POLICY BRIEF

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

TRADE NEGOTIATION STRATEGY

Lao exporters are facing various types of market access barriers, impeding the export's prospects of export diversification and value addition. The fact that Lao exporters are unable to reap the full potential of integration is due mainly to the existence of tariffs and non-tariff barriers. Given that Lao PDR is benefiting from various preferential market accesses, mostly duty free, the major issues lie in the ability of exporters to overcome non-tariff barriers such as complex rules of origin and high sanitation requirements.

Trade relations

The Government of the Lao PDR (GoL) has defined the following key groups of actions to achieve its overall goals and targets in its trade agenda: external trade cooperation; export development and promotion; import management; development of trade and transit trade; market development; and personnel and administrative reform.

Lao PDR has trade relations with more than 50 economies, and since the 1990s, it has entered into bilateral trade arrangements with 16 countries, most of which are among ASEAN members, except Brunei and Singapore. Thailand and Vietnam are the most important trading partners due to geographical proximities and close cultural ties. The Lao-US bilateral trade agreement (BTA) is the most comprehensive agreement that Lao PDR has signed to date. It involves deep commitments that mirror key areas under the WTO agreements. Most of these agreements do not aim to promote more market access but rather promote cooperation between parties, in the years before Lao PDR becomes a member of the World Trade Organisation (WTO).

At the regional level, Lao PDR is actively participating in the ASEAN Free Trade Area (AFTA) and has therefore undertaken commitments under the Common Effective Preferential Tariffs (CEPT) scheme. The country is also engaging in free trade area (FTA) negotiations with ASEAN-dialogues partners: China, the Republic of Korea, Japan, India, and Australia and New Zealand. Lao PDR also benefits from the Asia Pacific Trade Agreement (APTA), formerly known as the Bangkok Agreement. Despite joining APTA in as early as 1975, Lao PDR has not yet had the capacity to offer any concessions but has benefited from the Special and Preferential Treatment granted by the other five participating states (Bangladesh, China, India, Republic of Korea and Sri Lanka).

Lao PDR is in the process of WTO accession; under WTO principles and agreements, membership will add certainty and transparency to the policies faced by Lao exporters as well as foreign companies wanting to do business in Lao PDR. Moreover, membership gives the country access to an impartial rules-based dispute settlement process. Furthermore, as a WTO member, Lao PDR will have more secure transit rights with neighbouring countries, and a seat at the table as world trade rules are negotiated.

Trade Barriers

Thailand: The key export items to Thailand include: electricity, wood and wood products, mining, agricultural products (wheat, Job's tears, ground nuts, sesame, broom) and clothing. However, the export pattern has changed relatively from wood and wood products to clothes. The share of clothes in exports has more than doubled (and increased more than sevenfold in value terms) and now represents more than 50 percent of exports.

In terms of tariffs, Lao products may enter into Thailand subjected to preferences under Common Effective Preferential Tariff (CEPT), ASEAN Integrated System of Preferences (AISP) or paying

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Most Favored Nations (MFN) rates, depending on which one offers the most advantages and convenience for Lao traders. Thailand completed its CEPT implementation in 2003 by which 99% of the tariff lines has now been covered in the IL with import duties down to 0-5%. These include such products as handicrafts and garments. However, some highly sensitive agricultural products, including processed food, are still being excluded and will be transferred to the IL by 2012.

To facilitate trade between the two countries, more local and provincial customs checkpoints have been set up and the time for customs clearance has been extended up to 10 pm (for persons only). Under Greater Mekong Sub-region (GMS) cooperation, the inspection system for exports and imports has been streamlined.

The EU-market: The EU-25 is the second biggest export market for Lao PDR with Germany, France, the UK, Belgium and the Netherlands being largest. Garments are the most-traded goods, valued at Euro119 million in 2001. The rapid increase of garment exports between 1997 and 2001 accounts for most of the export share of the whole industry.

As a Least Developed Country (LDC) qualifies under the "Everything But Arms" (EBA) initiative, by which it can export virtually all products (except for arms and ammunition), including garments, handicrafts and processed food. But despite duty free quota free access, Lao PDR still cannot take full advantage of this initiative. In 2005, about 73 percent of Lao exports to the EU were receiving preferential treatment.

Vietnam: Vietnam is becoming an important export market for Lao PDR. After the reciprocal exchange of preferences (0% duties and 50% reduced tariffs) between the two countries took effect in September 2005, Lao exports to Vietnam have increased, by 29 percent from 2004 to 2005. The key emerging exports include mining, computers and accessories, raw materials for cigarettes and milk and milk products. Vietnam completed its CEPT implementation in 2006, under which most products are subject to duties of 0-5%.

The average MFN tariff for importing to Vietnam was 6.8 % in 2005, with 69.1% for agricultural and 6.5 % for non-agricultural products. These rates are expected to come down in the near future, particularly as a result of the country's implementation of tariff commitments as part of its WTO's membership since January 2007.

Despite the wide range of products under tariff concessions under the Bilateral Trade Agreement (BTA), Lao exports to Vietnam have not substantively increased; in 2005, BTA exports constituted only 2.4 percent of the total exports to Vietnam. The causes could be attributed to slow supply response from Lao PDR and the existence of non-tariff barriers in Vietnam. The exports of some sensitive products (rice, tobacco leaf and vehicle parts) are administered by tariff quotas.

China: Lao PDR' exports to China in 2005 totaled US$25.5 million, equivalent to 5.2 percent of total exports. The export values in 2003 and 2004 were US$11.2 million and US$12.6 million, respectively; wood and wood products took the highest share (43.9 percent), followed by rubber (16.4 percent), and oil seeds (5.3 percent).

Lao traders can export to China in one of four ways: under Special and Preferential Treatment, under the Early Harvest Program (EHP), as part of the ASEAN-China Free Trade Area, or on an MFN basis. The Chinese average rate for MFNs is 4.3 percent with an average of 19.6 percent for agricultural products and 4.2 percent for industrial products. Under the ACFTA, China began to implement the EHP beginning January 2004, by reducing tariffs to 0-5 percent for agricultural products. The implementation will be completed by 1 January 2009. During 2003-2005, Lao PDR did not export any goods under EHP to China, except for low-valued fruit and nuts. The under-use of preferences in exporting to the Chinese market are partly due to the slow implementation by China. Officially, China should have implemented the EHP in 2006. In fact, the process began in 2004, but was unrelated to tariff reductions.

The US: Currently, Lao PDR is able to export to the US market under the Normal Trade Relations granted since February 2005. This has greatly reduced duty payments by Lao exporters and also offered a level playing field for Lao products in comparison to WTO members. The NTR or MFN tariffs offered by the US cover some 11,000 tariff lines, ranging from zero for various products to a peak of around 60 percent. In contrast, the non-NTR tariff, known as 'Smoot-

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Hawley Tariff' is much higher than the NTR rates, e.g. 90 percent for a handcrafted shirt or acrylic sweater.

In 2005, Lao PDR exported US$4.4 million worth of goods to the US, of which 67 percent were textiles and clothing, followed by coffee and tea (16 percent), and works of art (8 percent). However, the export share to the US market was still minimal, equivalent to 0.6 percent of Lao PDR' total exports.

The US extends MFN tariff treatment to all WTO members except one (Cuba). All except two tariff lines are bound. Around 31 percent of all tariff items enter the US duty free. Certain products, however, receive tariff protection in the 50-350 percent range, notably tobacco, peanuts, certain dairy products, sugar, and certain footwear; most tariffs on textiles and clothing are in the 15-30 percent range. Tariff escalation is present in textiles and clothing, non-metallic minerals, and basic metal industries.

Market access barriers in the four sectors

There are two aspects of international trade barriers: tariffs and non-tariff measures. As a result of negotiations at regional and global levels, tariff rates have continually been declining, while non-tariff barriers (NTBs), regarded as instruments for protection, have been increasing.

Garments: With respect to the garment sector, Lao PDR' exports heavily rely on preferential access. On average more than 90 percent of garment exports enter the EU markets (Germany, France, the UK), under the EBA. Although Lao PDR gained NTR status in February 2005, garment exports to the US remain relatively low, only 1.4 percent of Lao PDR' total exports. The garment sector is among the most protected sectors in the US, with an average import duty of 11.1 percent. The garment sector in Lao PDR lacks backward linkage industries e.g. cotton, yarn and fabric production. As a result, it is very difficult for Lao PDR to meet the ROO requirements. For instance, to export to the EU, the local contents in combination with raw materials imported from ASEAN should not exceed 40 percent of the FOB value. There is double process requirement for textile materials in the EU, i.e. from yarn to fabric and from fabric to clothing. As a result, around 30 percent of Lao garment products, particularly woven apparel, do not meet local content requirements.

Handicrafts: With respect to the handicraft sector, Lao PDR exports mainly to the ASEAN market, about 98 percent its total handicraft exports in 2006. Most export flows were concentrated in Thailand and Vietnam where the tariff barriers are only subject to CEPT rates. Lao PDR also gets duty-free, quota-free market access for exports to Japan. Hence, tariffs are not the issue for the exports of Lao handicrafts including to those developed countries that have granted GSP to Lao PDR. As for non-tariff barriers, similar to the garment sector, handicrafts also face some barriers such as origin requirements, technical regulations (standards) and labelling requirements. For example, textile handicrafts (scarves, wall hangings, fabrics) require the use of only recognized/certified laboratories in the EC. In addition, there are requirements on data, certification, or testing such as consistency of fabric used, dyeing ingredients, and environmental friendliness imposed by the trading partners.

Food processing: Food processing in Lao PDR has a very low level of industrialization and most processing operations are in the small-sized workshops. There is only a handful of what can be considered industrial plants. Tariffs barriers are not the main issue, as Lao PDR, as an LDC, can access markets in the EU, Japan and Australia without tariffs and quotas. Nevertheless, these products are also facing non-tariff barriers, especially restricted rules of origin under preferential treatment. Further, the sanitary and Phytosanitary (SPS) requirements imposed by those export markets are very stringent and place additional cost burdens on exporters, as well as lessening the competitiveness of this sector. Additionally, administrative structures and legislative systems of importing countries can impose further constraints on their ability to comply with SPS measures. The importing countries change their requirements over time in a way that increases the difficulty for developing countries to meet these conditions. Some developed countries also impose more stringent conditions on imports to protect its citizens. Lao PDR needs to raise the issue of imposing more stringent requirements in relation to SPS and Technical Barriers to Trade conditions than the WTO does.

Tourism: The tourism industry has grown rapidly in Lao PDR, with 2 percent of the GDP, but it is still largely concentrated in a few locations (Luang Prabang, Vientiane, and, to a lesser extent, Champassak). Lao PDR is not considered a primary destination but part of a regional tour, which means international tourists tend to stay less than three days in Lao PDR. Lao PDR needs to upgrade services standards in all clusters of the tourism industry. The services in Lao PDR seem more opened than in many other countries, and the country could organise deals particularly with its neighbouring countries, and further benefit from the opening-up of this sector, for instance through developing regional tour packages.

Policy actions

As parts of the negotiation strategies, the following main elements have been identified: (i) enhancing the negotiation capacity for trade negotiators in all related line ministries through training and workshops, (ii) establishing a team of trade negotiation experts and creating networks and experience-sharing with neighboring countries, on coordination issues (iii) facilitating inter-ministerial trade related policy formulation and implementation, (iv) further improving and supporting information dissemination and (v) implementing commitments under AFTA on tariff reduction, elimination of non-tariff barriers and opening up service sectors.

On bilateral and regional trade the team would like to give high priority to negotiations with dialogue partners, especially in the areas of services and rules negotiations and to commitments under trade agreements in light of WTO accession. The recommendations are similar in multilateral trade, meaning a degree of political will to accede to the WTO with terms and conditions commensurate with Lao economic development, as well as an internal roadmap for WTO accession in light of the needs for legal reforms and rationalization, and an ensured capability in negotiations.

Trade negotiations have become key components of policy discussions; therefore, a consultation process within government agencies and with non-state actors should be strengthened. Inter-ministerial dialogue will ensure that interests and concerns as voiced by other ministries are fed into the negotiation mandates to be pursued by the Ministry of Industry and Commerce in different negotiating fora. Conversely, international commitments have to be communicated back to line ministries for proper implementation. It is also important to have extensive consultations with private, academic and other stakeholders.

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**

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