more elaborate and comprehensive strategy of cluster development, providing a less trade-distorting framework for the support of strategic sectors. A stronger emphasis is given to SME development in an attempt to link industrial and enterprise policies. Cluster programmes tend to concentrate on strategic sectors for national growth, foster industries in transition, support SMEs in technology absorption, and create competitive advantages to attract

FDI and promote exports (OECD, 2007). The existence of industry clusters at the local level also represents an important location factor for many MNEs. Dynamic clusters rely on the smooth interaction of a number of pillars, combining public policies and initiatives at the firm-level. Successful clusters typically entail the following characteristics, critical for generating new technology, innovation and firm creation:

- Strong role of government (national or sub-national) in promoting stability and basic infrastructure;
- An institutional environment that stimulates technological acquisition and transfer, including the protection of intellectual property rights, well-designed science and technologies policies and the involvement of research and development institutions;
- Global connectivity of clusters through value chains and markets;
- Competent intermediary organisations to promote horizontal connectivity and co-ordination among actors and stakeholders (OECD, 2015b).

Box 5.5 illustrates that successful linkage creation programmes with a cluster focus combine a well-functioning inter-agency co-ordination, private sector commitment, facilitation of information exchange and sector-specific capacity-building for SMEs in line with MNE standards.

Box 5.5. **Clusters and linkage programmes in Costa Rica, Brazil and Malaysia**

Costa Rica: Free trade zones and linkage development

Costa Rica is often cited as a success story in attracting FDI, mostly in its Free Zone Regime, that contributed to the transformation of its economy to high technology manufacturing and services. Within free zones, high technology companies lead growth in FDI and exports. In order to increase the value addition of MNEs' production and the competitiveness of SMEs, the government launched a project in 1999 to develop domestic suppliers of high-technology MNEs. The project had three main elements: a pilot supply programme, an information-sharing system and a national agency for supplier development (*Costa Rica Provee*). *Costa Rica Provee* aimed to understand the needs of MNEs, to identify potential suppliers and to connect MNEs with qualified suppliers. Between 2000 and 2010, the programme facilitated over 300 business linkages for local SMEs concentrating in the packing, packaging, metalworking, plastics and technology services sectors. An assessment of the programme showed that buying MNEs reduced their costs by 16%, reduced their quality problems by 2.5% and improved their deliveries by 32%.

Box 5.5. **Clusters and linkage programmes in Costa Rica, Brazil and Malaysia** (cont.)

The programme has since become the export linkages department of the national trade promotion agency (PROCOMER). It focuses on sectors targeted in FDI promotion (high-technology industries, life sciences and services). The Export Linkages Commission was created in 2010 to facilitate inter-institutional policy coordination to expand and deepen effective linkage building. The commission is led by PROCOMER and consists of relevant ministries, the Costa Rican IPA (CINDE), technological development institutes and chambers of commerce. Recently, further emphasis has been put on strengthening SMEs' capacities to innovate.

Brazil: SME cluster in the oil and gas industry

The Local Productive Arrangements Programme (*Programa de Arranjos Produtivos Locais*), which includes an export promotion dimension, is a cluster development programme targeting SMEs. While the government provides capacity building to SMEs, SEBRAE (the SME promotion office) has successfully promoted linkages between local SMEs and MNEs, notably those operating in the oil and gas industry. The government has been providing capacity building to help SMEs meet global standards, upgrade their use of information technology and enhance their management expertise. As a result, SMEs, in their interactions with oil and gas companies such as Petrobras, have been able to build capacities in maintenance, electronics, engineering, painting and assembly.

Malaysia: industry clusters and SME development

Industry clusters are an integral part of Malaysia's industrial policy. While Penang hosts one of the country's most developed technology clusters, particularly in the manufacturing of semiconductor-based electronic components, other industry clusters have emerged in Klang Valley, in the ICT and machinery sectors, and in Johor, in the furniture and palm oil industries. More recent effective public-private co-operation can be seen in the establishment of the Penang SME Centre and the Penang Science Council. The Centre, established in 2012 to act as an incubator for SMEs, is strongly supported by the Penang State Government, which provides rental subsidies to support SMEs to take advantage of the facility. It is the result of effective collaboration between the Penang Skills Development Corporation, investPenang and the Penang Science Council. Good systemic co-ordination resulted in close links and relationships between companies and institutions in Penang.

The geographical proximity of the companies, investPenang and other support agencies, has helped economic agents develop strong ties and networks. This has greatly facilitated the exchange of information and feedback circles, even informally. In Penang, public-private partnerships and other collaborative efforts have also led to a number of spin-offs and to the creation of new enterprises by former employees of MNEs.

Source : OECD (2013b); UNCTAD (2010) and OECD (2013c)

Addressing skills gaps

Policies that develop and maintain a skilled and adaptable workforce, and ensure the full and productive deployment of human resources, support a favourable investment environment. If a country is willing to use FDI as a catalyst for economic development through the creation of productive business linkages, a skilled labour force, tailored to private sector needs, is vital. Human resource development policies should be designed in light of broader development objectives and investment policies.

Public and private sector stakeholders all agree that low skill levels and labour productivity are among the major constraints to investment in Lao PDR. The World Bank *Investment Climate Assessment 2014* notes that "productivity in Lao PDR is estimated to be about half what would be expected for a country at this level of development". While real wages have continuously risen over the past years, labour productivity has not improved, thus affecting firm-level competitiveness. International organisations such as the United Nations and the World Bank stress the weakness of the overall local education system[3] and the IMF (2015) highlights that government spending in education is currently low compared to regional peers. The World Economic Forum's *Global Competitiveness Report 2016-17* ranks Lao PDR 106th out of 138 economies for higher education and training.

The government is well aware of the need to improve its education system, which is illustrated by the numerous strategy plans and policy documents that have focused on education and skills development in the past few years.[4] The next NSEDP for 2016-20 also puts education and productivity growth at the centre of its strategy. This includes improving the quantity and the quality of primary, secondary and tertiary education as well as further developing technical vocational education and training (TVET). While emphasis is put on expanding the educational basic infrastructure to increase access to education, curricula for vocational and university education will be further adapted to the Lao economy so as to develop and upgrade the necessary skills. Measures will aim to raise labour productivity through capacity building, notably for SMEs, reforms in the agriculture sector, and labour movement from agriculture to higher productivity industry and services sectors.

Creating the environment for increasing the supply of qualified individuals not only requires educational reforms but also private sector involvement. The government's Education Sector Development Plan 2011-15 recognises that there are few links between education institutions and the private sector, not only for courses and cursus planning and delivery, but also for student placement and employment. The government nevertheless understands the need to involve the private sector in the design and

implementation of its human resource development strategy, especially for tertiary education and TVET, so as to ensure the relevance of existing curricula *vis-à-vis* the needs of the labour market.

While putting increased efforts on improving the overall education system is one of the most important elements to improve competitiveness, the results of these commitments will only bear fruit in the long run. Parallel measures need to be put in place to face the pressure of imported skills and to make sure the Lao people benefit from an increasingly liberalised and open economy, especially within the ASEAN Economic Community. The government should recognise the need, in the meantime, to facilitate the import of the necessary skilled labour, so as to avoid undermining the growth of potentially competitive sectors (World Bank, 2014). The situation improved slightly when the *Labour Law* was amended in 2013 to allow firms to fill 15% of vacant positions with foreign labour, up from 10% previously (EIU, 2015). In the same vein, Lao PDR and Viet Nam signed in 2015 an agreement to promote legal labour migration between the two countries. Viet Nam is an important source of FDI and many of its citizens work in Lao PDR illegally. This agreement is thus a good step to reassure potential Vietnamese investors that are looking for specific skills to realise their investments.

Further encouraging training by companies is another measure that the government needs to address in the short term. While formal education equips individuals with the skills needed to learn, new recruits tend to lack the firm-specific knowledge that businesses require to unlock an employee's full productive potential. Internships and co-operative programmes with educational institutions are proven strategies, and businesses should also be encouraged to help develop the skills of their employees through, for example, on-the-job training or by funding specialised education to benefit both the company and the employee. Training programmes can increase productivity and the spillovers from MNEs to local firms with higher absorptive capacity for new knowledge and technology. With all forms of education and training, policy action can help ensure that programmes are of good quality and accessible, meet business needs and are regularly reviewed. Policy can further promote integrated links between education and training institutions and providers, businesses and industry to tailor educational programmes to business needs and to provide young people with the information needed to make realistic choices about their studies for future employment.

Several industry associations, in co-operation with line ministries, have established training programmes to upgrade specific labour skills. For example, the Garment Skills Development Centre was created in 2011 by the Lao Garment Association with the support of the MOIC and the World Bank. The centre interacts with companies through a demand-driven and fee-based approach to deliver training, which has shown to have a positive

correlation with line-level productivity (World Bank, 2014). The remaining issue, however, is that few garment firms have been willing to invest in labour training. In any case, close co-operation between policymakers and the relevant stakeholders is necessary. A noteworthy illustration is the Lao National Institute of Tourism and Hospitability, which was created through the effective collaboration between the government, the private sector, development partners and international learning institutes. It provides tourism and hospitability training, such as food production, food and beverage service, accommodation operations, and travel and tourism operations, while maintaining a continuous dialogue with the private sector to ensure its services are customised to emerging requirements.

While adequate skills are frequently lacking in Lao PDR, the problem goes beyond skilled workers, as companies experience great difficulties to hire both skilled and unskilled labour. As indicated above, while real wages continue to increase, labour productivity remains low in most sectors of the economy, making it challenging for companies to find an adequate, even unskilled, workforce. Consequently, whereas skilled workers need to be imported, unskilled workers tend to be exported, notably to neighbouring Thailand (EIU, 2015). As a result, the government decided in 2015 to increase the minimum wage by almost 44% so as to boost employment in the country. This measure is not very likely to make a great difference, however, as the wages in Thailand remain significantly higher.

A general challenge of governments is to develop human resource development policies that encourage the engagement of individual companies to adhere to good human resource practices. In this light, the Lao government could encourage foreign and large domestic companies to adopt a code of responsible business conduct such as the OECD *Guidelines for Multinational Enterprises* (see Chapter 6 on responsible business conduct). Under the *Guidelines,* companies are encouraged to:

- promote local capacity building through close co-operation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets, consistent with the need for sound commercial practice;
- support human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees; and
- adopt, where practicable in the course of their business activities, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of intellectual property rights.

Notes

1. IDA Ireland, for example, gets about 40-50% of its new investment each year from existing companies (OECD, 2015a).
2. The 2016 *Law on Investment Promotion* specifies that the National Assembly has the power to approve projects requiring special incentives, but it does not make it a mandatory and systematic requirement. It will also be difficult to implement in practice given the high number of cases where special incentives are granted.
3. See for example: UNESCO (2012), *Country Programming Document 2012-2015*, Bangkok; and World Bank (2014), *Lao Development Report 2014: Expanding Productive Employment for Broad-Based Growth*, Washington.
4. These include the National Socio-Economic Development Plan (NSEDP 2011-2015), the Education Sector Development Framework (ESDF 2009-2015), the Education Sector Development Plan (ESDP 2011-2015), the National Growth and Poverty Eradication Strategy (NGPES), and the Education for All National Plan for Action (2003-2015).

References

DFDL (2013), *Legal, tax and investment guide: Lao PDR 2014*, Vientiane.

EIU (2015), *Country Report: Lao PDR*, June 2015, London.

ERIA and OECD (2014), *ASEAN SME Policy Index 2014: Towards competitive and innovative ASEAN SMEs*, ERIA Research Project 2012 No. 8, Jakarta.

European Chamber of Commerce and Industry in Lao PDR (ECCIL) (2013), *Investment Guide for Lao PDR*, Vientiane.

Farole, T. and D. Winkler (2014), *Making Foreign Direct Investment Work for Sub-Saharan Africa: Local Spillovers and Competitiveness in Global Value Chains*, World Bank, Washington.

GIZ (2014), *HRDME Enterprise Survey 2013 for Lao PDR*, Vientiane.

International Institute for Sustainable Development (IISD) (2011), *Investment incentives for sustainable development: The case of Lao PDR*, Geneva.

KPMG (2015), *Laos Tax Profile*, Vientiane.

Morisset, J. (2003), *Does a Country Need a Promotion Agency to Attract Foreign Direct Investment? A Small Analytical Model Applied to 58 countries*, World Bank Policy Research Working Paper, No. 3028, Washington.

OECD (2015a), *Strengthening Chile's investment promotion strategy*, www.oecd.org/daf/inv/investment-policy/Chile-investment-promotion-strategy-2015.pdf.

OECD (2015b), *Policy Framework for Investment, 2015 Edition*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264208667-en.

OECD (2013a), *OECD Territorial Reviews: Antofagasta, Chile 2013*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264203914-en.

OECD (2013b), *OECD Investment Policy Reviews: Costa Rica*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264203952-en.

OECD (2013c), *OECD Investment Policy Reviews: Malaysia*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264194588-en

OECD (2011), *Attractiveness for Innovation: Location Factors for International Investment*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264104815-en

OECD (2007), *Competitive Regional Clusters: National Policy Approaches*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264031838-en

Paus, E. and K. Gallagher (2008), *Missing Links: Foreign Investment and Industrial Development in Costa Rica and Mexico*, Studies of Comparative International Development 43: 53-80.

Stone, S., J. Messent and D. Flaig (2015), "Emerging Policy Issues: Localisation Barriers to Trade", *OECD Trade Policy Papers*, No. 180, OECD Publishing, Paris. http://dx.doi.org/10.1787/5js1m6v5qd5j-en

Tordo, S., M. Warner, O. Manzano and Y. Anouti (2013), *Local Content Policies in the Oil and Gas Sector*, World Bank Study 78994, Washington.

UNCTAD (2010), *Creating Business Linkages: A Policy Perspective*, Geneva.

UNCTAD (2007), *Aftercare: A Core Function in Investment Promotion*, Geneva.

Vixathep, S. (2014), *Entrepreneurship, Government Policy and Performance of SMEs in Laos*, Vientiane.

World Bank (2014), *Investment Climate Assessment 2014: Policy uncertainty in the midst of a natural resources boom*, Washington.

World Bank (2013), *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises*, Washington.

World Bank (2011), *Investment Regulation and Promotion: Can They Coexist in One Body?*, Washington.

Chapter 6

Promoting and enabling responsible business conduct in Lao PDR

This chapter provides an overview of the responsible business conduct landscape in the Lao People's Democratic Republic (Lao PDR), outlining the actions the government has taken to facilitate, promote, enable, co-operate on and exemplify responsible business practices. It also provides recommendations for how the climate for responsible business conduct in Lao PDR could be further enhanced with a view to promoting quality investment and sustainable development.

Summary

Responsible business conduct (RBC) principles and standards set out an expectation that all businesses avoid and address negative impacts of their operations, while contributing to sustainable development where they operate. RBC means considering and integrating environmental and social issues within core business activities. Promoting and enabling RBC should be of central interest to those policymakers wishing to attract quality investment and ensure that business activity in their countries contributes to broader value creation and sustainable development.

In principle, the legal framework that protects the public interest and underpins RBC has been partially established in Lao PDR, although capacity and implementation challenges remain a significant constraint to ensuring that stakeholder rights are respected. This is particularly evident in the implementation of labour legislation as well as management of concession agreements and new investments. Awareness of international RBC principles and standards is not yet widespread. Mainstreaming RBC at a government level and clearly communicating RBC priorities and expectations would go a long way in overcoming country risk perceptions, maximising the development impact of FDI, attracting quality investment and promoting linkages with MNEs, and creating a level-playing for business (particularly important in light of increasing RBC expectations in the supply chains, which can include legal obligations for some investors).

Policy Recommendations

- Ensure that investment incentives and concession agreements are targeted and well-designed and coupled with due consideration of their environmental and social effects. Strengthen RBC expectations in ongoing investment law reforms and promote an approach to investment consistent with international standards for responsible business. Promote more transparency on how environmental and social issues are considered in investments, including in special economic zones.

- Clearly communicate expectations on RBC and consider establishing a focal point on RBC in the government. Provide guidance on accepted practices, support and participate in awareness raising events, and promote policy coherence and alignment on RBC. Consider developing a National Action Plan on Responsible Business Conduct, in collaboration with stakeholders and in line with international good practices.

- Align the legal framework for protecting human and labour rights with international standards.
- Actively promote RBC among domestic businesses, including through targeted industry-specific programmes. Encourage the establishment of firm-level grievance mechanisms and cross-sectoral learning for addressing environmental and social risks.
- Include RBC expectations in FDI attraction efforts and as one element to facilitate information exchange between foreign and domestic firms. Include RBC criteria in supplier databases and in matchmaking events.
- Involve the private sector in human resource development policies and encourage internal and external training by employers. Communicate to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC – and recognise those that do it.

Scope and importance of responsible business conduct

RBC principles and standards set out an expectation that all businesses – regardless of their legal status, size, ownership structure or sector – avoid and address negative effects of their operations, while contributing to sustainable development of the countries in which they operate. This expectation is affirmed in the main international instruments on RBC, notably the OECD *Guidelines for Multinational Enterprises* (OECD *Guidelines*) and the United Nations *Guiding Principles for Business and Human Rights* (UN *Guiding Principles*), and, increasingly, in international trade and investment agreements and national development strategies, laws, and regulations (Box 6.1).

RBC means considering and integrating environmental and social issues within core business activities. A key element of RBC is risk-based due diligence – a process through which businesses identify, prevent and mitigate their actual and potential negative effects and account for how those impacts are addressed, including throughout the supply chain and business relationships. RBC is sometimes used interchangeably with corporate social responsibility (CSR), although RBC is understood to be more comprehensive and integral to core business than what is traditionally considered CSR (mainly philanthropy).[1]

Box 6.1. **The OECD Guidelines for Multinational Enterprises**

The consensus built around the 2011 update of the OECD *Guidelines for Multinational Enterprises* and the unanimous endorsement of the UN *Guiding Principles on Business and Human Rights* by the UN Human Rights Council has brought about international convergence and coherence on what responsible business conduct entails. The expectations that businesses consider impacts of their activities beyond the impact on the company is echoed in other international standards as well, including the ISO 26000 Guidance on Social Responsibility, the IFC Performance Standards, and the OECD Recommendation on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence, as well as, increasingly, regional and country strategies (see Box 6.3).

The OECD *Guidelines for Multinational Enterprises* are the most comprehensive recommendations on what constitutes responsible business addressed by 47 adhering governments to businesses operating in or from their territories on:

- disclosure,
- human rights,
- employment and industrial relations,
- environment,
- combating bribery, bribe solicitation and extortion,
- consumer interests,
- science and technology,
- competition, and
- taxation.

Their purpose is to ensure that business operations are in harmony with government policies; to strengthen the basis of mutual confidence between businesses and the societies in which they operate; to improve investment climate; and to enhance the contribution of the private sector to sustainable development. The Guidelines reflect good practice for all businesses and do not aim to introduce differences of treatment between multinational and domestic enterprises. The adhering governments wish to encourage their widest possible observance to the fullest extent possible, including among small- and medium-sized enterprises, even while acknowledging that these businesses may not have the same capacities as larger enterprises.

Each adhering country sets up a National Contact Point (NCP) tasked with promoting RBC and the *Guidelines*, as well as helping resolve issues in case the *Guidelines* are not observed. NCPs have considered over 360 such instances in almost 100 countries since 2000.

Many businesses also find that responsible business is good business, in addition to ensuring that they respect human rights and comply with laws and regulations of the countries in which they operate. Understanding, addressing, and avoiding risks material to business operations in a more comprehensive way – that is, beyond financial risks – can often lead to a competitive advantage. For example, suppliers of MNEs that integrate internationally recognised environmental and social practices can in practice more easily address concerns about environmental, social, human rights or labour issues that may come up in the MNE due diligence processes when assessing country and supplier risks. Promoting and enabling RBC is of central interest to policymakers wishing to attract quality investment and ensure that business activity contributes to broader value creation and the implementation of Sustainable Development Goals (see Box 6.2.).

Box 6.2. **The role of government in promoting responsible business**

According to the OECD *Policy Framework for Investment*, which has been designed by governments to support investment reform and most recently updated in 2015 to reflect experience of 25 countries and regional bodies that have applied it, governments can promote and enable RBC in several ways through:

- *Regulating* – establishing and enforcing an adequate legal framework that protects the public interest and underpins RBC, and monitoring business performance and compliance;
- *Facilitating* – clearly communicating expectations on what constitutes RBC, providing guidance on specific practices and enabling enterprises to meet those expectations;
- *Co-operating* – working with stakeholders in the business community, worker organisations, civil society, the general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC;
- *Promoting* – demonstrating support for best practices in RBC;
- *Exemplifying* – behaving responsibly in the government's role as an economic actor.

RBC as a development opportunity in Lao PDR

Awareness of international RBC principles and standards is low

Although a number of initiatives related to CSR have been undertaken in recent years, awareness of international RBC principles and standards is not yet widespread in Lao PDR. RBC is a relatively new subject in the region in general, according to a 2014 study on CSR and human rights commissioned by the ASEAN Intergovernmental Commission on Human Rights (Thomas & Chandra, 2014) which found that most CSR activities in ASEAN remain philanthropic in nature and that there is a low level of awareness among business leaders and policymakers alike.

This is changing. References to RBC have been included in the new 2025 ASEAN Socio-Cultural, Economic, and Political-Security Community Blueprints. The Economic Blueprint underlines the importance of enhanced stakeholder engagement for ASEAN integration and improved transparency, with one strategic measure identified as promotion of CSR activities (ASEAN, 2016a). The Socio-Cultural Blueprint builds on the idea of multi-stakeholder and multi-sectoral engagement and calls for promotion and integration of Sustainable Consumption and Production Strategy and best practices into national and regional policies or as part of CSR activities (ASEAN, 2016b). The Political-Security Blueprint calls for strengthening collaboration with the private sector and other relevant stakeholders to instil CSR (ASEAN, 2016c). Notably, at the 24th ASEAN Labour Ministerial Meeting on 15 May 2016 in Vientiane, ASEAN labour ministers adopted the *Guidelines for Corporate Social Responsibility on Labour* to provide broad guidance to governments, enterprises, employers' and workers' organisations on raising awareness, proactively encouraging engagement, and promoting social dialogue and compliance with core labour standards (ASEAN, 2016d).

This is an important signal by ASEAN member states that RBC is increasingly relevant for the region. Likewise in Lao PDR, the government has emphasised the need to focus more on inclusive and sustainable growth in implementing the Eighth National Socio-Economic Development Plan (NSEDP) 2016-2020 (RTM, 2015a). Development partners have also encouraged the integration of CSR in business models in the *Vientiane Declaration on Partnership for Effective Development Cooperation (2016-25)* as a result of dialogue with the government, calling for stronger partnerships between the private sector and the government in the development process (RTM, 2015b). They highlighted the importance of socially and environmentally responsible FDI, underlining that the social, environmental and economic price of 'growing first and cleaning up later' is too costly (RTM, 2015c).

In terms of existing initiatives, while there is no comprehensive national strategy or policy on RBC, the government participates in several RBC-related technical assistance programmes. For example, the *Poverty Environment Initiative,* undertaken in collaboration with the United Nations Environment Programme and the United Nations Development Programme, aims to mainstream poverty and environment concerns in investment management (UNDP, 2016). The International Labour Organization (ILO) is also implementing several relevant projects in collaboration with the government, including the first-ever Decent Work country programme since 2011 and a specific project to improve working conditions, productivity and competitiveness in the Lao garment sector (ILO, 2016a). Some development partners have also been active directly, for example, GIZ published a baseline assessment of social and environmental regulations and standards and CSR in several sectors (GIZ and BGR, 2015).

The private sector and civil society have also promoted CSR, although these efforts have in general been on an *ad hoc* basis. The Lao National Chamber of Commerce and Industry, in cooperation with ASEAN CSR Network and ASEAN Foundation, organised the first Responsible Business Forum in June 2015 (ASEAN CSR Network, 2015). Foreign business associations have also hosted promotional events[2] and a multi-stakeholder effort, including the government, to develop a CSR reporting tool to support implementation to the Eighth NSEDP is ongoing (Vientiane Times, 2015). The Ministry of Planning and Investment, particularly the Investment Promotion Department which co-ordinated this review on behalf of the government and is involved in the development of the reporting tool, has made a particular effort to promote RBC within the government and attended the 2016 Global Forum on Responsible Business Conduct, as well as the High-Level Roundtable for Policy-Makers organised as part of the Global Forum, in order to benefit from peer learning and experience sharing on RBC.

Consolidating efforts – the role of the government

The government should consider building on these existing efforts and working with stakeholders to develop a *National Action Plan on Responsible Business Conduct,* according to international good practice and in line with the objectives set out in the Eighth NSEDP. This process, if undertaken in an inclusive and open manner, could serve to promote more transparency and dialogue more broadly around several development challenges Lao PDR is facing. Promoting more transparency is a cross-cutting thematic recommendation of this review. Additionally, considering the existing capacity constraints the government is facing, it should use its role as a convener to facilitate collective action on RBC. Improving the

business environment is never an exercise in isolation and understanding and prioritising, and eventually addressing, context-specific environmental and social challenges related to business activity can go a long way in maximising the contribution of the private sector to development. Finally, as this review highlights, policy reforms to move up the value chain are cross-cutting by definition and, thus, policy coherence and effectiveness are important factors. Developing a national action plan (NAP) on RBC would be a good way to promote policy coherence and alignment to support the implementation of the SDGs (Box 6.3).

Box 6.3. **Using National Action Plans as tools for promoting RBC**

Many countries are developing or have developed national action plans on RBC or business and human rights, following a recommendation by the UN to do so as part of the state responsibility to disseminate and implement the UN *Guiding Principles*. Governments are using NAPs to highlight their policies on RBC and signal the need for future action. NAPs are useful tools for promoting policy coherence within the government, engaging with stakeholders, and demonstrating commitment to RBC. The UN Working Group on Business and Human Rights has set up a dedicated webpage to provide easy access to existing plans, as well as key public information and analysis on the various stages of NAP development, implementation and follow up (UN OHCHR, 2016).

A notable example of an NAP is the draft United States *National Action Plan on Responsible Business Conduct*, adopted in 2016. Announced by President Obama as one of the core activities under the US Global Anti-corruption Agenda, the US NAP on RBC will be consistent with the OECD Guidelines and the UN *Guiding Principles* and is expected to address ways in which the US government can promote and encourage established RBC norms related to, but not limited to, human rights, labour rights, land tenure, anti-corruption, and transparency (United States, 2015b; White House, 2014).

Within ASEAN, Malaysia and Myanmar are in the process of developing or are committed to developing an NAP, while in the Philippines and Indonesia the idea has been promoted by a National Human Rights Institution or civil society but with not actual commitment yet. In all other ASEAN member states, there is no NAP under discussion (UN OHCHR, 2016).

Maximising investment benefits and addressing perceived country risks through RBC

Promoting RBC as a competitive advantage for domestic industries

The expectation that businesses observe RBC principles and standards covers the entire supply chain and therefore affects suppliers to MNEs and

exporters. Suppliers that integrate internationally recognised environmental and social practices have a comparative advantage over those that do not as they can more easily address concerns about environmental, social, human rights or labour issues that may come up in the due diligence processes of MNEs when assessing country and supplier risks. MNEs are increasingly basing their decisions about where to do business on the ability to ensure predictable and reliable supply chains, capable of delivering effectively at each stage (Taglioni and Winkler, 2014; OECD, 2014: 27). It is estimated that costs of delays can be substantial for certain product categories and any delays due to, for example, labour unrests or environmental damage, contributes to those costs (Hummels, 2007; OECD, 2014: 27).

Promoting and enabling RBC among domestic enterprises, including through targeted industry-specific programmes, can go a long way in addressing perceived risks related to doing business in Lao PDR and thereby in attracting new investments. RBC could be particularly relevant for diversifying efforts in value-added manufacturing. Consider the textiles and garment sector, which has been the focus of much international discussion since the April 2013 Rana Plaza factory collapse in Bangladesh. Risks related to labour and human rights (for example, child or forced labour, discrimination, restrictions on the right to join a trade union, low-wages, excessive hours of work), occupational health and safety and environmental risks (such as use of hazardous chemicals, water consumption and pollution or high energy use) are prevalent throughout the sector globally. Like in other countries in the region, some of these issues are present in the sector in Lao PDR.

The garment sector in Lao PDR is the largest manufacturing employer, generating one tenth of exports (ILO, 2016a; Ruppert Bulmer *et al*., 2016). However, productivity in the sector is low and high labour turnover is often cited as a significant constraint for improving productivity. Some employers report that only half of workers stay beyond three years (ILO, 2016a). Some staff turnover is to be expected in any industry, but this rate is high even by regional industry standards (World Bank, 2012) and has a direct impact on productivity in terms of loss of experienced workers and costs related to hiring and training. While the fact that the sector in general employs migrant women under 25 who may view employment as a temporary opportunity does play a role, challenging working conditions – long hours, compulsory overtime, limited understanding of contractual rights and obligations, issues with wages and representation – have been reported to be a significant factor (ILO, 2016c; World Bank, 2012). There is also a perceived lack of information on practices in the sector which may limit the industry's access to premium buyers (World Bank, 2012). Frequent non-compliance with labour laws, weak labour inspections, and in some cases also the fact that

the law itself is not fully aligned with international standards, exacerbate these issues.

Considering the small size of the industry compared to other producing countries, such as Cambodia or Bangladesh, and the existing constraints such as skills that may take time to address, policies that focus on improving the working conditions could incentivise workers to stay in their jobs longer. ILO has reported examples of factories where labour law compliance and overall good RBC practices are paying off and workers have been deciding to stay. Upgrading labour and environmental standards could help create a niche market that would incentivise retailers and buyers under expectations to ensure good conditions within their supply chain to source from factories that integrate internationally recognised environmental and social practices in their operations (Ruppert Bulmer *et al*., 2016). Actively promoting RBC among Lao businesses and raising awareness about the obligations that international partners are under can be decisive for ensuring better conditions as well as addressing the perceived lack of information on practices in the sector which may limit the industry's access to premium buyers. Strengthening the capacity of workers to voice concerns, through promoting, for example, firm-level grievance mechanisms, is also important.

The government should include RBC principles and standards in the industry-specific training programmes discussed in Chapter 5 as a way to build absorptive capacity of domestic companies and encourage business linkages with foreign investors. This could encompass everything from promotion to capacity building exercises to supporting cross-sectoral learning efforts (for example, supporting cost-sharing efforts within and among industries for specific due diligence tasks, participation in initiatives on responsible supply chain management and cooperation between industry members who share suppliers). Industry associations and MNEs, as well as trade unions and civil society organisations, should play a key role in the design and delivery of technical support and training.

RBC expectations should also be included in FDI attraction efforts and may help attract MNEs that are more inclined to source locally. One element of supplier databases and matchmaking events could be RBC, in line with the recommendation that investment promotion authorities increase efforts to facilitate information exchange between foreign and domestic firms. Additionally, training and awareness-raising with business leaders could also be useful in promoting a wider understanding and recognition of the importance of RBC. Educational institutions such as business schools can be important platforms.

RBC can also be promoted as a way of bridging the skills gaps, through incentivising firms to provide on-the-job training and learning opportunities,

apprenticeships, traineeships and internships. Adoption of the *Guidelines* and the UN *Guiding Principles* should be actively encouraged, as promoting local capacity and adopting practices that permit the transfer and rapid diffusion of technologies and know-how is encouraged under the *Guidelines*. Lastly, the authorities should make educational and training programmes more market driven by increasingly involving the private sector in human resource development policies and encouraging internal and external training by employers. Communicating to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC – and recognising those that do it – can serve as a good incentive.

Increasing transparency and better understanding the impact of investments

The new *Law on Investment Promotion* provides an opportunity to strengthen the expectations around responsible investment and to promote an approach to investment consistent with international standards for responsible business, such as the *Guidelines* and UN *Guiding Principles*. Doing so would also support the objectives of the Eighth NSEDP to promote more inclusive and sustainable development, as well as to protect the environment and manage concession agreements more effectively. Simplifying the multi-layered and complex process through which new investment are considered and concession agreements are granted, as well as promoting more transparency around the decision-making process, particularly as related to how environmental and social issues are considered, should be prioritised. Lowering opportunities for discretion and unpredictability (see Chapter 5 on investment promotion and facilitation) could bring substantial benefits, not only in terms of more predictability and clarity for investors, but also by correctly assessing the true extent of social and environmental impacts of proposed projects.

One policy area where more clarity, better practice and better coordination between relevant authorities could bring immediate benefits is in improving the way that environmental and social impact assessments are considered. Requiring *ex ante* and *ex post* impact assessments is an important tool for examining, mitigating and preventing potential negative impacts of business activity. Chapter 8 discusses the existing regulatory system for such assessments in detail; it is complicated and faces the same capacity constraints discussed in the rest of the review. Furthermore, awareness of community members and stakeholders about good project management practices and environmental protection seems in general quite low, such that projects may be approved without having met the necessary

legal requirements. As demonstrated by reports of significant issues with investments in Lao PDR,[3] it would be worthwhile to revisit how environmental and social impacts of investment are considered *ex ante* and *ex post*.

Promoting RBC and transparency, as well as introducing capacity-building programmes to empower local communities, could help overcome some of these challenges. For example, the extractives sector is associated with extensive social, economic and environmental impacts even if it generates income and fosters local development. Many companies operating in the sector have found that involving stakeholders, such as local communities, in their planning and decision-making can not only help them meet their responsibilities, but also lower costs and risks associated with a project. A 2014 Harvard University study found that for a mining project with capital expenditure between USD 3-5 billion, the costs attributed to delays from community conflicts can be on average USD 20 million per week due to lost productivity from temporary shutdowns or delays (Davis and Franks, 2014).

In 2016, the OECD developed through a multi-stakeholder and inclusive process the *Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector* for practitioners in the mining, oil and gas industries.[4] The guidance offers a practical framework for identifying and managing risks related to stakeholder engagement, provides an assessment framework to evaluate performance, as well as targeted guidance for specific stakeholder groups such as indigenous peoples, women, workers and artisanal and small scale miners. Main recommendations include:

- Integrating stakeholder engagement into project planning and regular business operations through sharing of decision-making power with interested and affected parties;
- Practising stakeholder engagement that is driven by stakeholders through ongoing consultation and follow-through;
- Developing a stakeholder engagement strategy which prioritises engagement with the most severely affected rather than the most influential stakeholders;
- Meaningful stakeholder engagement and due diligence are critical for avoiding some of the potential adverse impacts of extractive operations as well as for optimising their potential positive contributions. They are also central components of RBC under the *Guidelines*.

Box 6.4. **Improving conditions in global supply chains through policy innovations**

Recognising the importance of RBC in international agreements

Renewed attention has been given to the role of the private sector in development with the 2015 Paris climate change and Sustainable Development Goals agreements. Several SDGs refer to responsible production patterns, inclusive and sustainable economic growth, employment and decent work for all, while the Paris agreement underlines the critical role of business in tackling climate change, including through reducing greenhouse gas emissions and improving environmental performance. *The 2016 Development Co-operation Report: The Sustainable Development Goals as Business Opportunities* outlines policy reasons for promoting RBC as a way to mobilise necessary resources for financing the development agenda, while improving access to markets and participation in value chains for domestic industries and increasing accountability and inclusiveness (OECD, 2016a).

Additionally, OECD research shows that more than three-fourths of international investment agreements concluded between 2008 and 2013 include language on RBC (mainly free trade agreements with investment protection provisions) and virtually all of the investment treaties concluded in 2012-13 include such language (Gordon *et al*., 2014).[5] The June 2015 G7 Leader's Declaration also made it clear that RBC issues were a top priority internationally. G7 pledged to lead by example to promote international labour, social and environmental standards in global supply chains; to encourage enterprises active or headquartered in the G7 to implement due diligence; and to strengthen access to remedy (G7, 2015). Specific encouragement was given to international efforts to promulgate industry-wide due diligence standards in the textile and ready-made garment sector. The need to help SMEs develop a common understanding of due diligence and responsible supply chain management was also highlighted.

Policy developments at a national level

More and more countries are also using RBC principles and standards to frame domestic law. In March 2015, the UK enacted the Modern Slavery Act, mandating that commercial organisations prepare an annual statement on slavery and human trafficking and report on their due diligence processes to manage these risks within their operations and supply chains (UK, 2015). France has introduced a similar but broader proposal to mandate supply chain due diligence in accordance with the OECD *Guidelines for Multinational Enterprises*, which, if enacted, would require all French companies with more than 5000 domestic employees or more than 10 000 international employees to publish a due diligence plan for human rights and environmental and social risks or face fines of up to EUR 10 million (France, 2014). RBC criteria have also been included in economic instruments. The OECD *Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence* was revised in April 2016 to strengthen RBC considerations in export credits and to promote policy coherence (OECD, 2016c). …/

Box 6.4. **Improving conditions in global supply chains through policy innovations** (cont.)

/…Canada has enhanced its strategy Doing Business the Canadian Way: A Strategy to Advance Corporate Social Responsibility in Canada's Extractive Sector Abroad to allow for withdrawal of government support in foreign markets for companies that do not embody RBC and refuse to participate in the dispute resolution processes available through the Canadian government, including National Contact Points (NCPs) for the OECD *Guidelines*.

Due diligence requirements for minerals supply chains have been integrated into Section 1502 of the 2010 United States Dodd–Frank Wall Street Reform and Consumer Protection Act. Federal Acquisition Regulation was revised in 2015, establishing a number of new safeguards to strengthen protections against trafficking in persons in federal contracts (United States, 2015a). Additionally, the 2015 Trade Facilitation and Trade Enforcement Act eliminated the exceptions to the prohibition on import of goods into the United States – it is now illegal to import goods made, wholly or in part, with convict, forced and indentured labour under penal sanctions. In March 2016, US border agents withheld goods tied to forced labour on the basis of the new Act (United States, 2016).

In 2014, the EU passed a directive on promoting disclosure of non-financial and diversity information to promote more transparency on environmental and social issues across sectors and companies over a certain size incorporated in EU member states and listed on regulated EU exchanges (EU, 2014). First reports are expected in early 2018 once the directive is transposed into national laws. An agreement on a framework to stop the financing of armed groups through trade in conflict minerals was reached at an EU level in June 2016 to ensure that EU companies source tin, tantalum, tungsten and gold responsibly (EU, 2016).

China is also increasingly incorporating RBC into its policies. In 2015, the OECD and China signed a comprehensive programme of work, setting out the strategic vision and activities on a number of topics, including RBC. Several joint activities have been undertaken under the programme. Notably, at the end of 2015, on the basis of OECD RBC instruments, China Chamber of Commerce Metals, Minerals & Chemicals Importers and Exporters adopted the Chinese Due Diligence Guidelines for Responsible Minerals Supply Chains.

The government could require that investors follow this international standard for engagement with stakeholders. Similarly, ensuring that stakeholder rights are respected and that civil society organisations and local communities are supported and encouraged to engage without fear of reprisal or punishment is a pillar of government responsibilities around RBC (OECD, 2015a).

Better understanding the social and environmental impacts of special economic zones (SEZs) would also help maximise the potential of FDI in Lao PDR. As discussed in Chapter 1, SEZs usually tend to stimulate few linkages with domestic firms, and working conditions and their social and environmental implications are not always closely scrutinised. Closer monitoring of RBC practices in zones to ensure SEZ investments are responsible and sustainable and clearly stating expectations that RBC principles and standards should be observed is warranted (see section below).

Box 6.5. **Debunking the pollution haven hypothesis**

Taking due account of the need to protect the environment and public health and safety is a pillar of acting responsibly under international RBC principles and standards (see *Guidelines* Chapter V). This entails sound environmental management to control direct and indirect environmental effects of business activities; establishing and maintaining appropriate environmental management systems; improving environmental performance; being transparent about the environmental impacts and risks, including also reporting and communicating with outside stakeholders; being proactive in avoiding environmental damage; working to improve the level of environmental performance, even where this may not be formally required; and training and education of employees with regard to environmental matters, particularly when it comes to human health and safety.

A 2016 OECD report *Do environmental policies affect global value chains? A new perspective on the pollution haven hypothesis* examined the impact of environmental policies on global value chains and shows that countries that implement stringent environmental policies do not lose export competitiveness when compared to countries with more moderate regulations. High and low pollution industries and trade in manufactured goods between 23 advanced and six emerging economies from 1990-2009 were examined, and data on the domestic value added in exports from the OECD-WTO Trade in Value Added (TiVA) dataset was included in the analysis.

The findings suggest that emerging economies with strong manufacturing sectors could strengthen and implement environmental laws without denting their overall share in export markets. High-pollution or energy-intensive industries would suffer a small disadvantage, but this would be compensated by growth in exports from less-polluting activities. These results are compelling evidence against the so-called pollution haven hypothesis, which suggests that tightening environmental laws often prompts manufacturers to simply relocate some production stages to less regulated countries.

Source: Koźluk and Timiliotis, 2016.

Fighting modern slavery in global supply chains

Modern slavery, forced labour (including child labour) and human trafficking in the global supply chain are a serious and persistent problem worldwide. These crimes are not specific to one sector or one geographical region; they permeate the global supply chain in different forms. The ILO estimates that 21 million people are victims of forced labour – either trafficked, held in debt-bondage or working in slavery-like conditions. 90% of them are exploited in the private economy and 44% are migrants (ILO, 2014). These crimes cannot be addressed by one stakeholder or one country; they require active and continuing engagement among all stakeholders. States have the primary obligation to protect against human rights abuse within their territory or jurisdiction, including against abuse by private actors, such as business enterprises. This includes taking steps to prevent, investigate, punish and redress abuses through effective policies, legislation, regulations and adjudication, as set out in Principle 1 of the UN *Guiding Principles on Business and Human Rights*.

According to the US State Department, Lao PDR is a source of, and to a lesser extent, a transit and destination country for people subjected to forced labour and trafficking. Forced labour victims are most often economic migrants seeking work outside the country, most often in Thailand and in fishing, construction, and agriculture sectors. Foreign traffickers are reported to be increasingly collaborating with local middlemen, including individuals offering transport services near the Thai border and labour brokers. Little information exists on the scope of trafficking within Lao PDR, although there are reports of internal trafficking as well as Vietnamese and Chinese women and girls being transited through the country. There are also reports of forced labour in or near logging and construction areas along the Lao-Vietnam border, as well as trafficking to the larger cities or in close proximity to borders, casinos, or special economic zones, reportedly to meet the demand of Asian tourists and migrant workers. (US Department of State, 2016; 2015)

Child labour has also been reported as an issue. According to the 2012 *Report on the National Child Labour Survey 2010 of Lao PDR,* undertaken by the Ministries of Labour and Social Welfare, Planning and Investment, and the ILO, about 15% of total number of children were employed in some form of economic activity (265 509 out of 1 767 109), while 67% of those (178 014) could be considered child labour and 49% as engaging in hazardous child labour (130 137), mostly in agriculture, forestry, fishing, and manufacturing (ILO *et al*., 2012). These numbers might not be exact since the survey was undertaken according to the definitions set out in the 2006 version of the *Labour Law*, which did not include a specific definition of child labour.

These risk factors could hinder further investments in Lao PDR, particularly from countries where enterprises are subject to requirements related to RBC and supply chain due diligence (Box 6.4). The government has made efforts to improve the legal and regulatory framework for addressing these crimes, but capacity issues remain a persistent challenge in enforcing the existing laws. The legal framework could be further aligned with international norms. In November 2015, all ASEAN member states signed the ASEAN Convention against Trafficking in Persons, Especially Women and Children. In December 2015, the Lao National Assembly approved the first trafficking-specific law, promulgated in February 2016 (US Department of State, 2016). Although some elements of the 2005 *Penal Law* and 2004 *Law on Development and Protection of Women* address trafficking issues, no specific anti-trafficking legislation has been implemented yet[6] (UNIAP, 2016a-b; 2010).

Furthermore, the 2014 *Labour Law* includes revised definitions of youth labour (age 12-18) and child labour (under age of 12); a new article on unauthorised use of forced labour (art. 59) and unauthorised use of youth employees (art. 102); a prohibition of using any kind of forced labour, whether directly or indirectly, and employing anyone under 12 years old (Lao PDR, 2013). In 2014, the ILO adopted a legally-binding Protocol to the Forced Labour Convention (No. 29), which requires any state that has ratified this convention to take measures related to prevention, protection and remedy in order to suppress forced labour. This is one of five fundamental ILO conventions that Lao PDR has ratified (ILO, 2016b). Lao PDR should ratify the remaining fundamental ILO Conventions. It has ratified five out of eight so far; the remaining ones concern Freedom of Association and Protection of the Right to Organise (No. 87), Right to Organise and Collective Bargaining (No. 98), and the Abolition of Forced Labour (No. 105).

As Lao PDR continues to pursue economic diversification, particularly in labour-intensive sectors, it will be important to ensure that risks associated with modern slavery, forced labour (including child labour), and human trafficking are well understood by businesses, provincial leaders, and local community members. While this review does not go into detail about all the facets that affect how these issues are addressed and prosecuted in the country, it is important to note that most trafficking cases start as voluntary movement or migration related to better employment opportunities (UNIAP, 2016b). Preventative measures such as awareness raising, better coordination within the government, improving working conditions, and focusing efforts to address corruption[7] can be leveraged to reduce opportunities for trafficking and demand for forced labour. For example, projects such as the one currently being undertaken in the garment sector by

the ILO to strengthen the national labour inspection system, improve workers and employers understanding of the labour law and their role in ensuring good working conditions could be scaled up to other sectors (ILO, 2016a).

Role of development partners

Development partners have an important role to play in promoting RBC in Lao PDR. This begins with ensuring that businesses from their countries are aware of their obligations under the *Guidelines* and the UN *Guiding Principles*, and that they observe them. Improving access to remedy, including promoting the good offices of the National Contact Points of the *Guidelines*, is also important. National Contact Points have received instances in the past related to human rights and environmental issues in Lao PDR.[8] Supporting the reforms of the investment climate based on the *Policy Framework for Investment* and using official development assistance in innovative ways to encourage the uptake and implementation of RBC by domestic and foreign businesses has been encouraged in the 2016 OECD *Development Co-operation Report: The Sustainable Development Goals as Business Opportunities.*

Notes

1. Increasingly, CSR is being used in a similar way to RBC. For example, the latest strategy of the European Commission *A renewed EU strategy 2011-14 for Corporate Social Responsibility* uses CSR in line with RBC. Both RBC and CSR (beyond philanthropy) aim to promote the same idea - that businesses should consider the impact of their activities not just on the company itself.

2. See for example the 2016 *Dutch-Lao seminar on Corporate Social Responsibility (CSR) in Laos*, https://eccil.org/index.php?option=com_content&view=article&id=330:dutch-lao-seminar-on-corporate-social-responsibility-csr-in-laos&catid=26&Itemid=152 or the AmCham seminaro http://amchamlao.com/event/corporate-social-responsibility-seminar

3. See for example the news reports *Chinese Banana Plantations Lose Their Appeal in Laos as Pollution Concerns Grow,* www.rfa.org/english/news/laos/chinese-banana-plantations-04142016151133.html; *Lao Authorities Tackle E-Waste Pollution*, www.rfa.org/english/news/laos/laso-authorities-tackle-06232016153659.html; or the 2013 report *Rubber Barrons* by an international NGO Global Witness, https://www.globalwitness.org/en/campaigns/land-deals/rubberbarons/.

4. The OECD-FAO have also developed *Guidance for Responsible Agricultural Supply Chains* and the OECD is currently working on RBC in the financial sector and developing guidance on *Responsible Supply Chains in the Garment and Footwear Sector.*

5. The research shows that the major functions of such treaty language are, in the order of prevalence: (*i*) to establish the context and purpose of the treaty and set forth basic responsible business conduct principles through preamble language; (*ii*) to preserve policy space to enact public policies dealing with responsible business conduct concerns; and (*iii*) to avoid lowering standards, in particular relaxing environmental and labour standards for the purpose of attracting investment.

6. A full list of relevant legislation can be found on the United Nations Inter-Agency Project on Human Trafficking website (UNIAP, 2016a).

7. Corruption is perceived as a major concern in Lao PDR, as reflected in the Transparency International's *Corruption Perceptions Index* where Lao PDR ranks 123 out of 176 countries in 2016.

8. See the Database of Specific Instances - http://mneguidelines.oecd.org/database/.

References

ASEAN (2016a), Economic Community Blueprint 2025, www.asean.org/storage/images/2015/November/aec-page/AEC-Blueprint-2025-FINAL.pdf. (Accessed 20 June 2016).

ASEAN (2016b), Socio-Cultural Community Blueprint 2025, http://asean.org/storage/2016/01/ASCC-Blueprint-2025.pdf. (Accessed 20 June 2016).

ASEAN (2016c), Political-Security Community Blueprint 2025, www.asean.org/wp-content/uploads/2012/05/ASEAN-APSC-Blueprint-2025.pdf. (Accessed 20 June 2016).

ASEAN (2016d), Guidelines for Corporate Social Responsibility (CSR) on Labour, http://asean.org/storage/2012/05/ASEAN-Guidelines-for-Corporate-Social-Responsibility-on-Labour.pdf. (Accessed 20 June 2016).

ASEAN CSR Network (2015), Lao Responsible Business Forum: CSR has a significant role in realizing equitable, inclusive and sustainable development in Lao PDR and in ASEAN, www.asean-csr-network.org/c/news-a-resources/csr-news-from-around-asean/230-lao-responsible-business-forum-csr-has-a-significant-role-in-realizing-equitable-inclusive-and-sustainable-development-in-lao-pdr-and-in-asean.

Davis, Rachel and Daniel M. Franks (2014), Costs of Company-Community Conflict in the Extractive Sector, Corporate Social Responsibility Initiative Report No. 66. Cambridge, MA, Harvard Kennedy School, www.hks.harvard.edu/m-rcbg/CSRI/research/Costs%20of%20Conflict_Davis%20%20Franks.pdf.

EU (2016), EU political deal to curb trade in conflict minerals¸16 June 2016, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1510 (Accessed 16 June 2016).

EU (2014), Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups, http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm. (Accessed 9 October 2015).

France (2014), French National Assembly, Proposition de Loi 1897 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, http://www2.assemblee-nationale.fr/documents/notice/14/propositions/pion1897/(index)/propositions-loi.

G7 (2015), Leaders' Declaration G7 Summit, 7–8 June 2015, www.g7germany.de/Content/EN/_Anlagen/G7/2015-06-08-g7-abschluss-eng_en.pdf?__blob=publicationFile&v=3

GIZ and BGR (2015), CSR in Lao PDR: Baseline Assessment of Social and Environmental Regulations & Standards, Vientiane, February 2015

Gordon, K., J. Pohl and M. Bouchard (2014), Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey, OECD Working Papers on International Investment, 2014/01, OECD Publishing. http://dx.doi.org/10.1787/5jz0xvgx1zlt-en

Hummels, D. (2007), Calculating tariff equivalents for time in trade, Nathan Associates, Inc. for the US Agency for International Development, Washington, DC, www.nathaninc.com/sites/default/files/Calculating_Tariff_Equivalents_for_Time_in_Trade.pdf

ILO (2016a), Improving the Garment Sector in Lao PDR: Compliance through Inspection and Dialogue, International Labour Organisation Website, www.ilo.org/asia/whatwedo/projects/WCMS_357242/lang--en/index.htm. (Accessed 21 March 2016).

ILO (2016b), Ratifications Ratifications for Lao People's Democratic Republic, International Labour Organisation Website, www.ilo.org/dyn/normlex/en/f?p=1000:11200:0::NO:11200:P11200_COUNTRY_ID:103060. (Accessed 21 March 2016).

ILO (2016c), Project Fact Sheet - Improving the Garment Sector in Lao PDR: Compliance through Inspection and Dialogue, www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms_357250.pdf.

ILO (2014), Strengthening the global fight against all forms of forced labour: the Protocol to the Forced Labour Convention, International Labour Organisation, www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/publication/wcms_321414.pdf. (Accessed 21 March 2016).

ILO/IPEC/LSB (2012), Report on the National Child Labour Survey 2010 of Lao PDR, International Labour Organization, International Programme on the Elimination of Child Labour (IPEC), Lao Statistics Bureau (LSB), www.ilo.org/ipecinfo/product/download.do?type=document&id=21256. (Accessed 21 March 2016).

Lao PDR Government (2013), Labour Law, No. 43/NA, 23 December, English Translation by International Labour Organisation,

www.ilo.org/dyn/natlex/docs/MONOGRAPH/96369/113864/F1488869173/LAO96369%20Eng.pdf. (Accessed 21 March 2016).

OECD (2016a), Development Co-operation Report 2016: The Sustainable Development Goals as Business Opportunities, OECD Publishing, Paris, http://dx.doi.org/10.1787/dcr-2016-en

OECD (2016b), Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractives Sector, http://mneguidelines.oecd.org/OECD-Guidance-Extractives-Sector-Stakeholder-Engagement.pdf.

OECD (2016c), Recommendation of the Council On Common Approaches For Officially Supported Export Credits And Environmental And Social Due Diligence (The "Common Approaches"), 7 April 2016, www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/ECG%282016%293&doclanguage=en.

OECD (2015a), Policy Framework for Investment, 2015 Edition, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264208667-en

OECD (2014), Development Co-operation Report 2014: Mobilising Resources for Sustainable Development, OECD Publishing, Paris, http://dx.doi.org/10.1787/dcr-2014-en.

RTM – 12th High Level Round Table Meeting (2015a), Background Document, Department of International Cooperation, Ministry of Planning and Investment, http://rtm.org.la/wp-content/uploads/formidable/2015-HL-RTM-Background-Document_Final.pdf.

RTM – 12th High Level Round Table Meeting (2015b), Vientiane Partnership Declaration for Effective Development Co-operation 2016-2025, http://rtm.org.la/wp-content/uploads/2015/11/Vientiane-Partnership-Declaration.pdf.

RTM – 12th High Level Round Table Meeting (2015c), Report, Department of International Cooperation, Ministry of Planning and Investment, http://rtm.org.la/wp-content/uploads/formidable/Report-of-the-2015-HL-RTM_Final.1.pdf.

Ruppert Bulmer, E., C. Hollweg and M. Hoppe (2016), The labor impact of Lao export growth, World Bank Group, Washington, D.C., http://documents.worldbank.org/curated/en/2016/02/25996553/labor-impact-lao-export-growth.

Taglioni, D. and D. Winkler (2014), "Making global values chains work for development", Economic Premise, No. 143, The World Bank, Washington, DC, http://documents.worldbank.org/curated/en/2014/05/19517206/making-global-value-chains-work-development.

Thomas, T., and Chandra, A. (2014), Thematic Study on CSR and Human Rights in ASEAN. Retrieved from AICHR: http://aichr.org/?dl_name=AICHRs_Thematic_Study_on_CSR_and_Human_Rights_in_ASEAN.pdf.

UK (2015), Modern Slavery Act, www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

UNDP (2016), Managing investment through a poverty and environment lens, 26 April 2016, www.la.undp.org/content/lao_pdr/en/home/presscenter/pressreleases/2016/04/27/managing-investment-through-a-poverty-and-environment-lens.html.

UNIAP (2016a), National Laws & Agreements: Lao PDR, United Nations Inter-Agency Project on Human Trafficking website, www.no-trafficking.org/lao_laws.html.

UNIAP (2016b), Lao PDR website, United Nations Inter-Agency Project on Human Trafficking, www.no-trafficking.org/lao.html.

UNIAP (2010), Human Trafficking Laws, Legal Provisions for Victims: Comparing Legal Definitions & Frameworks Against the United Nations Protocol on Human Trafficking, United Nations Inter-Agency Project on Human Trafficking Report, www.no-trafficking.org/reports_docs/legal_prov_vics.pdf. (Accessed 21 March 2016).

UN OHCHR (2016), National Actions Plans, www.ohchr.org/EN/Issues/Business/Pages/NationalActionPlans.aspx.

United States (2016), *Customs and Border Protection,* CBP Commissioner Issues Detention Order on Chemical, Fiber Products Produced by Forced Labor in China, 29 March 2016, www.cbp.gov/newsroom/national-media-release/2016-03-29-000000/cbp-commissioner-issues-detention-order-chemical

United States (2015a), Final Rule, Federal Acquisition Regulation (FAR); FAR Case 2013-001, Ending Trafficking in Persons, 29 January 2015, https://federalregister.gov/a/2015-01524.

United States (2015b), Department of State, USG National Action Plan on Responsible Business Conduct: Frequently Asked Questions, 12 February 2015. www.humanrights.gov/dyn/2015/usg-national-action-plan-on-responsible-business-conduct/.

U.S. Department of State (2016), Trafficking in Persons Report - June 2016, www.state.gov/j/tip/rls/tiprpt/2016/index.htm.

U.S. Department of State (2015), Trafficking in Persons Report - July 2015, www.state.gov/j/tip/rls/tiprpt/2015/index.htm.

Vientiane Times (2015), Experts discuss Laos' draft CSR reporting tool, 25 November 2015, accessed on www.asianews.network/content/experts-discuss-laos%E2%80%99-draft-csr-reporting-tool-4359.

White House (2014), "Fact sheet: The U.S. global anticorruption agenda", Office of the Press Secretary, 24 September, The White House, Washington, DC, www.whitehouse.gov/the-press-office/2014/09/24/fact-sheet-us-global-anticorruption-agenda.

World Bank (2012) Lao PDR - Labor standards and productivity in the garments export sector: a survey of managers and workers, World Bank, Washington, D.C., http://documents.worldbank.org/curated/en/2012/07/16652831/lao-pdr-labor-standards-productivity-garments-export-sector-survey-managers-workers.

Chapter 7

Infrastructure connectivity in Lao PDR

This chapter examines the current context of infrastructure development in the Lao People's Democratic Republic (Lao PDR). It reviews connectivity challenges and recent reforms to boost infrastructure investment, including private participation in infrastructure, and the remaining obstacles to improving the legal and institutional framework for private investment in infrastructure.

Summary

Lao PDR has grown rapidly in the past decade at average real GDP growth rates above 7%, achieving significant economic and social progress. Growth has been propelled mostly by the country's large natural resource endowment and its close proximity to some of Asia's fastest growing economies (see Chapter 1 on trends in foreign investment and trade). The Eighth National Socio-Economic Development Plan (2016-20) strives to continue this growth path with the goal of graduating to a middle-income economy by 2020. It identifies the need to strengthen economic integration within the region and broader economic diversification, notably through developing the agro-processing and tourism industry, as key strategies, and recognises the importance of infrastructure development for supporting the transition from a land-locked to a land-linked economy in order to achieve its development objectives.

While Lao PDR has enhanced its connectivity to its main trading partners through both transport and trade facilitation improvements, investments in upgrading transport networks are necessary to keep pace with rapidly increasing demand. From 2000 to 2013, vehicle registrations, for instance, increased by 500% in the three main provinces (World Bank, 2013). Given Lao PDR's vulnerability to climate change and natural disasters (see Chapter 8 on the investment framework for green growth), a large upgrading of the existing network is also needed. As of 2012, over 40% of villages lacked access to all-weather roads (World Bank, 2013).

Meeting future demand for infrastructure will require relatively large investments estimated at USD 11.4 billion in 2010-20, besides potential additional investments needed for cross-border infrastructure projects. This represents 13.6% of Lao PDR's estimated 2010-20 GDP, which puts investment needs at levels much above those estimated for neighbouring countries (Battacharyay, 2010) and largely above the resources currently committed to infrastructure development by the government and donor community. Mobilising resources for infrastructure needs is, therefore, a major challenge, but the payout from improved infrastructure connectivity can be large.

Infrastructure connectivity is crucial for Lao PDR's economic development. Despite being relatively competitive compared to other land-locked countries, the relatively high cost of accessing international gateways is a handicap for developing an export-base in manufacturing and for local firms to integrate into global value chains. Ongoing OECD research shows that global value chains are much more sensitive to local infrastructure quality than overall trade. Poor infrastructure systems are a major

determinant of overall logistics costs, which in turn are among the primary causes of trade costs. Worldwide, firms' locational decisions have become more influenced by their need and ability to ensure predictable and reliable supply-chains, capable of delivering effectively on each stage of the chain (Taglioni and Winkler, 2014). The costs of delays, for instance, can be substantial for certain product categories (a tariff equivalent of 1% or more) (Hummels, 2007). In some of Lao PDR's neighbours, Portugal-Perez and Wilson (2010) estimate that improving physical infrastructure to the level of Malaysia could boost exports by almost 25-30%, which would be equivalent to 15-20% reduction in the value of tariffs on goods.

Infrastructure development is also crucial to link isolated rural areas to markets and strengthen the development of the tourism sector in Lao PDR. The Greater Mekong Subregion (GMS) has a large tourism potential due to its historical cultural sites and natural assets. International tourism is growing quickly in the region. In Lao PDR, annual tourist arrivals have grown over 20% in recent years, but represent only a minor share of tourists arriving in the region as a whole (less than 10%) (ADB, 2014). Tourism activity is highly concentrated in Vientiane Capital, which accounts for more than 40% of international arrivals and roughly 50% of hospitality investments. A key impediment to more inclusive and geographically dispersed tourism growth has been the insufficient last-mile transport infrastructure in secondary destinations (ADB, 2014). Improving access to tourist sites outside the capital is therefore crucial to bring development opportunities to other regions and thereby to reduce inequalities.

In the past, investment in infrastructure has been largely undertaken by the government, with strong support from multilateral and bilateral donors, whose assistance has often outpaced the level of government resources allocated to infrastructure sectors. Private investment in infrastructure has been limited to a few projects, mostly in the power sector, but the government is willing to encourage greater private sector participation in infrastructure. It has rightly identified the need to strengthen the legal and institutional framework as the starting point for this to happen.

With the support from the Asian Development Bank, the Ministry of Planning and Investment seeks to implement a new *Public-Private Partnership (PPP) Decree* consistent with international practice and compliant with Lao legislation and to build the necessary institutional capacity to deliver. Establishing such a building block is necessary. Lao PDR has no proper PPP legal and institutional framework in place yet. The draft framework brings some important regulatory and institutional mechanisms to improve infrastructure delivery capacity, such as the establishment of a PPP unit and a project development facility, but many

challenges have still not been addressed. A number of issues would need to be further clarified by regulations and guiding documents.

Private investment will not solve any funding issue impeding further investments in infrastructure, but it can be an important ally in promoting a more efficient use of available resources when undertaken in a propitious and competitive environment. For this, the selection of infrastructure projects and the choice of delivery mode need to be grounded in a robust value-for-money analysis not biased by any fiscal motivation. It is the role of the government's new PPP framework to ensure that infrastructure investments are carried out in the most efficient manner. For this, further efforts are needed to improve the planning and assessment of infrastructure projects so as to ensure value for money. Establishing sound PPP policies is a step forward, but many other challenges will continue to exert pressure in this regard, including the underdeveloped financial sector. Overcoming these challenges will take some time. In the near term, multilateral and bilateral donors will continue to play a critical role in facilitating investments in infrastructure, be it through PPPs or traditional delivery.

Policy recommendations:

- Strengthen the capacity and co-ordination across the government for planning and assessing infrastructure priorities so as to ensure infrastructure strategies are well integrated with overall industrial strategies (*e.g.* inefficient last-mile transport infrastructure to secondary destinations may have hindered greater tourism development and diversification);

- Consider establishing a framework for preparing public investment and PPP proposals to facilitate project comparison and prioritisation according to projects' socio-economic importance, environmental sustainability and financial feasibility. Make sure infrastructure project selection and prioritisation incorporates budget constraints and follows structured project appraisal procedures and cost-benefit analysis;

- Ensure that the PPP policy is grounded on efficiency rather than fiscal motives. Continue to devote enough public resources to infrastructure investment and build capacity to carefully assess and allocate risks between parties in PPPs so as to secure value for money;

- Ensure a transparent and competitive tendering environment during the selection stage of PPP investors so that they are based upon

value for money expectations. Direct appointment should be reserved for exceptional cases;

- Clarify some of the draft language in the PPP decree, including on roles and responsibilities among institutions, specific procedures for smaller projects, land clearance and compensation issues, and rules and circumstances under which renegotiations are permitted;
- Ensure implementation regulations and guidance documents are clearly drafted and that there is no overlap or inconsistency between the PPP decree and the *Law on Investment Promotion*.

Taking stock of infrastructure connectivity challenges in Lao PDR

Limited ICT infrastructure and use is likely to contribute to increased trade costs

Despite significant progress over time, Lao PDR still faces some important infrastructure shortcomings as reflected in a number of infrastructure stock indicators and perception assessments (Table 7.1). It has among the lowest information and communication technology (ICT) availability and penetration in Southeast Asia, with only 67 people having access to mobile telephone out of 100 people, compared to levels close to 100 and above in China and other Southeast Asian countries, respectively. Internet penetration is also among the lowest in the region, with only 15 internet users out of 100 people and less than one person in 100 having access to fixed broadband internet subscriptions. Among other effects, improved access and use of ICT infrastructure can greatly reduce the cost of exchanging often complex and sizeable volumes of information, data and documents associated with international trade transactions. In general, ICT availability and use is estimated to contribute to about 6-7% of a country's average comprehensive trade costs (UNESCAP, 2012). In Lao PDR, the relatively poor ICT penetration is likely to contribute to relatively higher trade costs and may hinder industrial development.

Access to electricity has greatly improved in the past decade but is still limited compared to elsewhere in the region

In 2005, only 50% of the households had access to electricity (ADB, 2013), compared to nearly 70% as of 2012. Access to non-solid fuels for use in common day-to-day activities, such as lighting, cooking and heating, is still reserved to only a small percentage of the population. The lack of access to electricity is particularly acute in rural areas, with severe consequences to public health and the environment, as households end up

relying on poor substitutes for electricity, such as firewood and charcoal. Expanding electrification remains a government priority to reduce poverty and the government's goal is to have 90% of all households with access to grid electricity by 2020 (ADB, 2013).

Meeting the target will require substantial investments in generation and transmission capacity (ADB, 2013). The power grid is fragmented across three regional grids, which is inadequate to support planned expansion of hydropower generation and its connection to the GMS power market. It also fails to properly support domestic demand and, as a result, Lao PDR has had to import electricity from neighbouring countries despite being an exporter of electricity. In 2010, imports reached 45% of total electricity demand (World Bank, 2012). Reaching the more remote rural areas as per the government plans is also relatively costly. A plausible alternative that the government has increasingly encouraged is the development of off-grid solutions, notably of renewable technologies (see Chapter 8).

Off-grid mini hydropower and wind and solar power plants could contribute to extend access to electricity in rural areas and help to reduce the current use of biomass. Stand-alone, local mini-grid systems can be integrated later to the national grid once it reaches the area. Such measures can significantly improve the lives of rural populations, but requires implementing appropriate policies for their development (*e.g.*, dedicated institutional structures, clear power purchase regulations for small power producers, capacity-building measures for proper operation and management of systems, removal of ineffective subsidised programmes undermining the development of market-based solutions, promotion of energy efficient technologies and microfinance services).

Attracting investment in the domestic power sector will require addressing the historically low level of electricity prices, which undermine the industry's financial sustainability and capacity to meet investment requirements. Electricity prices remain among the lowest in the region (Table 7.2) and exert considerable financial pressure on the vertically-integrated, state-owned utility company, Electricité du Laos which holds the monopoly over transmission and distribution to all electricity customers served by the national grid. It is also the owner of EDL-Gen, responsible for EDL's generation function since 2010, and holds equity interests in four export-oriented hydropower plants in operation and a number of other independent power projects under construction. These have dedicated transmission lines connecting them to designated export markets. Low electricity tariffs partly explain why most independent power producers (IPPs) export power to neighbouring markets (ADB, 2013).

Table 7.1. Selected infrastructure indicators across ASEAN countries and China

	Electricity				ICT			Transport			
	Access to electricity (% of population)	Electric power transmission and distribution losses (% of output)	Access to non-solid fuel (% of population)	Quality of electricity supply, 1-7 (best)[1]	Mobile cellular subscriptions (per 100 people)	Internet users (per 100 people)	Fixed broadband subscriptions (per 100 people)	Ratio of paved roads to total road length (per cent)	Asian highway, Primary and Class III and below as a share of total Asian highway[2] (per cent)	Quality of roads, 1-7 (best), WEF[1]	Quality of air transport infrastructure, 1-7 (best), WEF[1]
	2012	2012	2012	2015	2014	2014	2013-14	2012-14	2012	2015	2015
Brunei	76	6.2	100	-	110.1	68.8	7.1	93	-	-	-
China	100	5.8	54.9	5.34	92.3	49.3	13.6	-	5.4	4.69	4.79
Cambodia	31	18.3	11.4	3.11	155.1	9	0.2	10.9	68.8	3.34	3.68
Indonesia	96	9.1	59.3	4.13	126.2	17.1	1.2	56.7	0	3.72	4.36
Lao PDR	70	..	2.4	4.71	67	14.3	0.2	16	87.5	3.62	3.8
Malaysia	100	6.2	100	5.78	148.8	67.5	10.1	79	0	5.69	5.74
Myanmar	52	25.3	7.3	2.72	49.5	2.1	0.2	51.6	84.8	2.33	2.62
Philippines	88	11.5	45.9	4.03	111.2	39.7	23.2	86	98.7	3.3	3.69
Singapore	100	1.6	100	6.74	158.1	82	27.8	100	0	6.21	6.8
Thailand	100	5.7	75.9	5.22	144.4	34.9	8.2	83.2	3.1	4.38	5.11
Viet Nam	99	9.8	51.1	4.11	147.1	48.3	6.5	66.3	16	3.34	4.17

Notes: (1)"The Asian Highway network consists of highway routes of international importance within Asia, including those crossing more than one sub-region; those within sub-regions that connect neighbouring sub-regions; and those located within member States that provide access to: (a) capital cities; (b) main industrial and agricultural centres; (c) major air, sea and river ports; (d) major container terminals and depots; and (e) major tourist attractions. The total AH network is divided into five major classes (primary, I, II, III, below III) that conform to road design standards. Primary class refers to access-controlled highways used exclusively by automobiles, with access at grade-separated interchanges only. Mopeds, bicycles and pedestrians are not allowed to enter the access-controlled highway in order to ensure traffic safety and the high running speed of automobiles. Class I refers to asphalt, cement or concrete roads with four or more lanes. Class II refers to double bituminous treated roads with two lanes. Class III is also regarded as the minimum desirable standard. Roads classified below class III are road sections below the minimum desirable standard. Data is available at the UNESCAP online statistical database; (2) The WEF's scale is from 1 (extremely underdeveloped) to 7 (well developed and efficient by international standards).

Source: World Bank World Development Indicators database, UNESCAP online statistical database, ASEAN-Japan Transport Statistics database and WEF (2015).

Table 7.2. **Electricity tariffs in Lao PDR and ASEAN, USD¢/kWh, 2014**

	Residential		Commercial		Industrial	
	Low	High	Low	High	Low	High
Brunei Darussalam	3.82	19.11	3.82	15.29	3.82	3.82
Cambodia	8.54	15.85	11.71	15.85	11.71	14.63
Indonesia	4.6	14.74	5.93	12.19	5.38	10.14
Lao PDR	3.34	9.59	8.8	10.36	6.23	7.34
Malaysia	7.26	11.46	9.67	11.1	7.83	10.88
Myanmar	3.09	3.09	6.17	6.17	6.17	6.17
Philippines	21.1	24.83	19.93	22.94	18.15	19.37
Singapore	19.76	19.76	10.95	18.05	10.95	18.05
Thailand	5.98	9.9	5.55	5.75	8.67	9.43
Viet Nam	2.91	9.17	4.38	15.49	2.3	8.32

Source: JICA (2014).

Transport connectivity has improved but the quality of the network remains below regional standards and acts as a barrier for further economic development and diversification

Transport connectivity has also improved considerably in the past decade, but the quality of the network remains below regional standards. The road network consisted of roughly 51 500 kilometres in 2014, an increase from 39 500 in 2010 (Government of Lao PDR, 2015), serves the vast majority of passenger and freight transport in the country. In 2011, road transport was reported to account for 98% of passenger-kilometre travels and 86% of weight-kilometre of freight moved in the country (ADB, 2011). Inland water transport remains limited and rail infrastructure is almost inexistent. The narrow coverage and seasonal flow of waterways hinders the development of inland transport alternatives, and the small population and low population density constrain the role of railways as an efficient alternative to domestic transport. The development of a GMS railway network in Lao PDR may eventually be feasible depending on the demand for commodity movements from other GMS countries (ADB, 2011). The government has identified several potential railway projects linking the country to Thailand and China, with some of them already moving to the construction bidding stage (Government of Lao PDR, 2015).

The poor quality of the road network is, therefore, an important shortcoming for economic development. Only about 16% of the existing

road network is paved, and over 87% of the Asian Highway route network within Lao PDR – which provides the backbone national road links to neighbouring countries and within Lao PDR – are classified as Class III or below (*i.e.* the minimum desirable standard or below). Moreover, about 40% of the villages lack access to all-weather roads, which is a significant challenge given the country's relatively high vulnerability to natural disasters (World Bank, 2011). Most of the public investment in the transport sector in the past has been directed to extending the network. Only limited funding has been for upgrading and maintaining the existing network. While the government recognises the importance of maintenance to ensure the sustainability of the existing road network, the revenues of the Road Maintenance Fund, established in 2001 for such purposes, fall short of annual maintenance needs. In the recent past, it has covered only about 40% of annual needs (World Bank, 2011).

These shortcomings in the quality of Lao PDR's connectivity infrastructure, as observed in stock indicators in Table 7.1, are also reflected in the country's relatively weak performance in the World Bank's 2014 *Logistics Performance Index* (LPI) compared to regional peers (Figure 7.1). Despite the progress achieved since the first LPI survey of Lao PDR in 2007, its performance under the indicator of "quality of trade and infrastructure" (*e.g.* ports, roads, airports, information technology) remains, nevertheless, among the lowest in the region. While the low perception of logistic firms and practitioners responding to the survey may likely reflect the country's land-locked characteristics to some extent, Lao PDR still ranks 128th among 160 countries covered in the survey under this component. All respondents rated the quality of Lao PDR's different connectivity infrastructure sectors as low or very low. The World Economic Forum's (2016) *Global Competitiveness Report* also attests to the low quality perception by firms of Lao PDR's infrastructure systems in comparison to some regional competitors (Table 7.1).

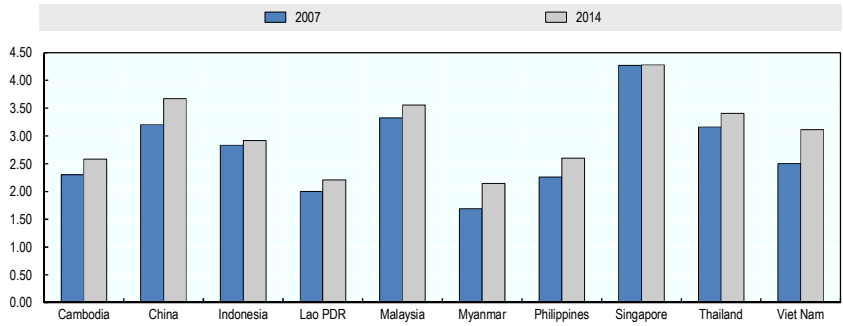
Shortcomings in the availability and quality of infrastructure networks compound the costs of being land-locked and act as a further deterrent for Lao PDR's trade and investment integration

The relatively limited availability and quality of the existing infrastructure network has important consequences for trade and investment connectivity within the region and with the rest of the world. Trade and investment-related infrastructure are important drivers of non-tariff trade costs (Figure 7.2). In a number of ASEAN countries, transport-related costs are among the main factors contributing to higher trade costs. Lao PDR is particularly affected as a land-locked country dependent on the access and quality of international gateways of its neighbouring countries. For instance,

the distance from Japan to Lao PDR is not that different from Japan to Thailand, and yet bilateral trade costs with Japan are 3.3 times that of Thailand with Japan.

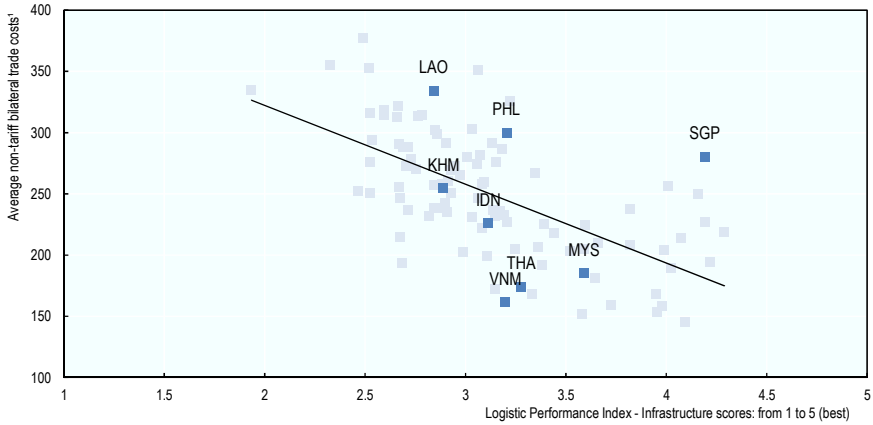
Figure 7.1. **The World Bank's Logistic Performance Index, Infrastructure indicator**

(score from 1 to 5 - best)



Source: World Bank Logistics Performance Index database.

Figure 7.2. **Infrastructure weakness is a deterrent to ASEAN trade integration**



1. Average non-tariff trade costs include all costs involved in trading goods relative to those involved in trading goods domestically. It captures trade costs in the wider sense, including not only international transport costs but also other trade cost components, such as direct and indirect costs associated with differences in languages, currencies and cumbersome import or export procedures.

Source: ESCAP International Trade Costs database and the World Bank's Logistic Performance Index database.

Lao PDR's infrastructure connectivity development strategy

The Eighth National Socio-Economic Development Plan 2016-20 is articulated within the context of the government's longer term plan to 2025 and the 2030 Vision. It reinforces the goal to continue Lao PDR's rapid growth path of recent years and graduate to a middle-income economy by 2020. It also aims to prepare the country for post LDC graduation, and for this it recognises the need to implement policies that will support productivity growth, along with consolidation of knowledge and skills, realisation of comparative advantage, acquisition and application of science and technology and continued diversification, emphasising the role of the agro-processing and tourism industries in regard. In particular, it identifies the continued need to strengthen economic integration within the region and broader economic diversification, notably by developing the agro-processing and tourism industries, as key strategies, and recognises the importance of infrastructure development for achieving such objectives (Government of Lao, 2015).

Estimated infrastructure investment needs exceed available funds at large

Supporting the government's vision to 2020 under the previous NSEDP, the Ministry of Public Works and Transport (MPWT) established the Strategic Plan for Highway Integration 2020 and Implementation Plan. The plan estimated that nearly USD 3.3 billion were needed in investments between 2010 and 2015 for implementing proposed transport upgrading and expansion projects supporting the objectives identified under the 7th NSEDP (2011-15). But available resources for road transport investments amounted to only USD 650 million or roughly 20% of estimated annual needs (ADB, 2011). Additional investment of USD 200 million per annum was estimated to be required in inland waterways, rail and aviation infrastructure to support the national development plan (ADB, 2011). The costs of maintaining the existing road network alone are already estimated to represent about 24% of the annual funds available to MPWT over the period (ADB, 2011).

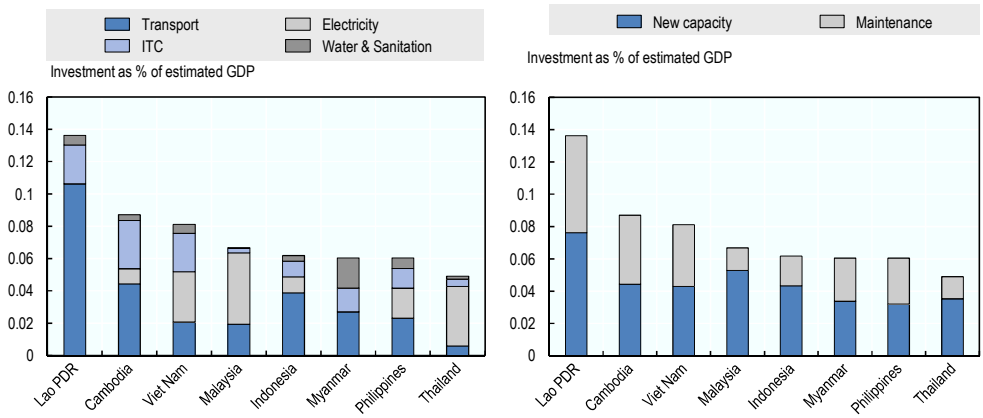
In the power sector, estimates suggested that nearly USD 1.2 billion was needed in investments (new generating capacity, transmission and distribution, and maintenance of existing network) to meet expected power demand from 2010 to 2016. About half is required in the transmission system, including for continuing with the government's rural electrification programmes (USD 160 million) (ADB, 2013). The development of exporting hydropower plants has been useful to generate income from royalties, taxes and dividends, which have been directed towards financing local infrastructure. But investments in the transmission network have been

insufficient to build a fully integrated network. The order of magnitude in the investment gap clearly shows the important funding constraint for local infrastructure development, stressing the importance of proper identification and prioritisation of projects for making the most efficient use of available resources.

Independent estimates of Lao PDR's infrastructure investment needs to satisfy consumer and producer's demand for infrastructure services suggest much greater investment needs than the amount planned by the government (Figure 7.3). These estimates build on specific economic and demographic growth scenarios to estimate required levels of investment and provide an alternative check to the bottom-up estimations from the government based on the costs to implement identified projects.[1] Meeting demand would require nearly USD 11 billion in infrastructure investments in 2011-20 (Battacharyaya, 2010). This is equivalent to over 13% of the estimated GDP for 2010-20, which stands much above the estimated needs for other economies in the region. Around 56% of this is estimated to be needed in the building of new infrastructure capacity and 44% in the maintenance of existing capacity. Regional infrastructure projects to which Lao PDR is a party would require additional investments.

Figure 7.3. **Infrastructure investment needs in Lao PDR and selected ASEAN economies**

(% of estimated GDP, 2010-20)



Source: Bhattacharyaya (2010).

ODA has played a critical role for infrastructure connectivity improvements in Lao PDR

The finance of infrastructure improvements in Lao PDR has greatly relied on the assistance of bilateral and multilateral donors. According to the OECD Aid Statistics database, gross disbursements of official development assistance (ODA) from the OECD Development Assistance Committee (DAC) donors and multilateral organisations to Lao PDR totalled USD 472 million in 2014, of which USD 53 million or roughly 12% was directed towards economic infrastructure.

In the road sector, which concentrates most of the investment needs, the MPWT has over time strengthened its ability to finance infrastructure expenditures, particularly through a substantial rise in the fuel levy in recent years (which constitutes the main source of capital of the Road Maintenance Fund established in 2011) and increased royalties and dividends from the large hydropower projects coming on stream (e.g. Nam Theun 2 Hydropower Project). But despite this, development partners still contribute a large share of total funding available to the sector. From 2009 to 2015, they were estimated to have contributed roughly 44% of the total available funding for road transport investments, including maintenance expenditures. About USD 50 million is needed per year from international development partners to sustain the government's road expenditure programme (ADB, 2011). Mobilising further domestic resources will therefore be critical in the future for the government to bridge closer to desired levels of investments in network improvements as identified in NSEDPs and upgrade and maintain existing assets.

Establishing an enabling environment for infrastructure investment

Mobilising domestic and foreign resources for infrastructure is an important challenge. Both government and donor support will continue to be crucial to fund required infrastructure improvements (World Bank, 2013; ADB, 2011), but as GDP per capita rises, the funding capacity grows and further mobilisation of funds from infrastructure users or taxpayers become increasingly feasible. Other infrastructure delivery options also arise, notably through public-private partnerships. In the medium-to-longer term, securing the needed resources for infrastructure will require strengthened mechanisms to adequately prioritise and deliver projects in the most efficient manner.

Encouraging greater private participation should not be done for fiscal reasons

In view of the large capital needs for infrastructure development, the government has turned to PPPs "as a useful tool to help bridge the infrastructure gap and improve the performance of public services in the country" (ADB, 2013). For this, the Ministry of Planning and Investment has sought the assistance of the Asian Development Bank to help design and implement a new PPP policy and legal framework. The endeavour comprises three main areas, namely (*i*) institutional capacity building, (*ii*) policy and legislation framework development, and (*iii*) demonstration of model/pilot projects in social sectors, namely education and healthcare. A PPP conceptual framework has already been laid out and provides the path to gradually achieve the long-term PPP objectives of the government.

The framework's rationale, however, as stated in the citation above, may be grounded on unreasonable objectives. The ambitious expectation that PPPs will mobilise the necessary resources to deliver on infrastructure investment needs is unlikely to materialise. The fiscal motivation underlying such policy orientation may even prove costly in the long-term if it prevails over proper value for money assessments (Box 7.1).

Moreover, it is rather unlikely that Lao PDR will be able to mobilise the needed resources from private commercial sources without any government financial involvement. Even the upgrading of NR13 – one of the most important economic corridors linking the country to neighbours in the north and south, passing by Vientiane Capital – would still require significant government support either through upfront investment or ongoing financial support (*i.e.* availability payments) (World Bank, 2013). In most PPP projects, the optimal risk allocation requires the government to bear the risks for which it is better placed to manage, mitigate and absorb, which often translates at least into contingent fiscal liabilities if not direct ones (OECD, 2007, 2012). Excessively transferring risks to the private party may erode part of the potential benefits of using PPPs in the first place.

In the appropriate environment, however, private investments in infrastructure can potentially help to increase the efficiency of infrastructure delivery. By bundling the responsibility for the initial capital investment with future maintenance and operating costs, PPPs provide incentives for the firm to minimise overall costs over the entire lifetime of the project. They may also help to insulate the project from stop-go funding characteristic of traditional delivery and protect maintenance expenditures by conditioning payments on service quality and availability (Perkins, 2013). But the potential for private sector efficiency gains can easily be dissipated if the regulatory framework for private participation is deficient. Transactions

costs associated with more complex contractual and governance structures required to ensure that the private sector delivers upon efficiency expectations, as well the costs of government oversight and regulation are not to be neglected. Likewise, inadequate project planning and risk sharing allocations in many transport PPP projects can result, and sometimes have, in expensive renegotiations for taxpayers (Perkins, 2013).

Box 7.1. **The rationale for private participation in infrastructure**

Contrary to what is often believed, PPPs do not release government funds, and therefore do not expand the number of projects that the government can undertake. Instead, while the government saves on investment outlays up-front, it relinquishes future user-fee revenue (if the PPP is financed with user fees) or future tax revenues (if financed with budget payments) which should be equivalent to up-front capital investments in present value terms (Engel et al, 2007).

Investment in infrastructure projects is a matter of project cash-flow, *i.e.* the capacity to generate risk-adjusted returns, regardless of whether it is financed through user fees or taxes. In the case of availability-payment PPPs, in which private investors "lend" capital to the state, they will only do so if the state has the ability to repay them, in which case the state is not credit-constrained and public provision is potentially an option. But even in the case of PPPs funded partially or totally by user-fees, if the government can protect the project's revenue stream from other uses, these revenues could likewise be used to repay debt under public provision as well. The perceived financial benefits of PPPs happens only because accounting rules have allowed PPPs to go off the balance sheet, allowing governments to anticipate spending and sidestep normal budgetary process since future obligations associated with PPPs are not required to be recorded on the public accounts (Engel et al, 2007).

The case for PPP should rely on its ability to generate greater value for money than the public provision alternative based on its capacity to generate productive, allocative and dynamic efficiency gains (Engel *et al*., 2007). The use of PPPs as a vehicle for escaping budgetary discipline by hiving financial commitments off public sector balance sheets often leads to problems. Contingent liabilities and other fiscal risks associated with PPPs can sometimes be significant. It is internationally recognised that any fiscal implication of infrastructure projects should be reflected in public sector budgets unless all relevant risks truly reside with the private sector. If risks are mitigated by public guarantees, placing them off budget becomes even more questionable (OECD, 2007; 2012).

Private investment has been largely concentrated in the exporting power sector

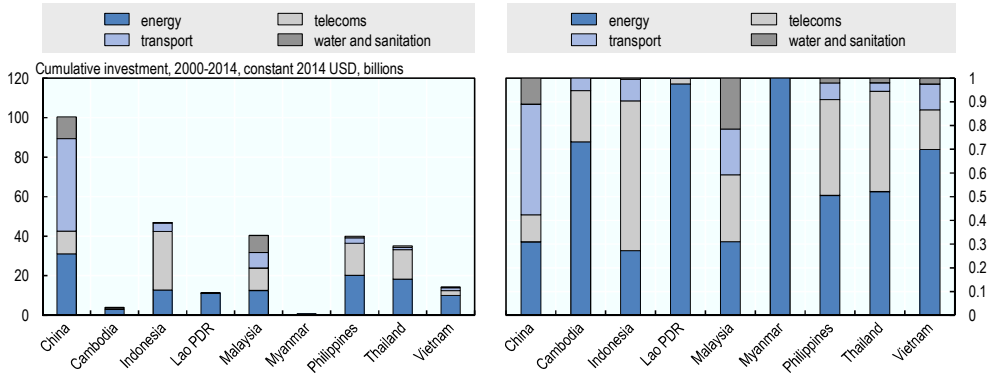
Often a challenge to mobilise private investment in infrastructure is the government's lack of experience with PPPs and consequently its sometimes weak capacity to adequately select and implement projects in partnership with private investors. In general, in developing and emerging economies, this has been particularly acute for projects in the transport sector, although it varies across transport segments. In more commercially driven transport sectors, such as ports and airports, greater levels of private participation have been achieved. Road and rail transport projects have had more difficulty in attracting private investors. These projects are characterised by high up-front costs with long-term payback periods and normally only a limited capacity to extract enough revenue from user fees to cover costs, adding considerable barriers and complexity to attracting private investors. Their commercial viability is complex, sometimes requiring the government to take part of the responsibility for commercial risks of the project. Road projects also often face public resistance where tolls are first introduced. Therefore, investors are particularly sensitive to the investment environment around such projects.

Private participation in infrastructure is not completely new to Lao PDR, so the government can leverage to some extent on its albeit limited experience so far. From 1991 to 2014, twenty projects reached financial closure with investments commitments totalling roughly USD 11 billion over the period (Figure 7.4). The large majority of investments have taken place in the electricity sector, where 15 projects reached financial closure during the period and accounted for nearly 97% of the investments. Most of the large hydropower projects that reached financial closure supply or are intended to supply power exports to neighbouring countries. Thai investors are the largest project sponsors in these projects, but some European investors have also participated. These projects have often been structured in the form of limited companies as per the *Law on Investment Promotion*, with the government or a state-owned company holding an equity interest.

Most of the projects developed so far, however, have been directly negotiated, failing to benefit from the potentially enhanced value-for-money arising from competition. Most of the potential efficiency gains provided by private parties are expected to occur at the contractual stage. Thus, ensuring a transparent and competitive tendering environment for such contracts is a critical condition for private investments through PPPs to deliver upon its value for money expectations. Direct appointment should be reserved to exceptional cases.

Figure 7.4. **Private participation in infrastructure in Lao PDR and regional peers, 2000-14**

(USD billion 2014)



Source: World Development Indicators database. Dollar amounts are in 2014 USD. As per the World Bank Global PPI update reports, nominal figures have been deflated using the U.S. consumer price index.

The need for improved infrastructure planning and project prioritisation capacity

Securing necessary resources to develop infrastructure and making infrastructure networks attractive for private participation where appropriate are made easier when infrastructure policy priorities are fully embedded in national economic development strategies, accompanied by a credible pipeline of projects, and are supported by a clear regulatory and institutional environment. This helps to secure greater policy co-ordination and alignment across the different levels of government and to assure investors of the government's long-term political commitment to infrastructure development.

In Lao PDR, the ADB's (2011) latest transport sector assessment pointed to some of the difficulties the government faces when planning and prioritising infrastructure projects. As it is understood, within the context of the national 5-year plan and in the beginning of the planning cycle, the MPI collects financial plans from the provinces and relevant government agencies for their proposed investments in infrastructure. It then allocates the available funding to each of the national, provincial, and district units, based on predetermined sectoral priorities. Funding allocations remain an annual exercise, despite requiring ministries and government agencies to prepare their investment planning estimates over a 3-5 year horizon.

Requests for funds often exceed the funds available. The process is also said to involve intense lobbying by the interested parties. The Ministry of Finance is consulted in the process but does not have a central role in its preparation (ADB, 2011).

There is a need to move towards more clear and predictable medium-term planning and funding allocations to increase stability for priority infrastructure projects and programmes and facilitate the co-ordination with donors (ADB, 2011). Budget constraints need to be more firmly incorporated in project selection and prioritisation. The government needs also to strengthen its value for money assessment framework through more structured project appraisal procedures. Cost-benefit analysis of projects should be carried out systematically for deciding which projects should be prioritised and whether projects would be better financed with budget resources or through PPPs for ensuring the best value for money, taking into account all the involved risks and their actual allocation between parties, including any contingent liability for the public sector. In this respect, the government may wish to establish a framework for preparing public investment and PPP proposals and feasibility studies in order to facilitate project comparison and prioritisation according to projects' socio-economic importance, environmental sustainability and financial feasibility.

Establishing a credible institutional and legal framework for private participation in infrastructure

The government wants to build a credible environment for PPPs, and has sought assistance from the ADB to help design and implement a new PPP framework. Establishing such a building block is necessary. Currently, no proper PPP legal and institutional framework is in place. These reforms are also aligned with those undertaken by other ASEAN economies (OECD, 2014). Many ASEAN governments have recently taken a more comprehensive approach towards building or upgrading their existing PPP regulatory and institutional frameworks. The Indonesian experience, for instance, offers an interesting example of a conceptually overarching institutional structure to mobilise private investments in infrastructure (Box 7.2). Although implementing such a structure has proved to be difficult in practice, its design theoretically provides for enhanced co-ordination of infrastructure policies across ministries and between the central and local governments, as well as better project preparation and execution.

Box 7.2. **Indonesia's institutional structure to mobilise private investment in infrastructure**

The experience of Indonesia offers a good example of a comprehensive approach towards building the institutional structure for facilitating private investment in infrastructure, while at the same time managing any contingent liabilities. The Indonesian government has created an adequately staffed PPP Unit, the Centre for Government-Private Co-operation, within the infrastructure inter-ministerial committee (KKPPI) and the Ministry of National Development and Planning (Bappenas), responsible for formulating policy, and co-ordinating and assessing PPP projects in infrastructure. In addition, Indonesia has created structures to facilitate the management of risks associated with PPP projects, including political, performance and demand risks, and to provide long-term financing for infrastructure projects to overcome some limitations of the local debt market.

The **Centre for Government-Private Co-operation** (PKPS) within Bappenas is to prepare and formulate policy, as well as co-ordinate, synchronise and evaluate government-private sector collaboration in infrastructure. Through the PKPS, prospective investors in infrastructure projects can obtain information on offered projects, including investment procedures and the rules of the game. The Centre has published a PPP Book containing a list of the country's infrastructure projects that are being offered to private investors and is intended partly to gauge investor interest. A 2009 edition has been followed by a 2010-14 version.

A **Project Development Facility** (in operation under Bappenas) funds project preparation so that government agencies can prepare detailed feasibility studies and bidding documents up to international standards before tendering the project.

A **Risk Management Unit** within the Ministry of Finance evaluates projects prepared by the PPP Unit and decides on the appropriate level of government financial support.

Infrastructure Guarantee Fund. The Fund was established at the end of 2009 to improve the creditworthiness of PPP projects by providing guarantees of financial compensation in the event of changes in government policies causing projects to be cancelled. The Fund is also expected to allow the government better to manage its own fiscal risk by ring-fencing government obligations *vis-à-vis* guarantees. It has been established as a state-owned company and funded through the state budget together with loans from the ADB and the World Bank. According to the Minister of Finance, the fund enables parliament to participate in setting the aggregate resource envelope for guarantees while allowing KKPPI and the Ministry of Finance to decide on the allocation to individual projects.

Indonesia Infrastructure Financing Facility. The IIFF, established on 15 January 2010, acts as a non-bank financial intermediary to mobilise mostly local financing for infrastructure and to help develop capacity in both the government and the domestic financial sector to develop viable PPP projects. The facility conforms to international best practices concerning corporate governance and risk management. The government holds a minority share, together initially with both the ADB and the IFC (with the World Bank providing a subordinated loan). Ultimately, the private sector is expected to take a share in the IIFF, once it has demonstrated its effectiveness.

Source : reproduced from OECD (2010).

As part of the reform efforts, the government plans to develop a Prime Minister's PPP Decree, consistent with international practice and compliant with Lao legislation. A draft decree has been prepared and made available for consultation on the MPI website. The draft available is now in its 7th version, dated from June 2015. Together with a *Law on Public Investment*, the draft decree brings some important regulatory and institutional mechanisms to improve infrastructure delivery capacity. For instance, it recognises the importance of establishing competitive tendering for such projects to delivery upon value-for-money expectations. It also foresees the establishment of a project development facility, funded initially through the state budget and ODA, to support government agencies in preparing and tendering projects. These resources will be critical for the government to prepare detailed feasibility studies and bidding documents up to international standards to create a credible pipeline of bankable projects.

The new PPP decree also demonstrates the government's increased commitment to provide funding to PPP projects that have strong economic returns but may not be commercially viable. For this, it foresees the provision of viability gap funding by the government, including availability payments. In this respect, the government may wish to consider the Indonesian experience (Box 7.2) and set up a dedicated fund to help assure PPP investors of its capacity to meet its commitments beyond the budget cycle and enhance the transparency and management of associated fiscal obligations. The decree also clearly states the right of project companies to create security interests over its assets, rights and interests, in the PPP project, and provides for alternative disputes resolution mechanisms, such as foreign arbitration.

Another important development is the envisaged creation of a PPP unit within MPI to be headed by a high-ranking official, vice-minister or above. While a PPP unit does not guarantee better results, it facilitates bringing together the necessary skills to identify, develop and negotiate projects suitable to private participation. It also diminishes the costs associated with co-ordinating interaction and responsibilities of various government agencies. In ASEAN, several countries have established or are in the process of establishing dedicated PPP units or specialised teams within the different ministries and relevant agencies (OECD, 2014). Limited delivery capacity of state agencies, both in terms of dedicated staff and sufficient budget for PPP preparation, are often an important part of the explanation for the limited number of bankable project proposals coming to the market. Weak state institutions, unclear legislation and deficient contract design have also been associated with frequent contract renegotiations which are costly for the taxpayer (Bitran *et al*., 2013; Guasch *et al*., 2014).

Many challenges still remain unaddressed, however. To begin with, the draft language requires improvements. On many occasions, it lacks an appropriate level of clarity to give confidence to investors and lenders. Another important issue relates to how such a PPP decree would relate to the *Law on Investment Promotion*, which regulates investments in concessions. Ideally, a unified regulatory regime for investments in infrastructure would be preferable. Having fragmented regimes increases the risks of inconsistencies and represents a source of uncertainty for investors. But if not possible, authorities should be careful in ensuring consistency between the PPP decree and the concession framework set out in the *Law on Investment Promotion*. The decree would also benefit from strengthened clarity on the institutional roles of the different ministries and agencies involved. The role of the Ministry of Finance, for instance, remains unclear as to whether it has any veto or approval power in the process. The absence of specific procedures for smaller projects should also be addressed. These projects may not necessarily need to be tendered and could go through direct negotiation on an exceptional basis. Greater clarity is also needed with regards to the powers of the government agencies to issue guarantees for PPPs, and on the rules governing the allocation of public support to PPP projects in order to ensure value for money.

The draft decree is also silent on land clearance and compensation issues. It would be preferable if the law clarified the institutional responsibility of the PPP unit or other agencies in obtaining land use, environmental and construction permits, as well as obtaining compulsory land expropriation clearance from the responsible judicial and administrative authorities when necessary, before calls for tender are made. In this respect, the government should also engage early in consultations with any affected party to mitigate any adverse social impact associated with land requirements by PPP projects (OECD, 2007, 2012). The PPP framework should, likewise, guarantee against changes in land use purpose during the entire execution of the project period, even when the project lender exercises the right to take over the project.

The current draft PPP framework also provides only limited guidance on the circumstances and the extent to which renegotiations are permitted, leaving large scope for these issues to be negotiated and stipulated by the parties in the contractual agreements. The lack of appropriate guidance may increase the risks of opportunistic renegotiations by the parties. Renegotiations have been common to PPP projects worldwide, often shortly after contracts are signed and to the detriment of initial value for money assessments, commonly resulting in direct and contingent liabilities for the government and lower efficiency and quality for users (Bitran *et al.*, 2013; Guasch *et al.*, 2014). Renegotiations will occasionally be necessary in long-

term infrastructure projects, and it is good practice to incorporate explicitly in contracts the conditions under which they may be reconsidered or renegotiated (OECD, 2007). At the same time, the outcomes of any renegotiation should not substantially modify the project's original risk allocation and jeopardise value for money. It should have no impact on the net present value of the project's benefits (Guasch *et al*., 2014).

Many of the contents of the draft decree would also need to be further clarified in implementing regulations and guidance documents. Guidance is needed to support PPP preparation, evaluation and selection. Notably more detailed guidelines and standards are needed to ensure project proposals and feasibility studies' quality and comparability and to ensure the quality of bidding documentation. Guidance is also required for implementing the mechanisms for early-on project termination and residual value repayment at end of PPP contract terms. Standardisation of PPP contract provisions in line with international standards should also facilitate such transactions. Implementing regulations need also to establish more detailed guidance for unsolicited proposals. The current draft, for instance, rightly subjects these proposals to competitive tendering, but fails to address with a greater level of clarity the rules and procedures for them to be undertaken (*e.g*. what should constitute a valid unsolicited proposal; would unsolicited project proponents be given any preference margin in the tendering of the project; would they be entitled to recover project preparation incurred expenditures from the winning bidder if different from the proponent).

Lastly, another barrier to raising infrastructure investment is the limited availability of domestic financing. Lao PDR's financial sector capacity is still relatively underdeveloped to finance large and long-term PPP infrastructure projects. PPP projects will likely require investors to have recourse to foreign bank loans denominated in foreign currency for undertaking such investment in Lao PDR, which increases considerably the risks for foreign investors and lenders since it exposes them to important currency risks since projects' revenues would be mostly denominated in local currency. Investors would, therefore, seek guarantees against exchange rate and currency convertibility and remittance risks. Multilateral financing and official development assistance will thus continue to play a key role in financing infrastructure investment in Lao PDR. They can play a particular role in leveraging the conditions for greater private sector participation, including by backing up government commitments towards private investors and providing investors with risk guarantees, besides assisting the government to improve its planning and implementation capacity.

Adopting PPPs is not straightforward. It will take some time for the government of Lao PDR to adapt and implement the required reforms to support a credible PPP programme. But there is strong regional commitment

and multilateral support to help it advance in building its capacity to deliver and manage PPPs. This is also in the interest of other ASEAN member states. The entire region stands to benefit from improvements in national infrastructure systems, besides enhanced regional connectivity associated with cross-border infrastructure projects.

Note

1. Estimates of investment required have many methodological drawbacks and should be interpreted with caution. Most importantly, they do not represent the level of infrastructure that would maximise growth or socio-economic targets, but rather are based on past observed behaviour of the relationship of income level and infrastructure demand in a sample of countries and extrapolated for the future using predicted income growth (Ruiz-Nuñez and Wei, 2015).

References

ADB (2014), *Proposed Loan Lao People's Democratic Republic: Greater Mekong Subregion Tourism Infrastructure for Inclusive Growth Project*, Project Number: 46293-003, Report and Recommendation of the President to the Board of Directors, Philippines: Asian Development Bank, August.

ADB (2013b), Initial Conceptual Framework and Roadmap for Public-Private Partnerships in Lao PDR, Philippines: Asian Development Bank, December.

ADB (2013a), Lao PDR: Energy Sector Assessment, Strategy and Road Map, 2013 update, Philippines: Asian Development Bank.

ADB (2011), Lao PDR: Transport Sector Assessment, Strategy and Road Map, 2013 update, Philippines: Asian Development Bank.

Battacharyay, B. N. (2010), "Estimating demand for infrastructure in energy, transport, telecommunications, water and sanitation in Asia and the Pacific: 2010-2020", *ADBI Working Paper No 248*, September.

Bitran, E., S. Nieto-Parra and J. Robledo (2013), "Opening the Black Box of Contract Renegotiations: An Analysis of Road Concessions in Chile, Colombia and Peru", *OECD Development Centre Working Papers*, No. 317, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k46n3wwxxq3-en.

Engel, E., Fischer, R. and Galetovic, A. (2007), "The Basic Public Finance of Public-Private Partnerships", *National Bureau of Economic Research (NBER) Working Paper No. 13284.*

Government of Lao PDR (2015), *12th High Level Round Table Meeting: Background Document*, Vientiane, Lao PDR, November 27.

Guasch, J., et al. (2014), "The Renegotiation of PPP Contracts: An Overview of its Recent Evolution in Latin America", *International Transport Forum Discussion Papers*, No. 2014/18, OECD Publishing, Paris, http://dx.doi.org/10.1787/5jrw2xxlks8v-en.

Hummels, D. (2007), *Calculating Tariff Equivalents for Time in Trade*, Nathan Associates for U.S. Agency for International Development.

JICA (2014), *Data Collection Survey on Long-term Energy Policy in ASEAN (Model Building): Final Report*, March.

OECD (2014), *Southeast Asia Investment Policy Perspectives*, www.oecd.org/daf/inv/investment-policy/Southeast-Asia-Investment-Policy-Perspectives-2014.pdf, Paris.

OECD (2012), *OECD Principles for the Public Governance of Public-Private Partnerships*, www.oecd.org/governance/budgeting/PPP-Recommendation.pdf, Paris.

OECD (2010), *OECD Investment Policy Reviews: Indonesia*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264087019-en.

OECD (2007), *OECD Principles for Private Sector Participation in Infrastructure*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264034105-en.

Perkins, S. (2013), Better Regulation of Public-Private Partnerships for Transport Infrastructure Summary and Conclusions, International Transport Forum Discussion Paper 2013-06, OECD/ITF: Paris.

Portugal-Perez, A. and Wilson, J. S. (2010), "Export performance and trade facilitation reform", *World Bank Policy Research Working Paper No 5261*, April.

Ruiz-Nuñez, F. and Zichao Wei (2015), "Infrastructure Investment Demands in Emerging Markets and Developing Economies", *World Bank Policy Research Paper No 7414*, Washington D.C., September.

Taglioni, D. and Winkler, D. (2014), "Making Global Values Chains Work for Development", *The World Bank Economic Premise No 143*, May.

WEF (2016), *The Global Competitiveness Report 2016 – 2017*, Geneva.

World Bank (2012), *Country Partnership Strategy for Lao Peoples Democratic Republic for the Period FY 12 – FY 16*, Washington D.C. January 25.

World Bank (2013), *Moving forward: developing highway PPPs in Lao PDR*, Washington D.C.

World Bank (2014), *Lao PDR Trade and Transport Facilitation Assessment*, Washington D.C, April.

Chapter 8

Investment framework for green growth in Lao PDR

This chapter assesses the investment framework for green growth in the Lao People's Democratic Republic (Lao PDR).It looks at challenges and opportunities for sustainable economic growth and provides recommendations to improve the regulatory framework for green investment with a particular focus on private participation in renewable energies. It also reviews financing for green growth and how the country faces climate change-related challenges.

Summary

Green growth implies fostering economic growth and development while ensuring that natural assets continue to provide the resources and environmental services on which our well-being relies. To do this it must catalyse investment and innovation which will underpin sustained growth and give rise to new economic opportunities (OECD 2011). Investment for green growth includes, among other things, investment in infrastructure such as renewable energy, energy efficiency, water purification and distribution systems, transport and housing, the preservation of natural resources and waste management (OECD 2015).

A green investment framework has much in common with a general policy framework for investment, but an investment-friendly policy framework does not necessarily result in direct investment in activities conducive to green growth unless certain elements are also in place. These include: a strong governmental commitment at both the national and international levels to support green growth and to mobilise private investment for green growth; policies and regulations to provide a level playing field for more environment-friendly investments; policies to encourage more environmentally responsible corporate behaviour; an institutional capacity to design, implement and monitor policies to foster green growth objectives; financial mechanisms for green investment; and policies to support private sector involvement in green infrastructure projects (OECD 2015).

This chapter describes Lao PDR's investment framework in these areas, providing an overview of the elements of the policy framework for green investment that have been instituted. In particular, it reviews the policy framework for improving the quality of investments in natural resources, examines in greater depth the private investment measures taken in the field of renewable energy, and reviews private sector engagement efforts in other sectors. It is structured around the questions on green growth and investment raised in the updated OECD *Policy Framework for Investment* and the OECD *Policy Guidance for Investment in Clean Energy Infrastructure*.

Lao PDR is facing environment and development challenges. Much of the population is still highly dependent on natural resources for their livelihoods, and reducing poverty, particularly in rural areas, is a key concern for the government. While investment in natural resources – hydropower, mining, forestry – has driven the country's economic growth over the last two decades, unsustainable use of these resources has resulted in increasing degradation and pollution. Forest cover, for example, decreased from 70% in 1943 to 42% in 2002 (GIZ 2014). These trends are

exacerbated by the country's vulnerability to climate change, which threatens progress made on economic growth and poverty reduction.

These challenges are also opportunities for Lao PDR to mobilise private investment in support of green growth, by improving the quality and sustainability of investment in natural resource sectors as well as generating new investment in 'green' sectors. Over one million people still lack access to energy and the country is endowed with abundant alternative and renewable energy sources, which highlight the potential for off-grid small scale renewable energy solutions (OECD 2016a). Sustainable natural resource management practices such as better water resource management, eco-tourism and sustainable agricultural practices could promote investment that generates employment, positive environmental benefits as well as growth.

Recognising the importance of promoting green growth and environmental sustainability, the government has made progress in instituting policies that promote green investment and support the 'greening' of investment flows, though at an early stage of development. It approved a National Strategy on Climate Change in March 2010 by focusing on the main domestic priorities such as agriculture and food security, energy, forestry and land use change and water. The *Environment Protection Law* was revised in 2012 and lays out the framework for national safeguards that help mitigate the impacts of investment in natural resources. In terms of promoting green investment, a National Renewable Energy Strategy has been set up, specifying long-term targets for renewable energy supply in the total energy mix, and several decentralised renewable energy solutions have been piloted. The government has not yet come up with specific policy instruments to actively promote renewable energy, however, or an implementation plan.

While the basic legislation and general government direction favour sustainable development and environmental protection, there is a substantial need for the government to build its capacity to ensure that its institutions can implement such regulations and monitor their implementation. Also, at present, the government relies almost entirely on international funding and donor contributions for the promotion of green growth, environmental protection and renewable energy promotion. Efforts should be made to mobilise private investment in green sectors. For renewable energy, in particular, sufficiently reliable and long-term resource data needs to be gathered, procedures for private participation need to be streamlined and simplified, incentives to encourage private participation efficiently put in place and new business models developed.

Key messages and policy recommendations

Build institutional and technical capacity to improve the quality of investment. Despite increased spending by the government and support from development partners, a lack of capacity – both institutional and technical – continues to be the main barrier to implementing and monitoring environmental protection policies in Lao PDR (ADB 2011). Significant progress has been made in developing a policy framework to promote better quality investment in Lao PDR and establish environmental safeguards systems. While there is awareness of environmental issues in different ministries, a prevailing lack of human resources and skilled personnel makes compliance with and enforcement of safeguards extremely challenging. The government needs to increase its effort to build long term capacity for environmental management across all institutions.

Develop a comprehensive, integrated energy policy to promote small scale renewable energy. The government has designed a renewable energy development strategy but it has not yet come up with a renewable energy policy and implementation plan to realise the targets specified in the strategy. A comprehensive renewable energy policy outlining the overall goals and periodic targets for grid-connected and off-grid renewable energy projects could be elaborated in a public document. It could serve as a framework and could be designed to commit all government departments and other stakeholders to join the agenda of change for providing a clear guideline for developing renewable and sustainable energy options.

Implement systemic resource assessment and monitoring for the energy sector. There is a lack of data and information of all sub-sectors of energy, which makes it difficult to come up with a comprehensive renewable energy policy – including solar, wind, hydropower and biomass. Reliable and timely statistics, including resource assessment data and mapping the potential areas across provinces for renewable energy projects, are necessary to assess the results of reforms undertaken so far and to provide broad technology options that help investors take an informed decision. Research on the possible impact of climate change on the hydropower potential of Lao PDR could be conducted considering the heavy dependence on hydro-electricity. Developing indicators to measure and monitor green investment, both domestic and foreign, could help ensure that green incentives are better targeted and monitored

Promote policies and incentives to scale up small scale renewable energy and promote energy access. Currently, electricity tariffs do not take into account the costs of generating renewable energy which means that these technologies are not cost competitive on their own. The lack of an independent regulatory authority for tariff formulation and regulation also

increases the transaction costs for small producers of electricity. A comprehensive pricing mechanism, such as feed-in tariffs, could be implemented to better support the development of the renewable energy-based electricity. In addition, almost no financial or fiscal incentives are being offered by the government to specifically encourage the development of renewable energy options. Depending on the availability of funds, the government could offer some tax relief (*i.e.* investment tax credits, accelerated depreciation, production tax credits, property tax incentives, personal income tax incentives, sales tax incentives, pollution tax exemptions) to investors and end-users to increase the affordability of sustainable energy technologies and options.

Diversify funding sources for green growth. The government currently relies entirely on international funding and donor contributions to promote green growth and improve environmental protection. Other options could include: eco-taxes on a range of products and activities to reduce the environmental impact; domestic public financing through a specialised financial institution within the government to leverage the private capital necessary for green growth; international funding options, including harnessing emerging international funding sources for climate change, such as the Green Climate Fund.

Improve donor co-ordination and alignment with national priorities. While donor programmes have significantly supported the environmental agenda in Lao PDR, there is a need for alignment with national priorities to ensure government ownership and subsequent scale up of piloted approaches. Mechanisms to promote donor coordination on specific environmental issues such as renewable energy or climate change, at a technical level, would help to avoid duplication and promote synergies across portfolios.

OECD green growth declaration. Lastly, the government could consider adhering to the OECD *Green Growth Declaration*, as 42 OECD and non-OECD countries have done so far. The *Declaration* highlights that growth and sustainable management of natural resources are complementary and points out key policy approaches that can support a green growth agenda. These include supporting market-based instruments and policies to change behaviour and expanding incentives for green investment in areas such as low-carbon infrastructure. Adhering to the *Green Growth Declaration* not only signals Lao PDR's support for green growth but could also pave the way for additional co-operation with the OECD on the issue. Lao PDR could thereby benefit from an understanding of how other countries, with similar developmental challenges, have been able to green their economies and societies.

Green growth in Lao PDR: turning challenges into opportunities

Lao PDR faces several challenges on its path to green growth including a high dependence on natural resources for growth, unsustainable use of its resources and increasing impacts of climate change. A measured and inclusive approach, based on a sound policy framework that encourages environmentally sustainable investment and promotes investment in green sectors, can help address the challenges and exploit the opportunities in a way that complements a sustainable, climate-resilient development path.

Improving natural resource management

Lao PDR is heavily dependent on natural resources for its economic growth, and the need to sustainably manage natural resources is crucial to ensure human development and reduce poverty. Lao PDR is one of the fastest growing countries in the region with average annual growth over the past decade exceeding 7%. This growth has been based on the country's wealth of natural resources – hydropower, mineral resources and forests – driven largely by demand from neighbouring countries. Hydropower and mining made up over a third of the country's GDP in 2014 and have attracted over half the FDI inflows over the past three decades. Forestry also continues to be a main pillar of the economy, and forest resources are an important renewable resource, helping to regulate surface water runoff, preserve hydrological systems and protect watersheds. In addition, much of the population is crucially dependent on natural resources for their livelihoods – for example, agriculture and fisheries sectors employ about three quarters of the labour force.

Accelerated use of natural resources has resulted in degradation and depletion of these resources and increasing deterioration in water and air quality. Forest resources, for example, are decreasing rapidly in quantity and quality. Approximately 42% of the country's land area was covered by forest in 2002, compared to 64% in 1960 and 70% in 1943, and the country has been suffering losses of around 91 200 hectares of forest every year since the early 1990s (ADB 2011; GIZ 2014). Forest loss and degradation is driven largely by mining and hydropower development, land conversion for agriculture, construction for roads and domestic purposes, and shifting agriculture practices. In addition, bans on logging in neighbouring countries have also increased demand for timber in Lao PDR. Acknowledging the pressing need to act, the government has been increasingly working, over the past decade, to regenerate, classify and certify its forests while improving overall forest management (OECD 2013).

The environmental effects of mining, hydropower and agriculture projects not only have consequences on local communities but also undermine Lao PDR's attractiveness for tourists and investors (United Nations 2010). The government recognises that relying heavily on the resource sector for growth can pose an increasing risk for environmental sustainability, but there is a lack of an institutional base to ensure that all new hydropower, agricultural and mining projects comply with a minimum level of environmental and social precautions, raising concerns for sustainable natural resource management (Yuzurio 2013; ADB 2011; World Bank 2012).

Enhancing the sustainability of Lao PDR's energy supply

Ensuring a sustainable and secure energy supply is a major challenge for inclusive, green growth in Lao PDR, while also providing opportunities to promote green investment. While energy consumption per capita is still very low, rapid economic growth in recent years has led to domestic power consumption increasing by an average of 13.4% annually from 2001 to 2010, and further growth is expected due to consumption by the mining and manufacturing industries, as well as through residential usage. Lao PDR also faces the challenge of ensuring energy for all. Increasing access to the grid or to off-grid energy solutions has been a priority of the government over the last two decades, and impressive progress has been made – the electrification rate increased from 36% of households in 2000 to over 87% in 2014 (ADB 2011; Lao Statistics Bureau 2015). Despite this, over one million people in the country still lack access to energy, particularly in rural and other hard to reach areas (OECD 2016a).

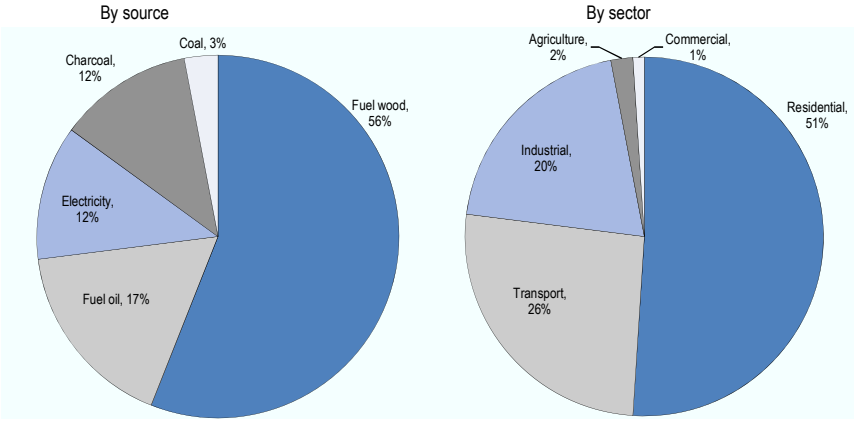
Energy access in Lao PDR is facilitated by the country's immense hydropower potential, but this power comes with its own social and environmental costs. So far, Lao PDR meets all its domestic demand (for users with access to the grid) through its hydropower resources (around 30% of total output) allowing it to export the remaining 70% of its hydropower electricity output to countries in the region, notably Thailand, Viet Nam, Cambodia, Singapore and China (OECD 2013). As a result, Lao PDR is often called "the battery of ASEAN", and hydropower development is at the centre of the government's socio-economic development planning and economic reform efforts. Despite the economic benefits, the dependence on hydropower has meant electricity shortages during the dry season and power has had to be imported from neighbouring countries Thailand and Viet Nam.

Hydropower development on the Mekong has been subject to strong environmental and social concerns, both within the country and elsewhere in the region (OECD 2016a). Large-scale hydropower development has been associated with negative environmental effects such as greenhouse gas

emissions from reservoir development, changes to water quality and flow regimes, loss of agricultural land and impacts on biodiversity and migratory species. The mainstream Mekong river dams – many of which are in Lao PDR – are expected to affect fish migration, resulting in a loss to the fisheries sector and those that depend on it (many of whom are still living in poverty), and even extinction of certain species indigenous to the Mekong. Planned mainstream dams in Lao PDR are further expected to have negative downstream impacts on neighbouring country Cambodia by affecting the Tonle Sap lake and ecosystem which is critical as a food source to much of its population (Mitra *et al*. 2015).

Overall, electricity makes up only a small part of the Lao PDR's overall energy supply, and the government is facing an increasing need to diversify its energy mix by scaling up non-hydro renewable resources. The country is still very dependent on biomass and fossil fuels as primary energy sources. As in many other countries in the region, wood fuel and charcoal continue to support livelihoods and local development across the country, but dependence on these fuel sources also contributes to deforestation trends. Petroleum is imported to support transport. When considering the total energy consumption, wood fuel represents about 56%, followed by petroleum at 17%, electricity at 12%, and charcoal and coal for 14% – see Figure 8.1 (GIZ 2014).

Figure 8.1. **Primary energy consumption in Lao PDR**



Source: GIZ (2014).

Renewable energy technologies can contribute towards reaching the 90% electrification target by 2020, reversing the trend of forest cover loss and meeting transport fuel needs (Ploechel 2015; GIZ 2014). Lao PDR

could strengthen its energy security and save energy mainly through implementing the government's renewable energy and energy conservation programmes. The use of decentralised off-grid renewable energy based applications is also required to meet the demand for electricity, heating and cooking from the population in rural and remote areas (Pillai, 2014). Box 8.1 presents the potential for renewable energy in Lao PDR.

Box 8.1. **Renewable energy potential in Lao PDR**

Biomass, biogas and biofuels: Being a primary agricultural country, the potential for biomass energy from agricultural waste products - such as rice straw and husks, sawdust, and corn cobs - is high. Theoretical potential from agricultural waste is estimated at 6,400 GWh, with over 70% of this from rice residues. So far, biomass is only used at the household level, as more than 80% of the population still relies on biomass energy, especially for cooking. Biomass is also used for small-scale rural industrial production (*e.g.* alcohol production and tobacco processing). The estimated potential from biogas and solid waste resources is around 313 megawatt (MW) and 216 MW respectively. The country also has good potential for bio-fuel production from oily crops such as jatropha, oil palm, and soybean, driven largely by the government's targets for biofuel expansion. Biofuel development, however, is constrained by low agricultural productivity.

Solar: Lao PDR has good irradiation levels, however, the mountainous topography of the country limits the degree to which large scale systems would be technically feasible. The potential capacity of solar energy is estimated at around 3.5 and 3.8 kilowatt-hours per square meter per day, and the overall technical potential for the country is estimated at 11 terawatt-hours per year. While less suited to large scale application, solar power systems have a role to play in providing off-grid electric power for remote rural areas. At present, around 20 000 households, mostly in remote areas have been supplied with solar home systems.

Wind Power: Lao PDR has considerable wind power potential, particularly in mountainous areas in the country, close to the border with Viet Nam - 20% of the country's land area has average wind speeds greater than 6m/s. Technical potential for large scale applications is less due to current limitations in the overall power generation and transmission grid systems in the country, and is estimated at 100- 380 MW. Off-grid village level wind turbine systems could be a viable option for areas without access to electricity.

Small Hydropower: Hydropower installations in Lao PDR with capacity less than 15 MW are considered as small hydro and as renewable source of energy. The estimated potential for small hydropower in Lao PDR is around 2000 MW, of which, to date, around 30 MW capacity projects have been developed.

Source: (ADB 2015; Pillai 2014).

Addressing growing impacts of climate change

The impacts of climate change are increasingly threatening economic and development gains to date, and there is a need to climate-proof all investments. Lao PDR is particularly vulnerable due to a high dependence on natural resources and low adaptive capacity at national and subnational levels. Most of the country is highly exposed to climate related hazards including flood and drought. For example, between 1970 and 2015, 35 floods, droughts and tropical storms were recorded, with damages estimated at USD 560 million (Guha-Sapir *et al*. 2016). Climate change is expected to result in increased variability in rainfall, increase in temperature and increased frequency of extreme weather events which will further compound the impacts of natural hazards, including on water resources, ecosystems and agricultural production. Increasing drought will also adversely affect hydroelectricity generation by altering water flow in the Mekong (EcoLao 2012; Government of Lao PDR 2015).

While Lao PDR has historically emitted minimal greenhouse gases compared to other countries in the region, there is a need to reduce the impact of current investment and to promote investment in sectors where emissions are expected in the future. Rapid economic growth has resulted in an increase in total emissions – Lao PDR went from being a net carbon sink in 1990 to emitting over 50 000 Gg CO2e in 2000, with 83% of these emissions resulting from forest loss and land conversion for agriculture and other development projects (Government of Lao PDR 2013). While the energy sector was responsible for only a minor share of emissions in 2000 (around 2%), increasing consumption of imported fossil fuels for transport and existing dependence on fuelwood in households means that energy sector emissions are likely to increase in the future. Renewable energy – especially off-grid solutions – and energy efficiency solutions for buildings and transport will help Lao PDR meet its mitigation ambitions as well as deliver development benefits.

Regulatory and policy framework for green investment

A policy and regulatory framework conducive to green growth is critically important to promote and mitigate the risks related to investment in green infrastructure and new technologies. Important aspects of such a framework include coherent and comprehensive policies and regulations related to the environment and green growth, engaging and committing to the relevant multilateral environmental agreements, and including environmental considerations in multilateral and bilateral trade and investment agreements (OECD 2012).

International commitments and efforts in favour of green growth objectives

Lao PDR has ratified and engaged in most of the major international conventions related to the environment and is party to 10 multilateral environment agreements. It ratified all three Rio Conventions including the United Nations Framework Convention on Climate Change (UNFCCC) in 1995, and the Convention on Biological Diversity and the UN Convention on Combatting Desertification in 1996. It also ratified several other MEAs including the Montreal Protocol on Substances that deplete the Ozone layer, the Convention on International Trade in Endangered Species of Fauna and Flora and the Stockholm Convention on Persistent Organic Pollutants (POPs) (Ministry of Natural Resources and Environment 2012).

Specifically related to climate change, Lao PDR ratified the Kyoto Protocol to the UNFCCC in 2003, and submitted its first and second national communications to the UNFCCC in 2010 and 2013. More recently, it submitted an Intended Nationally Determined Contribution (INDC) to the UNFCCC in 2015 and signed the Paris Agreement in April 2016.

In addition, the government has also been engaging in regional efforts to address environmental issues through ASEAN and other initiatives. Due to the position of Lao PDR in the region, many of its environmental challenges are trans-boundary. For example, Lao PDR plays a critical role in preserving sustainable water supplies and supporting ecosystems along the Mekong, and changes to the Mekong River's biodiversity will affect the environment and peoples' livelihoods throughout the region. In addition, several of Lao PDR's ecologically important landscapes are shared with neighbouring countries and this requires regional cooperation to effectively protect and manage them (Box 8.2).

Overview of green growth-related policies

Investments in the areas relevant to green growth are essentially government-funded and private initiatives remain very limited in Lao PDR. Nevertheless, the government recognises the need to address sustainability and mainstream environmental considerations, including action on climate change, into socio economic development planning (Government of Lao PDR 2015). The draft Eighth Five-Year National Socio-Economic Development Plan (2016-20), for example, emphasises the need for economic, social and environmental considerations to be addressed in order for Lao PDR to graduate from a least developed to a middle income country. Reducing the impacts of natural shocks on the economy and people is one of three main outcomes in the plan, and includes priorities to improve environmental protection and address climate change (MPI, 2016).

Box 8.2. **Addressing environmental issues requires effective regional governance**

National plans to expand hydroelectricity power generation capacity in Viet Nam, Lao PDR and Cambodia need to recognise and reflect regional river management issues, especially in the Greater Mekong Sub-region. For instance, upstream hydroelectric dams could generate environmental challenges in downstream areas, such as reduced fish migration, lower silt deposits and irregular water discharges causing sudden floods.

The Mekong River Commission (MRC) was established in 1995 by Cambodia, Lao PDR, Thailand and Viet Nam to promote regional dialogue on issues relating to the management of the Mekong River. China and Myanmar are associated as "dialogue partners". The MRC is an intergovernmental body tasked with protecting the Mekong River and its residents; its origins stem from multi-national interests. To manage trans-boundary impacts effectively, the MRC works with member and partner countries on strategies and policies for the sustainable development of hydropower along the Mekong River. Its 1995 founding document mandates the use of Procedures for Notification, Prior Consultation and Agreement so that countries can be notified of mainstream hydropower development proposals and evaluate their potential risks and opportunities.

The MRC has been instrumental in adjudicating agreements and resolving conflicting interests around water usage in this river basis. It fails, however, to fully enforce agreements or to find agreements among all members. Strengthening the institutional capacity of regional governing bodies (beyond national jurisdictions) and this type of regional collaboration is extremely important to increase policy coherence between green growth strategies and regional energy self-sufficiency objectives.

Source: OECD (2013); OECD (2014a; 2014b); IEA (2015).

Several efforts to institute economic policies that incorporate sustainable development considerations and Lao PDR's assets are underway, as evidenced by a series of initiatives (Table 8.1). The government has set a number of targets for greening its economic and social sectors and has expressed its interest in integrating green growth into long-term and multi-sector strategies and policies.

Table 8.1. **National policies and regulations related to green growth and environment**

Policy/legislation	Main features
Overarching policies	
National Growth and Poverty Eradication Strategy (NGPES, 2004)	The overall policy framework governing the strategy on economic growth and poverty eradication recognises that solutions for environmental conservation have to be grounded in the broader context of national development where each sector integrates environmental principles in its policies, programmes and projects.
8th 5-yr National Socio-economic Development Plan 2016-2020 (2016)	The overall national development plan which outlines major strategies and priorities across all sectors. It aims to make Lao PDR a middle income country by 2030 supported by inclusive, stable and sustainable economic growth while alleviating poverty. It recognises the link between economic development, sustainability and the need to mainstream environmental considerations.
Environment and environmental protection	
Natural Resource and Environment Strategy (2016-2025) and 5-yr action plan (2016-2020)	The strategy outlines the mission and activities of the Ministry of Natural Resources and Environment (MONRE) and has a vision to make Lao PDR 'Green, Clean and Beautiful'. It focuses on improving natural resource management, reducing pollution and addressing climate change. The underlying action plan includes targeted actions to implement environmental dimensions of the Eighth NSEDP. It includes priorities for a) land management and administration b) Water resources management c) forest and biodiversity management d) mineral resources management and e) climate change.
Revised Environmental Protection Law (2013)	Provides principles for environmental protection, outlines commitments to protect, improve, rehabilitate, control, monitor and inspect the environment and lays the groundwork for applying environmental safeguards.
Climate change	
National Strategy on Climate Change of Lao PDR (NSCC) (2010)	The strategy states that Lao PDR needs to mitigate and adapt to changing climate conditions to promote sustainable development. It defines priority actions in seven key areas: (1) agriculture and food security; (2) forestry and land use change; (3) water resources; (4) energy and transport; (5) industry; (6) urban development; and (7) public health.
National Climate Change Action Plan of Lao PDR 2013-2020 (2013)	The action plan identifies key initiatives in order to implement the National Climate Change Strategy, focussing on mitigation, adaptation, technical and institutional capacity building and education and public awareness raising activities.
National Adaptation Programme of Action to Climate Change (2009)	The programme maps out a country-driven programme to address climate change adaptation requirements in the agriculture, forestry, water resources and public health sectors. It outlines 45 actions and 12 priority projects to promote climate change adaptation in these sectors.

Policy/legislation	Main features
Sector-specific environmental policies	
National Forestry Strategy to 2020 (2005)	Sets out the target for increasing forest cover to a total of 70% of land area by 2020, and maintaining it at that level going forward. This is hoped to reduce the risk of floods and prevent land degradation, as well as mitigate greenhouse gas emissions.
Renewable Energy Development Strategy (2011)	Aims to increase the share of small scale renewable energy to 30% of total energy consumption by 2030, including targets for biofuels, micro-hydro, and biogas.
Sustainable Transport Development Strategy (2010)	Sets goals and targets to reduce environmental and social effects of transport development, including targets to address road safety and health effects of transport development, promote active transport and public transport, limit the growth of private transport and improve vehicle inspection and emissions standards.

Source: (MONRE 2012; GIZ 2014; Government of Lao PDR 2015; United Nations 2010; Ministry of Natural Resources and Environment 2015a; MONRE 2015b).

National policies to address climate change and promote green growth

At the core of the government's efforts to promote green growth and mainstream environmental concerns is the National Strategy on Climate Change (NSCC) approved in 2010, which builds on the earlier National Adaptation Programme of Action developed in 2009. The NSCC states the need "to secure a future where Lao PDR is capable of mitigating and adapting to changing climatic conditions in a way that promotes sustainable economic development, reduces poverty, protects public health and safety, enhances the quality of Lao PDR's natural environment, and advances the quality of life for all Lao People" (Government of Lao PDR 2015).

To implement the NSCC, the government developed an action plan for 2013-20 which details mitigation and adaptation activities for agriculture, forestry, land use change, water resources, energy, transport, industry and public health. The NSCC promotes integrated actions that address both mitigation and adaptation as well as other co-benefits *i.e*. cost effectiveness, measures that improve resource use and clean production, efforts to promote co-benefits in terms of positive economic and social impacts. Table 8.2 reflects the nation's adaptation priorities given the current understanding of expected climate impacts. At present, a *Climate Change and Disaster Law* is also being developed to provide a legal framework for disaster management and climate change – the law is expected to be approved in 2017.

Table 8.2. **Focus of adaptation projects in key sectors**

Sector	Focus of projects and programmes
Agriculture	- Promote climate resilience in farming systems and agriculture infrastructure - Promote appropriate technologies for climate change adaptation
Forestry and land use change	- Promote climate change resilience in forestry production and forest ecosystems - Promote technical capacity in the forestry sector for managing forest for climate change adaptation
Water resources	- Strengthen water resource information systems for climate change adaptation - Manage watersheds and wetlands for climate change resilience - Increase water resource infrastructure resilience to climate change - Promote of climate change capacity in the water resource sector
Transport and urban development	- Increasing the resilience of urban development and infrastructure to climate change
Public health	- Increase the resilience of public health infrastructure and water supply system to climate change - Improve public health services for climate change adaptation and coping with climate change induced impacts

Source: (Government of Lao PDR 2015).

The INDC submitted to the UNFCCC in 2015, outlines the Lao commitment at an international level to act on climate change. It incorporates the main targets contributing to mitigation and adaptation under different plans and policies, including forestry, energy and transport (Government of Lao PDR 2015). Actions include increasing forest cover to 70% of land area by 2020 (under the National Forestry Strategy), promoting renewable energy to make up 30% of total energy consumption by 2030 (under the National Renewable Energy Strategy), promoting mitigation in the transport sector and supporting large scale hydropower – all conditional upon international support in terms of finance, technologies and capacity building.

In addition, the new Natural Resources and Environment Strategy, developed in 2015, outlines a broad vision for environmental management with a focus on green growth related issues and climate change. While the strategy clearly outlines a vision for the Ministry of Natural Resources and Environment (MONRE) and the areas where it has a mandate (such as land management, environmental protection. water and mineral resources management), there is currently no overarching policy or strategy that clearly outlines a green growth path and that spans different ministries. Recognising this gap, the MPI is working towards scoping out such a

strategy, with support from the Global Green Growth Institute (Global Green Growth Institute 2016). This process could be useful in ensuring different aspects of green growth are explored and mainstreamed across policy areas. For example, the government currently pays little attention to green industries in its national strategies for technology and innovation. The national strategy for science and technology promotes the development of new and modern technologies but does not mention technologies for green growth (OECD, 2014b).

National policies to improve the environmental sustainability of investment

Recognising the need to better manage the impacts of investment, the government has put several efforts into improving the policy framework for environment and social safeguards. The drive for environmental protection is formalised in the *Environment Protection Law* (1999), revised in 2012, which outlines environmental quality standards. Specific regulations for environmental safeguards at the investment project level are rooted in the *Environmental Impact Assessment (EIA) Decree* of 2010 and a more recent ministerial instruction on Environmental and Social Impact Assessment in 2013 (Baird and Frankel 2015). Recent revisions to the safeguards framework, particularly for hydropower, have resulted from experience in applying safeguards to large scale mainstream dams which have been built with international financing, such as from the ADB and the World Bank.

According to EIA regulations, larger investment projects which are likely to have substantial impacts – such as large scale hydropower or those requiring resettlement – require EIAs, whereas smaller investment projects require initial environmental examinations (IEEs). MONRE is responsible for overall EIA regulations, for reviewing EIAs and IEEs and for issuing environmental compliance certificates, while sector ministries are responsible for approving projects based on regulations being met. Irrespective of project type, developers are required to obtain the environmental compliance certificate before the project can be initiated. MONRE has also released more detailed guidelines to support EIA implementation (Wayakone and Makoto 2012). EIA regulations have also been mainstreamed into sector specific policies – the National Policy on Sustainable Hydropower Development, for example, stipulates that all hydropower plants with a capacity of over 15 MW are subject to an EIA which should also consider cumulative impacts and trans-boundary environmental impacts as needed (Ministry of Energy and Mines 2015). Sector specific guidelines on mining have also been drafted (GIZ and BGR 2015).

Despite the progress made in developing policies to promote better quality investment, weak environmental governance continues to hamper the implementation of environmental safeguards in Lao PDR. There is a lack of institutional capacity to plan, regulate and monitor implementation of EIA legislation. The qualities of IEA reports produced are poor in terms of considering alternatives, the quality and coverage of EIAs varies across provinces, and public participation in the EIA could be improved across the board (Wayakone and Makoto 2012). Further, the onus on properly monitoring and reporting progress on environmental management plans is left to project developers which makes it easier (and less costly) for project developers to overlook their environmental obligations. The lack of capacity in MONRE to review EIAs – even in terms of number staff required – is a major impediment to implementation. There has also been a heavy reliance on donor financing to develop and implement safeguards legislation so far, with less drive from the government to institutionalise best practice (Campbell *et al.* 2015).

In the case of hydropower, internationally financed projects that comply with international safeguards standards are usually able to meet national safeguards requirements, whereas it is common for companies that do not have to comply with the demands set by international financing support to treat the EIA process as a 'rubber stamping' exercise. In addition, while there have been several attempts to address and demonstrate good safeguards practice in EIA application for hydropower projects, this has happened to a lesser extent for mining. As a result, there is a lack of capacity, skills and experience in addressing environmental issues in the mining sector, both in the government and in many mining companies. The large number of smaller companies engaging in mining activities also makes implementation and enforcement of EIA regulations more challenging (GIZ and BGR 2015). Government policies that can support companies to act responsibly towards the environment are further examined in Chapter 6 on responsible business conduct.

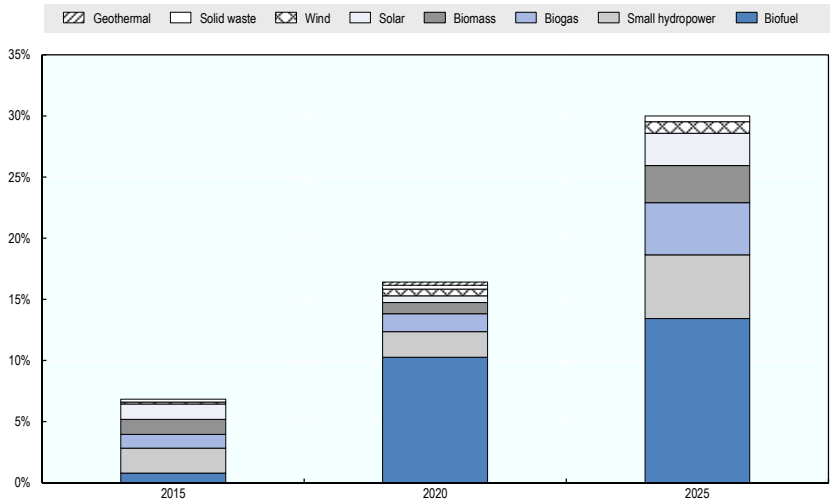
Measures to promote private participation in renewable energy

A Renewable Energy Development Strategy introduced in 2011 sets a target of increasing the share of small scale renewable energy to 30% of total energy consumption by 2030. It also sets a target for biofuels to meet 10% of transport fuel demand in 2025. The strategy focuses on small scale renewable energy as a way of increasing access to energy and promoting cleaner sources of energy. It largely targets the increase in small scale hydropower and biofuels development, with less emphasis on other forms of renewable energy (Figure 8.2). The strategy also states the government's intention to encourage investors who "produce clean energies to meet

domestic demand and who take socially and environmental corporate responsibility" for renewable energy development (Government of Lao PDR 2011; Pillai 2014). Other than the 2011 renewable energy strategy, no sector specific policies on renewable energy have been promoted yet. A holistic energy sector perspective is necessary to scale up investment in sustainable energy sectors, and an overarching integrated energy policy which clearly integrates renewables would be important to ensure renewable targets are achieved.

According to the Ministry of Energy and Mines, one of the main objectives with respect to large scale hydropower development is to increase government revenues from independent power plant exports and to promote hydropower development by the private sector, particularly from neighbouring countries. As a result, the government has actively promoted private sector participation for large scale hydropower (see Chapter 5 on investment promotion and facilitation). While there are no specific promotional incentives for investments in renewable and sustainable energy projects, renewable energy development can benefit from the broader incentives under the *Law on Investment Promotion* (including bio-fuels production, grid-connected or isolated systems, off-grid projects and individual systems). For example, sugar factories and biodiesel developers benefit from duty-free imports of production machinery, equipment, and raw materials, as well as for chemical materials needed for biofuels production within seven years (Pillai, 2014).

Figure 8.2. **Targets for renewable energy development in Lao PDR up to 2025**



Source: Adapted from Government of Lao PDR, 2011.

Several donor financed projects have been initiated in recent years to pilot and demonstrate the use of small scale renewable energy technologies to increase access to energy (Box 8.3). These projects have focused on developing private sector led models to deploy small-scale hydro and solar technologies, and on developing mini-grids at the community level. Despite these efforts, the widespread uptake of renewable energy technologies has been hampered by the absence of a specific incentive mechanism, lack of an overarching renewable energy policy and high transaction costs of IPPs (ADB 2011).

Box 8.3. **Promoting private participation in decentralised energy solutions in Lao PDR**

There have been several recent efforts to promote decentralised solutions in partnership with the private sector in Lao PDR. While successful at the project level, these initiatives have faced challenges in being scaled up, including a dependence on donor financing and the lack of an enabling policy environment for renewable energy and decentralised solutions.

Supporting social enterprises for rural electrification: Sunlabob Renewable Energy Limited is a social enterprise based in Lao PDR which provides solar and other renewable energy solutions to rural areas in Lao PDR and elsewhere in the region. It has been supported by various donors since its' establishment. One of their main business models is based on renting solar solutions such as, solar home systems or solar lanterns, to power basic appliances in rural households (e.g. lights, radio, fans, etc.), and reducing dependence on kerosene and batteries. The company also provides training to local people in maintaining the systems they supply and in collecting the rental fee. The model has proved to be successful in bringing benefits to local communities as well as generating clean energy. Despite this, the company faces several challenges in scaling up, including a lack of access to finance and guarantees for loans, competition from similar government and donor subsidised programmes, and the lack of policy support / targets for solar energy.

Public-private partnerships to promote micro-hydro: The government piloted a scheme in 2012 to promote investment in micro-hydro through a public-private partnership system. The scheme was based on a lease-purchase agreement whereby project developers would be expected to support the up-front costs of the system and received a fixed term lease from the Government of Lao PDR. The pilot was supported by the World Bank. Initial studies identified 15 potential projects but finally, only two were found financial viable and were followed through to completion by 2015. Many projects were not financially viable due to low electricity tariffs and the absence of government support or tariff subsidies for renewable energy.

Source: World Bank 2015; Pillai 2014; Schroeter 2012; Energy Sector Management Assistance Program 2009.

One of the main barriers to scaling up renewable energy is the issue of electricity tariff formulation and regulation, as there is no independent regulatory authority for electricity tariff formulation and monitoring power sector operations. Retail tariffs have to be approved by the Ministry of Energy and Mines based on a proposal submitted by state-owned electric utility Electricité du Laos (EDL). Tariffs to sell electricity from independent renewable energy generating stations to EDL are determined through negotiations on a case-by-case basis, which greatly increases the transaction costs for power producers (Pillai, 2014). In addition, electricity tariffs are low, and residential consumers are subsidised by industrial and commercial consumers. This means that renewable energy solutions are not cost competitive. A comprehensive pricing mechanism, such as feed-in tariff, could be implemented to better support the development of the renewable energy-based electricity.[1]

Other private sector-led initiatives in green growth sectors

Lao PDR continues to rely heavily on its forests to support national development and is working to protect and regenerate them, with the aim of increasing forest cover to 70% by 2020. Private operators are increasingly involved in wood-processing and the plantation of commercial trees such as eucalyptus, teak, agar wood and rubber, which contributes to the government's targets to reduce deforestation (OECD, 2014a). One example is the Smallholder Forestry Program supported by the Climate Investment Funds in Lao PDR, through which IFC is working with private forestry companies to develop smallholder out grower schemes that support smallholder farmers and reduces pressures on forest resources[2].

There are also initiatives to reduce chemical usage in agriculture, as the country has great potential when it comes to producing organic crops which are well-demanded in regional markets. Many local farmers have recognised this potential and are attempting to get their products certified, and the Lao Organic Agriculture Group has been established to this end. Growing organic crops gives an opportunity for farmers to reduce their costs by finding alternatives to purchasing fertiliser, while their crops realise far higher prices in markets. Yields may decrease initially but as microbes build up in the healthy soil, they increase in the longer term.

As tourism is taking a growing role in Lao PDR's economy and represents the first source of foreign exchange, ecotourism has been a priority of the government for over a decade. The National Ecotourism Strategy and Action Plan 2005-10 laid the foundations for ecotourism by providing key guiding principles. It emphasised the key role that the private sector can play to develop and sustain the sector and the action plan included measures to encourage private participation in ecotourism. The

strategy also underlined the need to bring together various governmental, non-governmental and private-sector stakeholders involved in tourism, environmental protection and nature conservation, as well as local communities, under an integrated and collaborative framework (LNTA, 2005). As a result of efforts to promote smaller ecotourism projects and community tourism, ecotourism has contributed to reducing poverty and can serve as an alternative livelihood for communities living close to protected areas (OECD 2016b).

A website dedicated to the industry (http://ecotourismlaos.com) and administered by the Lao National Tourism Administration provides useful information for travellers but also for potential investors, such as detailed guidance on how to design and operate eco-lodges. It also includes a list of investment opportunities that have been identified by the government, including under the form of public-private partnerships.

Financing for green growth and climate change

Development assistance plays a significant role in supporting the environmental agenda

As in many least developed countries, official development assistance (ODA) to Lao PDR is a critical source of investment capital, and the most important source of financing for environmental projects. According to OECD DAC statistics[3], just over USD 223 million in ODA flows supported climate change projects in the country in 2013-14, with around half going towards activities to support climate change adaptation (47%), a third supporting climate change mitigation (33%) and the rest supporting both mitigation and adaptation (Figure 8.3). In comparison, public expenditure on the environment was estimated at just under USD 0.6 million in 2005 (the latest year for which estimates are available) (World Bank 2010) .

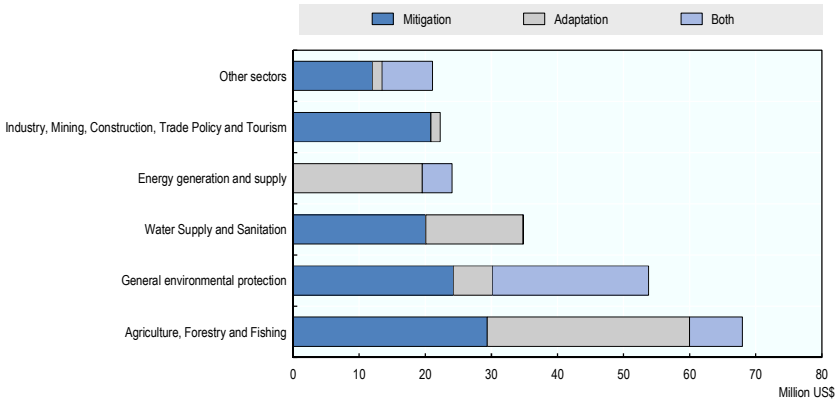
The top five development partners in terms of volume of support for climate change in 2013-14 were the ADB, Germany, Japan, the Global Environment Facility and the World Bank. Natural resource management and support for general environment management received the most support. Donors and non-governmental institutions have supported initiatives to address various environmental concerns, including biodiversity conservation and protected area management, improving air and water quality, establishing policies for environmental protection, and climate change adaptation and disaster risk reduction.

Most donor programmes for the environment and green growth focus on building capacity and strengthening the institutional framework. For example, the national safeguards system in Lao PDR has benefited from a

succession of programmes supported by Sweden and Finland between 1999 and 2015. The programmes resulted in increased capacity and a detailed policy framework, including the legislation supporting EIA application (Kirkemann *et al.* 2010). Another example is the joint UNDP-UNEP Poverty Environment Initiative which supports the Investment Promotion Department in the MPI and provincial authorities to manage investments in a way that maximise social benefits and minimise environmental impacts. It also works with MONRE to strengthen its environmental and social impact assessment processes. These initiatives and others are expected to build Lao capacities and strengthen institutional and regulatory preparedness to balance the need for short-term economic gains from investments against the sustainability of its valuable natural resources as sources of long-term growth and development. Capacities need to be strengthened to better monitor the effective use of funds, but experience worldwide shows that ODA recipient countries use their available funds more effectively if channelled into the national budgetary process instead of coming from fragmented sources (OECD, 2014b).

Figure 8.3. **Climate-related development finance to Lao PDR, 2013-14**

Current USD commitments



Source: OECD DAC Statistics.

While development assistance has resulted in several positive impacts, careful alignment with national priorities is crucial to secure government ownership. To some extent, the environmental management agenda in Lao PDR has been donor driven which has had implications for the long-term sustainability of approaches piloted. One example is the social and environmental safeguards applied to the World Bank financed Nam Theun 2 hydropower dam on the Mekong river (Campbell *et al*. 2015; Hirsch 2010).

The EIA included comprehensive coverage of alternatives, impacts and mitigation options and is widely hailed as a best practice case in applying safeguards to large dams, but the transaction costs for such a comprehensive assessment were high, and the government subsequently stated that it would not follow such a long process in subsequent EIAs.

Specialised funds support gaps in public investment for the environment

Lack of sustainable financing for environmental initiatives is an ongoing challenge for green growth in Lao PDR. One government response to this issue has been to develop special funds to support environmental protection (Table 8.3). While there is no specific green growth or climate change related fund, the different funds cover specific areas that support action on these issues, such as forest development, rural electrification and promotion of renewable energy.

Table 8.3. **Environmental funds in Lao PDR**

Name of Fund	Responsible institution	Objectives
Environmental Protection Fund	MONRE	Strengthen environmental management, biodiversity conservation, waste management and pollution control.
Forest and Forest Resources Development Fund	MAF	Strengthen forest management, environmental protection and sustainable development of forest resources.
Rural Electrification Fund	MME	Support the installation of solar electricity systems in rural areas.
Renewable Energy Fund	MME	Assist the renewable energy and biofuels industry, remove barriers and build capacity.
Multilateral Trade Fund	MCI	Promote compliance with WTO requirements.
Public Management Trust Fund	MOF	Support programme reforms and build capacity at local level.
District Development Fund	UNDP/UNCDF	Improve governance at the local level in areas of planning, technical inspections and procurement.

Source: UNCTAD (2010); GIZ (2014).

These funds are a way of leveraging and channelling donor funds. The Environment Protection Fund (EPF) is a good example of an environmental fund that has managed to collate and distribute significant volumes of donor financing. Originally established in 2005 by the ADB, the EPF manages an endowment fund from ADB to support its operations and serves as a vehicle for managing sinking funds from various donors. With a mandate to support

the budget for environmental management and protection, the EPF has managed sinking funds from the World Bank and UNESCO, and it has a successful track record in small scale project financing (MONRE 2012; Irawan *et al*. 2012; GIZ 2014). As a result, the World Bank has recently approved new financing of USD 41.8 million through the Second Lao PDR Environment and Social Project, which will channel funds for protected area management and livelihoods development through EPF (World Bank 2015).

The funds also serve to collate private sector financing for green growth and for distribution of benefits to communities. The EPF, for example, manages voluntary contributions from hydropower development. The Forest and Forest Resources Development Fund collects 30% of timber revenues and distributes them to communities who have an agreement to manage forest areas sustainably. In the long term, it is anticipated that revenues from private investment in forestry and infrastructure development, and benefits from production forests, will ensure the fund's sustainability (GIZ 2014; United Nations 2015).

Better alignment with national priorities and improved co-ordination among donors is needed

The government has made efforts to manage and channel donor funding for environmental issues. The MPI has instated the Round Table Process by which the government engages with development partners. Under this, a thematic Working Group on Natural Resources and Environment brings together senior officials from donor agencies and the government to discuss strategic directions for the environmental agenda in the country. In 2015, for example, this group convened to review Lao PDR's INDC and to discuss the contribution of environmental issues to the outcomes of the draft Eighth NSEDP for 2016-20 (UNDP Lao PDR 2015).

High level coordination mechanisms need to be accompanied by mechanisms to promote coordination at a technical level to promote synergies between donor programmes on similar themes. A review of lessons learned from development assistance in general in Lao PDR from the UN shows that there are two major areas of improvement required: first, donor support should be better coordinated, avoid duplication and be better aligned with the country's plans and goals; and second, financing for development issues needs to be diversified beyond ODA to other sources of funds such as development cooperation with other developing countries, private sector and philanthropies (United Nations 2015).

Notes

1. A feed-in-tariff is commonly defined as a payment made to households or businesses generating their own electricity through the use of methods that do not contribute to the depletion of natural resources, proportional to the amount of power generated.

2. See www-cif.climateinvestmentfunds.org/projects/smallholder-forestry-project

3. The OECD Development Assistance Committee (DAC) statistics track development finance from DAC members, non-DAC providers, multilateral development banks and climate funds to developing countries in support of climate change mitigation and adaptation. Bilateral flows are measured using the 'Rio Markers' approach. These statistics include data on Overseas Development Assistance (ODA) (*i.e.* concessional finance, including grants and concessional loans) and as well as Other Official Flows (OOF) (*i.e.* non-concessional developmental finance such as loans provided at market rates).

   While the OECD DAC statistical system provides the most consistent source of data on climate-related development finance across bilateral and multilateral providers, it is important to note the difference between climate-related development finance and climate finance as reported by parties to the UNFCCC. Whilst party reporting is often based on climate-related development finance statistics, not all climate-related development finance is reported as climate finance as some members may apply additional quantitative methodologies to identify climate finance. Hence the two are not directly comparable.

References

ADB, 2011. *Lao People's Democratic Republic: Country Partnership Strategy (2012-2016)*, Mandaluyong City, Philippines.

ADB, 2015. *Renewable Energy Developments in the Greater Mekong Subregion*, Mandaluyong City, Philippines.

Baird, M. & Frankel, R., 2015. *Environmental Impact Assessment - Comparative Analysis In Lower Mekong Countries*,

Campbell, L. et al., 2015. Environmental impact assessment: Theory, practice and its implications for the mekong hydropower debate. *International Journal of Water Governance*, 4, pp.93–116.

EcoLao, 2012. *Scoping Assessment of Climate Change Adaptation Priorities in the Lao PDR*, Bangkok.

Energy Sector Management Assistance Program, 2009. Fighting Poverty through Decentralized Renewable Energy - Energy SME Conference. In *Fighting Poverty through Decentralized Renewable Energy*. Phnom Penh, Cambodia: World Bank. https://openknowledge.worldbank.org/bitstream/handle/10986/17522/774320WP0ESMAP00PUBLIC00PROCEEDINGS.pdf?sequence=1&isAllowed=y (Accessed September 1, 2016).

GIZ, 2014. *First Steps for Making Climate Finance Work in Lao PDR*, Jakarta. www.giz.de/en/downloads/giz2014-en-making-climate-finance-work-in-laos.pdf (Accessed August 16, 2016).

GIZ and BGR, 2015. *Corporate Social Responsibility in Lao PDR: Baseline Assessment of Social and Environmental Regulations & Standards*, Vientiane. www.bgr.bund.de (Accessed August 23, 2016).

Global Green Growth Institute, 2016. GGGI » Partnering with Lao PDR to secure a green growth future. http://gggi.org/ai1ec_event/partnering-with-lao-pdr-to-secure-a-green-growth-future/ (Accessed August 22, 2016).

Government of Lao PDR, 2015. *Lao People's Democratic Republic Intended Nationally Determined Contribution*, Vientiane.

Government of Lao PDR, 2011. *Renewable Energy Development Strategy in Lao PDR*, Vientiane. www.eepmekong.org/index.php/resources/country-reports/laos/57-laos-06/file (Accessed August 27, 2016).

Government of Lao PDR, 2013. *The second national communication on climate change submitted to the United Nations Framework Convention on Climate Change for Lao People's Democratic Republic*, Vientiane. http://unfccc.int/resource/docs/natc/laonc2.pdf (Accessed August 22, 2016).

Guha-Sapir, D., Below, R. & Hoyois, P., 2016. *EM-DAT: The CRED/OFDA International Disaster Database*, Brussels: Université Catholique de Louvain. www.emdat.be.

Hirsch, P., 2010. The Changing Political Dynamics of Dam Building on the Mekong. *Water Alternatives*, 3(32), pp.312–323. www.water-alternatives.org (Accessed August 29, 2016).

Irawan, S. et al., 2012. *Case Study Report: Environmental Protection Fund in Lao PDR*, Vientiane.

Kirkemann, P., Thaarup, J. & Villadsen, S., 2010. *Long Term Development Cooperation between Laos and Sweden*, Stockholm.

Lao Statistics Bureau, 2015. *Lao PDR Statistical yearbook 2014*, Lao Statistics Bureau. www.lsb.gov.la/en.

Ministry of Energy and Mines, 2015. *Guideline for Implementation - Policy on Sustainable Hydropower Development in Lao PDR*, Vientiane.

Ministry of Natural Resources and Environment, 2015a. *First Five Years Action Plan 2016-2020 on Natural Resources and Environment Strategy 2025*, Vientiane.

Ministry of Natural Resources and Environment, 2012. *National Rio+20 Report for Lao PDR*, Vientiane. https://sustainabledevelopment.un.org/content/documents/1017laonationalreport.pdf (Accessed August 8, 2016).

Ministry of Natural Resources and Environment, 2015b. *Natural Resources and Environment Strategy, 10 Years 2016-2025*, Vientiane.

Ministry of Planning and Investment (MPI), 2016. *Five Year National Socio-Economic Plan VIII (2016-2020) - 5th draft*, Vientiane. http://rightslinklao.org/wp-content/uploads/downloads/2016/03/Draft_8th_NSEDP_2016-20.pdf (Accessed August 22, 2016).

Mitra, B.K. et al., 2015. Water-Food-Energy Nexus Approach: Towards Green Regional Cooperation in Southeast Asia. In IGES, ed. *Greening Integration in Asia: How Regional Integration Can Benefit People and the Environment*. Hayama: IGES, pp. 149–171.

OECD (2016a), "Integration and renewable energy in Emerging Asia", in *Economic Outlook for Southeast Asia, China and India 2016: Enhancing Regional Ties*, OECD Publishing, Paris, http://dx.doi.org/10.1787/saeo-2016-9-en.

OECD (2016b), "Lao PDR", in *Economic Outlook for Southeast Asia, China and India 2016: Enhancing Regional Ties*, OECD Publishing, Paris, http://dx.doi.org/10.1787/saeo-2016-19-en.

OECD (2015) *Policy Framework for Investment, 2015 Edition*, Paris: OECD Publishing. http://dx.doi.org/10.1787/9789264208667-en.

OECD (2013), *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, Paris: OECD Publishing. http://dx.doi.org/10.1787/saeo-2014-en.

OECD (2012), Investment framework for green growth. In *OECD Investment Policy Reviews: Tunisia 2012*. Paris: OECD Publishing. http://dx.doi.org/10.1787/9789264179172-en.

OECD (2011), *Towards Green Growth, OECD Green Growth Studies*, Paris: OECD Publishing. http://dx.doi.org/10.1787/9789264111318-en.

Pillai, G.M., 2014. *Lao PDR National Sustainable Energy Strategy Report: Enabling Environment and Technology Innovation Ecosystem for Affordable Sustainable Energy Options*, Bangkok.

Ploechel, C., 2015. *NAMA for the Renewable Energy Sector of Lao PDR*, New York.

Schroeter, A., 2012. Best practices and learnings from an inclusive business - Sunlabob Renewable Energy, presented at Inclusive Business Development Workshop, Seoul, 2012.

UNDP Lao PDR, 2015. Natural resources sector reviews future goals (UNDP Press Release). *Vientiane Times*. www.la.undp.org/content/lao_pdr/en/home/presscenter/pressreleases/2015/11/10/natural-resources-sector-reviews-future-goals/.

United Nations, 2010. *An investment guide to the Lao People's Democratic Republic*, New York and Geneva: United Nations.

United Nations, 2015. *Country Analysis Report Lao PDR: Analysis to inform the Lao People's Democratic Republic– United Nations Partnership Framework (2017-2021)*, Vientiane.

Wayakone, S. & Makoto, I., 2012. Evaluation of the Environmental Impacts Assessment (EIA) System in Lao PDR. *Journal of Environmental Protection*, 3, pp.1655–1670. http://dx.doi.org/10.4236/jep.2012.312182 (Accessed August 23, 2016).

World Bank, 2012. *Country Partnership Strategy for Lao PDR: 2012-16*, Vientiane.

World Bank, 2015. Factsheet: Second Lao Environment and Social Project (LENS II). www.worldbank.org/content/dam/Worldbank/document/EAP/lao-pdr/la_lens_factsheet_June_2015.pdf (Accessed August 28, 2016).

World Bank, 2010. *Lao PDR Environment Monitor*, Vientiane. www.worldbank.org/lao.

Yuzurio, S., 2013. Promoting Green Growth in Laos | JICA USA Office. *JICA USA Newsletter*. www.jica.go.jp/usa/english/office/others/newsletter/2013/1301_02_03.html (Accessed August 19, 2016).

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(20 2017 03 1 P) ISBN 978-92-64-27598-0 – 2017

OECD Investment Policy Reviews

LAO PDR

OECD Investment Policy Reviews present an overview of investment trends and examine a broad range of policies and practices affecting investment in the economies under review. This can include investment policy, investment promotion and facilitation, competition, trade, taxation, corporate governance, finance, infrastructure, developing human resources, policies to promote responsible business conduct, investment in support of green growth, and broader issues of public governance. The reviews take a comprehensive approach using the OECD Policy Framework for Investment to assess the climate for domestic and foreign investment at sub-national, national or regional levels. They then propose actions for improving the framework conditions for investment and discuss challenges and opportunities for further reforms.

This first *OECD Investment Policy Review of Lao PDR* uses the OECD Policy Framework for Investment to assess the investment climate in Lao PDR and discusses the challenges and opportunities faced by the Government of Lao PDR in its reform efforts. It includes chapters on trends in foreign investment and trade, the legal framework for investment, regulatory restrictions on foreign investment, corporate governance, investment promotion and facilitation, promoting and enabling responsible business conduct, infrastructure connectivity and the investment framework for green growth.

Also available in this series:

Kazakhstan (2017), Ukraine (2016), Philippines (2016), Nigeria (2015), Botswana (2014), Mauritius (2014), Myanmar (2014), Tanzania (2013), Jordan (2013), Mozambique (2013), Malaysia (2013), Costa Rica (2013), Tunisia (2012), Colombia (2012), Kazakhstan (2012), Zambia (2012), Ukraine (2011), Indonesia (2010), Morocco (2010), Viet Nam (2009), India (2009), China (2008), Peru (2008), Russian Federation (2008), Egypt (2007).

http://www.oecd.org/investment/countryreviews.htm

Consult this publication on line at ***http://dx.doi.org/10.1787/9789264276055-en***.

This work is published on the OECD iLibrary, which gathers all OECD books, periodicals and statistical databases.
Visit ***www.oecd-ilibrary.org*** for more information.

ISBN 978-92-64-27598-0
20 2017 03 1 P

OECD publishing
www.oecd.org/publishing

Australian Aid

NEW ZEALAND
FOREIGN AFFAIRS & TRADE