Overview of the Policies for Attracting Foreign Direct Investment Inflows into Lao PDR

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Abstract

This paper examines foreign investment policies for attracting foreign direct investment (FDI) to Lao People Democratic Republic (Lao PDR). The first regulatory in Lao PDR aimed at shifting the country's foreign economic relation was the enactment of the foreign investment laws. The policies and regulations have been revise recently to create a more favorable investment climate. The government has provided a wide range of tax rationality especially of tax and non-tax incentives for corporation projects within the Specific Economic Zones (SEZs), reduction on import taxes and tax on foreign corporate profit that is lower than for domestic enterprises. FDI laws are relatively liberal, allowing 100 percent foreign ownership across a wide range of sectors. At present, the Lao government is working towards improving the trade and investment laws to encourage FDI and trade in the country. Laos is exploring the laws of a variety of market-oriented countries around the world.

Keywords: Foreign direct investment, Policies, Regulation, Special Economic Zones, Government of Lao PDR

1. Introduction

Lao PDR is a landlocked country located in Southeast Asia and bordered with five countries namely: Cambodia, China, Myanmar, Thailand and Vietnam. Its land area is approximately 236,800 square kilometers (GIZ, 2009). Lao PDR is lightly populated with 6.7 million people with an average population growth of 2.8 percent annually, which has been thinly spread across the country. Roughly 80 percent of population is involved in agriculture, forestry and fishing, producing half of the country's gross domestic product (52 percent of GDP), while industry and service sectors have been positively expanded with a share of 22 and 23 percent of GDP, respectively (Kyophilavong, 2015). Lao PDR is in the process of transferring its economy from centrally planned economy to market-oriented economy. Its GDP growth is around 8 percent annually and is classified as a "least -developed country" by the United Nations (UN, 2014).

Lao PDR has implemented various incentive investment policies in order to attract foreign direct investment inflow into the country after implementing economic reforms. Lao PDR reformed the centrally planned economy to market mechanism in 1989 by opening more cooperation with many countries, and formulating necessary policies to attract FDI from around the world. However, due to less incentive investment policies and lack of foreign investors protection law, FDI inflow into Laos has been relatively small.

With the enacting of Investment Law in 1994, the government of Lao PDR has paid attention to attracting FDI by improving business environment, political stability and macroeconomic policy. There has also been commitment to maintain membership in the World Trade Organization (WTO) and the ASEAN Free Trade Area (AFTA) that encourage member-countries to give incentives to foreign investors especially in tax policy and land policy. Since 2005, FDI inflow for Lao PDR has significantly increased especially in mining and hydropower sectors because of good tax incentives. For example, in 2006 FDI inflow rose up to USD187 million and in

2007 it increased by more than 37 percent and between 2009 and 2015 FDI increased to US$ 10,430 million[1].

However, FDI inflow for Laos is relatively lower as compared to that of its neighboring countries though investment policies are not much different. The difference in terms of FDI inflow is the motivation for undertaking the study to analyses investment incentives that would attract foreign investors and improve FDI inflow into Laos. The study suggests possible recommendations that would help Lao government in drawing up both short term and long-term strategies for improving the investment policy and law.

2. Policy Framework of FDI attraction

Lao PDR has implement policies to attract FDI as soon as the country began its economic reform. Such polices have been institutionalized via the promulgation of law on foreign investment in 1988; so far, the law has been revised in 1994, 2004, 2009 and 2016 (Investment Promotion Law, Revision 2016 and entered into force on 17 November 2016). Table 1 summarizes key changes in FDI policies overtime and in accordance with each vision it shows that, in general, Laos intends to increase rights of foreign investors, to make invest environment more favorable and narrow the policy gap between foreign and domestic investor. These developments reflect the government's efforts in creating conducive investment environment in accordance with Lao's integration process.

Table 1. Key changes in investment policy in each revised law on investment for Lao PDR

Policy areas	Revised Law in 1994	Revised Law in 2004	Revised Law in 2009
Decentralizing registration/Licensing process area	FDI license shall be granted within[2]: ● Projects which fall in the list of promoted activities- fifteen working days; ● Projects which fall in the list of open activities with condition- twenty five working days; ● Projects which involve the grant of a concession-forty five working day ● Within 90 days from the date of receipt of an investment license, the foreign enterprise shall commerce investment activities with the steps in the feasibility in the foreign investment license application; ● An application must go through to the one stop service of the Committee for Promotion and Management of Investment (CPMI)	● FDI enterprise are allowed to choose forms of investment, rate of capital contribution and Laos partner; ● Registration procedures and licensing process are allowed to the Law in 1994	The investor may in following types of investment shall be granted: ● The general business shall submit their application to the one-stop-service of Ministry/Department of Industry and Commerce in conformity with Law on enterprise. The total capital of the foreign investors in general business shall not be less than one billion kips. The enterprise registration certificate shall be issued within 10 working days; within no later than 30 working days starting from date of submission of application from as in conformity with the Law on Enterprise[3]; ● The concession Business shall submit their application to the one-stop-service of Ministry/Departure of Planning and Investment for appraisal before submission to Government or provincial authorities for further consideration[4]. The investor must start business activities within 90 days, if the investor dose not start business operations within 60 days addition days, the concession certificate will be revoked and the project guarantee funds will be confiscated by the government (In the ● case of a concession investment in investment calling list, the approval shall be issued no later than 45 official working days start from the date of receiving the application[5]); ● Activities for development of special economic zones and specific economic

[1] The author's based on the ministry of planning and investment of Lao PDR (MPI) database
[2] Article 19, Law on the promotion of foreign investment No.01/94/NA dated 14 March 1994
[3] Article 17, Law on the promotion of foreign investment No.02/NA dated 08 July 2009
[4] Article 21, Law on the promotion of foreign investment No.02/NA dated 08 July 2009
[5] Article 31, Law on the promotion of foreign investment No.02/NA dated 08 July 2009

			zones (SSEZ): Secretariat to National Committee for Special Economic Zones at Government Office will issue the license
Forms of foreign investment	• 100 % foreign-owned enterprises (foreign investors must have a minimum registration capital of US$100.00 and the license will have a minimum life of 15 years); • Business cooperation by contract; • joint ventures (e.g. wood production) must be joint ventures Foreign investment maybe wholly owned joint venture with a minimum 30% investment[6]	• 100 % foreign -owned enterprises; • Business cooperation by contract; • joint ventures between foreign or domestic investors (Foreign investment maybe wholly owned joint venture with a minimum 30% investment)	• A wholly domestic or foreign –owned investment; (foreign investor with registered capital of not less than USD 500.000) • A business cooperation by contract; • A joint venture between domestic and foreign investors (foreign investors in the joint venture shall contribute at least 10 percent of the total capital)
Land	• Laos is responsible for compensation, site for foreign invested projects; • FDI projects may rent land for operation, but are not permitted to re-renting land	• The Lao PDR recognizes and accepts the rights of foreign investors in all respects regarding leasing, land use, intellectual property ownership as well as the lawful assets and rights of foreign investors or the rights related to investment enterprise; • Permission to lease land for up to 20 years from a Lao national and up to 75 years from the government; • Permission to own all improvements and structures on the leased Land, transfer leases to other entries; • To receive benefits from the lease of or concession over land such as the rights to use, sell or use assets associated with the leased land or concession as security to any persons or financial institution or for the purpose of joint venture, to sublease the right to use land, to transfer the land lease or concession agreement in accordance with the lease term, to use the land lease agreement or concession in joint venture or as security with other people	• Zone 1 (note 1): exemption from land lease or concession fees for 15 years; • Zone 2 (note 2): exemption from land lease or concession fees for 10 years; • Zone 3 (note 3): exemption from land lease or concession fees for 3 years[7]; (Investment in the development of hospital, kindergartens, school, vocational school, colleges, universities, research centers and some public) • The term of investment in SSEZ; it shall not exceed 99 years and may be extended on a case basis with the approval of the government
Policies on Exchange rate, foreign currency	• Foreign investors must open a kip bank account in the Lao PDR; when want to use foreign curries, they will need additional accounts. Investors may convert kip to other currencies within the Lao PDR	• The capital contributed in foreign currency must be into Kip based on the exchange rate of the bank of the Lao People's democratic Republic (BOL)[8]	• The investors must open a Kip of Bank of the Lao PDR
Polices on import, export	• Import duty of 1% on equipment and materials for use in an enterprise • Export duty are exemption	• Exemption from import duties for intermediate components and raw materials imported for processing or re-export; • Exemption from export duties for export finished products; • Exemption from import duties for imported equipment, means of production, spare parts and other	• Exemption from import duties for the importation of raw material, equipment, spare parts and vehicles; • Exemption from export duties for exportation of general goods and products. The exportation of natural resources and natural resources-made products shall comply with concerned regulation and Laws;

6 Article 5, Law on the promotion of foreign investment No.01/94/NA dated 14 March 1994
7 Article 54, Law on the promotion of foreign investment No.02/NA dated 08 July 2009
8 Article 7, Law on the promotion of foreign investment No.73/PO dated 22 October 2004

		materials directly used in operation of investment projects	• The importation of all types of fuel is not exempted from duties and taxes[9]
Tax policies	• Profit tax rate of 20 percent for foreign invested companies • Investment in Zone 1: A profit tax exemption for 7 years, thereafter a profit tax rate of 10 percent • Investment in Zone 2: A profit tax exemption for 5 years to a profit tax rate of half of 15 percent for 3 years, thereafter a profit tax rate of 15 percent • Investment in Zone 3: A profit tax exemption for 2 years to a profit tax rate of half of 20 percent for 2 years, thereafter a profit tax rate of 20 percent[10]	• Vehicles directly used in investment operations will be exempt from imported duties. Vehicle indirectly used in investment operations will be taxed 1% of their imported values. Foreign and domestic enterprises that have agreements with the Central Government and provincial authorities and entitled to temporarily imported vehicles; • Special privileges, including reduction or exemption from the profit tax rate, are given based on the size of investment and significant positive impacts that such investment have on socio-economic development of Lao PDR	• Zone 1 : Level 1: promoted activities shall receive profit tax exemption for 10 years; Level 2: promoted activities shall receive profit tax exemption for 6 years; Level 3: promoted activities shall receive profit tax exemption for 4 years; • Zone 2: Level 1: promoted activities shall receive profit tax exemption for 6 years; Level 2: promoted activities shall receive profit tax exemption for 4 years; Level 3: promoted activities shall receive profit tax exemption for 2 years; • Zone 3: Level 1: promoted activities shall receive profit tax exemption for 4 years; Level 2: promoted activities shall receive profit tax exemption for 2 years; Level 3: promoted activities shall receive profit tax exemption for 1 years;

Source: Researchers' compilation

Under the previous law on investment promotion that would be in force until early 2017, there are three types of investments licencing in Lao PDR, each having a different process for investment approval procedures. According to OECD (2017), the three types of investments licencing are general business activities; concession licences; SEZs activities. Figure 1 indicates the licencing procedure for each type of investment.

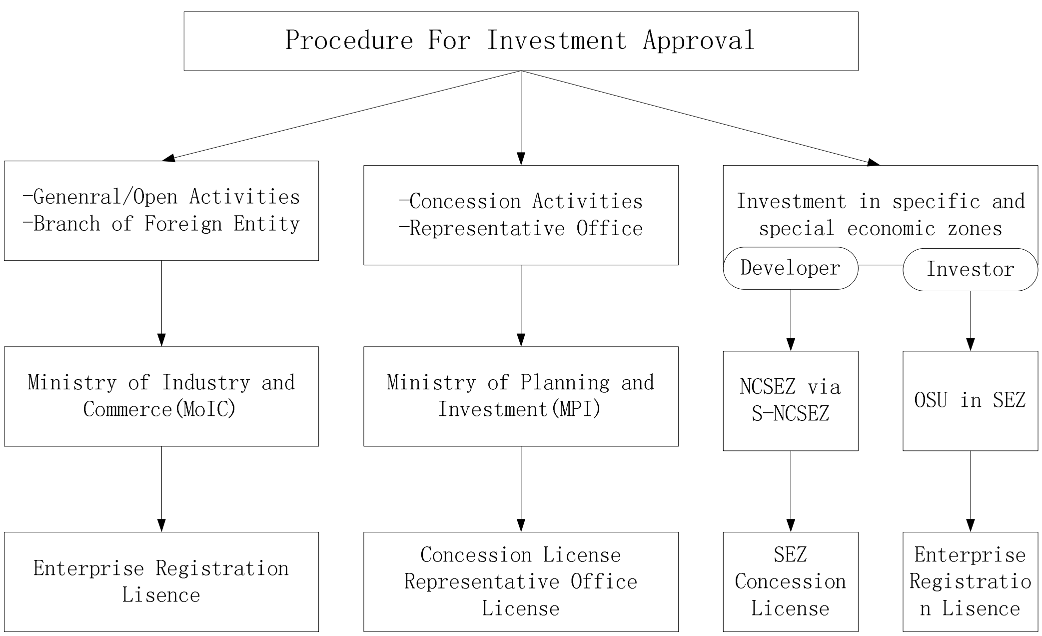

Figure 1. Investment approval procedures in Lao PDR under the 2009 Law on Investment Promotion
Source: The Investment Promotion Department, Ministry of Planning and Investment.

At the present, starting a business is a major challenge for all investors in Lao PDR, as illustrated by its ranking at the 160th position out of 190 economies for 'starting a business' in the World Bank Doing Business Index for

[9] Article 52, Law on the promotion of foreign investment No.02/NA dated 08 July 2009
[10] Article 18, Law on the promotion of foreign investment No.01/94/NA dated 14 March 1994

2017 (Table 2). There are different entry points for investors with different processes for obtaing an approval to invest in Laos. The Ministry of Industry and Commerce is responsible for investments in general activities while the Ministry of Planning and Investment for those in concessions. Until recently, the National Committee for SEZs was responsible for those in zones, but the newly amended Law on Investment Promotion has moved this responsibility under the MPI. These distinct entry points bring a certain degree of confusion to investors, especially when incoherent or conflicting messages are delivered. Some provisions of the Law on Investment Promotion are subject to interpretation, creating unpredictability and leaving too much space for discretionary decisions. Each entry point is present as a one-stop shop but none is functioning properly.

Table 2. Doing Business Indices for Lao PDR and neighboring countries

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

Source: World Bank (2013).

3. Lao PDR's international commitment on foreign investment

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

With the establishment and gradual improvement of the legal system, policies on foreign investment, Lao PDR has also signed some international bilateral and multilateral agreements on foreign investment. This is indispensable in Lao PDR is international economic integration and in overall policy on investment encouragement and protection.

Lao PDR has a broad network of international investment agreements, both stand-alone treaties and investment chapters in broader free trade agreements. Investment treaties typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to Investor-State Dispute Settlement (ISDS) mechanisms to enforce those provisions. Increasingly, treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment.Since 2011 Lao PDR has negotiated and concluded over 20 Bilateral Investment Treaty (BITs) that are in in force. Lao PDR is also party to an increasing number of regional and multilateral trade and investment agreements.

Lao PDR's recent investment treaty policy has been in many cases driven by a new regional dynamic: since the conclusion of ASEAN Comprehensive Investment Agreement in 2009, the group of ASEAN Member States has signed agreements with Australia and New Zealand (2009), Korea (2009), China (2009), and India (2014).[11] ASEAN is currently also negotiating on the inclusion of an investment chapter for the existing Economic Partnership Agreement with Japan and Regional Comprehensive Economic Partnership (RCEP).[12]

In this process, a number of core assumptions have been challenged. Econometric studies, for example, have failed to demonstrate conclusively that IIAs actually lead to increased FDI flows – a policy goal commonly associated with the investment protection regime (Sauvant and Sachs, 2009). Beyond investment protection, IIAs are increasingly being used to liberalize investment policy. Studies have had more success in linking market access provisions in IIAs to increased inflows of FDI (Berger et al., 2013; Lesher and Miroudot, 2006).

4. Discussion on Lao PDR Investment Policies

The Government of Lao PDR can take justifiable pride in its accomplishments over the past three decades. Substantial economic reforms have led to high and sustained growth rates and rising overall living standards, although more still needs to be done to reduce poverty. The government aspires to graduate from a least developed country status by 2020 – a significant ambition achieved by few countries. While FDI has played a

[11] The dates noted after the treaties indicate their year of signature.

[12] The agreement was negotiated between the ASEAN Member States, and the countries of the ASEAN Plus agreements (Australia, China, India, Japan, Korea, and New Zealand).

key role in supporting economic development, domestic investment has also been strong. The government is engaged in a number of ambitious reforms to improve the business environment and further reap the benefits of investment, increasingly focusing on attracting responsible and sustainable investments.

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

Building upon improvements already achieved, the government has recently amended its investment law to further align it with international good practices, for example, the ASEAN Comprehensive Investment Agreement (ACIA) and WTO commitments. Strong attention should be given to the coherence of its provisions with other interacting laws and regulations. Effectively implementing the provisions of the Law on Laws would greatly help to ensure that the consistency of the overall legal framework is preserved (Bingham, 2010).

The success of this amendment will be key to position Lao PDR as a safe and attractive investment destination. The quality of investment policies directly influences the decisions of all investors, be they small or large, domestic or foreign. Property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all. The positive changes in awareness and viewpoint of the past three decades have become an essential foundation for the government's amendment and improvement of legal and policy framework with respect to FDI attraction and operations of FDI enterprises in recent years.

A SWOT analysis on Lao PDR investment policies as illustrated in Table 3, can provide a basis for better-informed decision-making by potential investors who wish to invest in Laos .

Table 3. SWOT Analysis of Lao PDR Investment Policies

Strengths	Weaknesses
- Free-tax for SEZs - Export-oriented industrial zones - Land is available to investor - Involvement of international finance institution	- No legal (HR stretched, infrastructure, resource, tourism, trade) - Opaque decision making process
Opportunities	**Threats**
- Land link country of Southeast Asia - Tourism is growing - One Belt One Road	- Competition from neighbor countries: market size, skilled labor, raw materials, e.g. - Slow licensing process

Source: Researchers' compilation

5. Conclusions and recommendation

This paper has reviewed the policy framework for attracting foreign Investment in Lao PDR. Since the promulgation of law on foreign investment, Lao PDR has achieved quite impressive performance in attracting FDI inflows. Together with the magnificent GDP growth, FDI sector accounts for an increasing share in GDP. This resulted from economic reform policies that Lao PDR has pursued from last few years, while suggesting the interrelationship between FDI and economic growth. However, to date, there has virtually been no thorough research on how FDI affect growth. In future, in-depth analyses of such topic may be useful for policy making so that countries can maximize the benefits of the FDI.

To ensure the country will be benefit from the FDI inflows, this will be important component to attract FDI inflows, some recommendations are given as follows: Government should provide incentive investment policies to diversify investment sectors: HR stretched, infrastructure, resource, tourism, trade. Should be set up to identify and eliminate all unnecessary licences and administrative obstacles to start and operate a business. Client charters with clear deadlines and fees for licensing should be prepared and relevant ministries should sign memorandums of understanding to ensure deadlines are systematically met. While the development of the multiple one-stop-shops should not be a top priority of the government, increased dialogue with the private sector should be more systematic including through aftercare and policy advocacy and by revamping the Lao Business Forum.More international liberalization (remove all investment barriers) and relatively of wage is critical factor to reduce the production costs and stimulate attract FDI.

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Notes

Note 1. Zones having least socio-economic infrastructure development in facilitating investments. The zones are

mainly mountainous remote areas. The zones will enjoy highest-level investment promotion incentives;
Note 2. Zones having moderate socio-economic infrastructure development in facilitating investments, and having less difficult geographical situation compared to Zone 1. The zones will enjoy moderate-level investment promotion incentives;
Note 3. Zones having good socio-economic infrastructure development in supporting investments. The zones are receives lower level of investment promotion incentives