BUILDING EXPORT COMPETITIVENESS IN LAOS

Summary Report

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CURRENCY EQUIVALENTS
(As of end October, 2006)

Currency		Lao Kip
Currency Unit	=	Kip
US$1.00	=	9,888 Kip

FISCAL YEAR: October 1 – September 30

ABBREVIATIONS AND ACRONYMS

ACFTA	ASEAN-China Free Trade Agreement
ACV	Agreement on Customs Valuation
AFTA	ASEAN Free Trade Area
AGOA	African Growth and Opportunity Act
AHPADA	Asian Handicraft Promotion & Development Association
AHTN	ASEAN Harmonized Tariff Nomenclature
APD	Agriculture Promotion Bank
ASEAN	Association of South East Asia Nations
ATC	Agreement on Textiles and Clothing
BAF	Bunker Adjustment Factor
BCEL	Banque pour le Commerce Exterieur Lao
BOL	Bank of Laos
BTA	Bilateral Trade Agreement
CAF	Currency Adjustment Factor
CEPT	Common Effective Preferential Tariff
CPI	Committee for Planning and Investment
C&F	Cost and Freight
DDFI	Department for the Promotion and Management of Domestic and Foreign Investment
DISM	Department of Intellectual Property, Standardization and Metrology
DLF	Department of Livestock and Fisheries
DTIS	Diagnostic Trade Integration Study
EBA	Everything But Arms
EC-15	European Economic Community of 15 nations
EHP	Early Harvest Program
ESEWA	Enterprise Support for Empowering Women and Artisans
FAO	Food and Agriculture Organization
FCL	Full Container Load/ Full Carload
FDA	Food and Drug Administration
FDD	Food and Drug Department
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FMD	Food and Mouth Disease
FOB	Free on Board
FTD	Foreign Trade Department
FTO	Fair Trade Organization

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GATS	General Agreement on Trade in Services
GATT	General Arrangement on Tariff and Trade
GBO	Grassroots Business Organizations
GEL	General Exception List
GDP	Gross Domestic Product
GNI	Gross National Income
GOL	Government of Laos
GSP	Generalized System of Preferences
GTZ	German Agency for Technical Cooperation
HACCP	Hazard Analysis and Critical Control Point
HS	Harmonized System
ICT	Information and Communication Technology
IDA	International Development Association
IF	Integrated Framework
IFAT	International Federation for Alternative Trade
IFC	International Finance Cooperation
IMF	International Monetary Fund
IPPC	International Plant Protection Convention
ISO	International Standards Organization
ISPM	International Standards for Phyto-sanitary Measure
ITC	International Trade Center
JICA	Japan International Cooperation Agency
LCD	Lao Customs Department
LCL	Less than/loose Container Load
LDC	Least Developed Country
LECS	Lao Expenditure and Consumption Survey
LHG	Lao Handicraft Group
LIFFA	Lao International Freight Forwarders Association
TIFFA	Thai International Freight Forwarders Association
LNCCI	Lao National Chamber of Commerce and Industry
MAF	Ministry of Agriculture and Forestry
MCTPC	Ministry of Communication, Transportation, Post and Construction
MIH	Ministry of Industry and Handicraft
MFA	Multi-Fiber Arrangement
MFN	Most Favored Nation
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOH	Ministry of Health
MPDF	Mekong Private Sector Development Facility
NAB	National Accreditation Body
NAHC	National Animal Health Center
NEM	New Economic Mechanism
NGPES	National Growth and Poverty Eradication Strategy
NPD	National Phytosanitary Database
NPPO	National Plant Protection Organization
NSC	National Statistic Center
NSEDP	National Socio-Economic Development Plan
NTA	Lao National Tourism Authority
NTB	Non-tariff Barrier
NTM	Non-tariff Measure
NTR	Normal Trade Relations
NWFP	Non-wood Forest Products
NZAID	New Zealand Agency for International Development
PMO	Prime Minister Office
PRA	Pest Risk Analysis
PRSP	Poverty Reduction Strategy Paper
SAARC	South Asian Association for Regional Cooperation
SEZ	Special Economic Zone
SIDA	Swedish International Development Cooperation Agency
SME	Small and Medium Enterprise
SMTQ	Standardization, Metrology, Testing and Quality
SPS	Sanitary and Phyto-sanitary Agreement
SRT	State Railway of Thailand
STEA	Science, Technology, and Environment Agency
UAP	Unprocessed Agricultural Products
UNDP	United Nations Development Program
USDA	United States Department of Agriculture
FAS	Foreign Agriculture Services
VAT	Value Added Tax
WTO	World Trade Organization
WTTC	World Travel and Tourism Council

ACKNOWLEDGEMENTS

This report was prepared by a team consisting of Mona Haddad (Task Team Leader); George Fane (Australian National University) and Khamlusa Nuansavanh (National University of Laos): trade policy and trade and poverty; Paul Brenton: market access; Philip Schuler, Maika Oshikawa (WTO), and Phouvieng Phongsa (WTO and Ministry of Commerce, Laos): WTO; John Arnold (consultant): trade facilitation; Michel Zarnowieki and William Ledrew (consultant): customs; Kees van Der Meer (standards); J. E. Austin (consultants): export competitiveness; IMF: macro assessment; Amanda Carlier: business environment.

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A NOTE ON PROCESS

Following the preliminary DTIS mission, the government requested the Bank to follow a practical approach with a focus on export competitiveness. To that end, the DTIS included a series of workshops with private sector and government stakeholders. During March 2005 (main mission) and July 2005, eight workshops on cluster export competitiveness were organized with a strong participatory and consultative approach (six in Vientiane on agriculture, light manufacturing and tourism; one in Savannakhet; and one in Luang Prabang on tourism). The workshops aimed at (i) providing an opportunity for the private sector and the government to discuss together the constraints they face in exporting; (ii) learning from best practice around the developing world on how clusters managed to improve their export competitiveness; (iii) allowing local stakeholders to come up with a SWAT analysis and an action plan on what needs to be done in Laos.

The DTIS benefited greatly from the work done for the National Export Strategy (NES) that was being undertaken by the government with the assistance of ITC. Recommendations from the DTIS work and the NES were merged in the export competitiveness component of the draft Action Matrix. Discussions with the government and IF agencies took place on how to incorporate the DTIS findings into the five-year plan of the government.

In March 2006, a workshop to discuss the draft Action Matrix was organized in Vientiane (modeled after the IF Simulation Workshop in Addis Ababa in September 2005, but discussing a real Action Matrix with real stakeholders). The workshop brought together representatives from the government, private sector, and donor community. It aimed at debating and agreeing on priorities of the Action Matrix within each group and across the three groups. In addition, two awareness raising workshops were organized in March 2006 in Luang Prabang and Pakse and included representatives from various provinces. The workshops aimed to share the main results of the DTIS and the draft Action Matrix, and seek feedback from the provinces. The workshops were supported by the World Bank and led by Mme Khemmani Pholsena (IF focal point in Laos).

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EXECUTIVE SUMMARY

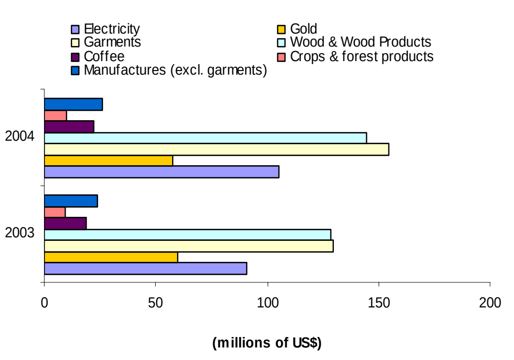
Integration with the regional economy and openness to international trade and investment have been key elements of the development strategy in Laos since the introduction of the New Economic Mechanism in the mid 1980s. Foreign trade and investment have underpinned much of the expansion of economic activity and poverty reduction that has occurred over the last two decades. The reforms introduced involved changes in the prevailing thinking about the role of the state in the economy, and facilitated the parallel expansions of trade, investment, production and employment.

The economy, which had stagnated under the post-war attempts at state control, responded strongly when the reforms began to take effect. GDP has grown at 6 percent a year since 1990, driven by strong growth in agriculture and manufacturing. Investment grew from 13 percent of GDP in 1990 to 22 percent of GDP in 2004, as both foreign and domestic investors took advantage of the opportunities to supply foreign markets with electricity, garments, wood products, coffee, vegetables and other cash crops and, more recently, gold and copper. Expanding exports played a major role in Laos' growth, growing at 11 percent per year to account for 24 percent of GDP in 2005—up from 9 percent in 1990.

Much of the early expansion in exports has been in activities that directly exploit the country's natural resource endowment — hydro-electricity and mining. Since the 1990s, exports became more diversified and embodied more value added—mainly in wood products, garments, and coffee.

In its National Growth and Poverty Eradication Strategy, the Government ties its ambitious poverty reduction goals – eradicating mass poverty by 2010, eliminating all poverty and tripling per capita income by 2020 – to an equally ambitious target of 7 percent sustained growth over the medium and long term. The Strategy identifies regional integration and export growth and diversification as important elements of the agenda to achieve these goals.

Lao exports of major commodities 2003-2004



The next steps that Laos needs to make to harvest further benefits from integration are more challenging, since they will require significant efforts to build the institutional underpinning of a market economy. They will also involve making some strategic decisions about the best way for Laos to deepen its integration into the world economy.

Challenges and opportunities

The challenge for Laos is complicated by the legacy of the past. The country has poor infrastructure, underdeveloped market institutions, an embryonic private sector and a public sector with little experience of managing a modernizing market economy.

This translates into a series of constraints on export diversification and growth that include:

- lack of awareness of modern, transparent, market-based ways of doing business;
- insecure property rights and an inefficient financial system, which inhibits the accumulation and use of capital;
- a regulatory system built on control and rent extractions rather than facilitation;
- restrictions on trade through burdensome licensing regulations;
- weak institutional and fiscal management capacity; and

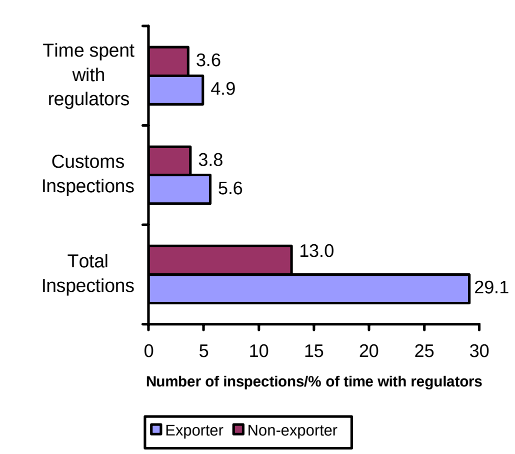
- decentralized authority for trade, with confusing and overlapping responsibilities of the central and provincial governments, which makes it considerably more complex for both donors and firms to do business in Laos.

Laos' natural resource endowment will continue to provide opportunities for expansion of mineral and hydro-electricity exports; but there is also considerable potential to expand exports of tourism services, light manufacturing and agriculture. Realising this potential will require entrepreneurial skill, ability to identify and respond to the requirements of international markets, improving the skill base used by these industries, and, in some cases, collaborative efforts to market what Laos has to offer to the world.

Sectors with high export potential

But the critical issue is that all of the strategies to expand exports depend on investment of one kind or another. They also depend on Lao businesses deepening commercial and contractual relationships with each other and foreign partners. One priority for government is to reduce regulatory burdens and make it easier to engage in international trade, bearing in mind that exporters cannot pass excess costs of regulation on to their customers (and also recognizing that the purpose of exports is to exchange for imports: if importing is difficult or costly, the incentives to export are reduced). An equally important priority is for the government to reduce policy and administratively induced uncertainty that can deter investment, and to foster the development of the critical institutional and infrastructural ingredients of an attractive environment for investment.

Heavy regulatory burden affects exporters more



Making trade easier

Given its status as an LDC, Laos generally has quite easy access into world markets. Complex rules of origin often constrain making full use of the preferences available to Lao exports, however, and delays in implementing commitments under the agreements underpinning the ASEAN Free Trade Area have limited access to potential tariff preferences in that market. But, generally speaking, the policies of other countries do not subject Lao exports to harder access than exports from other sources. The issue is more about Laos being able to take advantage of the preferences offered by increasing its competitiveness.

Laos has made significant progress in reducing the costs of engaging in international trade. Its MFN import duties are low (in 2003, the unweighted average tariff was at 9.5 percent) and not highly dispersed. Despite recent liberalization and simplification, the management of trade is still restrictive, with burdensome, nontransparent, and inconsistent rules acting to increase costs and reduce competition from new entrants. For example, exporting wood products may require over 10 signatures from various ministries and agencies. Further, procedures for import licenses are, even after some streamlining, still unnecessarily complicated, and leave room for unofficial controls. Reform in these areas has been constrained by the fragmentation of the trade policy and administration architecture. These add to frictions caused by the underdevelopment of transport infrastructure and logistic services.

Importers complain about lengthy, costly, and unpredictable procedures. The capacity of the Customs Department is still weak, the authority over Customs clearance is spread across ministries and regions, and informal payments are still widespread. Despite some reform effort, much remains to be done to make the Customs Department a modern one, including in the areas of legislation, organizational structure, human resources, computerization, clearing procedures, and enforcement.

Laos' status as a landlocked country entails three dimensions. The first—physical isolation from markets—is not really a problem, given its proximity (700 km) to ports in Thailand and Vietnam. The second—inefficiency of logistics services—is being resolved as the 2004 Transit Agreement with Thailand will expand competition and should provide a significant reduction in logistics costs. The third—lack of infrastructure and capacity at border crossings—is a serious barrier to trade. There is much to be gained from rationalizing the regulation of imports and exports, and simplifying procedures for movement of goods into and out of the country—in particular establishing an inland container depot near the border with Thailand.

Laos will also have to put considerable effort into improving the country's capacity to meet international Sanitary and Phytosanitary requirements on food safety and animal and plant health if it is to ensure market access for agricultural and forestry products, as well as to protect its own industries from damaging incursions of pest and diseases.

The initial efforts that Laos made to liberalize trade were largely unilateral. Now the country's trade and integration strategy focuses much more on the pursuit and implementation of bilateral, regional and multilateral agreements, including accession to the WTO. These agreements provide opportunities to improve trade policy and economic competitiveness, but they can seriously tax the institutional capacity of government and business sectors and sometimes prioritize legislative and institutional developments that will only generate benefits for LDCs in the longer term. Laos needs to develop a clear vision of how it wants to use these agreements to further its own trade and reform agenda.

Making investment and doing business easier

Investment in one form or another is a crucial ingredient for export growth: households and enterprises foregoing current consumption, directly or indirectly, to invest in human or physical capital, gathering information, adopting new technology or new ways of doing business. They do so in expectation of future returns. If returns are low or uncertain, and risk taking is discouraged, investment will be low, and so will growth of exports.

Laos is not an easy place to do business, and many institutional and policy features of the business environment add to uncertainty, increase costs and reduce how much of the returns from investment the investor can appropriate. Among the factors causing these problems are perceived risks of macroeconomic instability: the government's fiscal position remains fragile, threatened by poor revenue mobilization, limited control over provincial spending, and weak budget planning and execution. The poor state of the state banks lies at the centre of the limited ability of the financial system to intermediate efficiently between savers and investors. Also important are factors such as:

- unclear and poorly communicated government policy toward the business or enterprise sector and lack of coordination among line ministries in the policy making process;
- the high cost of power, transport, telecommunications, and other critical services;
- excessive and unnecessary regulation of ongoing business operations;

- orientation toward control rather than facilitation by the tax and trade administration systems;
- lack of access to land and its limited use as collateral for debt;
- lack of a sufficiently functional legal system to support investment, enterprise establishment, contract enforcement, and commercial transactions;
- insufficient intellectual property rights protection for both domestic and foreign investors; and
- rigid labor regulation.

Remedying these problems will require both immediate- and longer-term actions. The first priority is to improve the legal and regulatory environment, in order to facilitate economic activity and meet the conditions of international agreements. Key short-term actions include:
- simplifying the business start-up process, and moving from a licensing toward a registration system;
- introducing a one-stop investment service where licensing remains;
- repealing the Industrial Processes Act, which regulates production processes;
- updating labor laws to align with regional standards; and
- revamping the tax system and its administration.

In the longer term, sustained efforts and considerable financial resources will be required to build institutional capacity, strengthen entrepreneurial skills, and improve physical infrastructure.

A way forward

The challenges facing Laos as it charts the next stages in its pursuit of integration and export development are daunting: but they need to be seen in the light of the challenges that Laos has already dealt with (and the returns that the country and its people have reaped from confronting them).

There is also the prospect — which the IF is designed to help with — of support from development partners in addressing some of the capacity and institutional development issues that lie ahead. An action matrix has been developed which identifies a set of priority projects that donors can support. These include the following.
- A collection of projects aimed at improving competitiveness in tourism, light manufacturing and agriculture, supporting micro, small and medium sized enterprises to develop capacities needed to engage in export oriented production, improving infrastructure and capabilities at the regional level, and developing an export processing zone in Savannakhet;
- A set of projects targeting trade facilitation through modernization of customs, improving trade logistics and strengthening SPS capabilities;
- Projects providing support for development of appropriate industry policy and for investment promotion, as well as establishing a unit to manage implementation of the IF and its activities;
- Capacity building for trade negotiations and developing coordinated trade negotiation strategies; and
- Projects concerned with promoting trade opportunities for the poor, with support for development of the handicraft sector and for construction of rural roads.

The diagnostic work carried out for this report is part of a continuing effort to identify key constraints to competitiveness—by the government (such as the Export Competitiveness Strategy 2006-2008 supported by ITC) as well as bilateral donors and international agencies (including the upcoming Investment Climate Assessment by the World Bank and ADB, and the "Lao PDR National Human Development Report: Trade and Human Development" of UNDP). But more importantly than these strategies and reports, a key element of an integration strategy for Laos should be to develop internal capacity to analyze trade and investment and related policies and to identify complementary actions needed to secure the benefits and to facilitate the adjustments that integration and growth will bring in their train.

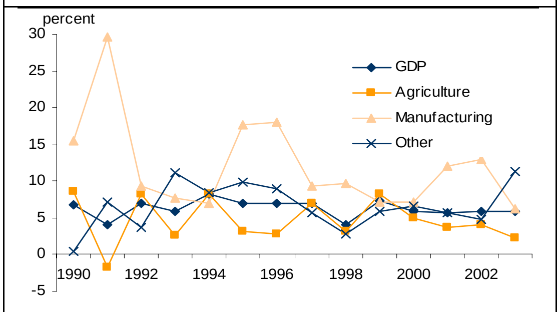
LAOS TODAY AND THE POTENTIAL OF TOMORROW

TRADE, GROWTH AND POVERTY REDUCTION

Laos took a decisive turn towards market-oriented policies in 1986 when the government adopted the New Economic Mechanism (NEM). The NEM embodied a transition away from the system of state control over production and trade and policies of provincial self-sufficiency, at the same time as it recognized private ownership and property rights.

The economy, which had stagnated under the post-war attempts at state control, responded strongly when the reforms began to take effect. GDP has grown at a trend rate of 6.3 percent a year since 1990, driven by strong growth in agriculture (4.7 percent) and manufacturing (11.1 percent). Growth dipped in 1998 as a result of the effects of the regional financial crisis, but the economy has recovered since then. (Figure 1)

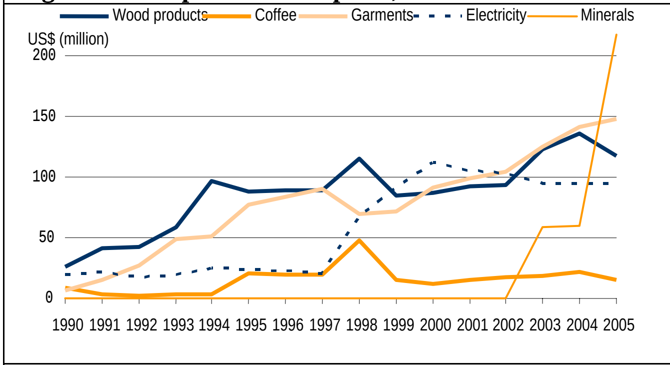
Figure 1. GDP growth in Laos



Source: ADB

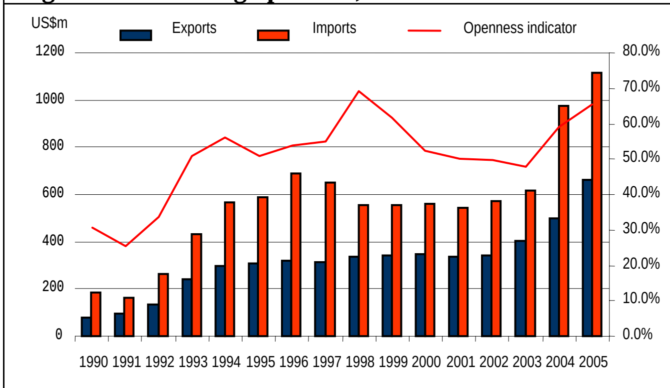
Investment has grown from 13.5 to 21.8 percent of GDP, as both foreign and domestic investors have taken advantage of the opportunities to supply foreign markets with electricity, garments, wood products, coffee, vegetables and other cash crops and, more recently, gold and copper (Figure 2). Exports have grown at a trend rate of 10.8 percent per annum to account for 24 percent of GDP in 2005 (up from 9.1 percent in 1990 — Figure 3). International trade now plays a very significant role in the economy.

Figure 2. Composition of exports, 1990-2005



Source: World Bank, IMF, CIE

Figure 3. Increasing openness, 1990-2005



Note: the openness indicator is export+import/GDP
Source: UNIDO, IMF, and World Bank

Laos's strong growth has translated into a significant reduction in poverty: the number of people living below the national poverty line fell from 46.0 percent in 1992-93 to 33.5 percent in 2002-03 (Table 1). While inequality has grown, changes in income distribution have not been as pronounced as in other countries, as strong agricultural growth has ensured that the rural population has benefited from the reforms.

Table 1. Changes in poverty and inequality

	1992-93	1997-98	2002-03
Poverty incidence (headcount) %			
Urban	26.5	22.1	19.7
Rural	51.8	42.5	37.6
National	46.0	39.1	33.5
Inequality (Gini coefficient)			
National	0.31	0.35	0.33

Source: Richter et al 2005, World Bank

This positive performance reflects a number of elements of the reform program, and the country's natural endowment.

- Early and convincing recognition of the role of the private sector stimulated a strong response from investors interested in meeting market opportunities. The state rapidly abandoned its involvement in industry, with the share of state enterprises in manufacturing output falling from around 100 percent in 1990 to 10 percent at the end of the decade, and the private sector began to take the lion share of domestic credit (87.0 percent in 2000, up from 19.0 percent in 1990).
- Agriculture responded positively to the rationalization of incentives created by the termination of price, marketing and input supply controls. Rice yields grew in the lowlands and the upland switched to more appropriate cash crops.
- Foreign direct investment has been growing: hydro-electricity production was the largest recipient (although one mining project has now become the largest operational foreign investment project.)
- The government has been reasonably successful in fiscal and monetary stabilization. Changes in exchange rate management have ensured that the official rate has depreciated to offset domestic inflation, and to keep pace with movements in the parallel market. Taxation has replaced transfers from SOEs as the core source of government finance, and the government has been able to increase its spending on public health and education, with some commensurate improvements in sector performance (albeit from a very low base).

FUTURE SOURCES OF EXPORT GROWTH AND FOREIGN EXCHANGE EARNINGS

Expanding exports have played a major role in Laos' growth over the past two decades. But much of this expansion has been in activities that directly exploit the country's natural resource endowment — hydro-electricity and mining. While these exports are — and will continue to be — an important source of government revenue, they have limited linkages with the rest of the economy, and tend to have very localized impacts.

The government's development strategies rightly focus on export diversification. The question is what must be done to achieve this goal? To help explore this issue, the DTIS has examined the potential to increase the value of exports and foreign exchange earnings outside of the electricity and minerals sectors. This involved a series of consultative workshops with industry representatives involved in export activities in the tourism, light manufacturing (including handicrafts) and agriculture sectors.[1] It also involved looking at the potential to generate income from export of labor services. The findings are very much in line with the National Export Strategy 2006-2008 being developed by the government and supported by ITC.

Tourism

Tourism is a critical industry for driving economic development in Laos. The industry currently generates more then $120 million in revenues, accounting for 3.4 percent of total employment, 23 percent of export revenue, and more than 4 percent of total GDP. Tourism is growing in the region, and there is a natural niche for Laos: the sector is projected to grow by nearly 12 percent in the coming years. In addition, capital investment in tourism projects is expected to double over the next ten years.

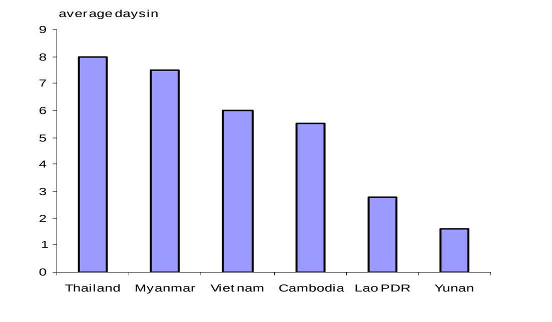
To achieve its growth potential, the tourism industry needs improved marketing skills, better targeting of market segments, and development of diversified offerings. This is going to involve building human capacity, attracting appropriate foreign investment, building better frameworks for dialogue with government, and strengthening associations within the tourism cluster.

Tourism is still largely concentrated in a few locations in the country, namely Luang Prabang, Vientiane, and, to a lesser extent, Champasak. Among international tourists, these "point" locations are not considered to be destinations in themselves, but side trips as a part of a regional tour. As a result, they spend fewer than 3 days in Laos – the lowest in the Mekong Region (Figure 4). More than 65 percent of arrivals are from the Mekong

1 Eight export competitiveness workshops were organized during the DTIS missions: in Vientiane, Luang Prabang, and Savannakhet.

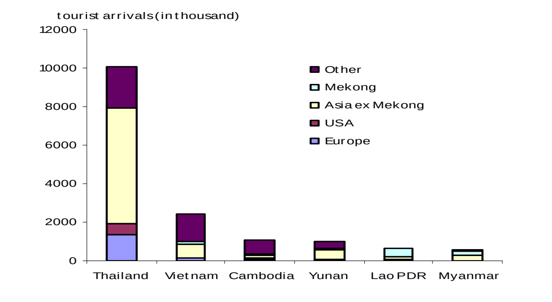
region and can be attributed to regional cross-border day trippers (Figure 5). Reflecting the regional mix of tourist arrivals, tourists that come to Laos spend, on average, less per stay than in any other country of the region (Figure 6). Knowledge of Laos as a country is limited; this is both an advantage and disadvantage for the tourism sector. Laos is still undiscovered and still carries a premium of mystique, but lack of awareness in the market is constraining growth.

Figure 4. Tourists don't stay long in Laos



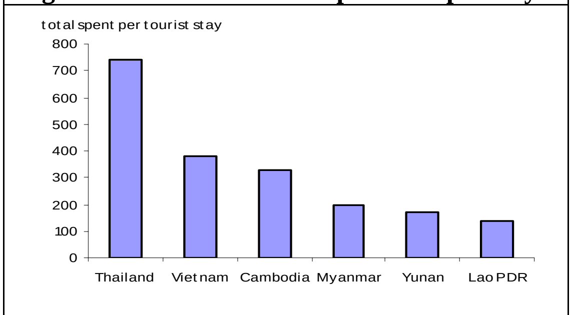
Source: Asian Development Bank, 2004.

Figure 5. Mekong tourists by nationality



Sources: ASEAN Statistical Yearbook, 2003; World Travel and Tourism Council, 2004

Figure 6. Tourists in Laos spend less per stay



Source: Asian Development Bank, 2004

Tourism is important to the Government's regional economic development objectives. The tourism industry has a major role to play in improving rural incomes and in poverty alleviation in rural areas. This is especially true in Luang Prabang province, which used to be relatively poor but has become more prosperous in the last 15 years. Tourism also has the potential to play a key role in increasing economic opportunities for the southern provinces of Attapeu and Sekong as well as for SMEs.

With special emphasis on community and eco-tourism from tour operators and international donors, the industry is becoming an increasingly important source of rural income and poverty alleviation. The potential doubling of the industry revenues would have a tremendous impact on people in this sector. Even a modest impact on the productivity and incomes of the people who rely on this industry would be quite significant.

Tourism also has important spillover effects in terms of creating a Lao national "brand" in global markets and developing a favorable international image for the country. It also has spillover effect in promoting rural tourism and handicrafts.

Significant investment is occurring in the tourism industry; but a critical issue for investors is to identify what types of tourists they want to attract and how to effectively reach those audiences. This requires developing an understanding of tourist needs and preferences, identifying the most attractive niche markets appropriate to Lao offerings, and preparing appropriate marketing efforts to increase the number of tourists and their length of stay. Attracting the desired tourists will also depend on improving the ability of Lao tour operators to proactively target attractive clients, improving language and communication skills and the professionalism of tour guides and service providers.

Laos could achieve a tripling or quadrupling of tourism revenues without adverse social and environmental impacts simply by getting people who do come to Laos to spend more, stay longer, and visit the country on the off-season. Some thought will have to be given to the costs and benefits of expanding tourist volumes during the high season as this may decrease the attractiveness of the experience for the tourist (with adverse consequences for word-of-mouth promotion) while having adverse social and environmental consequences.

Laos could tap into high-value, longer-stay, seasonally balanced tourism, while still promoting low-cost tourism that has positive spillover effects on the poor. This would require the industry to work with the international press, improve the local offerings, learn about market niches abroad, and improve and diversify local package offerings.

Opportunities and constraints

Laos has many strengths as a tourist destination. They include great natural beauty, world heritage sites, beautiful architecture, a navigable river for boat tourism, relatively low costs, and unique ethnic cultures that have maintained traditional dress and customs. The country is also well known in France, and the natural hospitality of its people is an asset.

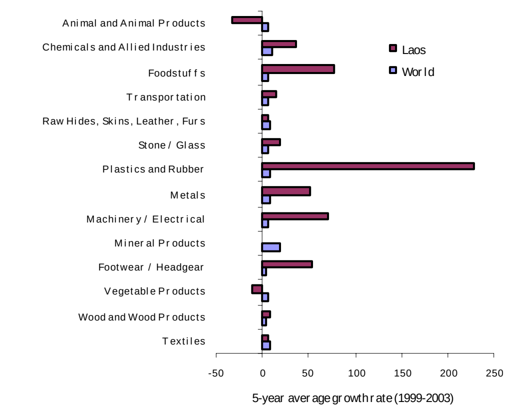
Taking advantage of these strengths is constrained by the business environment. Critical foreign investment in the industry is being held up by delays in passage of the new Law on Foreign Investment, and local investment must confront the inadequacies of the financial system when trying to raise capital. Underdevelopment and high cost of banking services also raise costs and reduce convenience for tourists. Local airlines are inefficient and the small market scale as well as Thai Airways' cost advantage in connecting flights makes it unattractive for international airlines to enter. Procedures for organizing international conferences in Laos are cumbersome.

Light manufacturing

The manufacturing sector in Laos has been growing at over 11 percent per annum since 1990, and now accounts for nearly 20 percent of GDP. Garments, wood products, and assembly of electronic and mechanical parts are the main export segments, with textiles and wood products dominating.

A number of high-growth segments in light manufacturing are starting to have a significant presence. These include rubber, which grew at more than 200 percent annually over the past 5 years; machinery and electrical parts (71 percent); and footwear and headgear (54 percent; see Figure 7). Individually, these segments comprise no more than 2 percent of Lao exports, but their significant 5-year growth trajectory indicates that they have a strong future. The rubber industry, in particular, is attracting much foreign interest in addition to domestic investment – mainly for export to China.

Figure 7. Sectors with high export potential

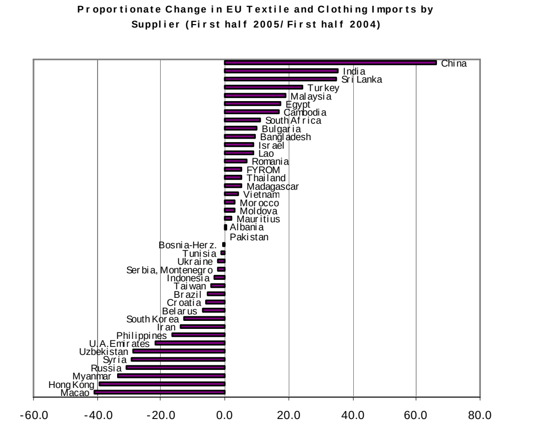


Source: UNCOMTRADE.

The garment industry employs some 20-25,000 people, down from its peak of 30,000. As of the end of 2004, there were a total of 57 firms, of which an estimated 70 percent have some foreign ownership. Lao-owned operations are mostly subcontractors that take on spillover contracts with very tight margins. A few Asian investors from Singapore, Taiwan, and Malaysia have recently invested in the sector, apparently using the Lao location for access to EU preferences (Lao companies are still filling only $60 million of the $150 million value of exports allowed under the Lao quota). Nevertheless, these foreign investors bring customers, technology, skilled labor, and sources of raw materials.

The textiles and garments sector seems to be experiencing pressure from the expiration of the MFA. While it is too soon to assess the impact of the Multi-Fiber Arrangement (MFA) phase-out, initial data from imports into the EU market show that overall Laos has been able to maintain a positive growth in exports (Figure 8). But two of the five apparel manufacturers in Savannakhet are closing; and those in Vientiane report continued severe price pressure from buyers. As China is again subject to quotas for certain apparel products, in both the US and the EU, this may offer Laos an immediate opportunity to fill excess demand and raise orders through 2008. However, the constraining business environment makes it difficult for entrepreneurs to take advantage of short-term opportunities. In addition, the garment industry suffers from lack of experienced management staff; workers with low education and skill levels; low productivity; and difficulties in accessing raw material.

Figure 8. Initial response to the MFA phase-out in the EU market



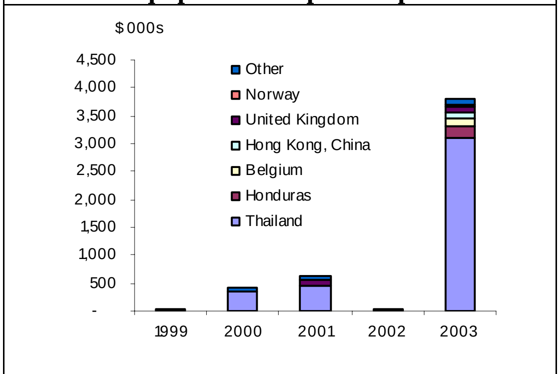
Source: Paul Brenton, World Bank

The wood and wood products sector is a major contributor to exports and income, and holds significant potential. World markets are triggering high growth in processed wood products such as paper and paperboard (16 percent), toilet and facial tissue paper (15 percent), fiberboard (29 percent), and paper trays/dishes (11 percent). These products are largely driven by growth in urban populations. With significant growth expected to continue in China and India, Laos could be well placed to enter into the Asian paper market.

Furniture has potential— but faces constraints. The majority of wood exports from Laos are still direct from sawmills, with very little value added. However, a few furniture producers are exporting to international buyers, and wood flooring is seen by producers as a segment with high potential. The expansion of furniture exports is held back by the uncertainty of raw material supply, caused by the way that the government allocates logs taken from the country's forests. Furniture exporters also cite the expensive and time consuming process for clearing exports as a significant constraint. Analysis of the furniture value chain indicated that unofficial payments more than double the cost of clearing shipments, and that processing paperwork account for around a third of the time-to-delivery to end customers for Lao furniture.

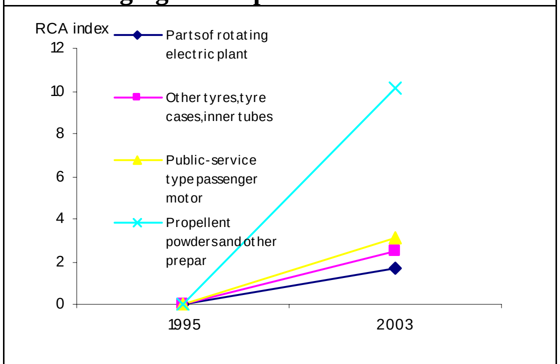
There is an emerging mechanical and electrical equipment and parts industry in Laos. According to the Ministry of Commerce, Laos has more than 20 motorcycle assembly factories. Hyundai assembles and exports motorcycles to Niger and Uganda, using a domestically made frame and imported parts. The mechanical parts are assembled in Laos and then shipped to Thailand, Vietnam, or China (Figure 9). This is a short-run, high growth segment that takes advantage of low labor costs and the production sharing networks of the Asian region. Laos is also gaining comparative advantage in several light manufacturing goods, as reflected by the Revealed Comparative Advantage Index for products such as electric parts and components, propellants, and motors (Figure 10).

Figure 9. Destination and size of Lao electrical equipment and parts exports



Source: UNCOMTRADE.

Figure 10. New light manufacturing sectors are emerging as competitive



Source: UNCOMTRADE.

Laos has some significant strengths that could underpin expansion of light manufacturing, including low labor costs, disciplined labor, a tradition of good labor-management relations, low electricity costs and preferential access into key markets. Exploiting these strengths will, however, require that key weaknesses are addressed. These include lack of market and trade information, shortages of skilled labor, lack of raw materials, poor infrastructure, high transport and communication costs, restrictive labor laws, limited marketing and managerial capabilities relevant to operating in this sector.

The development of the handicraft industry presents an opportunity to begin to link grassroots communities with traditional knowledge to international markets. Village craft micro-enterprises, producing articles such as hand-woven textiles, wooden crafts, basket weaving, paper mills, organic foods, and jewelry could be important sources of income for women, people in poor and remote areas and ethnic minorities. The NGPES suggests that these activities could contribute to sustainable development if policies are implemented that encourage natural resource preservation and the use of domestic materials in handicrafts for trade.

Since the handicraft industry is mainly informal, there is no accurate data on employment or income. A 2003 UNIDO study estimates the equivalent of 30-40,000 full-time workers employed in this sector, of which 15-20,000 people work full time and 100,000 work part time or as a complementary activity. The number of enterprises in the handicraft sector was estimated at 21,558 in 2000, up from 10,826 in 1995. Of the estimated output value of $30-40 million, half came from hand-woven textiles.

Most of the potential to develop traditional handicrafts rests with exports, as domestic demand is very limited. But the handicraft industry cannot as yet meet the demands of the world's commercial buyers in either quality or quantity. For this to happen, the government needs to create the conditions that make it possible for micro and small enterprises to engage in trade initiatives. Further, the many institutions supporting development of the handicraft sector need to coordinate and work within an integrated framework to increase effectiveness and maximize the capacities of existing programs. The sector will also benefit from efforts to overcome constraints such as high transportation costs, insufficient volume of raw material, limited market knowledge and skills, and lack of awareness of Lao products on the part of international buyers.

The government can help with overcoming these constraints by: (i) removing impediments to building business linkages with Fair Trade Organizations in North America and Japan; (ii) developing the legislative and infrastructural frameworks for Lao firms to engage in e-commerce; (iii) reducing regulatory constraints that make it difficult for firms to get the information needed to target niche markets, participate in trade shows, and improve marketing and supply management.

Opportunities and constraints

There are opportunities to improve competitiveness. Strategic opportunities for firms involved in light manufacturing to improve their competitiveness:

- strengthening marketing linkages, which will be critical to light manufacturing businesses as they continue to adapt to changing market dynamics;
- realigning Lao garments industry around its expertise as well as cheap labor, which will require a more focused understanding of market and customer needs;
- improving customer knowledge and market contacts as well as design capabilities, which are urgent priorities for boosting wood product and handicraft exports; and
- promotion and certification of Lao silk products, to increase their value.

The business environment is a significant constraint to growth and investment in light manufacturing, though positive developments such as the enactment of the new Enterprise Law are a step towards easing this constraint. In December 2005, the National Assembly of Laos has passed the new Enterprise Law to replace the 1994 Business Law, and a Presidential decree was recently issued to bring it into effect. This is a step in the right direction. However, as in the tourism sector, business leaders in light manufacturing are eagerly awaiting the implementation of the new Foreign Investment Law. The rigid Labor Law is another competitive risk for Laos, as noted by the Garment Exporters Association. The Law limits overtime to one hour per day, while competing countries average 2 to 4 hours per day. In addition, producers cannot employ workers after 10 pm, which means that manufacturers are not able to run two full shifts. Investment in the sector is held back by the high costs of establishing firms, and production for export is deterred by the cumbersome procedures and high costs of getting goods to international markets, and the challenges of acquiring land and mobilizing finance form the banking system. The planned Special Economic Zone (SEZ) in Savannakhet may offer a second "best fix" for some of these problems and attract investment in light manufacturing, but international experience has shown that such zones are not guaranteed to succeed. The SEZ will face the particular problem of competing for investment with locations in Thailand that may provide a more favorable overall environment.

Agricultural products

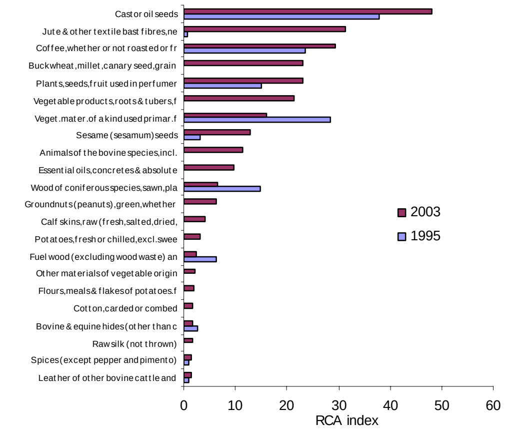
Agriculture remains the main source of income and livelihood for the people of Laos. The sector accounts for 48 percent of GDP, down from 52 percent in 1998, with rice representing 75 percent of all agricultural production. Other main crops include maize, coffee, sugarcane, tobacco, and peanuts.

Coffee is the largest agricultural export commodity, but other products are showing promises. Despite its importance in the domestic economy, agriculture only represented 6.1 percent of total Lao exports in 2003. Coffee is the largest export commodity, accounting for nearly 80 percent of agricultural exports in 2003 ($12.5 million). Cereals and hides skins and leather are the next largest exports. Trade statistics reveal that Laos has gained comparative advantage in several agriculture products, including castor oil, jute fiber, coffee, wheat, plants, and seeds and fruits used in perfumes, including the successful cultivation of agar wood (Figure 11).

There is also a significant amount of informal trade in agriculture across the Mekong region, particularly in livestock and non-wood forest products harvested in the forests and then traded into southern China and sold at local markets. These products include medicinal herbs, fibers, resin, and edible forest foods.

Agriculture exports to Thailand have grown, but exports to China remain low. Rising incomes and urban migration in Southeast Asia are both positive market trends for Lao agriculture. Vegetable and foodstuff exports from Laos to Thailand grew notably from 1999 to 2003, though there was very little growth in recorded exports to China. However, with the Early Harvest Program of the ASEAN-China Free Trade Agreement, the transport and trade facilitation programs of the Greater Mekong Subregion program of economic cooperation, and growing commercial linkages between Laos and China, Lao agricultural exports destined for China, especially Southern China, should grow significantly.

Figure 11. Agriculture sectors with comparative advantage



Note: A revealed comparative advantage (RCA) index >1 means the product has comparative advantage.
Source: UNCOMTRADE.

Notable market trends in agriculture include a growing demand for organic products in international markets, rising standards for agriculture produce and livestock, increasing efficiency of international distribution networks, and rising levels of income in Asia, which is likely to shift the consumption habits of a large portion of the market.

Examples already exist of Lao entrepreneurs marketing high-value coffee and organic rice to international markets. There have also been recent small-scale successes in expanding pork production for the domestic market, exporting selected horticulture products, selling non-wood forest products (e.g., herbal medicine), and establishing rubber plantations to meet export demand. Further, the investments being made in road infrastructure will create not just transport corridors but economic development corridors as well.

Initiatives for agriculture

Specific strategies and initiatives for the agriculture sector include:

- upgrading agricultural practices and developing standards for exports;
- upgrading the capabilities and capacity of the Science Technology and Environment Agency (STEA);
- reviewing the incentive structure for commercial farming;
- establishing provincial production zones and distribution centers;
- expanding access to regional and international markets;
- training farmers in value-added processing;
- investing in road and irrigation infrastructure;
- investing in seedlings;
- identifying appropriate technologies and investments.
- developing financial services for the sector;
- publishing annual sector reports aimed at potential investors; and
- supporting the formalization and growth of the coffee sector.

Export Competitiveness: Looking ahead

Laos has the potential to meet or exceed the growth rates of neighboring countries Vietnam and Thailand over the next ten years. However, proactive efforts must be undertaken to achieve this export potential. There is potentially high interest in international markets for a number of Lao export products and tourism offerings, but very little in the past has prepared the average Lao entrepreneur to understand the needs of international markets and respond with world-class offerings; therefore human capacity building in marketing and management is an urgent priority.

The formation of industry cluster working groups and the implementation of concrete initiatives, such as improving market linkages, e-commerce, product innovation, branding, workforce development, and supply chain management, can help to develop this capacity. Further, the Special Economic Zone (SEZ) planned for Savannakhet might offer a partial and localized way of addressing some of the constraints to domestic and foreign investment in manufacturing if strategic partners are brought in to provide the financing and management expertise needed to attract tenants.

Cross-cutting recommendations that would apply to tourism, light manufacturing, and agriculture are summarized below:

Industry cluster strategies. Working together in close communication and cooperation, industry leaders can develop and implement strategies that focus on quick wins as well as building long-term competitiveness.

Market research and understanding of international markets. Industries and government should both invest in building capacity among young professionals for market research, including sending a critical mass of young professionals abroad for training. In addition, supporting the dissemination of industry information can help strengthen the ability of industry associations to provide useful information and services to their members.

Branding of Laos and its high-value products and services. Building brands in high-value areas is critical for positioning Laos to compete in international markets. Branding opportunities are apparent in tourism, silk, coffee, wood products, and organic foods.

Sustainable competitiveness and growth depends on improving productivity through education, training, and capacity building… There is an urgent need to invest in more language training, computer training, and basic business skills; as well as in marketing training, design, and industry-specific schools such as tourism and hospitality.

…and on facilitating the emergence of entrepreneurs and competitive clusters. Competitiveness will require an understanding of international consumer and market trends, and translating this knowledge into higher-value products and services. It will also require well-considered investments in infrastructure that generate industry dynamism.

Productivity can be strategic as well as operational in nature. For example, by choosing to grow and export high-value agar wood instead of exporting raw logs of other varieties, Laos can greatly increase its export values. By focusing on high-income tourists already living in the region, the tourism industry could increase its off-season business and thereby amortize its investment more effectively, while creating more stable year-round jobs. By choosing the appropriate commercial development model for an export-oriented industrial park, the country could accelerate its entry into light manufacturing industries by attracting a critical mass of investors to set up satellite plants.

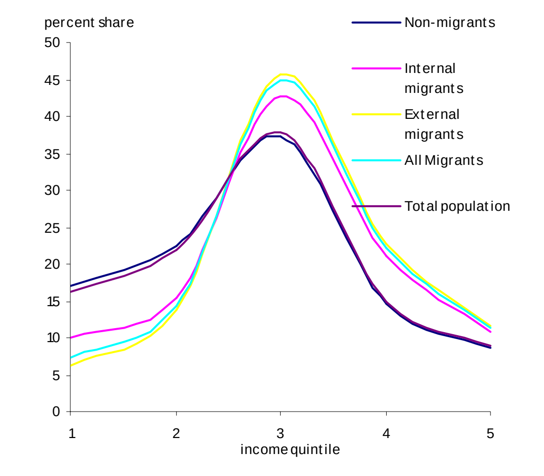
What the government can do

Expanding exports in these sectors will require concerted efforts by the business sector. The government can choose to support some of the collective initiatives where the private sector may have insufficient incentive to undertake activities which generate significant benefits to the community. But the critical issue is that all of the strategies to expand exports require investment of one kind or another, and Lao businesses deepening commercial and contractual relationships with each other and foreign partners. This suggests that the priority for government is to focus on reducing regulatory burdens (bearing in mind that exporters cannot pass excess costs of regulation on to their customers), reducing policy and administratively induced uncertainty, and fostering the development of the critical institutional and infrastructural ingredients of an attractive environment for investment.[2]

Exports of labor

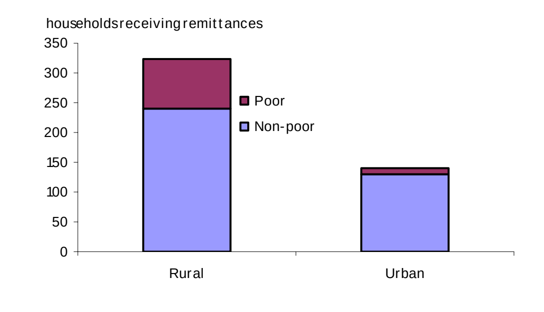
Laos can generate external incomes from its labor endowment by exporting products made within the country, or by receiving remittances from people who migrate to undertake work in other countries. The temporary movement of people for purposes of work is a key trade area that can play an important role in reducing poverty. For many developing economies, remittances constitute the single largest source of foreign exchange, exceeding export revenues, foreign direct investment, and other private capital inflows. In Laos, remittances are important not only for the poor, but also for the middle income group—which originally may have been poor (Figures 12-13).

Figure 12. Distribution of migrants and non-migrants by socio-economic status



Source: Labor Migration Survey, National Statistical Center, Vientiane. The sample covered all people, 0 years and up.

Figure 13. Non-poor are the main recipients of remittances



Note: Includes internal and external remittances.
Source: LECS III.

The most important destination for international migration from Laos is Thailand. Lao people face strict regulations on migration to other countries, and until very recently it has been illegal for Lao people to migrate to Thailand. Because of their informal status, most Lao workers in Thailand are breaking Thai laws that require migrants from Laos and other foreign countries to pay registration fees and obtain work permits. Many of the migrants who are legally registered in the host country (and all those who are not) are in breach of Lao laws, which require a Lao citizen working in a foreign country to satisfy a set of criteria which include not taking a job in nearly all of the occupations in which employment would be most readily available for Lao migrants (and particularly female migrants) from poor

[2] The World Bank and ADB are currently preparing an Investment Climate Assessment for Laos that analyzes in more depth business environment constraints.

families. (These include house maid, maid in hotel, cleaner, restaurant service worker, supermarket worker, parking lot attendant, road sweeper, and other unskilled workers).

Around 80 percent of the people who still depend on farming, and especially those who rely on subsistence farming, have begun to migrate to other activities and the government will need to ensure that there is adequate employment to avoid social problems. Making it easier for Lao people to migrate to Thailand, and trying to persuade the Thai government to ease the cost to migration could be a cheap way of raising the standard of living of the poor and the middle class if the domestic demand for labor does not grow quickly enough to absorb all of the people seeking employment. It would also assist efforts to minimize potential dangers such as migrant abuse.

MAKING TRADE EASIER

The ability of Lao exporters to exploit the opportunities available to them will depend on underlying competitiveness and a supporting framework that provides information on export markets and opportunities, along with suitable and low-cost infrastructure services (financial, telecommunications, energy, transportation) and appropriate and efficient trade facilitation services. It will also depend on what the government can practically do to reduce transaction costs — the costs of arranging, monitoring and fulfilling contracts — since contracting lies at the business heart of international trade. Phasing out policies that increase the costs of importing or provide protection to import substituting activities is crucial, since these policies increase exporters' costs and reduce their ability to compete for domestic resources and factors of production. Identifying and alleviating the main factors that constrain diversification will be crucial to allow for a more broad-based expansion of exports in the short and medium term.

This part of the report considers what actions the government can take to reduce the costs and uncertainties that are specific to international trade; the next part considers what can be done to do the same for investment and business development.

NEGOTIATING MARKET ACCESS

One avenue to reduce uncertainty and increase returns for Lao exporters has been to seek preferential—and in the case of the United States, Most Favored Nation (MFN) access—to export markets.

The wide range of preferences available to Laos, especially given its least developed country status, suggests that market access should not be an issue. But it turns out that Laos is not making full use of the preferences available to it. One reason is supply constraints in the country and lack of competitiveness in certain sectors. Another reason is complex rules of origin associated with preferences and the difficulty that exporters encounter in managing them. This has long been a characteristic of preferential market access arrangements, and the government will need to take full account of this issue as it decides how much effort it should devote to securing preferential access. Equally importantly, some of the areas of preferential access that Laos has been using in the past are being phased out: this is particularly the case for exports of garments.

Market access conditions in the EU

The EU is the largest single market for Lao exports. The strong growth in this market has been driven by clothing products, which now account for 90 percent of Lao exports to the EU.

"No preferences, no textile in Laos". That is the view of the Lao Association of Textiles and Garments. An important issue for Laos is the extent to which the growth in clothing exports has been driven by trade preferences, both direct, in the form of the EU's General System of Preferences (GSP) for developing countries, and now Everything But Arms (EBA); and indirect, in the form of constraints on other competitor countries under the Agreement on Textiles and Clothing (ATC).

If these preferences have been driving export growth, then Laos may be vulnerable to their erosion—immediately, with the end of the ATC; and over time if WTO negotiations are successful and MFN tariff rates decline in the EU. There are two forces in play: the reduction in overall barriers to imports into developed countries will increase demand for textiles and clothing, but Laos may lose market share to more competitive producers.

Table 2 shows the value and utilization of EU preferences in 2001 (the most recent data available). A high proportion of Lao exports to the EU are eligible for preferences, most of which relate to exports of manufactures (i.e., clothing). Almost 60 percent of the exports that were eligible for preferences actually requested preferences in 2001 under the EBA.

This is the fourth highest rate of utilization among the 49 EBA beneficiary countries. Actual preferences used in the EU market were equivalent to 6.6 percent of the value of total exports in 2001 (more than 9 million Euros). If, however, preferences had been fully utilized the transfer would have amounted to more than 11 percent of exports (or more than 16 million Euros).

One reason for the remaining under-utilization is that the financial benefits of the preferences are outweighed by costs relating to the rules of origin. Complying with the rules typically require producers to adopt less than optimal input sourcing patterns and to incur costs in meeting certification requirements. These costs often exceed the gain from the margin of preference.

Table 2. Exports of Laos to the EU and the utilization of available preferences (2001)

	Total	Agriculture	Manufacturing
Total exports (Euro 000)	143716	8436	135280
Exports eligible for preferences (Euro 000)	133872	617	133256
Preferences requested (Euro 000)	78878	504	78374
Ratio of exports eligible for preferences to total exports (%)	93.2	7.3	98.5
Rate of utilization of preferences (preferences requested/eligible for preferences) (%)	58.9	81.8	58.8
Value of preferences as a share of total exports to the EU (%)	6.6	1.0	7.0

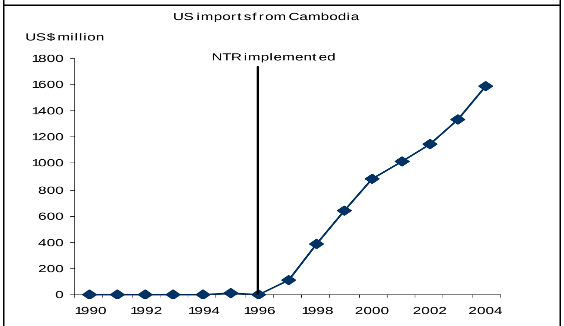
Source: Eurostat

Access to the US market

Normal trade relations with the US, agreed in 2005, offer great opportunities for increased exports in the clothing sector. The large fall in applied tariffs with Most Favored Nation (MFN) status – from more than 50 percent to less than 20 percent – could provide a substantial stimulus to exports to the US. Figure 14 shows that exports from Cambodia to the US were virtually zero prior to the granting of normal trade relations in 1996. In the subsequent 9 years, these exports increased dramatically, reaching around $1.5 billion in 2004. While exporters in Laos will have to face a more competitive environment than did Cambodian exporters, the liberalization of US tariffs still offers substantial opportunities for expansion. Again, the challenge is to ensure that the local business climate and trade facilitating infrastructure allow Lao exporters to respond to these opportunities.

Laos will also become eligible for GSP preferences in the US when it completes negotiations for WTO membership.

Figure 14. Cambodia taking advantage of Normal Trade Relations in the US



Source: World Bank

Access to the Japanese market

Despite its relative proximity, Laos exports little to the Japanese market. In 2003, exports to the EU were nearly 20 times greater than those to Japan. Laos is eligible for preferences under the Japanese GSP. Most of the value of preferences accrues to wood products, but the tariff and the margin of preference of these products is relatively low.

The margins of preferences are larger for clothing products. But here, again, the rules of origin are an issue, since the rules for knitted products are more restrictive than those for non-knitted products. Liberalization of the rules on knitted products could stimulate greater exports to Japan and allow for greater utilization of preferences.

Access to East Asian markets and ASEAN

Lao exports to ASEAN members have grown strongly during the 1990s and early 2000s. Because Laos has a longer implementation schedule (as a less developed ASEAN member) and has been slow in implementing the ASEAN Free Trade Area (AFTA) Common Effective Preferential Tariff agreement (CEPT), it has not received the full range of preferences available from other ASEAN members (as these are given on a reciprocal basis). It has, however, been granted preferences for some products under a bilateral agreement with Thailand.

Lao exports to ASEAN are highly concentrated by country (Thailand accounts for more than 96 percent of Lao exports to the original 6 ASEAN member countries) and by product (wood products account for around 80 percent of total exports to ASEAN). Given the low MFN tariffs applied to most products in ASEAN countries, diversification of this export base will have to be driven by strong capacity to compete, underpinned by effective export promotion activities and cheap and accessible trade-supporting infrastructure services.

Laos could leverage ASEAN membership to support export diversification and growth by joining the other ASEAN countries in harmonizing around international standards, and implementing a strategy of mutual recognition of testing assessments, in order to reduce technical barriers to trade and therefore trade costs.

REDUCING AND RATIONALIZING TRADE REGULATION

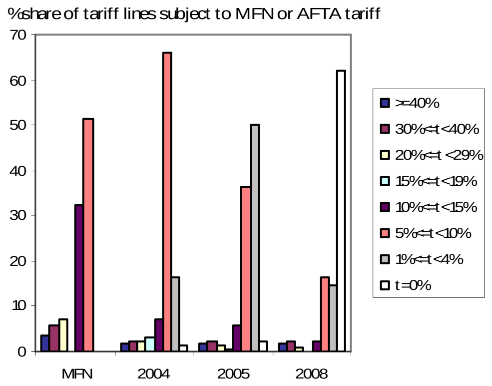
Laos has already made significant progress in reducing the costs of engaging in international trade. Controls have been relaxed and direct taxation of imports and exports has been reduced.

These steps to liberalize international trade were taken unilaterally. Now, however, the main effort on trade policy is focused on regional and bilateral agreements – the ASEAN Free Trade Area, the Early Harvest Program (EHP) of the agreement between ASEAN and China, and the Bilateral Trade Agreement with the United States (BTA) – and on WTO negotiations. Tariff policy is also in line with liberalization, although there are cases of high tariffs on production inputs which disadvantage industries that use these inputs, especially where tariffs on competing imports are low or where smuggling prevails. Despite the liberalization that took place, the management of trade is still restrictive, with burdensome, nontransparent, and inconsistent rules acting to increase costs and reduce competition from new entrants. Further, procedures for import licenses are, after some streamlining, still unnecessarily complicated, and leave room for bribes and unofficial controls. Reform in these areas has been constrained by the fragmentation and weak capacity of the trade administration.

Import duties and their effective protection

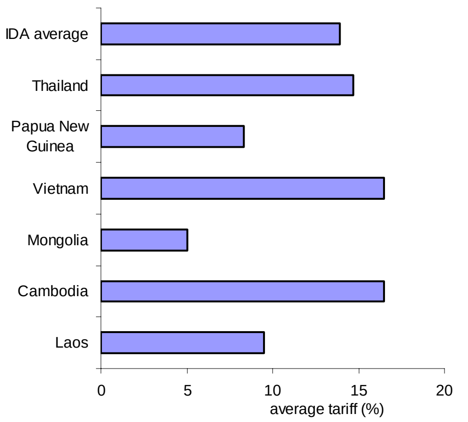
MFN import duties in Laos are low and not highly dispersed (Figure 15). The highest current import tariff rate is 40 percent (compared with about 150 percent in 1995) and for most products the tariff rate is below 15 percent. The tariff schedule has six rates: 5, 10, 15, 20, 30, and 40 percent, with an unweighted average of 9.5 percent in 2003—lower than many neighboring countries (Figure 16). The import-weighted average MFN duty rate on imports is lower and the standard deviation of these rates is fairly small. There is some tariff escalation in the tariff schedule, and thus effective rates of protection are likely slightly higher – especially in processed food and beverages (Figure 17).

Figure 15. AFTA implementation increases trade openness



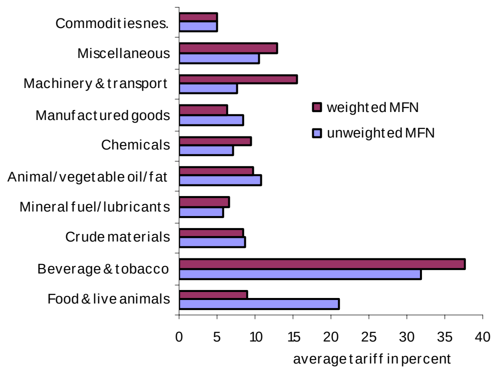
Source: MOC

Figure16. Overall tariffs in Laos are low



Source: IMF Trade Restrictiveness Index, 2004

Figure 17. Some sectors are more protected



Note: SITC classification
Source: MOC

Implementation of Laos' obligations as a member of AFTA is also reducing the average duty levied on many imports. By the time that Laos has fully implemented its obligations under AFTA's Common Effective Preferential Tariff Agreement, imports from ASEAN countries of most products will face a zero tariff, and nearly all will face a tariff of less than five percent.

There is scope to further rationalize tariffs by reducing the number of tariff bands and further reducing the maximum tariff. However, the biggest impediments to trade—both imports and exports—are non-tariff barriers.

Non-tariff barriers to imports

Foreign exchange management and import planning

As recently as 2002, foreign exchange controls were operated in conjunction with restrictive import licensing under a system that was a carry-over from the period of central planning and direct government control over the enterprise sector. Under this system, the government drew up an annual import-export balance plan. Projections were made by the central bank of the likely sources and uses of foreign exchange. As part of this process, firms were required to submit estimates of their expected annual foreign exchange earnings. They also had to submit requests for allocations of foreign exchange to pay for their projected import requirements. Once each firm's plan, or amended plan, had been approved it formed the basis of that firm's access to the foreign exchange needed to pay for imports. As an incentive to export, firms with export earnings were given ready access to their own foreign exchange earnings if they wished to use them to pay for their own imports, whereas firms without foreign exchange earnings were unlikely to obtain as much foreign exchange as they wished.

Although foreign exchange controls and import licensing have been greatly liberalized, the process is hard to document because the import licensing decrees have not been rescinded and the list of products subject to import licensing is largely unchanged. What has happened is rather that the increased availability of foreign exchange, the devaluation of the kip at the official rate and the central bank's relatively tight monetary policy since 2000 have combined to eliminate excess demand for foreign exchange at the official rate and import licenses that were once tightly restricted are now freely available.

The controls and decrees have been retained partly as a registration measure and partly in case of the recurrence of a foreign exchange crisis. While it is no longer a problem to get approval for the import-export plan, in practice the process is not always transparent and often a hassle to firms. If a company changes its export-import plan during the year, it has to have it re-approved. While few firms complain about not receiving the foreign exchange they need, maintaining such a system is no longer necessary.

Import licenses for general goods

Import licensing is regulated by a decree issued by the Prime Minister's Office, and annual notices that set out the lists of goods to which the particular provisions in the decree apply. One notice deals with prohibited imports, and the other identifies products for which import licenses are needed.

Most of these licensing requirements are merely 'technical measures' that are used for quality control, safety, animal quarantine or SPS which are implemented through single window services at the border checkpoints. While such technical measures can potentially be used for protective purposes, both government officials and private sector firms reported that the restrictive nature of import licensing is now much less than it was even five years ago. As recently as 2002, there was a blanket provision for imposing import licensing requirements on any product that the MOC or line ministries might wish to license. This condition has now gone, although the corresponding condition for exports is still in place. In the case of exports, it is maintained so that the authorities can try to hold down the domestic prices of sensitive items.

The two products for which import licensing is most important and most restrictive are cement and steel rods for construction. In both cases, import licensing is used to protect domestic producers—as is the case in many developed and developing countries. The licensing of imports of vehicles is now used as a registration device and importers have mostly been allowed to import as many vehicles as they want.

In addition to the licensing requirements applied by the central government, there are at least 214 non-tariff measures on imports at the provincial government level. Some provincial governments have been slow to implement directives from the central government. As a result, directives from the central government to relax import licensing restrictions were not necessarily implemented by the customs posts in the provinces.

The incentive regime for exporters

Export taxes and licenses. Export licensing is regulated by the same decrees and notices that regulate import licensing. Even exporting general goods requires several signatures and documentation. Prohibited exports are explosives, weapons, drugs, antiques, wild animals, logs and sawn timber, pornography, and currency printing equipment. The most important of these bans is on exports of logs and sawn timber, which is imposed partly for environmental reasons and partly to prevent the illegal logging of national forests. Some goods are not banned from export but require export licenses—these include diamonds, minerals, wood and forestry products.

Introducing a duty drawback scheme may be needed to provide exemptions for imported inputs used by indirect exporters. Laos allows duty exemptions on raw materials for exporters and is in the early stage of setting up special economic zones. It further adopted two PM's decrees in 2002 to create border trade zones, one with Vietnam (Dansavanh-Lao Bao) and one with China (Boten-Bohan). Most exporters use packaging and labeling inputs that are supplied by firms that specialize in these services. Garment exporters often use local firms to perform specialist functions, such as embroidery. There are undoubtedly many more examples and the importance of indirect exporters will increase as the manufacturing sector grows. In Laos, indirect exporters generally pay duty on their inputs. The reason is that since they sell some of their output domestically, as well as selling some to final exporters, it is seldom practical for them to use the bonded warehouse operations that are typically used by specialist exporters as part of a duty exemption system. Without a duty drawback scheme, the cost of the services supplied by indirect exporters is raised by tariffs on their inputs and this disadvantages the final exporters.

Now that Laos has developed a substantial manufacturing export sector, a duty drawback scheme could help boost exports. However, it would not directly address the impact of non-tariff barriers on the costs of importing production inputs, and would need to be assessed in light of the ability of Customs authorities to take on additional administrative and regulatory challenges.

Import and export procedures

Because of the continued extent of trade licensing, import and export procedures remain cumbersome. While these instruments may not be aimed at *restricting* trade, they create opportunities and incentives to increase the *costs* of trade. Imports under some 40 percent of the ten thousand odd tariff lines in the tariff schedule, and exports under around 16 percent of these tariff lines are under the control of government agencies. This can lead to some friction in the procedures summarized in Box 1.

STREAMLINING CUSTOMS

Despite major progress and reform effort, customs remain a stumbling block to imports and exports. Importers complain about lengthy, costly, and unpredictable procedures. The capacity of the Customs Department is still weak, the authority over Customs clearance is spread across ministries and regions, and informal payments are still widespread. Much remains to be done to make the Customs Department a modern one, including in the areas of legislation, organizational structure, human resources, computerization, clearing procedures, and enforcement.

The process for clearing import and export cargo has been greatly simplified in recent years, resulting in substantially reduced clearance times both in Laos and at the transit facilities in Klong Toey. For example:

- The ASEAN Harmonized Tariff Nomenclature has been implemented.
- A single administrative document similar to (but not entirely aligned with) the UN Layout Key format was introduced in 2000. This document is used for imports, exports, and transit goods, and replaces 16 separate documents.
- Direct clearance of goods at the factory is permitted in certain situations.

Box 1. Current import and export procedures

Import procedures for general goods. For goods not subject to import prohibition and government controls, an importer submits an import indicative plan to a provincial trade office, or to MOC in the capital. After approval, the importer forwards the plan to the trade authority at border checkpoints for monitoring actual importation.

Import procedures for controlled goods. MOC is responsible for monitoring the importation of vehicles and parts as well as fuel and gas. For other controlled goods, the importer needs to submit a request to relevant authorities before clearing goods out of the warehouse.

Import procedures for investors with concessional tariff rates. The government promotes domestic and foreign investment in most economic sectors. Investors can import raw materials and vehicles for production and pay customs duties at only 1 percent, with prior approval from the Committee for Planning and Investment. This process can take two to three weeks.

Export procedures for general goods. Goods which are not subject to government control and prohibition can be exported without any license. But the exporter needs to prepare necessary documentation such as business and tax registration, invoice, packing list and in some circumstances certificate of origin for preferential treatment purpose to present to the single window service at the border checkpoints.

Export procedures for controlled goods. Goods subject to approval from relevant authorities prior to export are provided in the Notification no. 285/MOC.FTD of 17 March 2004. The Import-Export Department of MOC oversees the exportation of rough and unwrought diamond as well as mining. All other types of goods are subject to approval by relevant authorities. To export these products, the exporters first submit a request to trade or relevant authorities. Once approved, they can go to the single window service and clear goods.

Despite these improvements, customs procedures for clearing imports and exports remain unnecessarily cumbersome, and the customs system as a whole remains weak and fragmented. Clearance still includes redundant steps, risk management techniques are not employed, and virtually all goods are inspected. Valuation procedures are currently not in accordance with the WTO's Agreement on Customs Valuation (ACV), though the revised Customs Law approved by the NA in May 2005 contains provisions on GATT valuation. The Department does not exercise full managerial control over field staff, because of the delegation of trade administration (and often policy) to provinces; procedures are oriented toward control rather than facilitation; smuggling and corruption are still problems; and the newly established post-audit function is not very credible.

Further, some of the gains achieved through past reforms have been offset by new procedures that add costs, both formal and informal, without providing significant advantages. New regulations have also been introduced without consulting stakeholders or considering the impact on trade. A recent example is the decision in 2004 to stop clearing imports at the warehouses of larger importers, and requiring that they be cleared instead through Thanaleng. This decision increased handling costs and damage to cargo as a result of third party handling.

The most important customs reforms needed to speed up the transit of goods include: (i) an institutional commitment to trade facilitation, in accordance with the goals of the Kyoto Convention; (ii) immediate attention to clearance of goods under temporary admission, and associated exports; (iii) establishment of bonded facilities at exporters' factories, to allow containerized goods, both inbound and outbound, to be cleared at the factory. Changes in procedures are also needed to address problems of transparency and corruption, such as a reduction in the number of signatures (from Customs and other agencies) required for clearance; computerization of customs documents; implementation of valuation procedures consistent with the ACV; and introduction of direct trader input and channeling (some of the problems that traders encounter when clearing goods result from uncoordinated processing by several government inspection and control agencies.) The government needs to rationalize the involvement of other government agencies in the clearance process.

The capacity of the Customs Department also needs to be upgraded, since the lack of (i) modern equipment, (ii) a risk management system (which would eliminate the need to inspect every shipment), and (iii) sufficient numbers of trained personnel all seriously undermine its ability to function effectively. Reforms and improvements are also needed in the areas of legislation, organizational structure, clearance procedures, and enforcement. Donor coordination in these areas is crucial.

To address these issues Customs has proposed a revised action plan that includes the establishment of a national customs administration with a vertical management structure. This plan is awaiting government approval. The Government should also give a very high priority to the implementation of the revised Customs Law and supporting regulations. As the new Law entails a major departure from existing policies and practices, including meeting WTO requirements, a comprehensive policy and procedures manual will need to be developed for use by Customs staff and the public. Extensive work will be required to develop the new regulations, including a detailed assessment of existing regulations, writing of new or revised regulations, and in implementation activities such as training and public information.

IMPROVING TRADE LOGISTICS

Of the three dimensions of Laos' status as a landlocked country, one – physical isolation from markets – is not really a problem, given its proximity (700 km) to ports in Thailand and Vietnam. The second dimension, inefficiency of logistics services, is being resolved; the Transit Agreement with Thailand, ratified in 2004, will expand competition and should provide a significant reduction in logistics costs. The third aspect, however – the lack of infrastructure and the lack of capacity at border crossings (land borders, international ports, and airports) – is a serious barrier to trade. The limited number of official international crossings and the cumbersome procedures at both crossings and gateway ports add time and cost and reduce the reliability of delivery. Efforts to improve the efficiency of Laos-Thailand border crossings and the Thai ports have been somewhat successful. However, the customs and trade management systems remain weak and fragmented: as a result, examples of world-class facilitation exist alongside restrictive practices and rent-seeking activities.

Where does the logistics sector stand in relation to other sectors?

The logistics sector should be evaluated in relation to the trade and production profile in

Laos. The formal business or enterprise sector in Laos consists of a limited number of small firms. As exports develop, these firms will need to move to larger orders and tighter order cycles, which will require more sophisticated and efficient logistics.

Land transport

Roads carry about two-thirds of freight traffic, and this share is growing. Recent investments in road infrastructure have focused on restoring the arterial road network, especially National Route 13, which runs from the North to the South of the country; as well as some links connecting Laos to Vietnam and China. For the latter, the major undertakings include rehabilitation of the east-west connection between Savannakhet and Lao Bao; the construction of the Northern Economic Corridor connecting Thailand and China; and the Greater Mekong Subregion initiatives on Lao-China trade.

While the domestic network is limited, much of the country has access to the extensive road network in Thailand through major crossings at Nongkhai/Thanaleng, Mukdahan/ Savannakhet, and Chong Mek/Pakse. These three main transit corridors connect Bangkok with the north, center, and south of the country. The most extensively used corridor is the one connecting Bangkok to Vientiane.

The connections to Vietnam are not as well developed. The Agreement on Road Transport signed between Laos and Vietnam in 1996 designated eight checkpoints. The main corridors have much less transit traffic than the Thai routes. While they provide shorter access to the sea, the roads are narrower, slower, and more difficult to traverse. They cannot support significant container traffic without improvement. Furthermore, the Vietnamese ports do not offer the same level of service as the Thai ports.

There are several border checkpoints with China, but the most promising corridor is the North-South extending from Beijing to Singapore. The principal corridor is from Kunming through Boten to Houayxay to Thailand. Upgrading of this corridor on both the Chinese and Lao sides is underway. Given the good road connections between Bangkok and Singapore and from Kunming to Beijing, the North-South Economic Corridor could eventually extend from the Chinese capital to the tip of the Malay Peninsula.

Inbound and outbound supply chains via Bangkok

Prior to the revision of the Lao-Thai Transit Agreement in 2004, the structure of the basic supply chains for imports and exports had not changed substantially for some time. Most goods shipped out of Laos were shipped unbundled in trucks (not containers) and loaded into Thai containers, as Lao trucks were not allowed into Thailand. If the changes allowed under the Agreement were combined with a reorganization of consolidation activities and a revision of customs procedures, there would be significant reductions in time and cost for the movement of goods between their origin or destination in Laos and the transshipment terminal in Singapore.

The basic movement of goods involves a six- or eight- wheel Lao truck transporting exports from the point of production across the border to Nongkhai. From there, the cargo is transferred in a back-to-back operation to an eight- or ten-wheel Thai truck and transported to the Bangkok port, where it is put into a container and loaded onto a vessel for transport to Singapore. If the consignment is large enough, the cargo is shipped as a full container load (FCL) container; if not, the cargo is consolidated with other cargoes having the same destination and shipped as a less than container load (LCL) container. While domestic Lao containers are now allowed to move between Nongkhai and Bangkok, mostly Thai containers are used, typically coming empty from Bangkok.

The lack of a container storage depot in Laos or near the border means that the transport of a container either inbound or outbound usually involves an empty move, and the exporter thus incurs the cost of a round trip. Empty backhauls are less of a problem for loose cargo, as there are more opportunities to find cargo for the other leg of the journey. Thai trucks delivering loose cargo to Nongkhai or Thanaleng can carry domestic cargo on the return trip to Bangkok. Similarly, Thai trucks delivering domestic goods to the Northeast can pick up Lao export cargo at Thanaleng or Nongkhai. It is more difficult for Lao trucks to do the same, since they cannot carry Thai domestic cargo and it is difficult to coordinate movements of Lao cargo to and from Bangkok.

Trucking services and tariffs

The Lao trucking industry is highly fragmented and largely informal. There are relatively few articulated trucks and almost no container chassis. The majority of trucks are either very old Russian or used Korean and Japanese trucks. Most trucking is provided by independent operators with one or two 6- or 10-wheel, rigid body trucks. Even formal (registered) trucking companies have relatively small fleets and rely on independent operators for peak capacity.

Lao trucks have difficulty operating in Thailand and are therefore at a cost disadvantage. Lao trucks are used for long domestic movements (up to 800 km) and for carrying cargo to Vietnamese ports. They do not operate in Thailand because of certification requirements, alternate side of the road operations and, most important, lack of backhaul cargo. Since Thai trucks are able to carry cargo in both directions, they can quote lower rates. For international trade through Vietnam's ports, the Lao truck operators have resolved the backhaul problem by transporting exports up to the port and allowing the driver to wait at the border to pick up shipments for the return trip from Vietnamese truckers who are unwilling to enter Laos.

Transit rates through Thailand have dropped as a result of the new Transit Agreement. Rates have declined by around 30 percent: but most of this fall was due to the increase in the number of Thai trucking companies allowed to compete for the haulage of cargo under customs bond, rather than to an opening of the market to Lao truckers. More than 164 Thai trucking companies have received a permit to transport international transit traffic, although so far only 20-30 have deposited the required one million baht bond with the Customs Department (the rest limit their activities to direct trade between Laos and Thailand). None of the Lao trucking companies have received a permit, although some are forming joint ventures with Thai companies that have this permit.

Of the various logistics problems facing Laos in foreign trade, the one with the greatest impact on the competitiveness for the SMEs is the cost for moving LCL cargo. The transport of loose cargo is charged based on volume, unless the shipper pays for the entire truck. The charge for a load of mixed consignments is significantly more than the truck rate, so shippers ship their goods on partially loaded trucks. It should be possible to eliminate this problem through the efforts of consolidators in Vientiane or Nongkhai.

What can be done?

Developing logistics services

For smaller exporters, improvements in logistics require strategies to consolidate cargo in order to achieve economies of scale. In order for smaller exporters to improve their logistics and take advantage of economies of scale in transport, they need better opportunities for consolidating cargo. To achieve this, it is necessary to strengthen the capacity of freight forwarders to handle these shipments, both individually and with their international partners. Typically, Lao forwarders are used for exports and Thai forwarders for imports.

At the same time, it is necessary to develop larger transport companies in order to improve fleet management. Larger companies are better able to handle larger orders and improve their efficiency by automating cargo booking and fleet management. While it would be difficult to increase the size of these firms through capital investment, given current market conditions, they can be expanded through mergers and contracting arrangements. Mergers among Lao companies involved in international road transport would not affect competition, since an increasing number of Thai companies are entering the transit market as a result of the new Transit Agreement. Nor would such mergers have much impact on competition in the domestic market, given the highly fragmented structure of the trucking industry. Alternatively, larger firms can expand through subcontracting of independent truckers and through joint ventures with larger Thai logistics providers. Both are already occurring.

Increased access to the transit market can be achieved through joint ventures. While the new Transit Agreement nominally provides open access for Lao transporters, the procedures for licensing Lao trucks and drivers to operate in Thailand is less clear. Furthermore, in order to compete with the relatively well-organized Thai logistics industry, Lao trucking companies will need to improve their management capacity and skills, and invest in new trucks that can operate efficiently in Thailand.

Joint ventures are also needed to overcome the limited information available to Lao forwarding companies about the availability of loads, especially for backhaul moves. Indeed, two Lao companies have already developed such relationships.

Reducing regulation

The current emphasis in the global market is on reducing the time it takes to fill orders. This places additional pressure on exporters to reduce their delivery times for inputs and lead times for export. Bureaucratic procedures that delay these transactions create a competitive disadvantage for Lao companies.

While efforts to reduce regulatory delays usually focus on improving customs procedures, more significant delays and impediments result from government controls over imports and exports. The import and export procedures in Laos are among the most restrictive in the region, requiring not only the registration of companies that engage in trade, but also annual trading licenses specifying the volume that will be traded, and authorizations for each shipment that must be checked against the annual allocation. The time required to obtain these authorizations is said to average about two weeks because of the need to process the documents through different agencies, each in a different location. For importers and exporters located outside of Vientiane capital, there is the additional delay of processing the documents through provincial offices. These procedures, combined with the requirement to prepare a plan of annual imports, all act to inhibit trade. Further, relatively few exporters have annual orders from their buyers. Rather, the exporters must be able to respond quickly to new orders, which have, at most, a six-month lead time. Even for manufacturers with long-term orders, these represent only a portion of their total output.

In contrast to the burdensome regulations for trade, Laos only minimally regulates logistics services. This is advantageous, as attempts to regulate this dynamic industry would limit its ability to change in response to competition from foreign service providers. However, a proactive approach will be required by the industry to upgrade the quality of its services. While there have been some efforts to provide training, more needs to be done to improve standards and make both the providers and users aware of these standards. Government regulation can contribute to this effort by:

- improving the allocation of liability for cargo losses, and for providing cargo insurance for logistics companies at reasonable prices;
- facilitating customs clearance by licensing customs clearance agents. Currently there is no such requirement, and consignees clear about 80 percent of the goods delivered to Thanaleng. This not only increases delays and malfeasance, but also discourages the introduction of modern procedures and technology. Furthermore, without a professional clearance agent organization, Lao customs has no channel through which to communicate changes in procedures.
- certifying products and enforcing standards applied by trade partners; e.g., quality of material used, country of origin, and chemical content. This does not imply that government laboratories should do the testing, as these labs are usually inefficient and often ineffective. Rather, the government should oversee private testing facilities and reporting procedures.

Implementing the Transit Agreement with Thailand

Many of the features of an effective transit corridor through Thailand have been implemented on a piecemeal basis. The Transit Agreement for movement of goods in transit is an attempt to introduce a more comprehensive arrangement between Laos and Thailand. While this agreement has already significantly liberalized the movement of goods between the two countries, full implementation will require further clarification concerning:

- *Requirements that Lao trucks must meet in order to operate on Thai roads.* Without a clear statement of what regulations apply to Lao truckers, it is likely that their initial efforts to operate in Thailand will fail.

- *Procedures for sealing cargo in transit.* Thai customs continue to remove the seals from import containers destined for Laos and affix their own seals. They also continue to replace Lao seals with their own on export containers at the time they enter Thailand. There is no reason to replace these seals or to inspect the contents of the containers, except in exceptional situations and then only in the presence of Lao customs.
- *Procedure for bonded movements.* Within Thailand, the Thai international Freight Forwarders' Association (TIFFA) provides Thai trucking companies with guarantees for payment of duties should the goods they are moving fail to exit Thailand. The trucking companies must also be bonded for carriage of goods in transit. Comparable arrangements need to be established for Lao truckers and forwarders, possibly through a joint arrangement with TIFFA.
- *Service charges for transit movements.* The Transit Agreement leaves these extraneous charges to subsequent discussions, but indicates that they should not exceed the rates for comparable domestic services. It is important to agree on these rates and make them known, and to provide better enforcement in order to reduce informal charges.

Developing LCL logistics

The development of an efficient supply chain for small shipments, specifically loose truck load or LCL consignments, has been slow to evolve. Consolidation has traditionally occurred at the port of export. This procedure allows shipment of a full container with mixed consignments in order to minimize costs, including those for handling of and damage to cargo. However, consolidation also increases transit time, since it may take up to a week to acquire sufficient cargo for onward shipment to the destination port. Further, consolidation is only done for shipments going to major destinations.

A new strategy that could be useful to Laos involves multiple consolidations in a door-to-door movement. The initial consolidation occurs close to the source of production, while the final deconsolidation occurs close to the destination. This process reduces the delays for each consolidation, and increases the portion of the trip from origin to final destination that is containerized. This strategy is information intensive but not necessarily capital intensive, and can be replicated for relatively small traffic volumes. Such a system would significantly improve the competitive position of the smaller Lao exporters, which export primarily LCL shipments.

The challenge for Laos is to replicate this system despite the small volume of traffic. There have been efforts in this direction, with cargo consolidated into domestic containers and carried by truck to Bangkok. But so far this has not been cost competitive. To be competitive, movements in domestic and maritime containers must be tightly integrated. This requires improved cross-docking in Bangkok, and better integration between domestic and international freight forwarders and transport companies. The service should be provided by the business or enterprise sector on a competitive basis. Because of the need to coordinate the deconsolidation/ reconsolidation activities, it may be necessary for the same party to provide the service in both Vientiane and Bangkok.

In order to implement this system for small-scale industries, the following actions and conditions are necessary:

- A study of commercial viability, including forecasts of (i) the volume of consolidated cargo exported over the next five years by major destination; (ii) savings from the introduction of an efficient consolidation/ deconsolidation operation in Vientiane and Bangkok; and (iii) the revenues generated by such an operation;
- Agreement between Thai and Lao Customs for facilitated movement of consolidated shipments under bond between bonded warehouses in Laos and Bangkok;
- A bonded warehouse for consolidation of cargo, with a competitively bid concession for operating the warehouse;
- Expedited procedures for processing consolidated shipments in Bangkok;
- Competition in the provision of deconsolidation/reconsolidation services in Bangkok;
- A system to supply the information required by customs, international transporters, and forwarders to plan and

coordinate the movement of consolidated shipments.

Inland container depot/dry port

Establishing an inland container depot can reduce the transport costs of containerized cargo. Implementation of the Transit Agreement with Thailand and increased competition among trucking companies and clearance agents has caused the rates for transport of containerized cargo to fall substantially. However, these rates are still relatively high, because of higher truck operating costs and, more importantly, the need to reposition empty containers from the unloading point for imports to Bangkok and from Bangkok to the point of loading for exports.

To address this problem, Laos could establish an inland container depot (ICD) that would operate as a dry port. Currently, most import containers are designated for delivery to Bangkok and the consignees or their representative arrange for onward movement. With an ICD/dry port, the inland transport for import containers having Vientiane as their port of destination can be arranged jointly for all shipping lines through one or more trucking companies.[3] This arrangement would reduce costs associated with this movement, and eliminate the need for a bank guarantee or detention charges. For exports, the shipping lines could issue a bill of lading with Vientiane as the origin port and then assume responsibility for transportation to Bangkok and beyond. The ICD/dry port could also be used to store empty containers until they are reloaded, thus increasing the percentage of loaded backhauls and reducing trucking costs.

A proposal has already been prepared by a private operator to establish an ICD at a new location near Thanaleng. The final choice of location should be part of a broader strategy for improving supply chain performance. A marketing study is needed to identify the performance characteristics needed to make the ICD successful, including the level of coordination needed between with customs and transport services.

[3] As an example, the operators of the ICD in Sialkot, Pakistan also provide a trucking service between the ICD and Karachi which is one of the best organized trucking operations in Pakistan.

ADDRESSING SPS NEEDS

Laos has high agricultural growth potential, and demand from neighboring countries for Lao fruits and vegetables, coffee, and possibly high-quality beef is increasing at a rapid pace. However, the growth in agricultural trade is constrained by the lack of capacity, in both the public and business or enterprise sectors, to meet international sanitary and phytosanitary (SPS) requirements on food safety and animal and plant health. Meeting these standards will require more skilled staff and better laboratory equipment; the creation of databases on diseases and pests; and the capacity to monitor avian flu, foot and mouth disease, and agrochemical use; and to carry out risk assessments and cost-benefit analyses. The lack of capacity in these areas is already affecting market access for coffee and wood products, and is adding to cost and risks for other products that have been drawn to Laos by trade liberalization.

Developing these capacities will involve large upfront costs. Therefore, an action plan is needed to (i) carry out a comprehensive assessment of current capabilities; and then (ii) outline a gradual approach to SPS management and capacity building. Other priority actions include:

- drafting of pertinent legislation, and rationalization of existing regulations;
- creation and maintenance of databases;
- setting up an emergency response system;
- human resource training and technical capacity (equipment and facilities) for the control of animal diseases.

Priority issues

SPS concerns are focused on several main areas:

Phytosanitary certificate for coffee. Phytosanitary certificates to export coffee are issued upon the request of the exporter (or foreign importer). The phytosanitary concern is that fresh coffee beans have a risk of carrying fruit flies and coffee rust disease. However, there is usually no such concern for dried, unroasted coffee beans for consumption.

Risks from informal border trade. Pests and diseases in animals and agricultural products, unsafe food, and harmful pesticides can easily get into Laos through uncontrolled and unregistered border trade. Neighboring countries are exposed to the same risks from the products transited through Laos.

International Standards for Phytosanitary Measures (ISPM) 15 for wood packaging. ISPM 15 presents the guidelines regulating wood packaging material, primarily to control the spread of timber pests through the movement of timber packing and dunnage in international trade. Many countries have implemented procedures to accept ISPM-compliant imports. Laos has not yet implemented the ISMP measures; nor has it conducted risk assessments to determine the possible presence of wood pests.

Avian influenza. Avian flu was confirmed in Laos in January 2004. Accurate surveillance and diagnosis are not readily available in many Asian countries, including Laos.

Foot and mouth disease. Laos is one of several Southeast Asian countries where foot and mouth disease (FMD) is endemic. The occurrence of the disease could be attributed to Laos being a major transit corridor for livestock trade from Vietnam to Thailand, from Cambodia to Thailand (through the south of Laos), and from China to Thailand (through northwest Laos). Certain trading practices are also considered a factor in the spread of the disease – traders buying infected animals for lower prices and selling them in other areas for slaughter. Practical and feasible solutions are needed to control the movement of livestock.

Potential areas for growth

Traditional crops. Traditional crops such as rice and maize have low requirements for SPS services, and their cultivation can easily be expanded.

High-quality beef. The country's large grassland areas offer opportunities for the production of high-quality beef. However, the costs of necessary veterinary controls and investments for developing high-quality beef exports are high. A feasibility study is needed to assess the costs and benefits of public and private investments in this sector.

Organic farming. Since the use of chemicals in agriculture is not common in Laos, organic farming could be a possible niche market. However, most farms are too dispersed and remote to easily get organic certification.

What needs to be done?

The WTO accession process adds to the sense of urgency about meeting SPS requirements, and a number of Lao officials have expressed the need for a comprehensive discussion of SPS management that will:

- define the basic capacities needed to effectively manage food safety and agricultural health in the context of the country's economy;
- identify factors that determine priority actions; e.g., a product's potential for the export market;
- consider possible gaps and overlaps in functions and responsibilities.

There is also clearly a need for a more detailed assessment of present SPS capacities, in order to better identify needs and priorities in capacity building. Preparation of an action plan would serve this purpose, since it would require information gathering and assessment of the following issues:

- institutional responsibilities and coordination;
- adequacy of the legal and regulatory framework;
- databases on food-borne diseases, and pest and disease databases on agricultural health issues;
- capacity to perform risk assessments on food safety and animal and plant health;
- capacity to do cost benefit analysis on options for public intervention on food safety and animal/plant health issues;
- capacity for managing health hazards, animal diseases, and plant pests, including a rapid alert system;
- technical and human resource capacities to prepare policies, monitor food safety and agricultural health, perform tests for inspection, and issuance of certificates;
- awareness of food safety among stakeholders;
- work programs carried out by the various services;
- business or enterprise sector capacities;
- capacities for tracking and tracing and quality assurance.

LEVERAGING WTO ACCESSION

Laos has started the process of joining the WTO. Along with implementation of the country's commitments to AFTA, and the bilateral trade agreement with the United States (which calls for some actions that Laos will have to take as a member of the WTO), the accession process could play a key role in shaping the country's approach to integration in the coming years. How can Laos best utilise accession and membership in the pursuit of its integration strategy?

WTO accession presents Laos with opportunities to improve its trade policy and economic competitiveness as well as supporting its domestic reform agenda. However, it also taxes the institutional capacity of the government and the business or enterprise sector. Donors and international agencies can help to build this capacity, but the benefits of membership will depend on Laos having a clear vision of how it wants to use WTO membership to further its trade and reform agenda.

The road to WTO accession is not easy for developing countries, and particularly those transitioning from a centrally planned to a market economy. WTO membership requires significant legal, administrative, and regulatory reforms, which are difficult to implement in low-capacity environments. In neighboring Vietnam, accession talks have focused on passage of new domestic legislation compatible with WTO commitments, and on a demonstration of Vietnam's capacity to enforce these laws effectively. Laos faces similar issues, and is attempting to resolve them and gain entry before the Doha Round, after which entry requirements may get even tougher.

Potential benefits for Laos from WTO membership

Market access usually dominates attention given to WTO accession. But Lao exporters already receive MFN treatment or better in the markets of their major buyers. Other ASEAN members grant preferential access on a reciprocal basis, and most OECD countries unilaterally offer low or zero duty treatment on imports from Laos through programs such as the Generalized System of Preferences (GSP) or, in the case of the EU, through the Everything But Arms initiative. Laos' membership in the WTO will give its exporters the assurance that their goods will continue to receive MFN treatment. The only market access gain that might accrue is GSP access to the US market, since US laws prohibit extending GSP treatment to communist countries unless they are WTO members.

WTO accession can be an anchor for Laos' own reforms. The process of negotiating membership and complying with WTO rules requires countries in transition to create the basic laws, policies, and institutions that support a market economy; to create a trade regime based on the rule of law; and to publish all trade-related regulations. These measures help create an investment climate that is more predictable, thus reducing transaction costs for importers, exporters, and investors. In addition to strengthening the foundations of a market economy, joining the WTO can reinforce domestic economic policy reforms. Nowhere is this more evident than in East Asia, where China, Cambodia, and Vietnam all treat WTO membership as an integral tool to reinforce their economic reform programs.

Membership in the WTO will give Laos a seat at the table when countries negotiate the rules governing international trade. Among the issues being discussed in the current round of negotiations (known as the Doha Development Agenda), those that are important for Lao trade include:

- ***Trade facilitation.*** Laos would benefit from stronger disciplines on transit rights and increased transparency of customs procedures.
- ***Full developing country participation in tariff liberalization.*** While enjoying preferential access to markets in the region and in developed countries, Lao exporters face high MFN tariffs in many developing country markets, including fast-growing economies that are potential markets for Lao exports (e.g., India).
- ***Disciplines on anti-dumping.*** As a country in transition from central planning, Laos may not obtain market economy status and could become vulnerable to anti-dumping actions by other countries. Stronger disciplines on anti-dumping could force WTO members

to use less discriminatory and more transparent policies.

- ***Access to patented drugs:*** Laos would benefit from greater flexibility under the TRIPS agreement to use compulsory licensing and parallel imports to ensure access to patented medicines.

The WTO dispute resolution mechanism will put Laos on equal footing with larger, richer members. Access to the WTO's dispute settlement procedures is a fundamental benefit of membership, giving a member legal recourse to contest protectionist trade policies. This allows small and poor countries to compensate for their lack of political power in trade disputes with larger and richer partners. For example, soon after Ecuador joined the WTO, it quickly used the process to challenge the EU's banana import policies. However the costs involved in the dispute settlement process could still be a constraint for many developing countries.

MAKING INVESTMENT AND DOING BUSINESS EASIER

Export diversification and growth will not occur without investment, and a central element of an integration and export diversification strategy for Laos is to improve the climate for investment and carrying out business.

Detailed assessments of the various elements that make up the investment climate suggest that the lack of competitiveness is a major impediment to attracting investment to Laos. Barriers to competitiveness include:

- poor infrastructure – absence of a railway system, a low-density road system (less than 100m per km^2), lack of year-round access to many district centers – which is a major obstacle to the development of an integrated domestic market;
- a difficult business environment – while Laos has cheaper labor than other countries in the region, productivity is also lower, and it ranks 144th out of 145 countries in terms of the length of time that it takes to start a business, and 150th out of 161 on the cost of doing business. Limited foreign investment and low numbers of domestic private firms are an indication of how difficult the investment environment is in Laos. In a country of 5.5 million people, there are only a few hundred manufacturing firms with more than 10 employees.

To address these challenges, the NGPES has laid out the basic framework for the reform agenda. It stresses the need to:

- maintain macroeconomic stability through prudent monetary, fiscal, exchange rate and interest rate policies;
- improve the financial sector;
- improve the business climate by creating a predictable and transparent policy environment;
- streamline administrative procedures and regulations that are an obstacle to domestic and foreign private investment; and
- strengthen market institutions, including most notably those related to dispute resolution and contract enforcement.

These are difficult challenges to address, but they lie at the heart of an effective trade strategy for Laos.

MACROECONOMIC MANAGEMENT

While the economy has recently shown relatively robust growth, driven largely by a surge in mining activity, the pace of structural reform has been slower than envisaged, leaving underlying weaknesses. The fiscal position is fragile, with high public debt (75 percent of GDP); weak revenue collection; major liabilities in the state bank system (which the budget will have to absorb when the banks are fully recapitalized); and structural problems in the tax and customs systems, including lack of central control. Further, the financial sector lacks the well-functioning payment system and efficient financial intermediation needed to support business or enterprise sector investment and the diversification of exports – which is important because the large power and mining projects that are expected drive growth in the next few years will not contribute much to employment.

The National Growth and Poverty Eradication Strategy highlights several key reforms in the area of macroeconomic management that are needed to overcome these challenges.

The first priority is to strengthen fiscal management, particularly in the areas of:

- *revenue mobilization*, to offset tariff revenue declines resulting from AFTA commitments. Priority measures include strengthening the tax and customs systems in the short run, and introducing a VAT in the medium term; and
- *public expenditure management,* to address lack of control over provincial spending, and improve budget planning and execution.

Another key priority is to establish a functioning banking system, in order to achieve the Government's development goals and meet the competitive challenges of regional integration. Specific priority measures include:

- improved governance of state banks, pending the entry of strategic partners;
- amendment of the Banking Law;
- strengthening of prudential oversight; and
- building the capacity of the central bank.

On the revenue side, some steps have been taken to improve central oversight over provincial customs posts, although this remains a challenge. Progress has been slower on taxes. A first step could be to integrate the administration of large taxpayers into a single unit under central government control. Strengthening the technical capacity in both the customs and tax administrations is also crucially important.

On the expenditure side, weaknesses in the public expenditure management system – including capacity constraints, weak control over expenditures, and poor fiscal reporting – are widespread. To address these challenges, the Government has launched a Public Expenditure Management Strengthening Program, with the support of the World Bank. The main priorities of this program are to:

- strengthen control over provincial treasuries, notably with regard to transmission of national revenues to the center;
- improve budget planning and execution, by updating the budget's nomenclature and developing supporting accounting systems; and
- develop a central government cash management system.

There is also a need to review the regulatory framework for fiscal relations between the central government and the provinces, to clarify the assignment of revenue and expenditure responsibilities, and develop a robust mechanism for inter-governmental transfers.

With regard to the banking system, which must be able to support the Government's development goals and meet the competitive challenges of regional integration, the main emphasis continues to be on the reform of state banks, as they dominate the banking system.[4] However, progress in restructuring these banks has been slow, and they remain deeply insolvent. Strategic partners (i.e., foreign banks) need to be brought in to strengthen the technical expertise of the banks; and a new Banking Law needs to provide them with the autonomy needed to run a successful banking operation. In the interim, the focus is on improving and streamlining the banks' management structures, strengthen their performance indicators, and ensure a sound lending framework.

Prudential oversight of the banking system also needs to be strengthened, for both state and private banks; oversight could include establishing standard financial soundness indicators and identifying potential areas of vulnerability.

WELCOMING PRIVATE INVESTMENT AND BUSINESS

The business or enterprise sector in Laos is underdeveloped and dominated by very small, informal enterprises. Addressing their problems through reform of the business environment is at the heart of what the Government needs to do to achieve a sustained increase in exports.

[4] The three main state banks—BCEL, LDB, and APB—account for more than two-thirds of total deposits.

Development of the sector is constrained by a number of factors within the ambit of state action, all of which relate to the conditions and institutions needed to underpin a market economy. These factors include:

- unclear and poorly communicated government policy toward the business or enterprise sector and lack of inter-ministerial coordination and consultation with stakeholders in the policy making process;
- the high cost of power, transport, telecommunications, and other critical services;
- excessive and unnecessary regulation of ongoing business operations;
- orientation toward control rather than facilitation by the tax and trade administration systems;
- failings of the financial system, including the high cost of finance and of the collateralization of land;
- lack of access to land;
- lack of a sufficiently functional legal system to support investment, enterprise establishment, contract enforcement, and commercial transactions;
- insufficient intellectual property rights protection for both domestic and foreign investors; and
- the rigid regulation of labor.

Remedying these problems will require both immediate and longer-term actions. The first priority is to improve the legal and regulatory environment, in order to facilitate economic activity and meet the conditions of international agreements. Key short-term actions include:

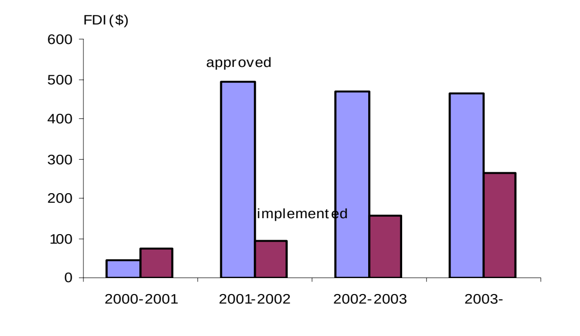
- Simplifying the business start-up process, and moving from a licensing toward a registration system;
- Introducing a one-stop investment service where licensing remains;
- Repealing the Industrial Processes Act, which regulates production processes; and
- Revamping the tax system and its administration.

In the longer term, sustained efforts and considerable financial resources will be required to build institutional capacity, strengthen entrepreneurial skills, and improve physical infrastructure.

Where is the business or enterprise sector?

More than a decade after Laos started its transition to a market economy, there has been limited entrepreneurial response to the greater market freedoms. This lack of supply response is most noticeable in sectors such as manufacturing that require long-term investments. The slow increase in the level of foreign investment, and the low level of implemented investments compared to approvals, are evidence of the difficult business environment (Figure 18).

Figure 18. FDI approval and implementation



Source: Government presentation at Business Forum August 2004

Policy uncertainty

The combined impact of poor public-private dialogue, unclear government policies, and lack of transparency in decision-making creates a business environment with a high degree of policy uncertainty. While there have been statements made in NGPES and other broad-scope documents confirming the Government's support for business development, policy commitments remain vague and are typically not reflected in actions. Further, public-private dialogue is extremely limited. Until recent months, before the Government began taking steps toward a more open and consultative policy approach, there was almost no consultation with the sector in the development of relevant legislation or administrative procedures. Despite increasingly open decision-making processes with regard to specific investments, the lack of clarity policymaking is still a barrier to investment. Box 2 summarizes remarks made by local and foreign investors during this consultation.

Box 2. What are private investors saying?

Comments from local investors

On Government: (i) More transparency in the Government's procedures is required to operate in an appropriate way. (ii) Better-trained Government officials are needed to deal with business or enterprise sector issues. (iii) The domestic market is too small to attract investments. (iv) It takes a long time to set up a business or to complete any kind of transaction with the Government. (v) There is a lack of coordination among different agencies.

On the financial system: (i) Banks are not lending based on commercial criteria [i.e., loans are given for political reasons]. (ii) Rates are very high.

On the legal system: (i) Laws are not being enforced consistently. Enforcement of existing laws, rather than creation of new ones, is the priority. (ii) Labor regulation is too strict, difficult to dismiss staff. (iii) Corruption of officials in charge of law enforcement.

Comments from foreign investors

(i) The accounting system is not standardized; foreign companies have to keep two sets of books. (ii) Fulfilling a company's tax duties takes up to 6 months per year; tax officials are corrupt. (iii) Many potential foreign investors are discouraged by the experience of current investors. (iv) Most companies still pay a 35 percent profit tax. (v) Workers are less skilled than those in China and Vietnam; some factories are undertaking their own training. (vi) The banking sector is unable to provide commercial lending. (vii) The garment industry is being neglected by the Government, even though 26 percent of export revenues come from this sector.

Legal framework for business

The legal framework for the business and enterprise sector is gradually being adapted to the needs of a modern market economy. Steps in the right direction include the new investment laws, the decrees on small and medium sized enterprises as well as the recently approved Enterprise Law.

The key laws comprising the framework for the business or enterprise sector are:

- *The Labor Law, 1999*. This Law clearly sets out the responsibilities of employers, and processes to be followed in dismissing a worker.
- *The Industrial Processes Law (Factories Law), 1999*. This Law is particularly archaic and problematic for businesses, as it requires manufacturing businesses to get approval for all minor operating changes in their manufacturing production. Further, several years after its passage, the implementing guidelines have yet to be issued.
- *The Land Law, 2003*. This Law gives landowners the right to lease, dispose of, sell, or exchange land, but it also sets burdensome and sometimes arbitrary limits on use. For example, FDI firms can lease land for up to 50 years for an agreed-upon purpose, but if plans change, the lease is then limited to three years. Further, the many authorization and approval steps required give officials significant discretionary power and create opportunities for corruption.
- *The Law on Promotion of Foreign Investment, 2004.* This Law replaces the Foreign Investment Law of 1994, but is still not up to international or regional standards. It falls short in two fundamental areas: (i) lack of transparency in investment licensing; and (ii) a poorly defined "positive list" rather than a "negative list" in the investment sectors. The Law does provide for international arbitration in the case of disputes.
- *The Law on the Promotion of Domestic Investment, 2004*. This replaces the 1994 Law, and has the same shortcomings as the Foreign Investment Law. The existence of two separate regimes for foreign and domestic investment creates additional burdens for investors.
- *Decree on the Promotion and Development of Small and Medium Sized Enterprises, 2004*. This decree supports a broad range of activities to promote SMEs, including access to finance, training of entrepreneurs, setting up a supportive regulatory and administrative environment, etc. It also establishes a Fund with resources to cover administrative and staff costs (including bonuses and training), financial support for SMEs and promotional activities.
- *Decree No. 15 on Trade Competition, 2004.* This decree lays out key principles for regulating anti-competitive practices and promoting fair competition. It does not give state-owned enterprises preferential access to resources, including commercial credit, and SOEs are not required to purchase goods only from state firms.
- *Enterprise Law, 2006.* This law will replace the 1994 Business Law which governed the establishment of businesses. The Business Law contained some vague

provisions but was rigid in other aspects (e.g., specifying a minimum paid-in capital requirement). The new law has been designed in consultation with the business sector. It has been approved by the National Assembly and the related implementing decree is under preparation.

Regulations and procedures to start a business

It takes longer in Laos than anywhere else in the world, except in Haiti, to start a business. To formally establish a business in Laos, entrepreneurs are required to go through a multiplicity of regulatory processes, obtain several licenses/certificates, and meet huge documentary requirements (Table 3). Further, contrary to current international practice, Laos continues to require the submission of a feasibility study/business plan for all businesses. This long, time-consuming, and in parts a highly opaque process provides room for extensive official discretion and encourages firms to remain informal rather than focus on growth. Unregistered businesses pay a monthly fee to the district authorities, and a monthly lump-sum amount to the tax collectors as "profit tax."

Table 3. Requirements to open a business

	Laos	Regional average	OECD average
Number of procedures	9	8	6
Time (days)	198	51	25
Cost (% of income per capita)	18.5	48.3	8.0
Minimum capital (% of income per capita)	28.5	100.5	44.1

Source: Doing Business, 2004.

Establishing a one-stop shop is a good start, but implementation is slow. The recently amended Law on the Promotion of Domestic Investment allows for the possibility of a one-stop shop approach for domestic firms. However, the Government has yet to implement this approach in practice. The recently amended Foreign Investment Law also provides foreign investors access to a one-stop service. Implementing decrees for both domestic and foreign investment laws were released in October 2005.

Capacity and institutional constraints

Capacity constraints are numerous, especially at the provincial level. Laos is a highly decentralized country, and provincial governments, rather than central authorities, are responsible for: (i) processing/authorizing firm registrations and investment licenses; (ii) firm-level inspections; and (iii) allocating land-use rights and a private firm's access to other resources. The only exceptions are some very large or politically sensitive business ventures, which may need authorizations at the national level.

The capacity, attitude, and workload of the officials concerned varies by agency and provincial location, and significantly influences the time it takes for entrepreneurs to go through these processes. The provinces located on key trade routes tend to be more business savvy and supportive, while officials in the less well-connected provinces often lack a clear understanding of business or enterprise sector activities and, despite good intentions, may tend to be obstructionist rather than supportive to entrepreneurs. But the regulatory procedures in the country's capital, Vientiane, were found to be the most burdensome and time consuming, due to the rigid and hierarchical approach taken by capital city bureaucrats.

Institutional constraints. As is normal for an economy in transition, many of the institutions needed to underpin a market economy have not yet been established or are very new and require strengthening. For example, Laos now has a reasonably comprehensive set of business laws, albeit of mixed quality, but lacks the institutional capacity to effectively enforce them. There is also little effective recourse to the court system or other formal means to resolve disputes or enforce contracts, and building this capacity will take considerable time, as it involves the training of judges and commercial lawyers.

Key steps to facilitate business or enterprise sector development

The regulatory requirements placed on businesses in Laos are too high compared to those placed on competitors operating in Vietnam, Thailand, and other regional neighbors. They are also too high compared to the technical capacity of the civil servants in Laos, who lack the capability to serve the business or enterprise sector by, for example, critically reviewing business plans. They are too high for the capacity of the local entrepreneur, who already faces competitive handicaps in terms of poor infrastructure and less entrepreneurial experience. They are felt more by exporters (Figure 19). And finally, they are much too high for a country whose main potential source of growth is through facilitating rapid business sector development.

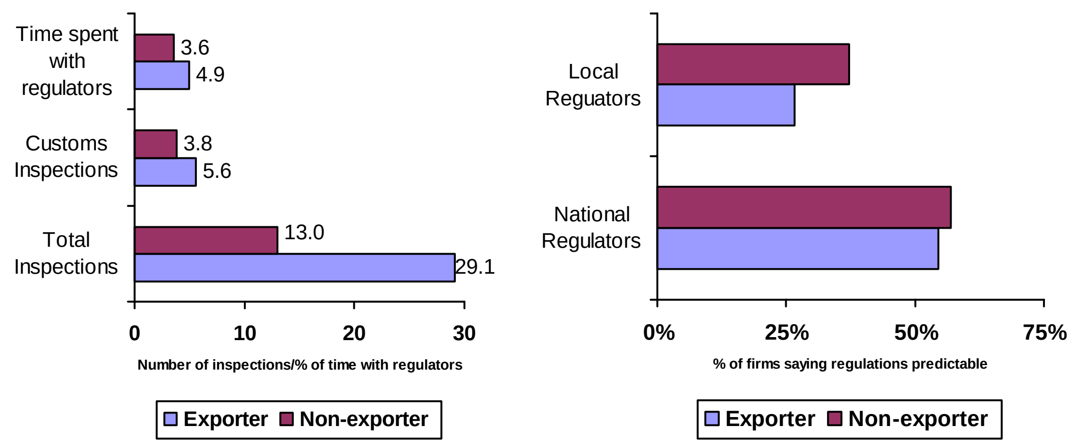
To address these problems, the reform agenda established in the NGPES stresses the need to:

- improve the business climate by creating a predictable and transparent policy environment;
- streamline administrative procedures and regulations that constrain domestic and foreign private investment; and
- strengthen market institutions, including, most notably, those related to dispute resolution and contract enforcement.

Priority regulatory reforms include:

- substantially simplifying the business start-up process by:
  - moving from a business licensing to a registration system, and removing the requirement for review of business plans for most sectors. The drafting of the new Enterprise Law provides the perfect opportunity to introduce these reforms;
  - in sectors where licensing is still necessary, immediately implement one-stop-shop services, and limit the time allowed for the sector ministry to review business plans; and
  - either remove the need for firms to obtain a company seal, or eliminate the Ministry of Security's monopoly on issuing seals, which adds an average of 45 days to the process of setting up a business;
- repealing the Industrial Processes act, or at minimum reviewing the implementing decree; and
- revamping the tax system and administration to minimize the opportunity for negotiation between firms and tax officials, and simplifying the reporting requirements for entrepreneurs to meet their tax obligations.

Figure 19: Heavier and less predictable regulatory burden felt by exporters



Source: Investment Climate Survey, World Bank and ADB

CONCLUSION AND KEY MESSAGES LOOKING AHEAD

Laos is committed to further integration with the rest of the world, and this is central to the country's future development. This will require building on past actions and moving

forward in a way which captures the benefits to be had from integration while limiting risks and possible disruption.

There is considerable potential for Laos to expand and diversify its exports; but some essential messages need to be reinforced:

- It is the private sector, not the public sector, that will carry the main burden in generating export growth. And it is risk taking to earn profits and incomes that motivates the private sector — whether individuals, households or businesses — to be the engine of export diversification and growth.
- Investment in one form or another is a crucial ingredient for export growth: people foregoing current consumption, directly or indirectly to invest in human capital, physical capital, new technology, or new ways of doing business. This is done in the expectation of a future return: if returns are low or uncertain and risk taking is discouraged, investment will be low, and so will growth of exports.
- Exports will not grow without open policies towards investment and imports.

The development of the private sector in Laos appears to be well supported in terms of pricing policy, exchange and interest rate elements of macro-monetary policy, wage determination, and the development of a body of legislation directly bearing on business. However, poor micro-fiscal instruments, elements of trade policy, long lags in developing regulations to implement legislation, discretionary interventions in the use of policy instruments and their administration, information bottlenecks, business registration and licensing red tape, all militate against the efficient development of the sector.

More importantly, the legal and judicial underpinnings of a market economy are still in embryonic form. This impedes contracting and transactions between unrelated parties. The absence of effective mechanisms to enforce security of loans and resolve disputes, and the lack of an effective bankruptcy system, stand in the way of the development of larger private firms. As a consequence, firms have to rely on good connections with the government to resolve commercial problems.

What then can the government do to facilitate export growth, and what are desirable elements of an export diversification strategy for Laos? Much of this is about what the public sector can do to foster the development of institutions that facilitate private investment and the commercial contracting that underpins it. It is also about what the Government can sensibly do to reduce transaction costs — the costs of arranging, monitoring and fulfilling contracts. This includes the issue of what kinds of investment the public sector itself should be undertaking, and it also concerns ensuring that public sector activity and policies do not depress or distort the pattern of returns to investment.

The challenge for Laos is complicated by the legacy of the past. Long years of war and past efforts at central planning have left the country with poor infrastructure, constraints on use of significant parts of the country's land because of unexploded ordinance, underdeveloped market institutions, an embryonic private sector and a public sector with little experience of how to manage a modernizing market economy.

This translates into a series of constraints on export diversification and growth that include:

- lack of awareness of modern, transparent, market-based ways of doing business;
- restrictions on personal movement, both within and across borders;
- rudimentary infrastructure;
- insecure property rights and an inefficient financial system, which inhibits the accumulation and use of capital;
- a regulatory system built on control and rent extractions rather than facilitation;
- restrictions on trade through burdensome licensing regulations;
- weak regulatory arrangements for managing public goods such as electricity and water, both domestically and potentially across borders;
- weak institutional and fiscal management capacity to equitably handle the potentially large income stream from hydropower and mining; and
- decentralized authority for trade, with confusing and overlapping responsibilities of the central and provincial governments,

which makes it considerably more complex for both donors and firms to do business in Laos.

The country's development objectives are more likely to be met if integration is pursued as one part of the broader transition process and is accompanied by actions aimed at:

- implementing prudent fiscal and monetary policies;
- fostering enterprise development and domestic competition;
- orienting trade and tax policies towards the incentives they create for decision making;
- reducing the costs of carrying out transactions within Laos and with the rest of the world;
- facilitating development of efficient markets for land labor and capital; and
- creating a legal and judicial framework that fosters and reduces costs of business transactions.

The Government faces complex technical and political challenges in carrying these actions forward, since they will require working on:

- the sequencing of further trade and investment reforms;
- adoption of complementary policies to secure the benefits — particularly for the poor — and facilitate the structural adjustments that integration and growth will bring in their train;
- institutional changes needed to manage economic policies and support business development as integration proceeds; and
- ensuring public awareness of, and support for, the changes involved with integration.

Complex as these issues are for Laos, there are some lessons that can be drawn from the experience of other countries that have been confronting the same challenges. This experience identifies some of the key principles that should guide development and implementation of an integration strategy. They include:

- imports are the end purpose of trade, so integration is about accessing the world's best sources of goods, services and technology. This implies, among other things, that:
  - the best approach to trade and investment liberalization is to implement it on a non-preferential basis — MFN and national treatment are good for Laos, and should be implemented as widely as possible,
  - bilateral, regional and multilateral agreements are a means to an end, not an end in the themselves;
- actions to shield local production from international competition impose costs on the community, and shift the burden of adjustment elsewhere in the economy (and not onto the rest of the world);
- because taxes and restrictions on imports reduce the volume of trade they are also, in effect, taxes and restrictions on exports;
- maximizing the benefits of foreign investment depends on subjecting foreign invested firms to strong external and domestic competition;
- investors — both foreign and domestic — are influenced as much by their expectations of future policy as by current policies. Thus, credibility, consistency, transparency and coherence of policy are required to ensure a rapid response to integration efforts. It is desirable to rely as much as possible on clearly established, generally applicable rules and timetables for reform; and
- the benefits of integration arise from having resources — capital, land and labour — respond to the incentives created by exposure to international prices and market opportunities. So flexibility and responsiveness of factor markets is necessary to get the best from integration. And the evidence is that private enterprises are the most flexible vehicle for organising investment and production responses.

Priorities for the Integrated Framework. The above messages and recommendations (summarized in the Table below) set the stage for export competitiveness and business development in Laos. Within this framework, key practical priorities for trade-related projects and technical assistance have been identified based on the DTIS analysis. These are summarized in the Action Matrix below. The Action Matrix was discussed with government and private sector stakeholders, as well as with donors. The three priorities identified for urgent action are: (i) the need to promote small and medium enterprises; (ii) trade facilitation; (iii) capacity building for ministries dealing with policy support, particularly the MOC (this should include setting up an IF implementation unit).

Summary of recommendations

Area/topic	Recommendation
Making trade easier	
Regulation and taxation of trade	
Tariffs and taxes on trade	Reduce the number of tariff lines that are subject to the top MFN tariff rate of 40% and reduce number of tariff bands
	Introduce duty drawback scheme for indirect exporters
Trade licensing system	Dismantle redundant licensing requirements, including annual import/export plans, replace necessary technical regulation with arrangements that do not discriminate between local products and imports
Organic certification	Review options for establishing organic certification body to certify and monitor compliance with international organic standards
Standards	Adopt and implement regional standards for key export crops (coffee, horticulture)
Air transport	Resolve issues concerning Lao Airlines structure and capacity, evaluate the possibility of adoption of open skies policy to enable private an international airlines to service more locations throughout Laos
WTO accession	
Economic analysis	Develop capacity to undertake ex ante evaluations of the implications of implementing WTO agreements.
Trade policy establishment	Consolidate trade policy establishment to improve economy-wide perspective, cross-agency coordination in negotiations.
Trade logistics and facilitation	
Container and freight movements	Simplify procedures for factory-to-port container movements along Vientiane-Bangkok corridor. Develop consolidation service for small freight shipments
	Negotiate necessary changes in Thai customs and border management arrangements
	Monitor clearance times and productivity at border crossings
Inland container depot	Establish inland container depot near Lao-Thai border in order to consolidate small shipments
Streamlining customs	
Legislation	Implement new Customs Law, develop policy and procedures manual
Organization	Continue efforts to build a unified national Customs administration, and build on efforts to improve control of field operations through the Monitoring and Control Program
Human resources	Develop a comprehensive human resource development plan, adopt competency based recruitment and promotion policies, implement clear and transparent policies for delegation of authority and accountability
Information and communications technology	Develop comprehensive ICT strategy
Customs valuation	Prepare a transition strategy for adoption of the WTO Agreement on Customs Valuation
Trade facilitation	Streamline clearance procedures and rationalize involvement of other government agencies in clearance processes
	Build on work under GMS Cross Border Transit Agreement to undertake a review of clearance procedures covering all government agencies
Strengthen enforcement capacity	Strengthen anti-smuggling operations, expand intelligence unit and establish a Customs fraud investigations function, address constraints on post-audit function
Sanitary and Phytosanitary Procedures	

Market opportunities and trade requirements	Examine potential SPS requirements in markets for potential/emerging non-traditional agricultural exports, review SPS requirements of trading partners and transit countries to identify WTO inconsistent measures to bring to WTO negotiating table, and review SPS requirements of Laos in light of WTO and AFTA principles
Institutional and legislative framework	Establish joint Enquiry/Notification point at Ministry of Commerce, review existing legal framework and amend to capture SPS roles and responsibilities and coordination mechanisms.
Surveillance	Amend legal framework to incorporate stronger monitoring and control of markets for agrochemicals, initiate data gathering and data base creation on health hazards, plant and animal diseases
Diagnostic capacity	Expand laboratory capacity and relevant capabilities
Emergency response	Amend laws, prepare guidelines and procedures
Risk assessment	Establish core group of risk assessors
Inspection and certification	Identify unnecessary requirements for export and import, simplify and strengthen governance of SPS border procedures
Making investment and doing business easier	
Macroeconomic management	
Fiscal management	Strengthen tax and customs administration and introduce VAT, to offset revenue loss from implementation of AFTA CEPT commitments. Further centralize control over tax and customs operations in the provinces
	Strengthen control over provincial treasuries, improve budget planning and execution, and develop a central government cash management system
	Conduct review of intergovernmental fiscal relations
Banking system development	Improve governance of state banks and find strategic partners for them. Secure passage of amendments to banking law to allow entry of foreign banks on equal footing with domestic banks in the medium to long term. Strengthen prudential oversight of banking system
	Conduct review of export financing services, and work with financial sector to develop relevant products
	Facilitate development of financial services for tourists – such as ATMs and credit card facilities
Business environment	
Simplify business start-up process	Move away from licensing to a registration system
	Implement without delay provisions in new investment laws that provide for a one-stop service
	Simplify requirements surrounding acquisition of company seals
Industrial Processes Law	Repeal the law, or at a minimum review the implementing decree
Labor Law	Review and update labor laws to align with regional standards
SME Law	Review alignment of SME Law and customs regulations
Taxation	Revamp tax policy and administration to reduce scope for tax negotiations and make it easier for firms to meet tax obligations

An Action Matrix of Projects and Technical Assistance to Promote Export Competitiveness in Laos

	Objectives	Priority/ Timing	Government Responsibility	Costing	Related Trade Assistance Programs	Type of Intervention	Econ' impact
Putting in Place the IF implementation and Monitoring Structure							
	Rationalize IF supervisory committees, establish a National IF Management Unit	High priority with actions already having begun and will be ongoing	MOIC/IF Steering Committee	Medium - Estimated cost of establishing and training a IF Implementation Unit is US$1.5 million over 5 years	IF Trust Fund	Governance	NA
Component 1: Export Competitiveness[1]							
Project 1: Support agricultural competitiveness	Encourage the production of organic agricultural products for export; improve quality standards of traditional agricultural products; improve productivity of traditional agricultural products; develop agro-processing industry for export; improve distribution channel infrastructure; improve productivity; training in modern agriculture techniques for farmers; encourage the production of medicinal plants and spices for export.	High priority with action to be undertaken from the first year	MAF, LNCCI, NUOL, MOIC	High - in particular significant investment is required to improve productivity and develop processing industry. Estimated costs for project to improve just the production and supply chain of organic agriculture are US$1.7-2 million over 3 years. Estimated costs for project to build-up the medicinal plants and spices sector are US$1.5-1.75 million over 3 years.	France's Coffee Value Chain Development (2005-08, US$2.4m) & Cash Crop Production Project (2006-08, US$6.4m); EC's Asia Invest Commerce in Horticulture Aided by Species Identification Systems (2006-09, €0.3m) & Developing Food & Agribusiness Training in the Mekong Region (completed 2006, US$0.4 shared with 5 countries); ADB's Marketing Support for the Organic Produce of Ethnic Minorities (2004-07, US$0.6m); Switzerland's Promotion of Organic Farming and Marketing (completed 2006, US$0.3m); FAO's Improvement of Coffee Industry Project (completed 2005, US$0.35)	Technical assistance; regulatory; human resource capacity building and infrastructure development; encouraging investment	Large

[1] Projects 1, 2 and 3 under Component 1 are in line with the National Export Strategy of 2006-2008 where more details can be found.

Project 2: Support light manufacturing competitiveness	<u>Garment sector:</u> Encourage local producers to gradually shift from working on CMT to FOB basis; improve productivity of garment sector; promote Lao garment products; improve quality of Lao garment products; develop trade information and linkages with buyers on garment.	High priority with preferably for action to begin from the first year	LNCCI, ALGI, MOIC	Medium - Estimated costs for a project to strengthen the export capacity and competitiveness of the garment sector are US$1.5-1.7 million.	*General Export Competitiveness Support:* Switzerland/ITC's Support to Trade Promotion and Export Development (2004-07, US$1m); Switzerland's Promotion of Cleaner Industrial Production (2004-08, US$0.95m); *Specific to Garment Sector*: UNDP's Textile and Clothing Project (2006-07, US$ 0.09m)	Technical assistance; human and infrastructure capacity building; international trade promotion; and information distribution	Medium -Large
	<u>Silk products:</u> Improve domestic supply capacity in Lao native silk; improve Lao silk product designs; develop new silk products; develop standard for Lao silk handicraft; improved training for silk production techniques; develop trade information on silk sector.	Medium priority with action to be undertaken as soon as possible	MAF, LNCCI, MOIC	Medium - Estimated costs for a project to improve capacity of producers and exporters of silk products are US$1.6-1.85 million	US's Economic Acceleration Program for the Silk Sector (completed 2006, US$0.5m)	Technical assistance; human resource capacity building and infrastructure development; and information distribution	Medium
	<u>Other handicraft products:</u> Improve design capabilities; study and improve distribution channels; trade information and linkages with buyers.	Relatively low priority	MOIC, LNCCI	Small financial outlay		Technical assistance	Small
	<u>Wood processing sector:</u> Promote and upgrade Lao wood products to the international standards and recognition; improve productivity of the wood sector; ensure sustainability of raw materials to support the industry.	Medium priority with action to be undertaken in the medium term	MAF, MOIC, LNCCI	Medium-High - Estimated costs for a project to improve quality and sustainability of wood products sector would be around US$2 million over 3 years	EC's Asia Invest Fund Upgrading the Wood-Processing Industry for the European Market (2005-07, €0.2m); FAO's Marketing System Development for Non-Wood Forest Products (completed 2006, US$0.37m)	Technical assistance; regulatory assistance	Medium

Project 3: Support tourism	Develop craft villages such as local artisans and craftsman (textiles, jewellery, wood based, etc); develop services capacity and competency of Lao tourism sector; strengthen the institutional framework; encourage tourism linkages to other sectors of the economy; diversify services capacity within the tourism sector; promote Lao tourism to make it internationally recognized.	High priority requiring ongoing support.	LNTA, LNCCI, MOIC, MFA	Medium- Estimated costs of a tourism training centre with involvement of the private sector of US$1m for a period of 4 years; estimated costs for model craft villages in 10 major tourism destinations of U$1m for a period of 4 years	ADB's Mekong Tourism Development Project (2002-07, 10.9m shared with Cambodia and Vietnam); EC's Asia Invest Fund - Marketing Responsible Tourism in Laos (2006-09, €0.3m); New Zealand's Nam Ha Ecotourism Project (2004-07, US$0.34m); German Human Resource Development for Market Economy Programme (2004-07 US$5.5 m; Planned: Japan's Tourism Development in the East-West Corridor (2007-10, US$2m); planned: German Vocational Education Programme (2007-10 € 5 m)	Human resource capacity building; trade promotion; encouraging investment	Medium
	Develop local agriculture and healthy food products (vegetable, meat, local food cottage, etc) in tourism destinations through developing the capacity and competency of small and medium sized farming and agro-processing enterprises.	High priority required on-going support	LNTA, LNCCI-LHRA-LHA, MAF, LTPC	Medium high - estimated cost for establishment of model village cottage food industry, animal farms, modern slaughter house in 10 major tourism destination of US$2m for a period of 4 years			
Project 4: Micro, small and medium enterprise project for export development	Build an integrated market access and trade facilitation infrastructure; support entrepreneurship development; develop and strengthen the capacity of local intermediaries to deliver financial and non-financial services to MSMEs; provide an enabling environment (access to finance, trade promotion, and trade facilitation infrastructure) to boost increased investment.	High priority with projects to begin from the first year	MOIC,BOL, LNCCI	Medium - Estimated costs of a trade information and export training program for the business sector would be US$0.8-0.95m over two years.	UNINDO & India's South-South Response to Poverty (completed 2006, US$0.15m shared with 5 countries); UNESCAP & Japan's Capacity Development of SMEs (completed 2006, US0.59m); ADB's Small and Medium Enterprise Project (completed 2005, US$0.79m); EC's SME Development Programme (2006-10, € 3 m)	Human resource capacity building & infrastructure development; information dissemination; encouraging investment	Medium - High

Project 5: Regional development of export potential	Construct and rehabilitate critical infrastructure essential for sustained regional economic activity in the tourism, manufacturing, agribusiness and mining sectors; Put in place appropriate incentive measures at the regional level to achieve rapid growth; Develop the instruments to ensure equitable, sustainable growth. Strengthen the capacity of local authorities to formulate, prepare, implement, and manage medium- and long-term integrated regional development projects.	Medium priority with a long term focus	Provincial authorities	High - A high level of capital investment required to address infrastructure issues which would not to be funded directly through IF. Other funding sources required, possibly including Aid for Trade. IF process can assist in policy development and capacity building (cost would be low to medium)		Regulatory assistance; technical assistance; human resource capacity building;	Medium -Large
Component 2: Trade Facilitation							
Project 1: Customs modernization	Develop regulations to implement the new Customs law Reform the national customs administration Strengthen capacity building to properly administer the customs valuation provisions of the law Simplify/modernize border clearance procedures (including expert advice to prepare long term customs modernization project) Automation and data processing systems (e.g. automated customs clearance system) Strengthen and expand the anti-smuggling program Licensing of customs brokers Develop a customs training program, e.g. seminar/workshop as well as medium and long term program.	High priority with actions to begin as soon as possible	MOF and MOIC	Medium-High - Funds needed for a broad range of activities mainly based on training but also including investments in improved customs processing systems.	IMF's Technical Assistance on Customs Operations (2004-07, US$0.5m); Japanese Customs Technical Cooperation Program (completed 2005, US$0.17m); ADB's technical assistance (2006-2008) to support trade facilitation and capacity building in the Greater Mekong Subregion (US$0.89m);ADB's Technical Assistance on implementing the Cross Border Transport Agreement in GMS (2006-2007, US$0.86m).	Legislative/ regulatory reform; human capacity building and infrastructure development; customs infrastructure development	Medium

Project 2: Trade facilitation	Pilot Gold Card Program (to expedite clearance procedures for approved traders)	High priority/2nd year	MOF, MOIC, MTCPC, Border agencies, National quarantine and standards agencies, National Transport Facilitation Committee	Medium-High - Funds needed for investments in improved technology and processes. Also, potentially high capital investment needed to build a container logistics centre	ADB's Trade Facilitation in Greater Mekong (2006-08, US$1.49m shared regionally); UNESCAP/Netherlands' Institutional Capacity Building for Landlocked Countries (completed 2006, US$0.4m); ADB's regional technical assistance (2006-2008) to support trade facilitation and capacity building; ADB's regional technical assistance (2006-2007) on implementing the Cross Border Transport Agreement.	Infrastructure development	Medium -High
	Increasing capacity building for officials dealing with Import-Export Issues						
	International container logistics center in Vientiane						
	Licensing of related government agents						
	Improve the single window operations in various provinces						
	Increase transparency						
	Institutional strengthening of trade facilitation focal point, to coordinate trade facilitation activities						
	Needs and gap assessment on customs procedures (as in Project 1); trade logistics development (including trade logistics center and service sectors development, etc.); standards/technical regulations development; and improved business mobility).						
	Facilitate cross border movements of goods, people, and vehicles (single window, single stop inspection at GMS selected land border crossings, involving Lao PDR, GMS transit traffic regime, vehicle standards, exchange of traffic rights, etc.)						
	Simplify or eliminate the export-import licensing and indicative plan.						

Project 3: Sanitary and Phyto-Sanitary (SPS) and Technical Barriers to Trade (TBT) Issues[2]	Institutional and legislative framework (high priority) Diagnostic capacity (high priority) Market opportunities and trade requirements Surveillance Emergency response Risk assessment and economic analysis Inspection and certification Building human skills Information and education Private sector development Technical Barriers to Trade (TBT) Regional cooperation	High priority with projects for long-term improvement of capacity to begin as soon as possible	STEA, MAF; MOH	High - Estimated costs of an export quality management project would be US$1.4-1.6 million, but investments in SPS-related laboratory equipment could increase this amount significantly	Norway's Market Access & Trade Facilitation Project (2006-09, US$1.7m shared regionally); Australia's SPS Capacity Building Project (ongoing, US$4m shared between 8 countries) & ASEAN Development Cooperation (2002-08, A$45m); EC's Asia Invest Capacity Building of Geographical Indication (2006-09, €0.3m shared with China and Cambodia), & EC's Project on Standards, Quality & Conformity (ongoing, €0.5m) & Intellectual Property Rights Cooperation (completed 2006, €0.5m); France's Geographiv Indications Elaboration Project (2006-08, US$1.2m); FAO's Improving Food Safety Management (2005-08, US$0.85m shared); ADB's Integrating the Poor Through Standard Setting (completed 2005, US$0.7m)	Technical assistance; human capacity building and infrastructure development; supply of technology	Medium -High

[2] More detail can be found in the Action Plan for Sanitary and Phytosanitary Management Capacity Building Report for Lao PDR, World Bank, May 2006, prepared in conjunction with the IF.

Component 3: Business Environment							
Project 1: Development of industrial strategy to facilitate business operations	Develop an industrial strategy that: sets a broad framework for promoting and developing Laos' industrial base; identifies priority areas; and ensures a consistent and stable policy environment.	Medium priority with actions to take place in the medium term	MOIC	Small-medium	*General Business Environment Support:* IFC's Mekong Project Facility (2003-07, US$2.85m); ADB's Private Sector Development Program (2005-10, US$0.7m plus US$10m loan); UNIDO's Integrated Programme (2004-08, US$6.3m); France's Business Management Training (2001-07, US$3.8m); Germany's Human Resource Development for Market Economy Program (2004-07, US$5.5m)	Regulatory and possibly legislative	Medium
Project 2: Investment promotion	Review and simplify business regulations, e.g. foreign investment start-up and registration procedure reform; create investment guidelines (sector by sector); set up a public-private stakeholder platform to discuss the reforms on a regular basis	High priority with actions already underway	CPI	Small-medium	Japan's Expert on Promotion of Investment for Lao Government (2007-09, US$0.3m); US's South East Asia Commercial Law (2005-07, US$0.24m shared regionally) & Competition Law to ASEAN (2005-08, US$0.75m shared regionally); ADB's Research on Improving Climate for Investment & Productivity (completed 2006, US$0.15m)	Regulatory assistance and possibly legislative	Medium -High
	Review the legal framework for investment, including contract enforcement and dispute resolution						
	Implement a one stop shop for investment, incl. training of officials						
Project 3: Banking system	Improve capacity of Lao banking sector to support export performance through the provision of trade finance through banking staff training, a rationalisation of regulations and expanded linkages with the private sector.	Medium priority with a long term focus	BOL, MOF	Medium - Estimated costs for a training-based project to improve trade financing would be US$1.2-1.4 million.	France's Capacity Building at the Ministry of Finance Project (2005-08, US$0.8m); ADB's Strengthening Governance for Bank Sector Reform (completed 2006, US4m) & Bank Sector Reform Program (completed 2006, US$15m); EC's Technical Assistance Programme for Transition to a Market Economy - Bank Training Project (completed 2005)	Technical assistance and human capacity building; regulatory	Medium -High

Component 4: Trade Policy, Trade Agreements, and Global Opportunities							
Project 1: Capacity building for international trade policy and negotiations	Improve capacity building of MOC and other ministries with trade-related functions to take considered and well-coordinated decisions on all aspects of international trade policy, regional and multilateral trade negotiations, and trade relations.	High priority with programs to begin in the first year	MOIC	Small-Medium - Estimated costs of a general training and research project to improve business competency among business and government involved in exports would be US$0.9 - 1.1 million over two years. Additional, more targeted training would also be required in relation to trade agreements and negotiations.	UNCTAD/France's Train for Trade (2003-07, US$2.3m); Australia's Trade Analysis & Reform Project (2005-08, US$5m shared 4 countries); EC's Asia Trust Building Capacity of the Economic Research Institute (2006-07, US$0.25m); EC's Multilateral Trade Assistance Project (completed 2006, €1m); UNDP's Promoting Private Sector Development Project (2006-09, US$2.33m) and National Human Development Report (2004-07, US$0.8m); WTO/UNESCAP's Technical Assistance (ongoing, US$1.7m shared globally); Canada's Asia-Pacific Training Network on Trade (2004-07, US$0.7m shared regionally) & APEC Eco Integration (2004-09, US$7.2m shared 6 countries); US's ASEAN Technical Assistance Facility (2004-07, US$7.33m shared regionally) and Strengthening Market Analysis Capacity (2005-07, US$0.24m shared regionally)	Technical assistance and human capacity building	High
	Establish clear division of roles and responsibilities between MOC and other ministries, including inter-ministerial coordination and public-private sector dialogue in support of the WTO accession process						
	Increase MOC's capacity to analyze trade issues, impact of trade policies, and to lead trade negotiations.						
	Support for trade-related policy formulation and implementation (e.g. analytical work, Trade Policy Advisory, etc.)						
	Promote an effective trade information center, improve collection of trade statistics						
	Increase capacity to efficiently administer Rules of Origin						
	Build in-house capacity on research and facilities for trade sector						
	Establish a Trade Database						
	Increase transparency						

Project 2: Technical assistance and capacity building for the formulation and implementation of trade negotiation strategies	WTO accession: assistance with legislative review and required documentation as well as legislative reform needed for WTO compliance; negotiation strategy and analytical support for accession, including in non-agricultural goods, agriculture, services, etc.; institutional and human capacity building for trade negotiations and policy formulation; consultations and information on WTO accession for line Ministries and stakeholders; training in Geneva to prepare Working Party meetings; Regional agreements: ASEAN (AFTA, AFAS), AFTA+China, etc.	High priority	MOIC	Medium	UNDP/ AUSAID's Integration Into the Trading System (completed 2006, US$1.68m)	Technical assistance and human capacity building; budget support	Large
Component 5: Trade Opportunities for the Poor							
Project 1: Promotion of traditional handicraft and textile industry at village level	Build business linkages with Fair Trade Organizations in North America and Japan Engage in e-commerce Provide technical training to artisans Mirco-credits, improved access to distribution channels, information and linkages to buyers	Medium priority	MOIC, LNCCI, STEA	Medium	UNESCAP/UNDP's Development of E-business Support Services in the Greater Mekong (completed 2006, US$0.2m)	Technical assistance and human capacity building	Small
Project 2: Roads linking villages to markets	Improve reach and quality of road network to better connect towns and villages to markets and export opportunities	High priority with actions to be undertaken as soon as possible (and already underway in certain areas)	MCTPC	High level of capital investment required. Not to be funded directly through IF. Other funding sources required, possibly Aid for Trade.	ADB Northern Economic Corridor Infrastructure Project (2004-07, US$30m)	Direct construction of infrastructure	Large

Note: - *All these can be components of one project or divided into separate projects*