



POLICY BRIEF

ADDRESSING THE IMPACTS OF THE PHASING OUT OF TEXTILES AND CLOTHING QUOTAS IN LAO PDR



ASSESSMENT OF THE TRADE AND INDUSTRIAL POLICY ENVIRONMENT IN LAO PDR

It is almost two decades since Lao PDR embarked on its transition to a market-oriented economy under the so-called New Economic Mechanism (NEM). The agenda of the Government of Lao PDR (GoL) is to graduate from the status of least developed country (LDC) by 2020. To achieve this, Lao PDR has set the goal of achieving robust economic growth rates, at around 7-8 percent on average per annum. One of the main elements driving this growth process is export; industry and trade are twin drivers driving this growth. The theme of the study is to assess the trade and industry policy environment in Lao PDR, with a focus on the garment, handicraft, food processing and tourism sector. The main purpose of the study is to assess the policy environment to identify constraints that create bottlenecks in the value chain and inflate the cost of doing business and exports.

Trade environment

The market-oriented economy was initiated in 1986 and accelerated in the late 1990s by joining ASEAN and further making a conscious effort to accede to the World Trade Organisation (WTO). Lao PDR has an outward-looking trade policy. Tariff rates are relatively low and the tariff structure has been simplified. The current applied rates average at 11 percent with a maximum rate of 40 percent. Under the ASEAN Free Trade Area (AFTA), the duties on more than 95 percent of products will be reduced to 0-5 percent by 2008. In addition, Lao PDR continues to integrate itself into the regional and international trade sector. With respect to non-tariff barriers, export licenses have gradually been removed and import licenses have been streamlined; however, more needs to be done to create more transparent and appropriate trade regulations.

Industrial policy

The industrialization and modernization process seems to lack integrated long-term planning in terms of an industry-supporting environment as well as supportive industries. The former includes human resource development for targeted industry, entrepreneurship development, infrastructure development, improvement on related laws and regulations, e.g. investment, land provision and tax incentives. The latter includes upstream and downstream industry to support in the value chain of the targeted industry, e.g. input suppliers, distributors and financial institutions. At present, the mining and hydropower industry is the main target, while the garment industry has a lesser focus. However, these

two industries require a greater emphasis on sustainability, including environmental issues and human development in the long run.

The problems of doing business in Lao PDR

The process remains difficult and costly. This includes supply-side constraints, the high cost of infrastructure - mainly transportation and telecommunications - and cumbersome export-import procedures, e.g. customs clearance. Other obstacles include dealing with licenses, registering property, access to finance in the normal banking system, and red tape in obtaining the investment incentives. Moreover, one of the main constraints is still the time taken to set up a business, which notably decreased in 2006 to 163 days, from 198 in the previous year. Still, this is much longer than in most countries in South East Asia. In addition, there is a relatively low level of entrepreneurial experience, know-how and skilled labor in Lao PDR, making it more difficult to compete regionally with its more developed and experienced neighbors.

Business growth

To date, businesses in Lao PDR have been overwhelmingly dominated by small or micro-scaled enterprises. Out of 390 enterprises surveyed in 2005, 58 percent were classified as small enterprises with 3-19 employees while 21 percent were in the micro-enterprises category with 1-2 employees. This suggests substantial constraints to firm-size growth. The primary causes are partly attributed to the high cost of critical services, particularly transport and telecommunications, and access to finance. The

study finds that supply constraints are key impediments to the development of labor-intensive sectors with high social impact, such as garments, handicrafts, food processing and tourism. The constraints include the shortage of raw materials; the lack of backward linkage industries; limited access to market information; severe problems with access to finance and banking facilities; insufficient education and training catering for industry-specific requirements; and weak infrastructural services.

The problems are further exacerbated by a cumbersome regulatory framework. Procedures for business start up are lengthy and costly; import licenses and export regulations are below international norms and would be required to be brought into compliance with WTO principles in light of Lao PDR' accession process. In addition, customs clearance and tax systems need to be revamped to create predictability and certainty for business operations. Even though duty exemptions are allowed for investors in importing equipment and raw materials for the manufacturing of goods for exports, the exemption procedures have proved to be lengthy and non-transparent. There is also limited awareness of the importance of private sector development. Public-private sector dialogue will need to be strengthened for an enabling business and investment climate.

Sector-specific assessment

The garment sector: With respect to industrial policy, there is insufficient attention paid to support backward linkages and build up a supporting industry for the garment sector. Clear policy should be designed to create upstream processing plants in order to be able to supply finished fabrics at short notices. Moreover, there is a conflict of policy intention for the duty exemption, which aims to ease production costs and result in competitive pricing of importing raw materials for garment factories. It is essential for the Government to encourage and create supporting industries by providing some industrial incentives and improving the procedure management. With regard to trade policy, it is essential to create an enabling business environment by streamlining import regulations, in particular the import of machinery and raw materials; shortening the time used for customs clearance; ensure consistency across customs checkpoints; and decentralizing the authority for issuing certificates of origin.

The handicraft sector: This sector lacks a supporting industry, particularly for silk yarn. Although a number of sericulture projects have been launched, it is estimated that domestic supply of silk yarn accounts for only 10-50 percent of the silk required for domestic production. The fact remains that the ministry concerned has not sufficiently invested in Research and Development (R&D) to improve production levels of silk yarn if silk handicrafts are to form a key sector for Lao PDR. The sector relies on very basic plantation facilities, which need to be improved if a large quantity of sericulture is to be produced. A lack of expertise and experience in e-business and commerce is still common, and the advertising of products is still largely localized. It is widely accepted that Lao companies face difficulties in finding skilled weavers, as the skills are only passed from generation to generation within a family. As yet, there is no vocational school teaching the full technique of silk textile weaving to support this industry, nor is there a system of quality control or brand development. Interviews conducted by the research team indicate that an Artisan and Handicraft Design Center in Lao PDR should be established if the traditional weaving technique is to be preserved. To ensure consistent standards, a good option would be to set up an agency to standardize production and provide certification for Lao silk products.

The food-processing industry: The industry focuses on the production of beer, soft drinks, sugar, tea, coffee, fruit and vegetables. Problems include supply side constraints for food processing; a shortage of raw materials produced in Lao PDR; limited access to market information, formal credits, skills and education; a lack of supporting industries; and inadequate infrastructure, capacity and quality standards. These deficiencies can be tackled through establishing an agency responsible for quality control of agricultural products, or food safety laboratories that meet international standards and requirements. In addition, to deal with the insufficient inputs, contract farming should be made more reliable and effective through training and putting in place effective legal mechanisms. It is important to promote this sector by organizing more trade fairs and exhibitions for Lao processed food products in regional and international markets. Furthermore, as with the other sectors, simplifying the bank lending process is necessary, while the customs and warehousing clearance process needs to be addressed.

The tourism industry: There is strong consensus that the tourism industry in Lao PDR must be better coordinated. The participation of the private sector in issues related to tourism policy is not sufficiently active, creating a missing link within the tourism cluster. In addition, regional tourism offices are not placing enough emphasis on supporting businesses with information dissemination and coordination, but instead concentrate on the regulation and licensing of tourism businesses. The strategies for tourism firms in Lao PDR are relatively unsophisticated. For instance, many tour operators provide tourism packages similar to those of their competitors. They are not approaching their clients directly but maintaining strategic alliances with tour operators abroad. In summary, the lack of a coordinated strategy has led to a deficiency in marketing skills.

Conclusion and recommendations

It is beyond doubt that the four sectors under consideration have great potential in helping to reduce poverty, to disperse incomes to Lao citizens living in rural areas and to improve living standards. Sound trade and industrial policy will directly facilitate the development of these four sectors. As a consequence, productivity will increase and export performance can accelerate. However, the fact remains that Lao PDR is still not an easy place in which to run a business compared to other countries in the same region. The country is still in the transition phase, as the nation has been undertaking a reform process to be in line with international practice in terms of its integration into the regional (AFTA) and global (WTO) economies.

Trade policy: This area has made significant progress towards a market-oriented and open-door economy, while the trade regime is mainstreaming to reduce tariff and non-tariff barriers, as well as revising and improving related regulations. This policy shows great improvement when present

The study “Addressing the Impacts of the Phasing out of Textiles and Clothing Quotas in Lao PDR” comprises findings published in four volumes:

1. **Human Development Assessment in Post-Agreement on Textile and Clothing in Lao PDR**
2. **Diversification and Value Addition,**
3. **Assessment of the Trade and Industrial Policy Environment in Lao PDR**
4. **Trade Negotiation Strategy**

conditions are compared with those in previous decades. However, further efforts are still needed; with a special focus on streamlining export-import procedures, reducing burdens related to customs clearance, and developing realistic export promotion strategies. The Government also needs to develop transparency and predictability with respect to internal rules and regulations.

Industrial sector: The pace of structural adjustment of industrial sector has been slow, and much more remains to be done before Lao industry can compete across the board, on equal terms with its main and international competitors. Basically, industrial policies remain ambiguous, which is why future industrial development should be properly adjusted to confront major global challenges. There is likely to be more intense competition for various goods and services, and the Government needs to ensure competitive technological processes and improved quality standards. It will be increasingly necessary for Lao PDR to adapt the industrial structure, and production and marketing mechanisms, to be able to participate in mainstream international trade and investments, and the country should try to differentiate itself from other neighboring countries’ production values. This means niche markets must be identified in line with the four potential sectors: garments, tourism, handicrafts, and the food-processing sector.

It is important to emphasize that trade and industrial policies are not the only factors that create constraints or facilitate the competitiveness of the aforementioned sectors; policy coherence and linkages between trade, industry and other sectors also play a role. To increase its international competitiveness, Lao PDR has to increase its labor productivity and local capacity development, including investments in technical institutions. In addition, technology upgrading and innovations will be key factors to enhance productivity.



For more information, please contact the National Statistics Centre (NSC), Luang Prabang Road, Vientiane Capital, Lao PDR: +856-21-214740, 242022, nscp@etillao.com www.nsc.gov.la