Investment Reform Map for Lao PDR

A Foundation for a New Investment Policy and Promotion Strategy

Lao PDR Investment Climate Reform Project

IN PARTNERSHIP WITH

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WORLD BANK GROUP

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FOREWORD

Over the last 15 years, IFC has played an important role in enhancing the investment climate in Lao PDR. Building on these efforts, the Investment Reform Map (IRM) aims to help generate new investments, diversify the local economy, and make it easier to spur business in Lao PDR. To achieve this, the nation needs a more consistent and transparent regulatory environment, lower cost of entry and operation as well as better integration of domestic firms into regional and global value chains.

With an annual average of 7 percent from 2004-2018, Lao PDR has had strong and consistent economic growth. This can be attributed to significant investments including foreign direct investment (FDI) in extractive industries of natural resources, especially mining and hydro-energy.

However, the nation has additional work to do to further inclusive economic development that creates substantial job opportunities for low-income people. Despite broader economic contribution, FDI in the natural resource sector has generated limited job opportunities. While non-resource sectors have high potential for job creation, FDI in these sectors seeks efficiency and competes on cost margins for exports or domestic consumption.

Lao PDR has a comparatively low volume of FDI stock — less than 30 percent of GDP during 2008-2017, the lowest among its regional peer countries. While the high cost of business dissuades large efficiency-seeking investments, approval processes — from investment entry to business operating licenses and import-export permits — remain complex and time consuming. Further, the discrepancy between policy and laws "in the books" and actual implementation on the ground is a major deterrent. Yet another constraint is the lack of a clear vision or strategy to attract, retain, and leverage FDI for greater socio-economic benefits.

Moving forward, Lao PDR needs more sound investment strategy and policy framework, which can derive more benefits from FDI, including job creation, knowledge transfer, and economic diversification. This is especially critical given the COVID-19 pandemic, which upended lives and livelihoods, altered the FDI landscape, and drastically disrupted global value chains. The FDI environment, already fiercely competitive before the pandemic, is now likely to be even more aggressive. Unavoidably, a small country like Lao PDR will face significant challenges to attract new FDI in the short- to medium-terms. Therefore, it is crucial for Lao PDR to strategically rethink its FDI policy and enable a conducive business environment for private investments.

Considering Lao PDR's pre- and post-pandemic investment climate, this IRM offers an analytical and dialogue-based mechanism to help develop a new investment vision and policy to attract and retain the type of FDI which the country needs. In order to help realize this development vision, the IRM presents a thorough diagnosis to assist the Ministry of Planning and Investment (MPI) and overall, the government of Lao PDR, to:

- Better understand the strengths and weaknesses of the current investment climate, especially the investment policy framework,
- Identify the elements of a new strategic vision and policy for FDI, and
- Identify priority reforms that should be undertaken over the next five years to implement the vision and policy.

Overall, this IRM is designed to help turn Lao PDR into an attractive FDI destination while benefiting its domestic firms and building a robust growth trajectory that is both inclusive and sustainable. IFC remains committed to support the nation's collective business reform agenda while helping the country and its people unlock their full potential.

Acting Regional Director,
East Asia and Pacific, IFC
Randall Riopelle

Government of Lao PDR has actively taken steps to enhance the country's business environment through a number of bold policy moves, including Prime Ministerial Order No.02/PM (1 February 2018) on the Improvement of Regulations and Coordination Mechanism on Doing Business in Lao PDR, Order No.03/PM (21 January 2020) on the Improvement of Services Related to the Issuance of Investment and Business Licenses and Order No.12/PM (16 October 2019) on the Facilitation of Import and Export, Temporary Import, Transit and Movement of Goods in Lao PDR. These initiatives required all relevant sectors to reduce barriers embedded in 10 indicators of World Bank Ease of Doing Business and prioritize further policy and legislation improvements.

This Investment Reform Map (IRM), as an assessment paper supported by International Finance Corporation's (IFC) Investment Climate Reform Project in Lao PDR, highlights Lao PDR's investment climate conditions and economic potential in light of regional and international linkages. By exploring the role of foreign direct investment (FDI) in the country - particularly its potential, optimization and challenges, the IRM provides a comprehensive analysis of the investment legal framework, policies, institutions, incentives and promotions which could be translated into an investment reform action plan to drive improvements to the Government of Lao PDR's future investment strategy.

We believe this IRM will be an important tool to enhance both domestic and foreign investment promotion policy. As such, the IRM also provides an in-depth analysis of the private investment context in Lao PDR to support policy makers in realizing investment policy improvements. A favorable investment climate will enable Lao PDR to attract and increase more investments in number and quality, contribute to national revenue generation, employment creation and improvements to socio-economic development.

In addition, since early 2020, Lao PDR like most countries around the world has suffered economic consequences from the COVID-19 pandemic. Therefore, accelerating private investment reform is crucial and urgent to drive an economic recovery and build confidence for domestic and foreign investors.

Finally, we would like to express our gratitude to IFC for its support in developing this IRM and its partnership more broadly to improve the investment climate and the ease of doing business in Lao PDR. All readers' comments and any recommendations are welcomed for investment climate improvement in the future.

Deputy Prime Minister,
Minister of Planning and Investment
Sonexay Siphandone

ACKNOWLEDGMENTS

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The report was prepared by the EFI's Investment Policy and Promotion (IPP) team under the general guidance of Ivan Nimac, Global Product Specialist for IPP in EFI's Investment & Competition practice, and the direct supervision of Khampao Nanthavong. The IPP team conducting this IRM was led by Xavier Forneris, IPP Coordinator for East Asia & West Africa, and included Maria Reinholdt Andersen, Sufian Jusoh, and Yan Liu. The authors want to acknowledge two colleagues, Erik von Uexkull and Hania Kronfol, for their significant contributions to the incentive analysis. The authors also want to thank the following colleagues based in the World Bank Group's Lao PDR office who provided important suggestions, inputs, data, and information throughout the process: Mombert Hoppe, Khampao Nanthavong, Konesawang Nghardsaysone and Keomanivone Phimmahasay. Jigjidmaa Dugeree and Mombert Hoppe, who served as peer reviewers, are also warmly acknowledged for their valuable inputs on the incentive assessment.

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Finally, the World Bank Group would like to express its gratitude to the Government of Japan for making this report possible through its financial contribution to the Lao PDR Investment Climate Reform Project.

LIST OF ACRONYMS

ACIA	ASEAN Comprehensive Investment Agreement
AFAS	The ASEAN Framework Agreement on Services
ASEAN	Agreement of South East Asian Nations
BCA	The Business Council of Australia
BIT	Bilateral Investment Treaty
BOI	Board of Investment
BOL	Central Bank of Lao PDR
BOP	Balance of Payment
CBA	Costs and Benefits Analysis
CIT	Corporate Income Tax
DB	Doing Business
DVA	Domestic Value Addition
EAP	East Asia Pacific
ECI	Economic Complexity Index
EFI	Equitable Growth, Finance, and Institutions
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GATS	General Agreement on Tariffs and Trade
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GoL	Government of Lao PDR
GVCs	Global Value Chains
ICB	Investment Competitiveness Benchmarking
ICSID	International Center for the Settlement of Investment Disputes
IFC	International Finance Corporation
IGM	Investor Grievance Mechanism
IIA	International Investment Agreement
ILO	International Labour Organisation
IMF	International Monetary Fund
IPA	Investment Promotion Agency
IPL	Investment Promotion Law
IPMC	Investment Promotion and Management Committee
IPP	Investment Policy and Promotion
IPS	Investment Policy Statement
IRM	Investment Reform Map

ISDS	Investor-State dispute settlement
ISS	Investment Sector Scan
IT	Information Technology
LPI	Logistics Performance Index
MFN	Most Favored Nation
MIGA	Multilateral Investment Guarantee Agency
MoIC	Ministry of Industry and Commerce
MPI	Ministry of Planning and Investment
MTI	Macroeconomics, Trade and Investment
M&E	Monitoring and Evaluation
NT	National Treatment
NSEDP	National Social-Economic Development Plan
ODA	Official Development Assistance
OECD	Organization for the Economic Cooperation and Development
OSS	One-stop-shop
OSSO	One-Stop Service Office
PCI	Product Complexity Index
PDR	People's Democratic Republic
PPD	Public-Private Dialogue
PTA	Preferential Trade Agreement
RCEP	Regional Comprehensive Economic Partnership
R&D	Research and Development
SCM	Subsidies and Countervailing Measures
SEA	South-East Asia
SEZ	Special Economic Zone
SIRM	Systemic Investor Response Mechanism
SOE	State-owned enterprise
TRIMs	Trade-Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
US	United States
US$	United States dollar
VAT	Value-Added Tax
WBG	World Bank Group
WER	World Economic Forum
WIR	World Investment Report
WTO	World Trade Organization

EXECUTIVE SUMMARY

A sound policy framework for investment is critical for foreign direct investment (FDI) to deliver a positive impact over the host economy. This type of external capital can facilitate the arrival of technology and know-how, diversification into new sectors and activities as well as foster the integration of domestic firms into global value chains (GVCs), among other benefits. Yet, the likelihood of these positive effects depends on various characteristics of the receiving economy, among which a policy framework conducive to investment activities is key.

The Investment Reform Map (IRM) is a mechanism for dialogue to develop the investment policy needed to attract the transformative type of FDI to help a country realize its development vision. In the case of Lao PDR, the objective of this IRM is to present a rigorous diagnosis and act as an engagement tool. This IRM strives to assist the Ministry of Planning and Investment (MPI), and more broadly the Government of Lao PDR (GoL), to determine the current and potential positioning of the domestic economy within an increasingly globalized and integrated international economy. This IRM presents the role of FDI in Lao PDR — including FDI trends, types and country investment climate constraints, while also analyzing the legal, regulatory and institutional frameworks for investment policy and promotion. Importantly, this IRM concludes with the Investment Reform Action Plan — an action plan of reforms for consideration by the GoL.

Through an assessment of Lao PDR's FDI trends, this IRM discovers that FDI contributes to a significant share of the country's investments, though FDI is concentrated in select sectors and mainly from neighboring countries in the region. The composition of Lao PDR's FDI has historically been in natural resources — including metals, electricity generation and construction, sectors that do not create highly productive jobs to fuel economic growth. Moreover, (greenfield, new, more recent) FDI has primarily been market-seeking. As the IRM finds, improvements in Lao PDR's investment climate and business environment would enhance its competitiveness in attracting higher quality FDI. As Lao PDR lags in economic complexity, more FDI (particularly efficiency-seeking) will play a critical role in assisting the country to move up the value chain and upgrade its productive capabilities.

The IRM is grounded on two analytical pillars of the investment policy **framework** designed by the World Bank Group (WBG). The first is the **investment lifecycle**, which sees FDI as in a dynamic relationship with the host economy, not merely a one-time transaction. This view corresponds to an investment policy capable of addressing issues along various stages of the relationship between foreign investors and the host economy, including FDI attraction, entry, retention, expansion and linkages. The second pillar is an FDI typology, which identifies four types of investment (natural resource-seeking, efficiency-seeking, domestic market-seeking, and strategic asset-seeking[1]). This taxonomy allows for the grouping of investments across different location determinants, development effects and ultimately types of policies.

With the previous investment policy framework in mind, this IRM is a tool to help the GoL capitalize on these FDI opportunities. The analysis develops a tailored diagnostic with the objective to enable dialogue between the country's policymakers and other relevant stakeholders to agree a plan of action. The IRM provides policymakers with the key analysis needed to consider FDI policy reform options and priorities. In particular, the IRM entails: i) analyzing FDI trends in Lao PDR, ii) diagnosing investment policy constraints along the investment lifecycle, iii) developing an action plan for reforms to realize the potential impacts of FDI in the local economy.

The IRM is also an example of the WBG's strategy on private sector development. A fundamental notion in this strategy is "creating markets", whose goal is to maximize development finance for value-

[1] Strategic asset-seeking FDI is generally based on the existence of intangible assets at the level of the firm. The methodology used in this IRM for identifying investment types is based on sector FDI data, hence unable to provide any categorization based on firm-level data. For these reasons, the FDI type analysis we conduct in this IRM does not include strategic asset-seeking investments.

adding investments, promote judicious use of scarce public resources, and crowd-in private capital. The success of this strategy requires enabling policy and regulatory environments that effectively de-risk private sector participation. To do so, "creating markets" is operationalized following the logic of the cascade: if development outcomes could be effectively supported by the private sector and markets, the presumption is they should be. Thus, the "Cascade logic" also stresses the identification of institutional barriers that challenge private sector growth in contributing to development outcomes. In all, this IRM follows these guiding notions, with an analysis that emphasizes those regulatory and legal barriers that hinder the development of FDI activity in Lao PDR.

Key recommendations are summarized below:

Lao PDR's FDI is highly concentrated in natural resource-seeking investments and market-seeking investments. The new vision or strategy should attempt to attract **efficiency-seeking investments**, which are precisely the type of FDI that can help the economy enter knowledge-intensive industries.

Lao PDR does not have a clear, explicit and consolidated investment policy. Several development plans and multiple pieces of legislation have been enacted to attract private investment and FDI, in particular. But these various plans, laws and policies remain unconsolidated. Thus, even with significant time spent on due diligence, foreign investors lack credible information to support operations in the country. A new vision, articulated in an Investment Policy Statement (IPS), will be extremely valuable to not only guide and provide confidence to investors, but also guide government officials in ministries, regulatory agencies, and sub-national authorities on the government's strategy vis-à-vis private investment and FDI.

During the investment regime review, several important legal issues were identified that could impact investment. This report provides specific recommendations on how to strengthen the investment protection framework for investors, which will also serve to enhance their confidence and therefore support promotion efforts. The progressive introduction of a novel mechanism to detect and resolve investor grievances (Investor Grievance Mechanism or Systemic Investment Response Mechanism) is also recommended.

With regards entry of investment, the report recommends an effort to identify and reduce (or remove) de facto and de jure restrictions on FDI entry and establishment in the country. A consolidated Negative List of restrictions on foreign investments could be developed. Screening and approval should be improved and streamlined. The institutional framework for investment should be enhanced and simplified with better intra-governmental coordination and exchanges of information between all institutions.

This report provides a roadmap to improve incentive regimes and the promotion framework based on best practices and lessons from experiences of other countries.

The IRM concludes with a Reform Action Plan that defines the reform priorities and sets forth recommendations for concrete short and medium-term action items. This Reform Action Plan should be coordinated with stakeholders to initiate reforms implemented within national political calendars and evaluated against a set of performance indicators. In addition, the IRM provides high-level recommendations on an IPS for Lao PDR.

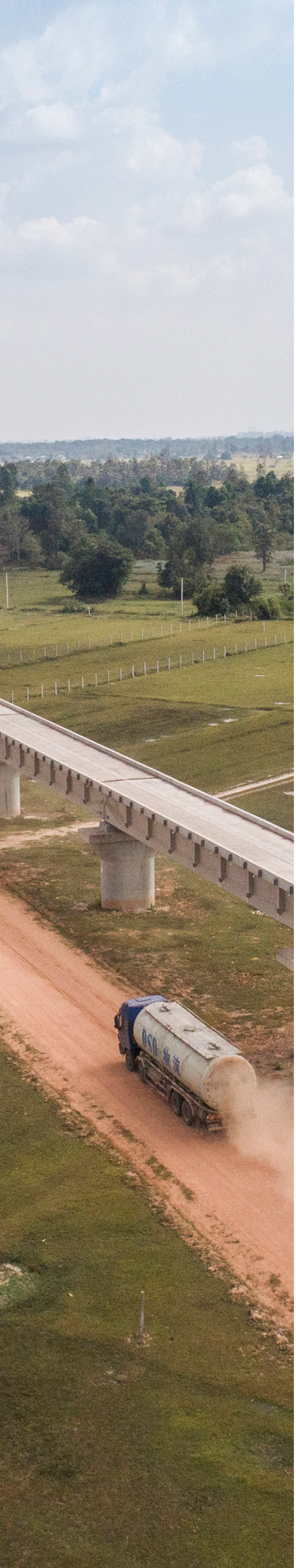
It is important to keep in mind that multiple and severe challenges in Lao PDR's business environment conspire to hinder private sector development. These constraints will necessarily inhibit the prospects for foreign investment to act as a catalyst for economic diversification and upgrading**. Ongoing efforts to improve the investment climate** should not only continue, but be accelerated with fresh impetus.

INTRODUCTION

1. A sound policy framework for investment is critical for FDI to deliver a positive impact on the host economy. This type of external capital can facilitate the transfer of technology and know-how, while also upgrading the country's workforce and firms through linkages and spillovers, diversification into new sectors, activities and integration of domestic firms into GVCs, amongst other benefits. Yet, the likelihood of these positive effects depends on various characteristics of the receiving economy, among which a policy framework conducive to investment activities is key. Moreover, the IRM exemplifies the WBG's strategy on private sector development. A fundamental notion in this strategy is that of "creating markets", with the goal to maximize development finance for value-adding investments, promotion of judicious use of scarce public resources and crowding-in of private capital. The success of this strategy requires enabling policy and regulatory environments that effectively de-risk private sector participation.

2. The IRM is an analytical exercise and a client engagement product, aimed at developing a country's investment policy. An IRM objective is attracting the type of FDI that can help a nation fulfil its development vision. In the case of Lao PDR, this goal is closely linked to FDI's ability to facilitate the upgrading and diversification of the productive structure of the country. The IRM is grounded in two analytical concepts of the investment policy framework designed by the WBG. The first, the investment lifecycle, sees FDI as in a dynamic relationship with the host economy and not merely a one-time transaction. This view corresponds to an investment policy capable of addressing issues along various stages of the relationship between foreign investors and the host economy, including FDI attraction, entry, retention and expansion, and linkages. Second, this framework sees FDI as a heterogenous phenomenon, which can be broadly categorized into four types: natural resource-seeking, efficiency-seeking, domestic market-seeking, and strategic asset-seeking. This taxonomy groups investments across different location determinants, development effects and, subsequently, types of policies.

3. As a tool, this IRM can support the GoL to capitalize on FDI opportunities. The analysis develops a tailored diagnostic to enable and underpin dialogue between the country's policymakers and relevant stakeholders. The output would lead to an agreed Reform Action Plan. The IRM provides policymakers with key analysis to consider FDI policy reform options and priorities. To this end, this IRM report is structured as follows: **Chapter 1** assesses Lao PDR's FDI trends and performance, while **Chapter 2** evaluates opportunities and constraints in its overall investment climate and specific investment policy. **Chapter 3** discusses the incentives regime and **Chapter 4** outlines investment promotion strategies and sectors for priority selection. The IRM concludes with **Chapter 5**, which presents a draft Reform Action Plan for consideration by the GoL.



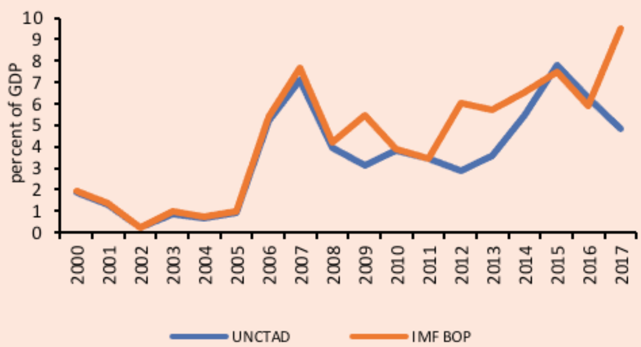
CHAPTER 1

Assessing the FDI performance of Lao PDR

1.1 FDI is a growing source of investment and external finance for Lao PDR

4. FDI is a key source of investment in Lao PDR. Balance of payments data show that net FDI inflows into Lao PDR have increased by more than 40-fold in the last 17 years (Figure 1). While aggregate private investment has been stable since 2015, net FDI inflows have continued to increase. In 2017, FDI accounted for 48 percent of gross fixed capital formation by the private sector (Figure 2). FDI also surpassed both remittances and Official Development Assistance (ODA) in 2012, becoming the largest external financial source (Figure 4).

Figure 1 FDI Inflows, Lao PDR (2000-2017)



Source: IMF BOP and UNCTAD.

Figure 2 Foreign vs. Domestic Investment, Lao PDR (2000-2017)

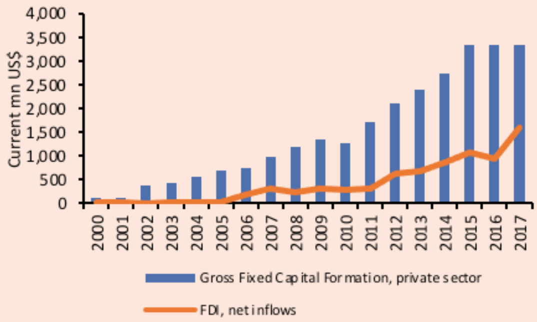
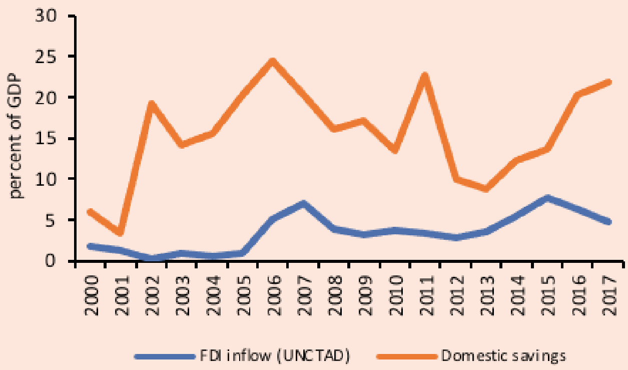
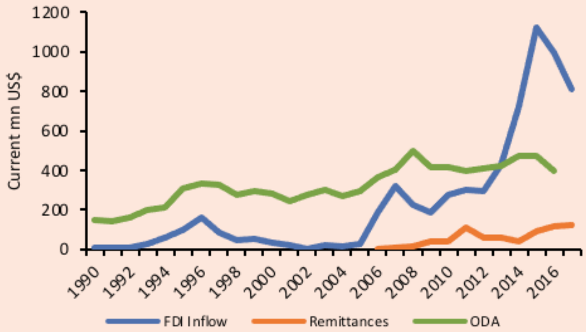


Figure 3 FDI vs. Domestic Savings, Lao PDR (2000-2017)



Source: World Bank (WDI), UNCTAD, and IMF BOP.

Figure 4 Sources of External Financing, Lao PDR (1990-2017)



1.2 Evolution and volatility of FDI in Lao PDR

5. Though FDI has historically been volatile, in the last decade inflows into Lao PDR have accumulated rapidly. FDI inflows peaked in 1996, before the Asian financial crisis, and continued declining until 2005. During this period, GDP growth outpaced inward FDI, with inflows as a share of GDP dropping sharply from 8 percent in 1996 to less than 1 percent in the early 2000s. In 2006, FDI rebounded to 7 percent, dipped after the global recession, and climbed since 2012 (Figure 5).

6. Most FDI into Lao PDR originates from neighboring countries in East Asia & Pacific. Between 2013-2018, the top five sources of FDI (in number of greenfield projects) were all Asian economies: Thailand, Japan, Vietnam, China, and Cambodia (Figure 7). When FDI is measured by project value, however, the United States enters as the fourth biggest source country (Figure 8). To summarize, Lao PDR's FDI is highly concentrated with respect to source countries.

Figure 5 Inward FDI Trends in Lao PDR (1990-2017)

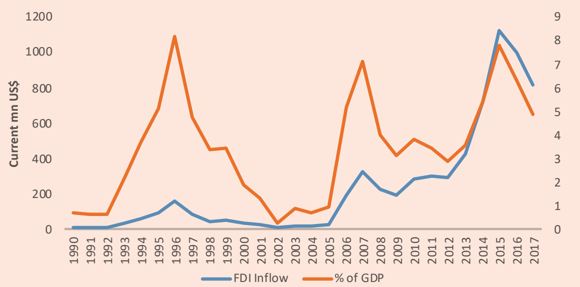
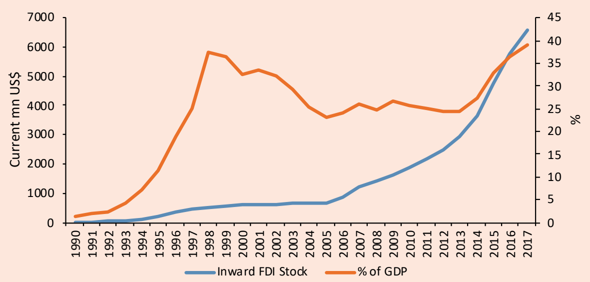


Figure 6 Inward FDI Stock, Lao PDR (1990-2017)



Source: UNCTAD.

Figure 7 Top Sources of Greenfield FDI (number of projects, 2013-2018 August)

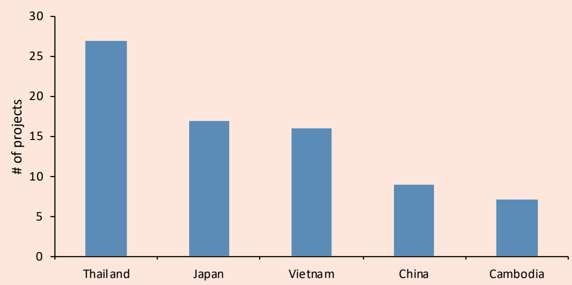
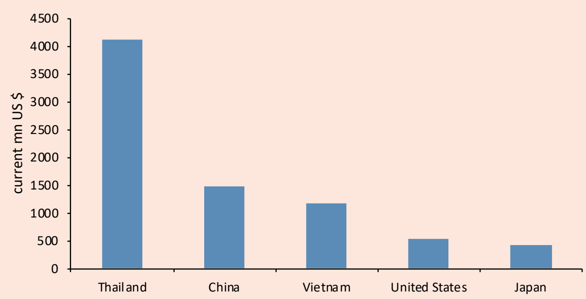


Figure 8 Top Sources of Greenfield FDI (capital investment, 2013-2018 August)



Sources: Financial Times fDi Markets database.

1.3. Benchmarking Lao PDR's FDI performance against its regional neighbors

7. Research shows a clear link between Lao PDR's main source countries for FDI and its trade structure. Lao PDR is landlocked and the least populated country in South-East Asia. As reflected in Figures 9 and 10, the economy heavily depends on trade and investment with regional neighbors, primarily Thailand, Vietnam, China, and Cambodia. In 2016, Thailand accounted for 66 percent of Lao PDR's total imports and 44 percent of total exports, while Lao PDR's second largest trading partner, China, provided 17 percent of its imports and absorbed 30 percent of its exports.

8. FDI growth in Lao PDR gained momentum relative to peer countries before 2015 but tapered afterwards. During 2012-2015, Lao PDR surpassed Thailand, Vietnam and Cambodia in terms of FDI inflows per capita, and ranked only lower than Cambodia when FDI is measured as a percentage of GDP. However, FDI inflows to Lao PDR have fallen during the past three years, while most other peer countries saw rises (Figure 11). The relative decline of FDI inflows in Lao PDR is concerning.

Figure 9 Lao PDR's Export Destinations in 2016

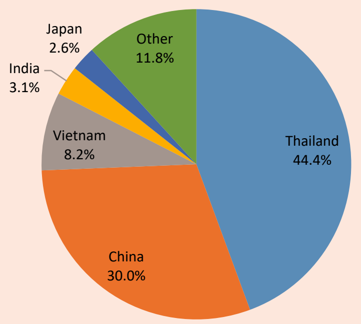
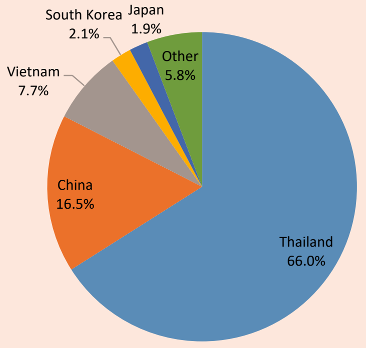


Figure 10 Lao PDR's Import Sources in 2016



Sources: Atlas of Economic Complexity, Harvard University.

Figure 11 FDI Inflows Per Capita - Lao PDR vs. Comparators (2008-2017)

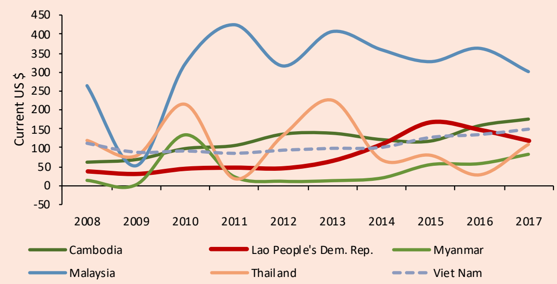
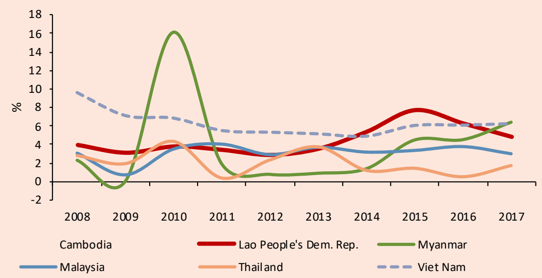


Figure 12 FDI Inflows (percent of GDP) - Lao PDR vs. Comparators (2008-2017)



[2]Whaen assessing a country's FDI performance, it is important to see how the country is faring vis-à-vis other countries. For our analysis, five countries in South-East Asia were selected, some of which are at a similar level of development as Lao PDR. Others, more advanced, can serve as aspirational models.

1.4 Type of FDI entering Lao PDR

9. Despite the significant increase of inward FDI over the past decade, Lao PDR's FDI performance falls short relative to regional peers. Between 2015-2017, Lao PDR's average FDI stock (as a share of GDP) was only 36 percent, the lowest among regional peer countries (Figure 13). When measured by inward FDI stock per capita, Lao PDR registered US$ 840 million on average, just one-fifth of Malaysia's level and only slightly higher than Myanmar, a country that only recently joined the regional competition for FDI after the lifting of international sanctions in 2012 (Figure 14).

Figure 13 Inward FDI Stock (percent of GDP) - Lao PDR vs. Comparators (2015-2017, average)

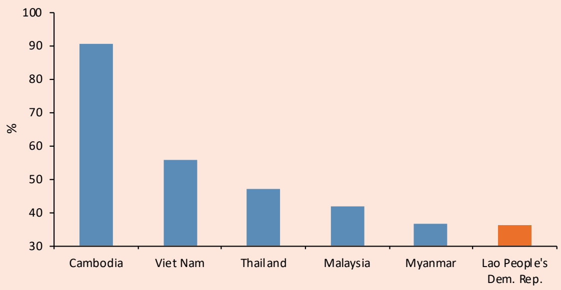
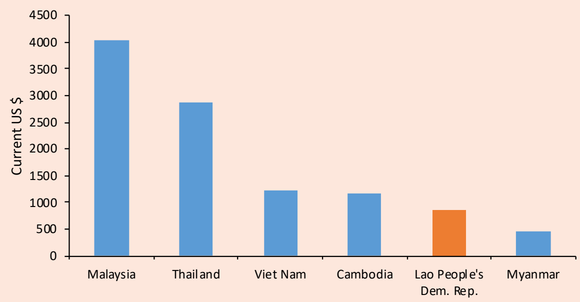


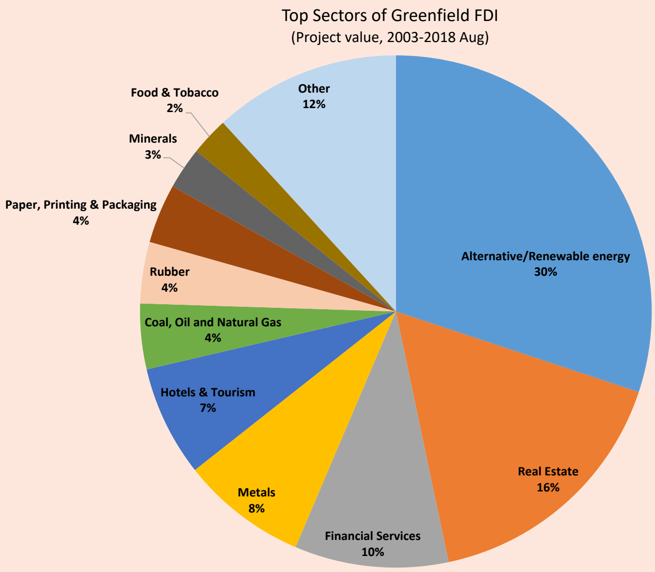
Figure 14 Inward FDI Stock (Per Capita) - Lao PDR vs. Comparators (2015-2017, average)



Source: UNCTAD.

10. As not all investment is the same or brings the same benefits to a host economy, it is important to examine the type of FDI entering Lao PDR. Between 2003-2018, FDI in Lao PDR was concentrated in hydropower, construction and mining: roughly 30 percent of all greenfield FDI was in renewable energy, followed by real estate (16 percent) and financial services (10 percent). Specifically, hydroelectric power made up 79 percent of renewable energy investment. FDI in natural resources (metals, coal, oil and natural gas, and minerals) represented 15 percent of capital investment (Figure 15). Capitalization of resources promoted the expansion of construction and real estate investment. Investment in hospitality (hotels) and tourism has received much attention from foreign investors in recent years, attracting 7 percent of greenfield FDI. Knowledge-intensive sectors (such as industrial machinery, software and IT services) accounted for a negligible share of foreign investment in Lao PDR.

Figure 15 Sectoral Distribution of Greenfield FDI in Lao PDR (top sectors, project value, 2003-2018 August)



Sources: Financial Times fDi Markets database.

11. The composition of FDI in Lao PDR is largely shaped by its natural resource endowment and human capital status. Lao PDR is known for its abundant mineral resources, notably coal, gold, copper and other valuable metals. Reflecting this mineral wealth, its top exports in 2015 were copper ore, rubber, gold and wood (Figure 16). Plentiful water resources and mountainous terrain enable it to produce and export large quantities of hydroelectric energy. Total natural resource rent exceeded 10 percent of Lao PDR's GDP during the past decade. Tourism is emerging as another main economic activity and monopolized 86 percent of service exports in 2017. Thus, it is not surprising that natural resources are a primary motivation of foreign investors interested in Lao PDR.

12. Another way to assess the composition of inward FDI to any economy is to use the Dunning typology (Figure 17), which considers four types of investment based on the dominant motivation of the investor: market-seeking, natural resource-seeking, efficiency-seeking and strategic asset-seeking. When this typology is applied to the case of Lao PDR and considering the total greenfield FDI the country received between 2012-2016, our research finds that market-seeking FDI is the largest category (85 percent), followed by natural resource-seeking FDI (10 percent), while efficiency-seeking FDI only accounts for less than 3 percent of total investment value. The high degree of market-seeking FDI could imply that since 2012, Lao PDR has increased investment diversification away from natural resources. For Lao PDR, market-seeking FDI has traditionally been market-seeking. Additionally, this could also be a response to high domestic consumption demand and a rising middle-income population, as its imports stand at greater than 80 percent.

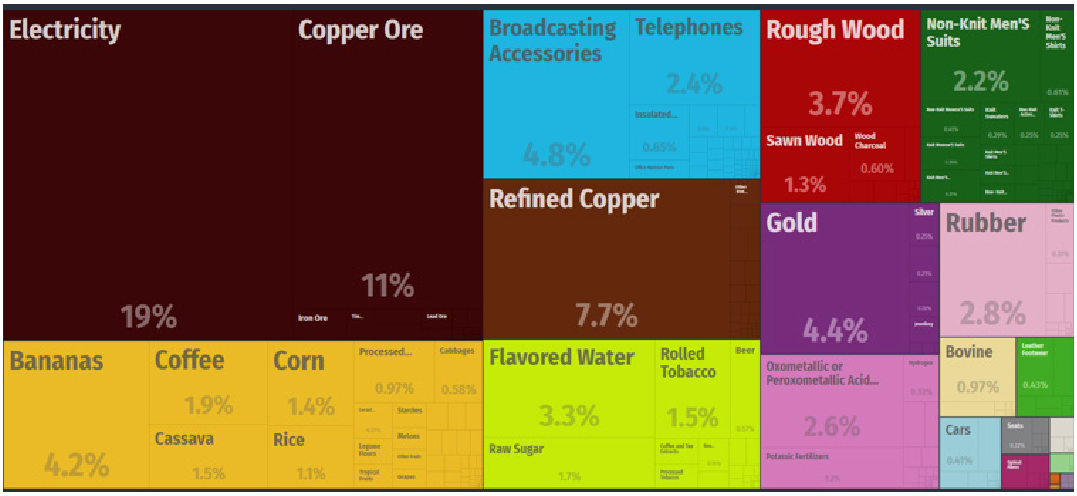


Figure 16 Lao PDR's Export Basket[3] (2016)

Source: The Observatory of Economic Complexity.

Figure 17 FDI Typology

Source: World Bank. 2018. Global Investment Competitiveness Report

[3]By HS-4 product category

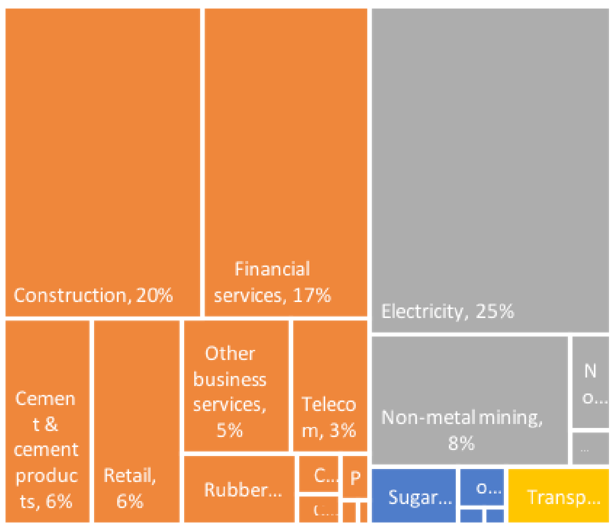
13. The small share of efficiency-seeking FDI suggests that Lao PDR has not fully leveraged regional and global value chains to access external markets. In other words, its economy is not well integrated into regional and global economies. Our analysis shows that Lao PDR receives very little efficiency-seeking FDI. This is a source of concern for its future development, as this type of FDI, with its export focus and thus imperative to be competitive internationally, is known to be the most transformative form among the four types[4]. The main efficiency-seeking FDI projects identified in our analysis are in the sugar and beverages sector (Figure 19). The analysis also shows significant levels of FDI in construction, a sector that creates many jobs but where imports are low. As it formulates a new FDI strategy, Lao PDR should try to attract more efficiency-seeking investments. Market-seeking FDI presents some limitations with respect to its transformative abilities, and there the potential for more market-seeking FDI in Lao PDR seems limited: how many foreign banks and producers or producers of consumer goods can a small economy such as Lao PDR accommodate to serve its limited and slow-growing consumer base.

14. Importantly, Lao PDR is not attracting the type of FDI that promotes skills upgrading, generates knowledge spillovers and creates ample job opportunities. The "lion's share" of FDI is channeled into electricity, construction and extractives[5], yet these sectors create inadequate jobs to fuel inclusive growth. Software and IT services, consumer products, and industrial machinery are examples of sectors that create many jobs per dollar invested and have higher technology and skill intensity. However, these sectors only occupy a marginal presence in Lao's FDI portfolio (Figure 20). Moreover, competitiveness outside resource sectors remains limited. Growth in the non-agricultural sector, largely driven by natural resources, did not result in a commensurate increase in jobs. Only 160,000 non-agricultural wage jobs in the private sector were created between 2002-2012. Growth in manufacturing is stagnant, the sector is small and dominated by garments and food processing. Overall, structural transformation in Lao PDR is sluggish compared with regional peers.

Figure 18 Lao PDR's FDI Typology - Share of Greenfield FDI by Type (2012-2016, number of greenfield projects)

Source: World Bank. 2018. Global Investment Competitiveness Report

Figure 19 Lao PDR's FDI Typology - Share of Greenfield FDI by Type and Sector (2012-2016, number of greenfield projects)



[4]Morrissey, O. (2012). FDI in sub-Saharan Africa: Few linkages, fewer spillovers. The European Journal of Development Research, 24(1), pp.26-31. Fruman C. (2016). Why does efficiency-seeking FDI matter? World Bank blog
[5]Measured by project value.

Figure 20 Distribution of Greenfield FDI by Business Activity, Lao PDR (number of projects, 2003-2018 August)

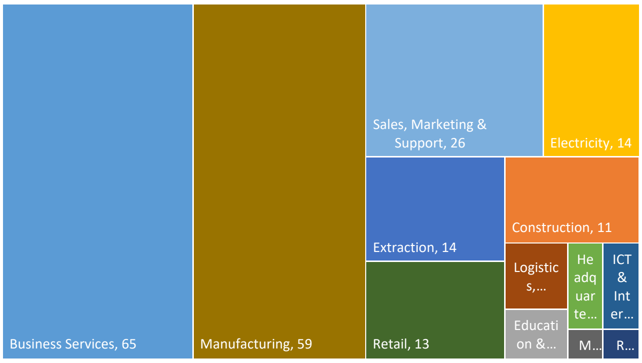


Figure 21 Distribution of Greenfield FDI by Business Activity, Lao PDR (project value, 2003-2018 August)

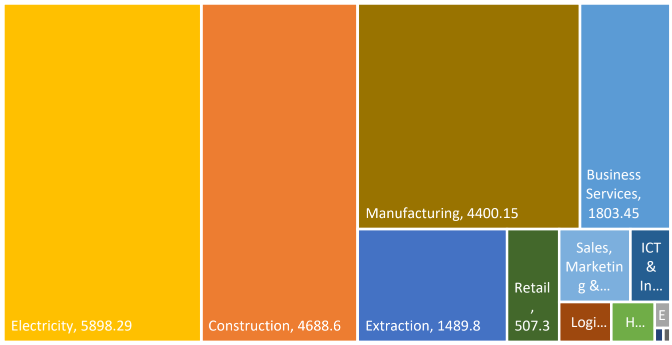
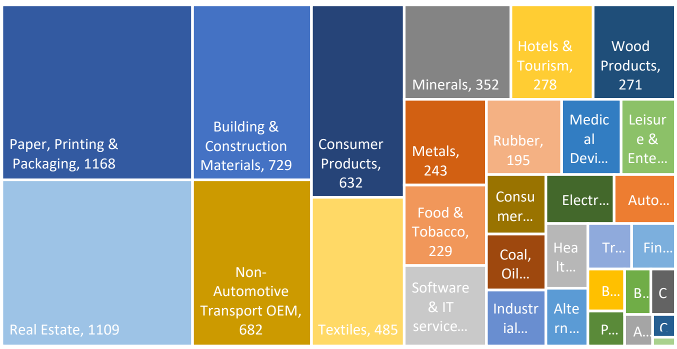
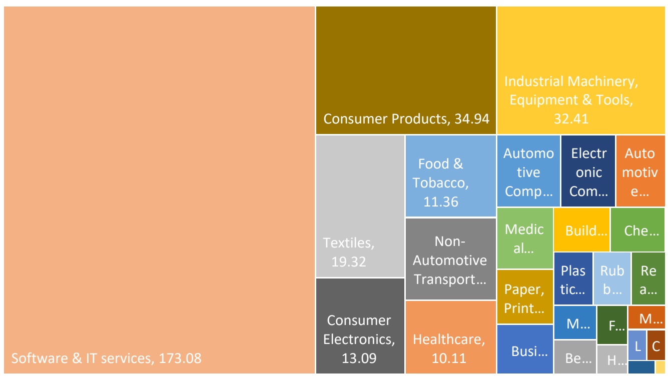


Figure 22 Jobs Created by Greenfield FDI by Sector, Lao PDR (number of jobs reported by investors, 2003-2018 August)



Source: World Bank. 2018. Global Investment Competitiveness Report

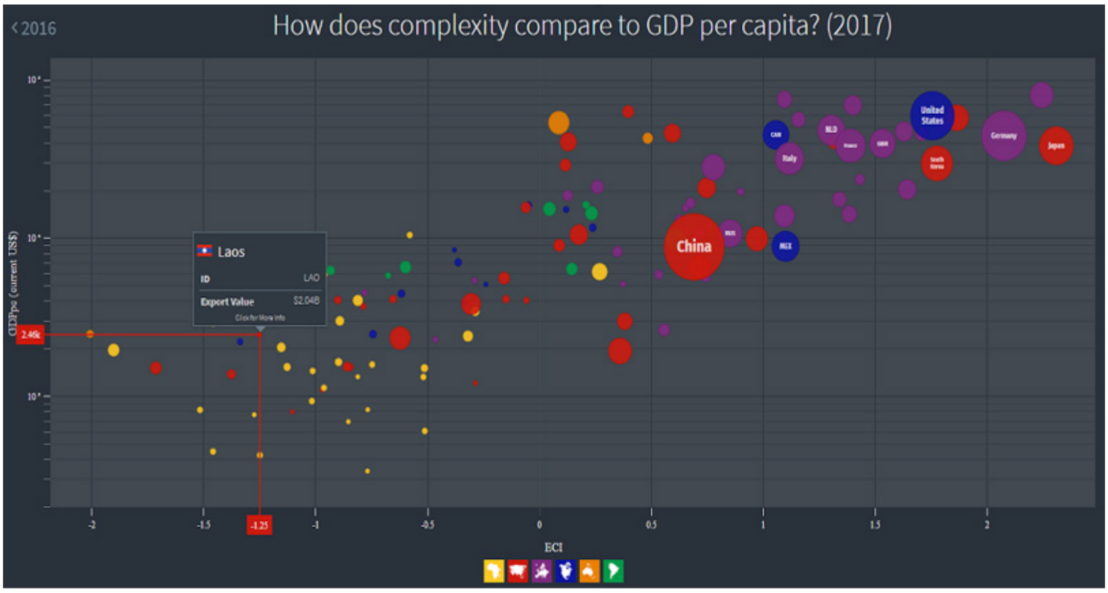
Figure 23 Jobs Created per Million Dollars of Greenfield FDI by Sector, Lao PDR (number of jobs reported by investors, 2003-2018 August)



1.5 Linking Lao PDR's FDI performance to the economic complexity analysis

15. With respect to economic complexity, Lao PDR lags relative to countries at the same income level. Economic complexity reflects the amount of knowledge embedded in the productive structure of an economy. Measured by the Economic Complexity Index (ECI), economic complexity is proven to predict a country's economic growth and competitiveness. Lao PDR's economic complexity is found to be among the lowest globally, with an ECI of -1.25 in 2017 (Figure 24).

Figure 24 Economic Complexity Index vs GDP per capita (2017)

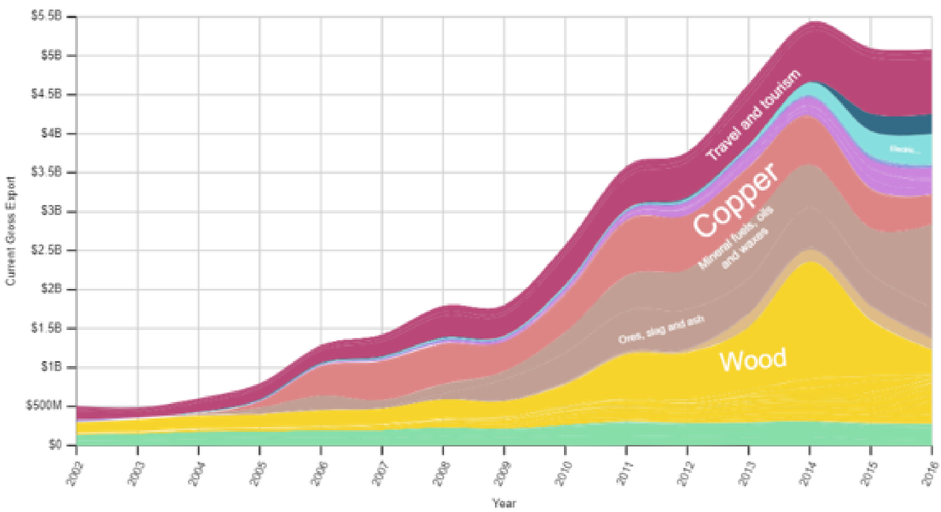


Source: The Observatory of Economic Complexity.

16. Lao PDR's economic complexity has decreased by 71 places over the past three decades. Driven by increasing demand from neighboring countries, Lao PDR embraced the commodity boom and encouraged resource-related investments and exports. However, high growth fueled by exploiting and exhausting resource endowments is not sustainable. To avoid the "resource curse[6]" , it is important Lao PDR moves up the value chain and upgrades productive capabilities to increase its product complexity. Attracting efficiency-seeking FDI has a paramount role to play in this regard. A nascent electronics industry is emerging in Lao PDR and expanded its export mix to include telephones and radio parts (Figure 25). This could be a good starting point to promote and diversify FDI in higher-end manufacturing.

Figure 25 Lao PDR's Exports: Emergence of Electrical Machinery and Equipment

Source: Atlas of Economic Complexity, Harvard University.



[6] The "resource curse" is a condition in which countries that are abundant in natural resources tend towards less growth, development, and poor democracy. Research by Jeffrey Sachs and Andrew Warner found a strong negative correlation between economic growth and high natural resources.

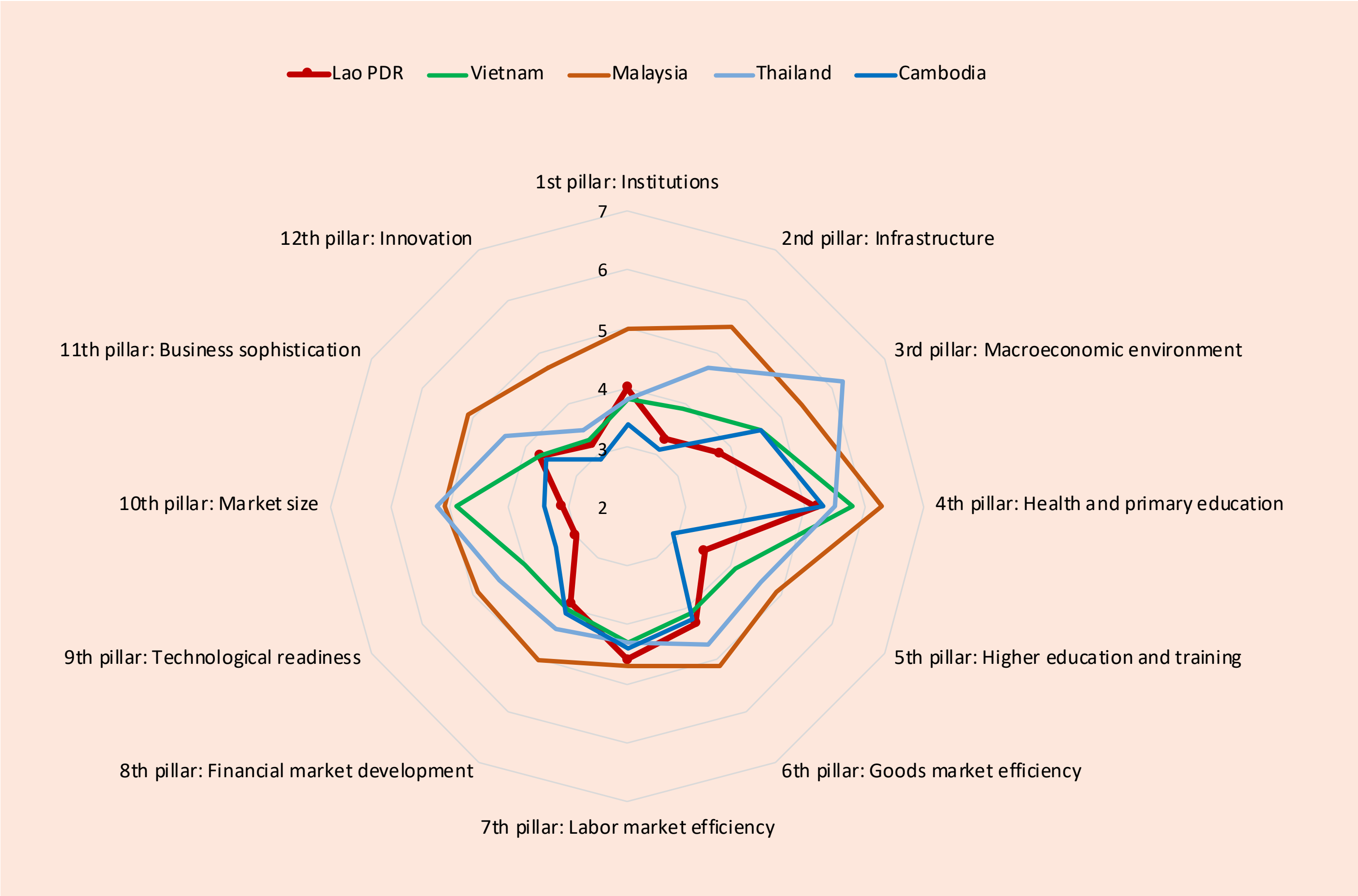
CHAPTER 2

Assessing the Investment Environment of Lao PDR

2.1 Overall investment climate of Lao PDR

17. Investment climate refers to the general business environment that affects private sector operations, including foreign and domestic investment. Our research[7] finds that as Lao PDR transitions into a market economy, its investment climate is improving while remaining poor in many regards (Figure 26). Rule of law is weak, business procedures are protracted and costly, while protection of property rights is insufficient. All of these elements contribute to jeopardizing the country's ability to create a dynamic private sector.

Figure 26: Global Competitiveness Performance in 2018, Lao PDR and Peer Countries

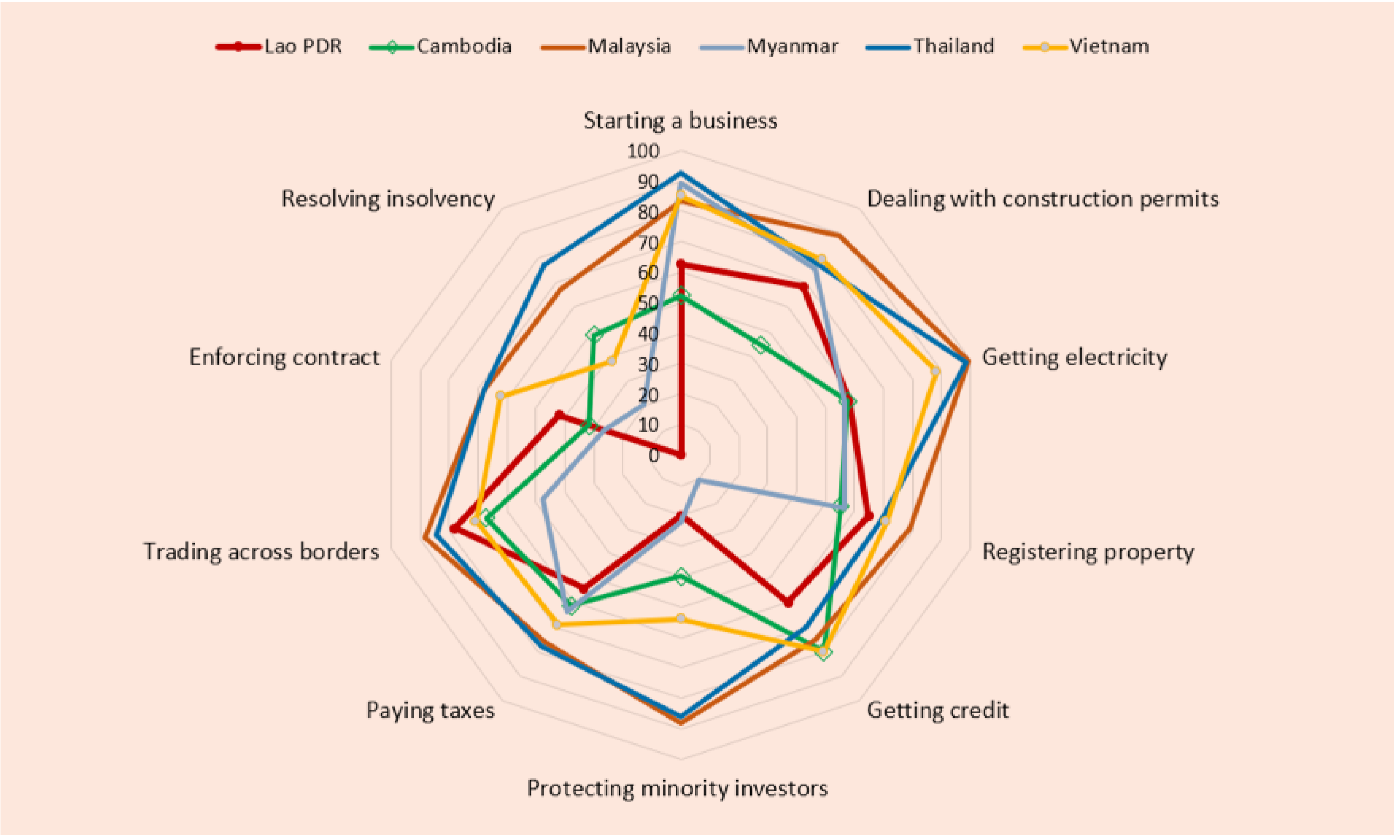


Source: World Economic Forum Global Competitiveness Index.

[7]Evaluating an investment climate is usually done through using enterprise surveys and standard indicators measuring the difficulty of doing business in a given country. This report used both methods and sources of information.
[8]Importantly, World Bank Ease of Doing Business data for Lao PDR only covers domestic investors. As such, these results serve merely as a proxy to also describe the investment environment for foreign investors.

18. Burdensome procedures, unpredictable law enforcement and discriminatory regulatory environment conspire to hamper investment. Lao PDR has a relatively low ease of doing business score of 50.8 out of 100 in the 2020 World Bank Ease of Doing Business report[8], trailing far behind the regional average of 63.3 and peer countries. A closer investigation reveals a grim picture of the business environment on multiple dimensions (Figure 27). Starting a business requires as many as 173 days, while the regional average is only 26. Getting electricity is another major challenge that takes 87 days and costs 705 percent of income per capita. Protection of minority investors is inadequate, enforcing contracts and resolving insolvency are extremely slow and costly. Doing Business reports are measured against domestic businesses, any additional steps or requirements faced by foreign investors are not counted in reports. Lao PDR is among the most challenging countries to invest and operate a business, as investors must obtain numerous permits from various agencies, go through cumbersome and complicated procedures, and bear huge risks. To appeal to notoriously fickle and sensitive efficiency-seeking investors, Lao PDR should urgently prioritize removal of these perceived obstacles. Protecting minority investors' rights, streamlining and simplifying business procedures, improving contract enforcement and reducing the costs and risks related to resolving insolvencies are the first steps toward a more conducive business environment that nourishes investment.

Figure 27: Lao PDR's 2020 Ease of Doing Business Score



Source: World Bank, Doing Business.

2.2 Logistical challenges impede Lao PDR's FDI attractiveness

19. Our research finds that Lao PDR's poor logistics impedes private investment and disincentivizes efficiency-seeking investment. As markets in the global economy are increasingly linked, logistics remains a core enabler for development. Indeed, transport costs were recently found to be higher in Lao PDR than neighboring countries, a result of a thin transport sector with low productivity levels and underutilization of weight capacity in the sector[9]. Between 2012-2018, Lao PDR's average Logistics Performance Index (LPI) ranking was 120th out of 190 countries, significantly worse than most peer countries[10] (Figure 28). The LPI quantifies how easy or difficult it is in a country to transport general merchandise. It comprises an array of activities beyond transportation, including warehousing, brokerage, express delivery, terminal operations, related data and information management. In a world where connectivity is pivotal to competitiveness and prosperity, huge gaps in logistics in Lao PDR undermines its investment attractiveness and development potential. The LPI thus goes beyond Customs procedures, for which Lao PDR's performance is relatively satisfactory[11].

20. While Lao PDR has made great strides in logistics in the past two years, improvements in timeliness were modest and even worse than 10 years prior. Timeliness measures the efficiency of shipments in reaching destinations within the scheduled or expected delivery time, key to supply chain reliability. The low "timeliness" rating severely crimps business operations and can keep efficiency-seeking FDI at bay. As explained earlier, efficiency-seeking FDI is precisely the type of FDI that Lao PDR is not receiving but should strive to attract due to its transformative effect. Efficiency-seeking investors are firms that produce in a host economy and then export outputs to third countries. This makes efficient, economical and timely logistics even more critical for this type of investor than for other types.

Figure 28: Logistics Performance Index, Lao PDR (2018)

Source: Logistics Performance Index.

Figure 29: Logistics Performance Index, Average Rank (2012-2018): Lao PDR vs. Regional Comparators

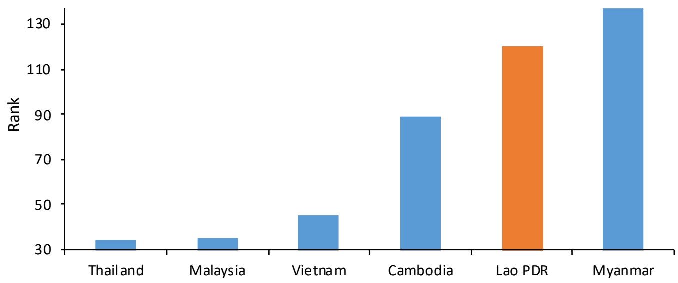
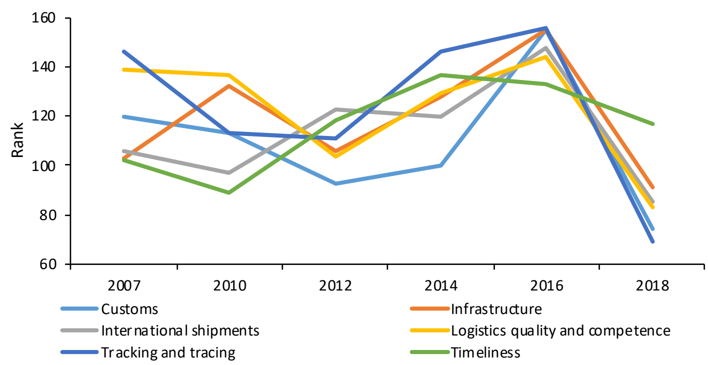


Figure 30: Lao PDR's Logistics Performance Index



Source: Logistics Performance Index.

[9]See World Bank Group. 2018. "Transport Costs and Prices in Lap PDR. Unlocking the Potential of an Idle Fleet."
[10]Notably, due to data consistency issues with LPI, Lao PDR's performance has moved up and down in recent years, without any clear underlying reforms underpinning the results. In addition, LPI data is only collected from non-Lao transport providers.
[11]As measured by the Doing Business Trading Across Borders indicator.

2.3 Human capital challenges

21. Low educational attainment has stymied Lao PDR's inclusive growth path through industry upgrading. Standardized tests have confirmed that Lao students learn very little from the basic education system (Figure 31). Lao children also spend fewer years in schooling in relation to peer countries. Despite the officially high enrollment figures in primary education, drop-out rates are high and completion rates are low. Only 77.5 percent of pupils starting in Grade 1 make it to the last year of primary school, and a mere 44.7 percent of children are enrolled in secondary school (Figure 32). Indeed, the World Bank Human Capital Project found that when years of schooling were adjusted for quality of learning in Lao PDR, children received the equivalent of 6.4 years of schooling. The 2014 Lao PDR Development Report found that many workers lacked foundational skills, such as the ability to read. Natural resource sectors are capital-intensive and offer relatively few job opportunities. The main engine of inclusive employment – manufacturing – is underdeveloped in Lao PDR and concentrated in activities that process raw materials.

22. Human capital remains a binding constraint for Lao PDR to tap into broader benefits of industrialization and achieve inclusive growth. In 2017, the agricultural sector employed more than 60 percent of the country's labor[12], while wage employment only constituted 16 percent of total employment. Among all factors in the World Economic Forum's firm survey1[13], _foreign investors pointed to an inadequately educated workforce as the most problematic factor for doing business in Lao PDR. Moreover, the country is impacted by an ongoing "brain-drain", with a skilled emigration rate of 37.4 percent in 2013. More recent data shows that brain drain remains an important issue: for instance, The Global Economy 2020 places Lao PDR as the 37th most affected country in the world (out of 176 included in the analysis)[14].

Figure 31: Harmonized Test Scores (2018): Lao PDR vs. Regional Comparators

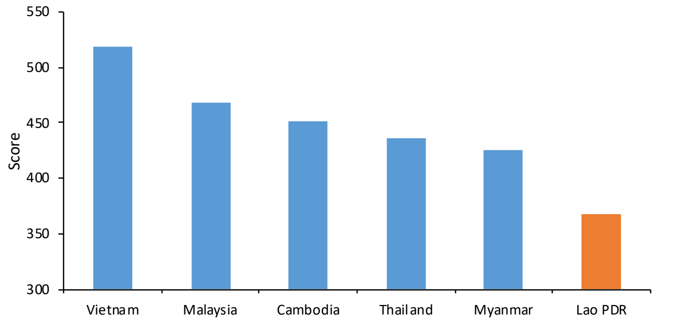
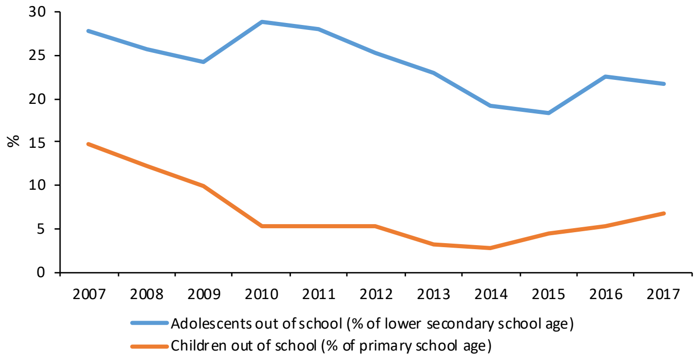


Figure 32: Lao PDR: School Drop-Out Rates



Source: World Development Indicators.

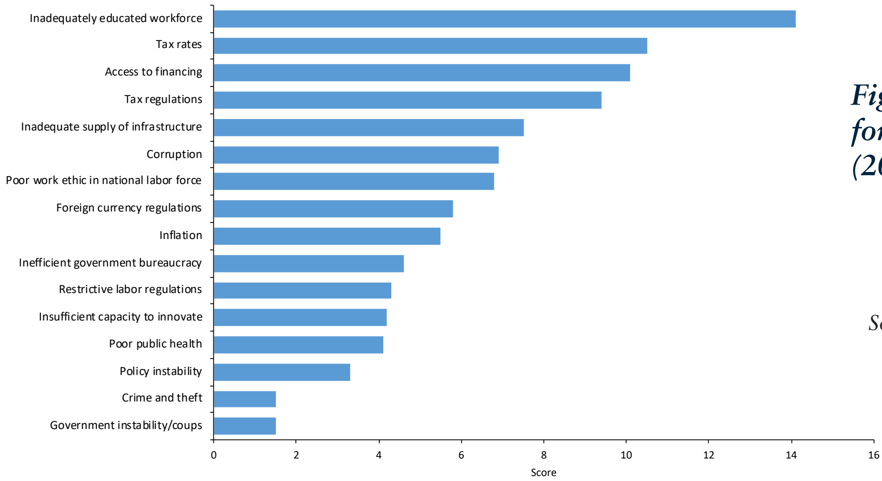


Figure 33: Most Problematic Factors for Doing Business in Lao PDR (2018)

Source: WEF Global Competitiveness Report, 2017-2018.

[12]According to ILO estimates.
[13]Global Competitiveness Report 2017–2018, World Economic Forum.
[14]Data retrieved at https://www.theglobaleconomy.com/rankings/human_flight_brain_drain_index/

2.4 Lao PDR's investment competitiveness

23. Numerous aspects of investment climate and business environment, ranging from available skills to the quality of the country's business environment, influence an investor's decision-making and attractiveness to a given country's economic sectors. The Investment Competitiveness Benchmarking (ICB) analysis diagnoses sector-specific constraints in Lao PDR, and thus identifies potential benefits and challenges for its FDI attraction. In short, the ICB completes this exercise by benchmarking Lao PDR's performance on any given indicator (Table 1) to the performance of all other countries that have successfully attracted FDI to a given sector or business activity (see Annex 1 for a comprehensive review of the ICB methodology). Again, the purpose of this analysis is **not to select sectors for prioritization**, but rather to assess Lao PDR's overall investment competitiveness. As such, the ICB analysis is conducted for sectors found to have attracted large amounts of greenfield FDI in recent years or highlighted in the country's 2018 National Socio-Economic Development Plan. These sectors include agriculture (proxied by food and tobacco)[15], energy (proxied by alternative and renewable energy), financial services, transportation, and tourism (proxied by hotels and tourism)[16].

Table 1: Summary of Investment Competitiveness Benchmarking Categories

Investment Climate Area	Pillar	Description
Demand	Demand	Domestic and foreign market size; national GDP per capita and growth; regional GDP per capita and growth.
Production Factors	Labor & Skills	Total size of labor force and labor force participation rate; literacy rates and primary, secondary, tertiary education enrollment rates; quality of education systems and training schools; labor practices (hiring and firing, pay and productivity); country capacity to attract and retain talent.
	Geography & Natural Resource Endowment	Access to land; percent of land area is arable; renewable water resource availability; urban population and population density.
	Existing Capabilities	Capital and value-added per worker; production and business sophistication; measures of supplier quality and quantity; capacity for innovation, research and development (R&D) spending; availability of latest technologies and firm-level technology absorption; and licensing and certifications.
Key Inputs	Energy	Electricity production; access and cost of electricity.
	Transport & Infrastructure	Quality of air transport, railroad, port, and road infrastructure; timeliness and tracking of international shipments; logistical competence; and fixed broadband internet subscriptions.
	Finance	Access to credits and loans, availability and affordability of financial services, soundness of banking system.
Institutions	Regulatory Barriers	Burden of government regulation; bureaucracy quality; tax rates; cost required to register property, start a business, and receive a construction permit.
	Rule of Law & Property Rights	Government effectiveness; extent of bribery; corruption and policy measures; legal proceedings and efficiency of legal system; strength of insolvency.
	Market Contestability	Anti-monopoly policy; extent and intensity of competition; prevalence of trade barriers and tariffs.
	Macroeconomic & Political Stability	Economic and political risk; debt and inflation measures; current account balance; political stability and risk; voice and accountability; conflict and ethnic tensions; cost of crime.

Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice, World Bank Group.

[15]Agribusiness was proxied using the food and tobacco sector in fDiMarkets. The fDiMarkets sector definition follows the classification developed by the Financial Times. As such, this sector's classification includes a variety of sub-sectors, ranging from raw crop products to manufactured food products.
[16]See Annex 3 descriptions of the ascribed Financial Times' fDiMarkets sector classification.

24. With respect to Lao PDR's investment competitiveness, the ICB analysis found that Lao PDR faces constraints in attracting FDI to higher value-added activities within its key sectors. The results of the ICB analysis are presented in Annex 1. It finds that Lao PDR's investment climate demonstrates that it is currently competitive in attracting FDI towards basic activities across all priority sectors. As an example, for the alternative/renewable energy sector, it is presently only competitive in welcoming FDI towards electricity-generating activities (Annex 1, Figure 43) and construction activities within hotels and tourism (Annex 1, Figure 47).

25. In the long run, to attract FDI to more sophisticated activities higher up the value chain, the ICB finds that Lao PDR needs to make significant improvements across its investment climate. As mentioned, the country struggles with the quantity and quality of its human capital, a finding that is supported by ICB. Technological readiness and innovative capacity are unsurprisingly low given the poorly educated workforce. Access to finance adds a significant barrier for investors, particularly to smaller businesses. Market contestability presents further constraints for FDI attraction in key sectors. In fact, a small number of State-owned entities dominate key sectors like financial services, transportation and utilities. Lastly, macroeconomic risks are elevated as external debt rose to 98 percent of GDP by 2016. Fiscal accounts face large imbalances as the government funded huge investments in infrastructure, despite its inability to collect a fair share of revenues from the natural resource sector.

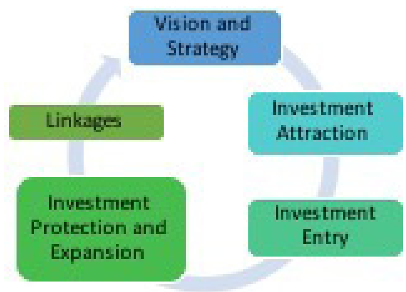
26. Regarding Lao PDR's business environment, significant improvements are critical to attract foreign investors. As outputs of the ICB analysis show (Annex 1), Lao PDR faces binding constraints to woo FDI across its priority sectors. Specifically, Lao PDR's comparative costs required to obtain construction permits, register property as well as poor border compliance and total tax rates were the top binding constraints to the business environment. In other words, very few to no countries in the world with Lao PDR's level of performance in these aspects of doing business have managed to attract foreign investors to these sectors in recent years. Of the priority sectors assessed, the ICB found the investment competitiveness of the alternative/renewable energy sector presented the relatively best performance.

27. For Lao PDR to improve its overall investment competitiveness, it remains critical these economic, business environment, and institutional constraints that deter FDI are addressed. Increased FDI inflows, especially to include a significant share of efficiency-seeking investments, have the potential of setting Lao PDR on a sustainable and inclusive development path. Efficiency-seeking FDI could bring advanced technology and know-how, upgrade skill sets of the domestic labor force and diversify its economy in favor of high value-added activities. To maximize these benefits, a holistic approach is required. Sound investment policies that remove legal, regulatory and administrative impediments must be bundled with efforts to fill gaps in infrastructure and human capital.

2.5 FDI vision and strategy in Lao PDR

28. The investment vision refers to the national economy's position on foreign investment and how it sees the role of investment in the overall national development strategy. For Lao PDR to see a beneficial role of FDI towards its development objectives, it is critical the country's development vision and strategy (Figure 34) is translated into clear short- and medium-term agendas. For some countries, the vision takes the form of an IPS. In the case of Lao PDR, our research has not found an official and publicly available document (resembling an IPS), in which the GoL has articulated its FDI vision.

Figure 34: Investment Lifecycle



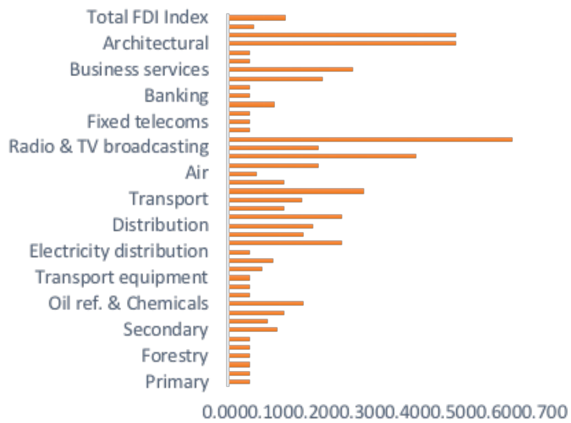
Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice.

2.6 Entry and establishment of investments

29. To an extent, the 8th National Social-Economic Development Plan (NSEDP) 2016-2020 provides insight into national FDI objectives. The 8th NSEDP, five-year plans, promotes foreign investment and a favorable business environment as key objectives and explicitly characterize FDI as an important contributor to economic growth. The 8th NSEDP assigns a target contribution of up to 30 percent of FDI to Lao PDR's GDP. Additionally, the 8th NSEDP acknowledges Lao PDR's fragile economic base, which sees undeveloped undiversified commercial goods production and an economy vulnerable to external factors. In the 8th NSEDP, the GoL essentially acknowledges that to ensure sustained and inclusive economic growth, it needs to provide strategies for investment attraction supported by transparent enforcement of legislation, rules and regulations. The document identifies several priority investment areas: industrial processing, handicrafts, energy, mining and infrastructure development, tourism, wholesale and retail, logistic services, finance and banking. Though these are valid objectives, experts would agree the handful of direct and indirect references to FDI in the 8th NSEDP do not amount to a clear and comprehensive investment policy or vision. Moreover, the 8th NSEDP's objective to increase Lao PDR's competitiveness can be actualized through investment promotion policies and industrialization strategies. Consequentially, the first recommendation of this IRM is the GoL formulate a clear and distinct investment policy, articulated in an IPS.

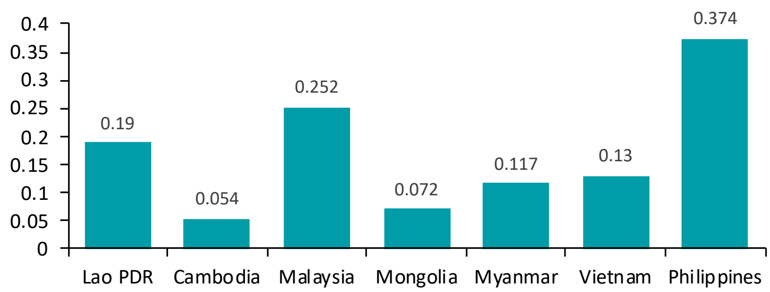
30. De jure statutory restrictions or obstacles can prevent the entry and participation of foreign investors in the Lao PDR economy. Our analysis considers one form of FDI entry restrictions out of four tracked by the OECD FDI Regulatory Restrictiveness Index, namely foreign equity limitations and screening for investment approval[17]. As Figure 35 shows, Lao PDR maintains a relatively high number of foreign equity limitations in several sectors and activities, particularly services (business services, media, engineering, wholesale distribution). Moreover, relative to its Asian peers, Lao PDR is the third most restricted country in the panel, only behind the Philippines and Malaysia (Figure 36). It is more restricted than all other regional peers highlighted, and significantly more closed than Mongolia or Cambodia, the latter the most open economy of the panel in terms of FDI equity limitations. Some sectors with high FDI restrictions (transport, distribution and business services) are key towards increasing Lao PDR's economic activities and competitiveness.

Figure 35: Foreign Equity Limitations, Lao PDR



Source: OECD Restrictiveness Index.

Figure 36: FDI Equity Restrictions – Lao PDR and its Regional Peers



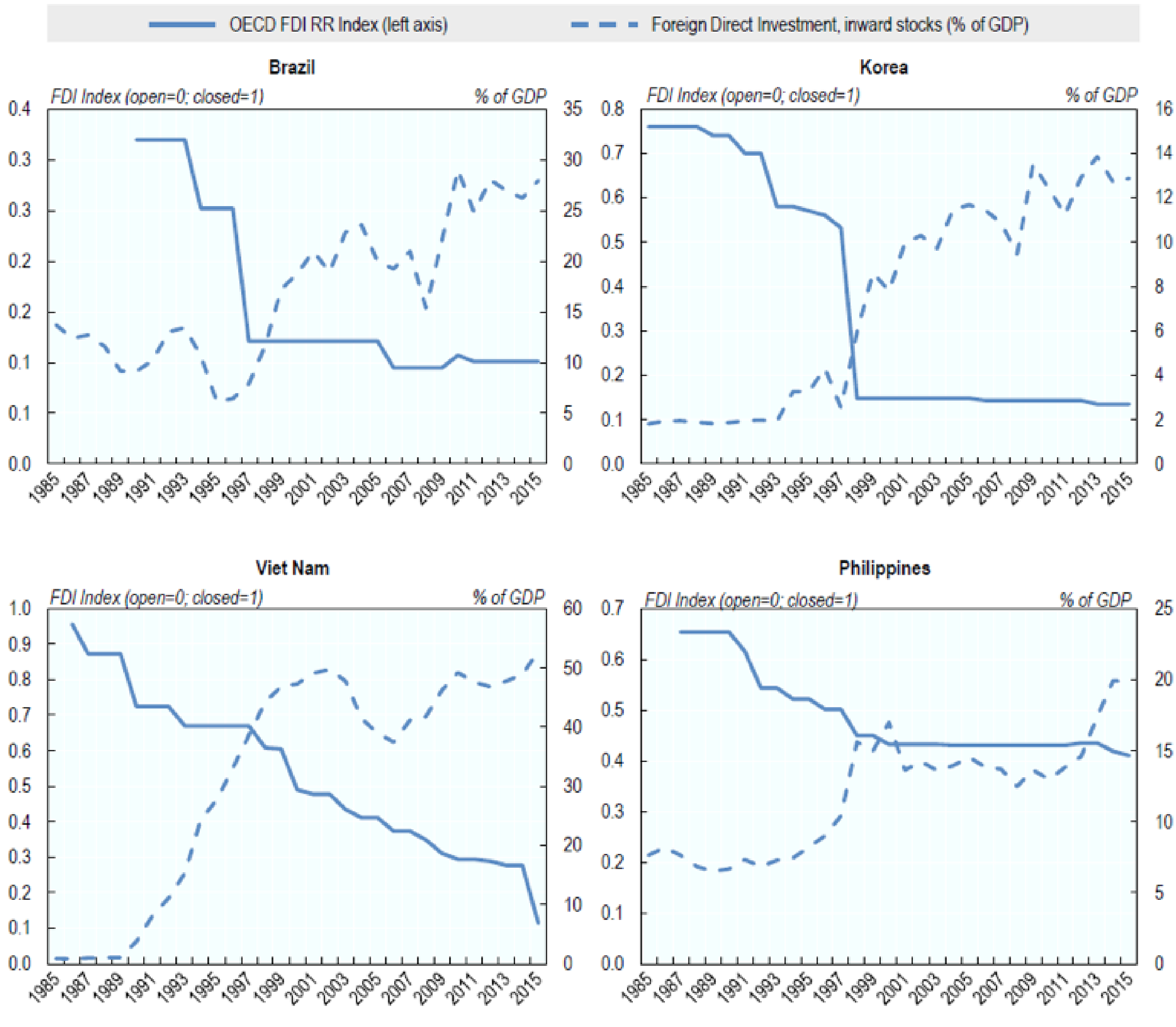
Source: OECD.

Sources: OECD FDI Index; World Bank IPP research (March 2019).

[17]The OECD FDI Regulatory Restrictiveness Index (FDI Index) measures **statutory restrictions** on FDI across 22 economic sectors. It gauges the restrictiveness of a country's FDI rules by looking at the **four main types of restrictions on FDI**: 1) Foreign equity limitations, 2) Discriminatory screening or approval mechanisms, 3) Restrictions on the employment of foreigners as key personnel and 4) Other operational restrictions, (restrictions on branching, capital repatriation or land ownership by foreign-owned enterprises). Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is the average of sectoral scores. The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and State monopolies, to the extent they are not discriminatory towards foreigners, are not scored.

31. Additionally, there is a correlation between the impact of easing entry restrictions in a country and its ability to attract higher levels of FDI. Brazil, Republic of Korea, the Philippines and Vietnam are examples of economies that have reduced restrictions on FDI entry[18]. As Figure 37 shows, these economies have since registered a significant increase in FDI inflows (as measured in percentages of GDP). This underlines the importance of removal or reductions in restrictions to entry. As a result, the opening of more sectors and activities to foreign participation, is key for a country that aspires to improve its FDI performance.

Figure 37: Reducing FDI Entry Restrictions and Impact on FDI inflows



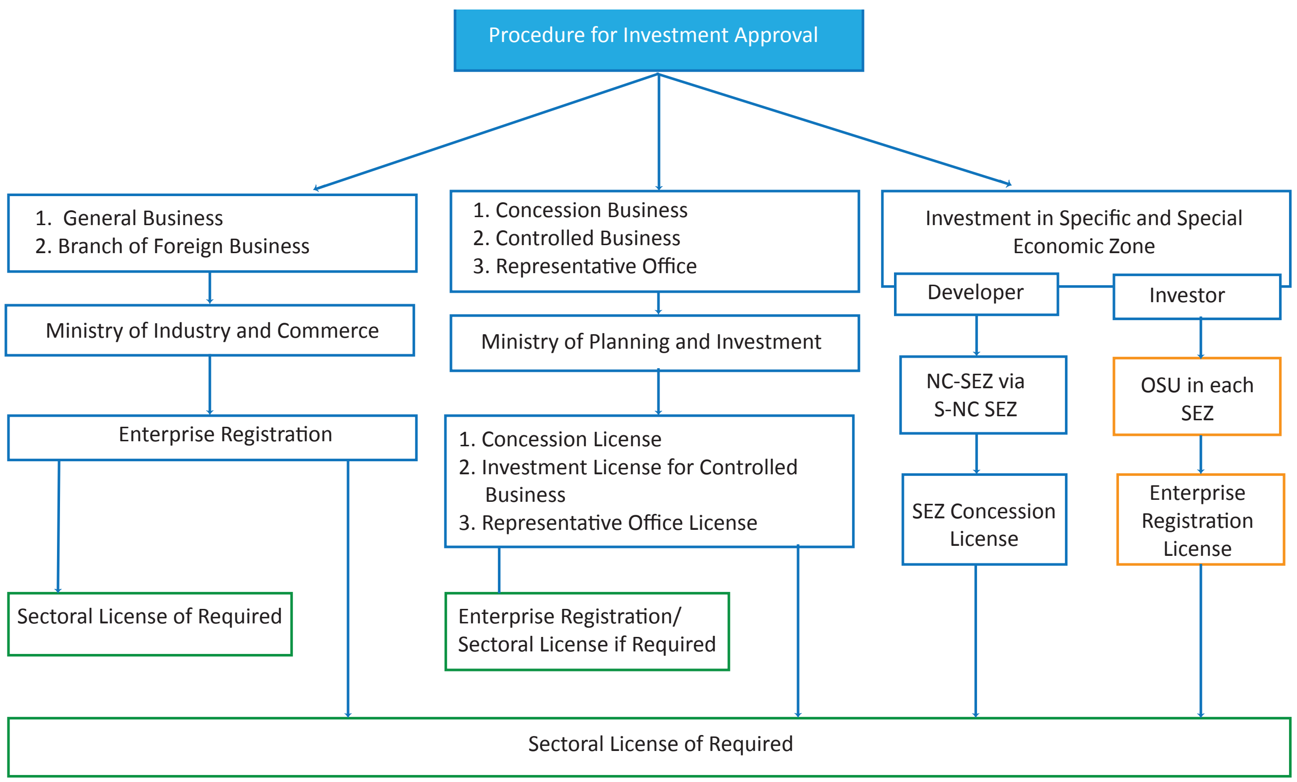
Sources: OECD FDI Index; WB IPP research (March 2019).

[18]As measured by the OECD Restrictiveness Index

32. Investment entry into Lao PDR is not straightforward. The Investment Promotion Law 2016 (IPL 2016), which replaced the Investment Promotion Law 2009 (IPL 2009), and its relevant decrees open all investment sectors and areas in Lao PDR except in "the sectors prohibited by Law, such as those areas considered detrimental to national security, the natural environment, public health and national culture and subject to the list of controlled businesses". Lao PDR does not have a complete list of entry restrictions. The language used in the IPL provides the GoL with significant room for discretion in determining sectors or areas detrimental to national security, the environment, public health or culture. This type of language does not provide foreign investors with certainty. The IPL 2016 also lists "promoted" sectors (agriculture, agro-processing industry, handicrafts and services) where 100 percent foreign ownership is allowed.

33. Furthermore, the **investment approval process is complicated** (divided into three categories), as illustrated in Figure 38. Prospective investors in Lao PDR must identify destination sector(s) before approaching the relevant agencies and whether their investments fall within the General Business which is divided into "Uncontrolled General Business", "Controlled General Business" or "Concession Business" categories. This is because the IPL (Articles 32-33) divides investment into **three categories** that each determine the investment entry process. The first category is General Business which includes "opened" activities and those under the Controlled Business and Concession Business lists. Investment in **opened activities** can go **directly to enterprise registration** at the Ministry of Industry and Commerce (MoIC), possibly complemented by sectoral operating licensing and depending on the activity. Investments in **controlled businesses** undergo prior screening through the **One-Stop Service Office for Investment at the MPI or provincial center, depending on the sector,** then to company registration complemented by sectoral licensing. Investments in **Concession Business** undergo screening and approval by the MPI (if not a legal entity, they first go to enterprise registration).

Figure 38: Investment Entry Procedure into Lao PDR



Source: Authors' own interpretation of the process flow based on information from the MPI and MoIC.

34. The list of required legal documents for investors interested in investing in General Business, Branch of Foreign Company, Concession Business, Controlled Business and Representative Office categories are shown in Table 2. It clearly shows fragmented legal framework for investment entry into Lao PDR, where investors are required to refer to different types of legal documents depending on the type of business invested in.

35. In addition, some investors may face investment entry approval, permits and licenses after obtaining investment entry approval. For example, at entry level into a four-star or more hotel business, an investor must comply with at **least three different procedures.** The investor must submit an application to invest under the Controlled Business category. At this stage, the investor is required to provide financial statement or source of funding certified by domestic or international financial institutions and show evidence of registered capital, not less than 30 percent of total capital in such a project. Upon obtaining Controlled Business approval, the investor must undergo enterprise registration and gain an operating permit under the Law on Tourism, No. 32/NA (24 July 2013). Article 78, Law on Tourism makes a cross reference to the Law on Enterprise and Law on Investment Promotion.

36. Businesses located within special economic zones (SEZs), such as the Savan Seno Special Economic Zone, are permitted 100 percent foreign ownership. Investors in one of the many SEZs must deal directly with authorities of the respective SEZ.

Table 2: List of Legal Documents for General Business, Concession Business and Controlled Business

1. General Business 2. Branch of Foreign Business	1. Concession Business 2. Controlled Business 3. Representative Office	Investment in Specific and Special Economic Zones
• Negative List (List of Conditional Types for Foreign Investors, List D02-2015). List of business types, business sizes, enterprise types and company forms reserved by ministries for consideration before approval of enterprise registration. • Instruction on Establishment of Foreign Enterprise Branches (legal entity), No. 1619/IC.ERM (dated 28/08/2013). • Ministerial Decision No.0023/2019 on Enterprise Registration determining the list of activities requiring operating licenses after registering a company.	• Prime Minister's Decree on Endorsement of Business Activities under the Controlled Business List and Concession List of Lao PDR, No. 3/2019. • Articles 55 and 56 of the Investment Promotion Law (2016).	• General Investment: Developers and investors can invest in all sectors in a SEZ, except for government prohibitive activities. General investments will not receive any promotional policy from SEZ. • Promotional Investment: Promotional investments, according to a SEZ Administrative Committee or Economic Administrative Board regulation, are mainly electronic industries, scientific and new technological research in the production of modern construction equipment, tourist precincts infrastructure, production and processing of hygienic agricultural products, organic products, production for export, forestation, schools and hospitals.

Source: Authors' own interpretation of the process flow based on the information from the MPI and MoIC.

2.6.i Investing in a general business

37. As discussed, there are two types of General Business under the IPL: Uncontrolled General Business and Controlled General Business as per the Controlled Business list determined in Decree No. 03/PM (10 January 2019). Uncontrolled General Business investors shall refer applications to the MoIC under the Enterprise Law. The MoIC issued three different types of lists under the Enterprise Law, namely restrictions to FDI in areas reserved for Lao people only in the Notification on reserved business category list for Lao people No. 1328 (13 July 2015) (Reserved List), the conditional business category for Foreign Investors in the Notification on conditional business category list for Foreign Investors (Conditional List) No. 1327 (13 July 2015) and the list of prohibited sectors namely the Notification on Prohibited Business Category List No. 1592 (26 August 2015) (Prohibited List).

38. The three lists are generally market access documents that link access to domestic investors only or foreign investors meeting certain conditions. The reserved list gives foreign investors access to the sector in the Reserved List subject to issuance of the enterprise registration certificate(s) and necessary operational licenses from the relevant line ministry. The Conditional List states minimum capitalization requirements for foreigners in each sector. The Reserved List and Conditional List contain foreign equity restrictions in each designated sector. The prohibited list generally closes the listed sectors to private investors.

39. Those investing in General Businesses may register enterprises under the Enterprise Law upon ascertaining they are not subject to restrictions. Lao PDR has abolished registered capital requirements for foreign investors as implemented through IPL 2016 and Notification No. 2770/Cabinet/MoIC (17 November 2017).

40. SEZ investors shall refer investment proposals to the relevant SEZs. Each SEZ has a one-stop shop which handles all investment applications, enterprise registration and incentive applications.

2.6.ii Controlled business and concession business

41. Controlled Business and Concession Business investors are subject to IPL 2016 procedures under MPI jurisdiction. Controlled and Concession Business lists are contained in the Decree on Endorsement of the [Business Activities under] the controlled business and concession lists of Lao PDR, No. 03/PM, (10 January 2019). Decree No. 03/PM (2019) lists 43 Controlled Businesses (compared to 62 sub-sectors in 2016) and 22 Concession Businesses. Those investing in Controlled Businesses and Concession Businesses may apply to register an enterprise at the MoIC only upon obtaining necessary investment approval(s).

42. IPL 2016 defines Controlled Business activities as "businesses that have an impact on the stability of national security, public order, national traditions and environment, society and nature" (Article 34). This article states these business activities will be determined by relevant sector authorities and/or the Investment Promotion and Management Committee (IPMC). It further adds the government will periodically set the Controlled Business list. The definition is further expanded by Decree No. 03/PM (10 January 2019) as "business activities affecting national security, social order, good and beautiful national tradition and culture and environment; society and nature to ensure stable growth of socio-economic development (Article 2)". Decree No. 03/PM in Annex A provides a list of 43 activities. Controlled Business investors require recommendations from relevant governmental agencies and will be subject to IPMC approval.

43. An investor planning to invest in a Controlled Business must submit an application to the One-Stop Service Office (OSSO) at central and provincial levels in accordance with division of administrative levels. Investors in possession of an enterprise registration certificate, under the Enterprise Law, intending to invest in a new or additional Controlled Business must submit the application to the OSSO directly. The OSSO shall coordinate with relevant governmental agencies at central and local levels to review and submit the application to the IPMC to consider and approve no later than 25 working days from the date which the OSSO received all complete documents in the application. After receiving the approved investment license, the individual or legal entity can proceed with the investment in accordance with the law. If business activities are required by laws or regulations of relevant sectors to obtain a specific license prior to operating such business activities, the enterprise shall apply for the business operating license in accordance with the legislation.

44. Decree No. 03/PM, 2019 lists a Concession Business as "a business activity requiring government concession such as land concession, development of SEZ and industrial processing zones for export, mining, development of energy sources, aviation concession and telecommunication (Article 2)." Domestic and foreign legal entities wishing to invest in business activities under the concession list are required to submit an application through the OSSO at central or provincial levels. Upon review, the application is sent to the IPMC, either at central or provincial levels, to consider no later than 65 days from the date the OSSO received all complete documentation. The IPL still retains some discretionary measures in the award of a Concession Business. For example, in the selection of investors, the IPL provides for "negotiations" of initial agreements (Article 32), broad content of the concession agreement (Article 34) and subjectivity of terms of investment (Article 36).

2.6.iii Possible reforms to investment entry

45. Our analysis highlights several shortcomings in the existing investment entry framework. A first series of issues pertain to the institutional framework for investment entry, which seems overly complex and confusing. Numerous governmental agencies at central and provincial levels are involved in one way or another, with overlapping competences, duties and functions. For instance, the IPL 2016 establishes the IPSC as the central investment body. However similar committees exist at provincial level, which could lead to duplication of functions between central agency and provincial agencies. Unlike investment authorities in ASEAN member states, the IPMC does not include private sector representation. For example, the Chairman of the Thai Chamber of Commerce sits on the Board of Investment (BOI) of Thailand, at least six of 14 members of the Board of the Malaysian Investment Development Authority are from the private sector and eight of 14 EDB Singapore Board members are from the private sector. These are examples of practice among more developed ASEAN member states in setting-up investment-related authorities. Private sector representation in the investment committee would add credibility to the body and ensure business perspectives and interests are taken into account. According to the OECD (2019), having a private sector representative on the board is a positive initiative, as it ensures the views and interests of businesses are taken on board in investment promotion agencies' (IPAs) broad strategic directions[19]. The IPL 2016 established a One-Stop Shop (OSS) for investors which, on paper, was a reasonable idea. However, the concept of "one-stop" shop for investment has been undermined by the existence of two OSS models, one under MPI and another under SEZs.

46. Secondly, the form of entry process for each type of investment is equivalent to what is called "screening and approval", a mode of entry far from today's best practices. The IPL and Enterprise Law provide for numerous activities subject to different levels of screening and approval. A potentially long list of Controlled Business, Concession Business and General Business included in the Reserved and Conditional Lists subject to screening goes against international best practices, which encourage reduced entry screening of investments. Investment entry screening is seen as a bottleneck that could negate investment promotional activities, whilst adding to investor costs that together could be considered an investment constraint. Investors are normally concerned with the speed, predictability and transparency of approval processes and subsequent

[19] OECD (2019), Mapping of Investment Promotion Agencies: Middle East and North Africa, Paris.

issuance of permits and licenses. Lao PDR could move from investment screening by encouraging free entry screening. Within ASEAN, Thailand has limited investment entry screening where foreign investors are required to obtain necessary sectoral permits from line ministries or agencies. In addition, investors are required to seek approvals from the BOI sub-committee for investment projects valued 200-750 million baht (US$ 6.1-23 million) and export-led projects exceeding 750 million baht (US$ 23 million) in investment value. The sub-committee is also responsible for screening projects with an investment value exceeding 750 million baht (US$ 23 million) prior to BOI Board consideration and approval. Malaysia and Singapore do not generally screen foreign investments on entry. Nevertheless, investors may be required to seek sectoral regulatory approval from relevant agencies. In addition, Myanmar's Investment Law 2016 outlines specific types of investments requiring investment permits from the Myanmar Investment Commission.

47. To avoid undesirable investments, Lao PDR may provide a list of prohibited or restricted investments in the National Negative List, thus providing advance information to potential investors on types of investments subject to advance screening when entering the country. Lao PDR may take steps to speed-up the approval process and in some circumstances, may even introduce automatic approval or mere registration of investments. Many activities on the lists seem relatively straightforward and could undergo enterprise registration and line ministry for licensing (crop farming, cement manufacturing, air transport, luxury hotels, legal services) without screening. Not having a finite list of activities under control, but relatively broad criteria, leaves ample room for **discretion**. Any sector could affect national security, public order, cultural traditions, society and nature, and could be added to the list. Best practice is to make investment entry automatic or as automatic as possible, using company registration (Box 1) as the main process to register domestic and foreign investments. If screening is used, it should be selectively, maybe in a handful of sectors the government finds strategic or sensitive. Outside these few "special" cases, entry into most economic sectors should be as automatic as possible, and subject to simple registration. In Lao PDR, however, screening seems to be pervasive to the point it has become the default mode of entry. The form and extent of screening differs: there is "special screening" for businesses in the Controlled Business and Concession Business; and "simplified screening" for businesses under General Business.

Box 1: Good Regulatory Practices for Company Registration

Business registration is the gateway through which businesses enter the formal economy. Legal recognition and the ability to conduct business as a legal entity provides businesses with rights to government services, fair treatment under the law, limited liability, less uncertainty, and greater access to credit and markets, thus enabling the businesses to thrive, grow, invest, and employ[20]. A system of efficient and effective business regulations can support firm creation and increased productivity. At the outset of the business lifecycle, it is important that business establishment processes are clear, simple and fast. Countries that have efficient business registration processes tend to have a greater number of new firms entering the market and a larger number of businesses per population (business density)[21]. At the same time, higher entry costs are associated with a larger informal sector and a smaller number of legally registered firms[22]. Ultimately, higher compliance costs negatively affect firm profits and discourage entrepreneurs, which in turn reduces job creation in the economy[23].

In order to establish a business and commence operations, in many countries a business (either foreign or domestic) typically needs to undertake a number of steps involving approvals or acknowledgments from one or more institutions. First, it needs to be registered as a legal entity (for example, a limited liability company, a sole proprietorship or a joint stock company). Often, that is followed (or done simultaneously) with registration at the tax authority and with the social security institution. In many countries, there are additional registrations and licenses that are needed in order to be fully recognized as a legal entity before it can conduct business activity. However, these are not in compliance with good international practice to streamline the requirements and processes for business establishment. Better practice is that sector licenses can be acquired after registration as a legal entity.

[20]"Reforming Business Registration: A Toolkit for Practitioners", 2013, World Bank Group.
[21]Klapper, Leora, Anat Lewin and Juan Manuel Quesada Delgado. 2009. "The Impact of the Business Environment on the Business Creation Process." Policy Research Working Paper 4937, World Bank, Washington, DC.
[22]Barseghyan, Levon, and Riccardo DiCecio. 2009. "Entry Costs, Industry Structure and Cross-Country Income and TFP Differences." Working Paper 2009-005C, Federal Reserve Bank of St. Louis.
[23]Fonseca, Raquel, Paloma Lopez-Garcia and Christopher Pissarides. 2001. "Entrepreneurship, Start-Up Costs and Employment." European Economic Review 45 (4–6): 692–705.

Registration as a legal entity has an entirely different public policy objective from obtaining a sectoral license. Good practice countries, including Singapore, New Zealand, the United States and many countries in the European Union, do not link registration as a legal entity with conducting business in a specific sector and getting a license. In fact, there is an increasing trend to allow applicants for company registration to just state that they will "engage in all legally permitted business activities". After registration, the LLC, sole proprietorship or joint stock company can decide what licenses are needed to conduct business if they want to operate in a particular sector.

Sectoral licenses should be imposed only in cases where there is a demonstrated policy purpose (such as protection of the health and safety of the population), where there is a legal basis (there is a specific law or regulation that requires a license or permit), and where it imposes minimum burdens on businesses to achieve the government's policy purposes. Since licenses are a strong command-and-control regulatory instrument, they should be used sparingly.

Licenses are often linked to on-site inspections, for example for health or workplace safety. Inspections are a means to control compliance with requirements and can be conducted: (1) before a license is issued to ensure that the applicant meets all necessary prerequisites or (2) after receiving the license to ensure that the company remains in compliance with their obligations. It is usually difficult to inspect all business entities, so a better practice is using risk assessment. This means that government is adapting its regulatory control to need. For example, businesses with a good compliance record (they have not been previously penalized) or engaging in a low risk activity (which is unlikely to harm public health, safety or property) should have less frequent inspections, lighter requirements, and lower penalties. For businesses with a poor compliance record or engaging in a high-risk activity (such as having many employees in a factory or having potentially polluting activities), then the level of control should be higher. Proper use of risk assessment in inspections will lead to a monitoring and enforcement system that creates lower burdens for the majority of low risk businesses, better achievement of government's policy objectives, and lower costs for government because it is targeting its scarce government resources where they will have the most impact.

Source: Business Regulation team, World Bank Group (2019).

2.7 Investment entry recommendations

48. Based on the above description and analysis, our recommendations for Lao PDR are to:

Revise the institutional framework for investment with a view to simplifying it, by:

- reducing the number of entities involved in the investment entry process. Optimally, the investor should only engage one authority, such as the one-stop shop. Alternatively, the investor should just deal with the authority issuing permits and licenses;
- consolidating all investment entry regimes and processes under one ministry;
- improving intra-governmental coordination and exchanges of information to further streamline entry processes;
- clarifying the roles and responsibilities of each institution involved in the investment entry process.

Reform the entry process and particularly seek to reduce the extent of screening by:

- identifying a small number of strategic sectors where investors are subject to screening as well as a small number of sectors subject to national security or strategic interest screening, such as telecommunications, mining or banking;
- clarifying that investments in all other sectors can enter automatically, without screening and by proceeding directly to company registration (possibly complemented by sectoral licensing that may be required in certain sectors). Lao PDR needs to rely more on these processes (enterprise registration, sectoral licensing and permitting) to regulate investment, rather than relying in ex-ante screening;
- reducing the room for discretion and ad hoc actions. Laws and regulations should clearly identify specific criteria for issuing approvals for investment licenses or for operating permits and licenses. Approvals must only be issued based on applicants meeting criteria. In addition, operational guidelines for investment approval are needed to guide implementation of laws and regulations, monitoring and reporting.

Consolidate all restrictions to entry of foreign investment in a Negative List under the IPL. The list should:

- be as short as possible (long negative lists mean numerous restrictions or prohibitions to foreign investment participation which would not be consistent with the objective of attracting more FDI into the economy);
- be revised on a regular basis (every one or two years) with a view to considering further liberalization (reductions to the negative list);
- use standard classifications to designate sectors and activities in the negative list.

To conclude this entry section, it is important to note the above analysis focused mostly on de jure restrictions, that is how entry restrictions and approval processes are defined under various laws and regulations. As a final recommendation on entry, we recommend the GoL commission a study or project to identify and reduce (or even eliminate where possible) de facto restrictions that can delay or prevent entry and participation of foreign investors in Lao PDR.

2.8 Investment protection

49. The importance of investment protection for foreign investors is well-known and well-documented. The 2017 Global Investor Survey, conducted by the World Bank's Investment Policy and Promotion team, clearly showed that foreign investors in developing economies were extremely concerned about political risks and investment protection. According to this survey, 81 percent of respondent investors considered investment protection important or critically important (Figure 39).

50. A key area of concern for foreign investors in the ASEAN[24] region is inconsistency and frequent changes in investment regulations. This is evidenced in numerous surveys and publications, such as the A.T. Kearney Investor Confidence Index[25], Economist Corporate Network[26] as well as by participants and panel members at the ACIA[27] Forum in Kuala Lumpur, 2013[28]. These and other surveys underline that investors are concerned at uncertain legal environments in ASEAN member states, with respondents concerned governments may change their minds over policy and legal issues with little or no warning and that court decisions could be highly arbitrary. According to the survey, the most consistent and standardized rules and regulations in ASEAN were in the following sectors, with the most consistent listed first: hotel and leisure; professional services; telecoms, IT and software; financial services; transport and logistics; agriculture; chemicals; manufacturing; healthcare and pharmaceuticals; consumer goods; commodities and energy; and property and construction.

51. The Economist Corporate Network survey found the largest impediments to business in Asia-10 countries were laws governing the establishment of a commercial presence and those restricting movement of labor – skilled and unskilled. Most ASEAN member states impose foreign equity limits on certain sectors or activities. Use of a foreign equity limit varies significantly between countries, with some legal and administrative instruments requiring foreign investors to obtain government approvals for almost all investments, even in non-sensitive sectors.

52. The Business Council of Australia found that other investment laws were applied beyond-the-border once an investor had approval to invest, but before a local entity could operate[29]. For

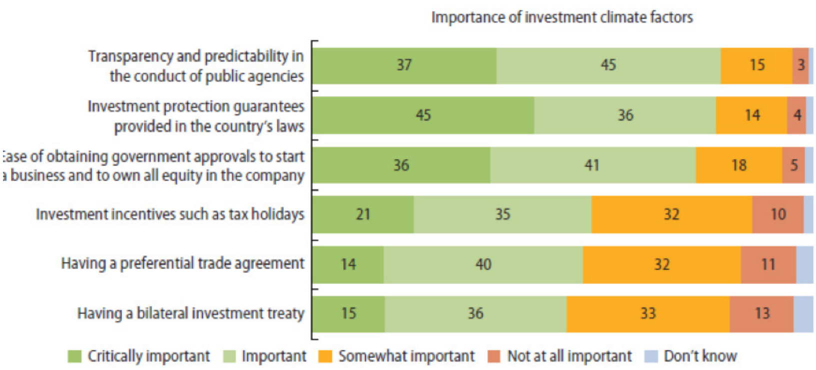


Figure 39: Investors Seek Predictable, Transparent, and Efficient Conduct of Public Agencies

Source: World Bank. 2018. Global Investment Competitiveness Report.

example, licensing and authorization requirements and restrictions on employment of personnel may be included in laws that apply equally to local businesses, but discriminate against a foreign business. The result of ACIA Forum discussions underlined the critical need for ASEAN member states to increase the efficiency of investment facilitation, whilst enhancing good governance and ease of doing business and transparency in rules and regulations.

2.8.i How investment protection is organized in Lao PDR

53. Our team conducted an in-depth analysis of investor protection in Lao PDR. Firstly, we defined investor protection based on six core guarantees that should form part of a robust investor protection framework. These guarantees are: 1) National Treatment (NT), 2) Most Favored Nation (MFN) treatment, 3) Fair and Equitable Treatment (FET), 4) protection against expropriation, 5) profit convertibility and transfer and 6) access to Investor-State Dispute Settlement (ISDS) methods. Secondly, this IRM reviewed Lao PDR's domestic legislation and international investment agreements to determine the extent to which these guarantees are recognized. The results of this analysis are presented below. While this is an assessment of de jure protection, the level of protection as defined under law, we also recommend the government extends this analysis to de facto protection in how guarantees are enforced in practice.

2.8.ii Domestic legislation

54. Lao PDR's investment legislation can provide an example of best practice for investor rights and guarantees. The legislation is by no means the only aspect of law applicable to foreign investors, let alone all private investors. However, since the entire domestic framework is applicable (from the Constitution, to tax and commercial laws, and sectoral legislation), Lao PDR's investment legislation is reviewed in this section for one essential reason. This reason is even if rights and guarantees may exist in other laws of the land, investment legislation that does not sufficiently include the six core guarantees would not be considered in line with best practice. As investment legislation is often the only piece of legislation that potential foreign investors will review, the damage to the economy in terms of investment lost even before investors enter Lao PDR will never be known. As investment law should be a primary tool in the arsenal of the country and institutions in charge of investment promotion and regulation to market Lao PDR as a destination for FDI, it is imperative that no effort be spared to align investment law with best practice.

55. Obviously, how the law is implemented and enforced is equally important. As such, the IPP team advises the order of actions to be: 1) strengthen the investment regime, on a de jure basis, and then 2) improve its implementation. Lao PDR's investment law is enshrined in the IPL, as amended in 2016. The law applies to domestic and foreign investment and investors (Article 1).

56. The IPL does not specifically incorporate the principle of National Treatment nor Most Favored Nation treatment. Article 22 provides that: "The State protects legitimate rights, interests and equality of all domestic and foreign parties of the economy who invest under Lao PDR laws, treaties, agreements to which Lao PDR is a party". This is a weak affirmation and cannot be considered as meeting NT or MFN standards. These standards are defined in a specific way in best practice legislation as well as in IIAs, including those applicable to foreign investment in Lao PDR (as will be shown in Section 2.8). The fact these standards are not present in domestic laws, but are incorporated in some IIAs, means these two core guarantees are only available to foreign investors from countries that have signed such IIAs with Lao PDR (directly or through membership of ASEAN or other regional organizations). We take the view these core

[24]Association of Southeast Asian Nations.
[25]A.T Kearney, Back to Business: Optimism amid Uncertainty, Foreign Direct Investment Confidence Index, 2013.
[26]The Economist, "Riding the ASEAN Elephant – How business is responding to the unusual animal," February 2013.
[27]ASEAN Comprehensive Investment Agreement.
[28]An ASEAN Project funded by AADCP II. Forum on the ASEAN Comprehensive Investment Agreement (ACIA Forum) conducted in Kual Lumpur, 21 March 2013, attended by about 200 participants mainly from the business and investing sectors.
[29]Business Council of Australia, Australia's Trade and Investment with Asia, 2011.

guarantees and indeed all six, should be extended to all foreign investors through domestic legislation to make Lao PDR a more attractive and safer investment destination. Similarly, Article 22 cannot be interpreted as extending "Fair and Equitable Treatment" to investors. This provision is vague compared to best practice investment legislation or even to ACIA, which covers FET in its Article 11. At its core, FET relates to transparency and due process.

57. The IPL includes a weak guarantee against expropriation. Article 23 provides that: "The government fully acknowledges and protects the lawful investment of investors against government seizure, confiscation or nationalization by administrative means." It adds that: "In case the government has the needs to utilize the facilities for public interests, the investors shall be compensated with actual invested value at the prevailing market price at the time of transfer using payment methods as agreed by both sides." This falls short of the best practice standard in several ways:

- The term "expropriation" is not used
- The term "indirect expropriation" is not used, meaning that indirect expropriation is not covered by the guarantee. Indirect expropriation is a growing form of expropriation and one that increasingly worries investors
- The IPL does not fully include four criteria internationally recognized and used to consider an expropriation lawful, namely: public interest, absence of discrimination, due process and compensation. Only two of these criteria are included (public interest and compensation)
- The best practice elements of compensation, "adequate, prompt and effective", are not included in the clause
- The IPL provides that the method to compute compensation must be mutually agreed between the State and investor. It is unlikely both parties would agree a method once an expropriation has taken place or in advance, through a contract for instance. Not all investors have a contract with the State. Best practice is to provide in domestic law that fair market value will be applied and the value will be assessed based on the value of the enterprise or assets the day before the expropriation took place.

Overall, the expropriation clause in the IPL is not in line with best practice investment regimes.

58. Transfer of funds is addressed in Article 71 of the IPL. It states: "Foreign investors have the rights to repatriate capital, assets and income, such as profits from investment, personal cash and assets, or assets of the enterprise through banks located in the Lao PDR after full payment of duties, taxes and other fees in accordance with laws and regulations." The provision does not guarantee, as it should, that investors have the right to transfer in a freely usable currency, and that they have the right to a prompt transfer (without undue delay).

59. The IPL could be improved with coverage of situations when transfers can be temporarily suspended. As an example, in 2013, the Central Bank of Lao PDR (BOL) used the IPL to impose daily limits on currency conversions (not on transfers), in response to low currency reserves. This type of restriction should be mentioned as a possible, temporary exception if permitted under agreement with the International Monetary Fund (IMF). Also, best practice investment laws (and IIAs) typically include more categories of funds and financial transfers in this clause.

60. The IPL includes a dispute settlement mechanism provision. Under Article 95, there is an option for administrative dispute resolutions through the one-stop shop. Investor-state dispute resolution is also available through the Office for Economic Dispute Resolution, People's Court and an international court, to which Lao PDR is a party. Awards of international arbitration are enforceable under the New York Convention of 1958. This is not in any way a clause in line with best practices, as can be seen in the analysis of IIAs in the next section. The fact that Lao PDR signed the New York Convention is a positive element. However, the country is not a member of the International Centre for the Settlement of Investment Disputes (ICSID Convention), unlike many Asian economies. To become a more attractive

2.8. iii International investment agreements

destination, Lao PDR could consider membership.

61. A second level of protection for foreign investors and investment is found in International Investment Agreements that Lao PDR has signed and ratified. They include numerous Bilateral Investment Treaties (BITs), ASEAN Comprehensive Investment Agreement (ACIA) and ASEAN plus Policy Dialogue Partners Preferential Trade Agreement (PTA) with investment chapters. As a member of the World Trade Organization (WTO) and ASEAN, Lao PDR is also bound by relevant investment commitments in the services sector under the General Agreement on Trade in Services (GATS) of the WTO and ASEAN Framework Agreement on Services (AFAS).

62. An important IIA for Lao PDR is ACIA, which applies to foreign investment from any of the nine other ASEAN member states. ACIA provides six core investor protection guarantees to all covered investors and their investments:

- Protection against discrimination (and its two guarantees: NT and MFN)
- Fair and Equitable Treatment and full protection and security
- Protection against direct and indirect expropriation
- Guaranteed transfer of funds
- Access to ISDS.

63. For instance, under Article 11 of ACIA, ASEAN member states have agreed to extend Fair and Equitable Treatment to covered investments. This means:

- A host ASEAN country is not allowed to make arbitrary decisions and must respect the legitimate expectations of investors.
- If the host ASEAN member state makes any decision against the interests of investors and their investments, the investors will have access to judicial or administrative tribunals, including the right to review decisions of the host ASEAN member state.
- In the event civil or criminal legal action is taken by the ASEAN member state against an investor, the latter shall have the right to defend itself, including the right to access legal representation. The investor will also have the right to appeal any adverse decisions or outcomes.

64. Article 11 of ACIA, also provides that a host ASEAN member state must provide full protection and security to an ASEAN investor's covered investment. Full protection and security complements FET and refers to physical protection of ASEAN investors' property from use of force during riots or insurgency occurring in the territory of that ASEAN member state. In the event of any losses suffered by the investment as a result such events, the ASEAN member state is required by Article 12 of ACIA to compensate ASEAN investors affected by such incidents. Compensation or restitution must be made on a non-discriminatory basis.

65. Freedom to manage capital and funds: Article 13 of ACIA guarantees that every ASEAN investor may freely and without delay conduct transfers relating to its investments into and out of the ASEAN member state where its investment is located. Such transfers can be made in a freely usable currency at the market rate of exchange at the time of transfer. The term 'freely usable currency' simply means the currency is widely used to make payments for international transactions, and widely traded in main exchange markets.

66. Protection comes with limited exceptions that allow ASEAN member states to prevent or delay transfers of funds. Such action must be done in an equitable, non-discriminatory and good faith application of laws and regulations. A host ASEAN member state may also impose temporary measures to restrict transfers of funds if there is any need to safeguard the country's balance of payments. Article 13 (4) ACIA provides that ASEAN member states may impose restrictions on any capital transactions as a temporary measure on a non-discriminatory basis at the request of the IMF, where the measure is taken to safeguard the balance of payments (Article 16, ACIA) or in exceptional circumstances where capital movement causes or threatens to cause serious economic or financial disturbance in the ASEAN member state concerned.

67. Protection against expropriation: ACIA protects investors against unlawful expropriation in a strong manner. Under Article 14 of ACIA, a ASEAN member state that expropriates, either directly or indirectly, an investment is required to provide proper compensation to affected investors. To be lawful, any expropriation of an investment must meet the following criteria:

- Expropriation or nationalization is for public purposes
- It is carried out in accordance with the law (due process)
- Expropriation must be made in a non-discriminatory manner
- The investor is provided with prompt, adequate and effective compensation.

68. These are the four standard criteria, yet they are not all incorporated in the IPL to the extent they should be. ACIA adds that any compensation for expropriation must be:

- Paid without delay
- Equivalent to the fair market value of the expropriated investment immediately before or at the time when the expropriation was publicly announced or occurred
- Not reflecting any change in value because the intended expropriation had become known earlier
- Fully realizable and freely transferable between ASEAN member states.

ACIA also includes a comprehensive clause for the settlement of investor-state disputes, after a prior attempt at an amicable settlement.

2.9. Recommendations for increased investor protection in Lao PDR

69. Firstly, the GoL could consider using a forthcoming revision of the IPL to improve the level of de jure protection extended to investors. At present, there are gaps in protection granted through domestic legislation and IIAs, as the protection framework is not in line with international or even regional best practices

.

The following guarantees should be added or strengthened:

- Include guarantees of National Treatment (NT) and Most Favored Nation (MFN) treatment, in line with best practices.
- Introduce the concept of Fair and Equitable Treatment (FET) in a well-defined and specific way that does not create excessively broad obligations for Lao PDR.
- Amend the expropriation clause:
    - » Include indirect expropriation to the guarantee, using ACIA as an example
    - » Fully include the four conditions that need to be met for an expropriation to be considered lawful
    - » Clarify that compensation must be adequate, prompt and effective as well as computed using the fair market value method in the event of expropriation.
- Strengthen the profit transfer guarantee to provide investors with the right to transfer profits and other funds to any country of their choice, in any freely usable currency, and without undue delay.
- Strengthen the dispute settlement clause in directions mentioned in our analysis.

Secondly, as part of efforts to increase de jure investor protection, Lao PDR could consider membership of the International Centre for Settlement of Investment Disputes (ICSID). In the region, Myanmar and Vietnam are currently considering joining ICSID. China has been a member since the early 1990s, Republic of Korea since the mid 1960s, while Cambodia, Indonesia and Malaysia are also members.

Thirdly, to complement and give full effect to de jure investor protection, it is recommended and imperative that the GoL initiate an analysis of de facto investor protection: that is how investor guarantees are applied and enforced in practice. The study would consider (for instance) how expropriation is conducted in practice, what is the process to hear investors expropriated or to compute compensation in the event of expropriation, how profits and funds are transferred in and out of the country and how arbitral decisions are enforced in Lao PDR. The study would then recommend actions to improve de facto investor protection. At the end of the day, both de jure and de facto investor protection should be enhanced. If statutory guarantees are improved through revisions to the law, but then undermined by inefficient processes that prevent investors for using or enforcing these rights and guarantees, the overall situation will not be deemed improved in reality.

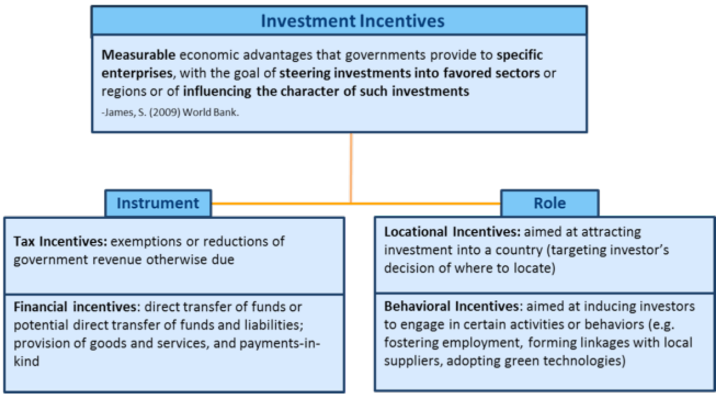
Finally, the team also recommends implementing an investor grievance management (IGM or SIRM) mechanism into Lao PDR in a phased manner, starting with a simple tool to record and analyze investor grievances and gradually move to a fully-fledged grievance management mechanism as a tool to help retain investment and prevent investor-state disputes. The basic elements on an IGM mechanism are found in Annex 4.

CHAPTER 3

Incentives Regime of Lao PDR

Figure 40: Definition of Investment Incentives

70. Investment incentives can play an important role in a country's investment policy and promotion framework, with far-reaching implications on tax revenue, governance and market competition. The definition of investment incentives used by the IPP team is summarized in Figure 40.



Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice.

71. In addition to incentive instruments, so-called "information incentives" can provide quick and reliable information on investment conditions. These types of conditions should be normal practice and a standard service offered by government agencies and line ministries dealing with investors. Making these two standard operations in most countries a non-fiscal incentive can raise alarms or concerns with investors about the investment environment of the country.

3.1 Incentives offered in Lao PDR

72. The main provisions on investment incentives in Lao PDR are laid out in the 2016 Investment Promotion Law, as amended, but several other norms are relevant to the incentive regime, including the 2016 Tax Law and regulations on SEZs. The IPL references four avenues or categories of criteria for investors (domestic or foreign) to receive incentives: a) investments in certain business sectors or activities, b) investments of a certain magnitude, c) investments in certain zones and d) concession investments.

73. Based on government priorities, nine categories of business sectors (or activities) are eligible for incentives according to Article 9 of the IPL. In summary, they are investments in:

1. Modern technology, scientific research, R&D, innovation, environmental-friendly and efficient use of natural resources and energy
2. Clean, toxic-free agriculture, seed production, animal breeding, forestry development,environment protection, activities promoting rural development and poverty reduction
3. Environmentally-friendly agro-processing, handicrafts
4. Environmentally-friendly and sustainable ecotourism and cultural tourism
5. Education and sports, human resources and skills development, vocational training
6. Modern hospitals, pharmaceutical and medical equipment factories, traditional medicine production and treatment
7. Public infrastructure addressing urban traffic congestion and over-populated residential areas, infrastructure supporting agriculture and industry, cargo transportation, transit and international linkage services
8. Policy banks and micro-finance institutions focusing on poverty reduction and communities with limited access to finance
9. Modern commercial centers promoting domestic products and world-renowned brands, exhibition centers and fairs for domestic products.

74. There are fiscal and non-fiscal incentive instruments to consider. The key incentive instruments offered in Lao PDR are tax holidays and indirect tax exemptions (VAT and Customs). The government also provides land at reduced rates, primarily through concession investments, but also the SEZ scheme. In terms of their objectives, most incentives seem to be of a "locational" nature, in that they are aimed at bringing investment into the country or a particular region. Some "behavioral" incentives have started to emerge to encourage investors to reinvest profits, expand operations, create local jobs or help protect the environment. The IPL provides for the following incentives instruments outlined in Table 3.

75. The GoL has the right (Article 19, IPL) to propose, to the Standing Committee of the National Assembly, any additional "special incentive" as may be deemed necessary for a given project. Further, one can argue whether the right to borrow money from commercial banks and other financial institutions in Lao PDR or overseas is really an incentive, as it is actually a part of the normal business environment in most countries. An incentive would be reduced-rated loans for certain investors or types of investments, for instance.

76. According to Article 41 of the IPL, a "concession investment" sees an investor authorized by the government in accordance with relevant laws and regulations to develop and operate a business notably a land concession, to develop a SEZ or zones for industrial processing for export, mining, electric energy development, aviation and telecommunications. Many such concessions appear to be negotiated and awarded to large firms (usually by MPI and relevant line ministry and/or local authorities). Concessions have been awarded to investors in mining, power (hydro), telecommunications and infrastructure, amongst sectors[30].

Table 3: Incentive Instruments Offered by IPL

Fiscal Instruments	Non-Fiscal Instruments
• Exemption and reduced rate of profit tax (CIT)	• Land use-related incentives (Article16): right to lease or have a concession over State land to conduct investment activities, right to transfer land use rights under certain conditions
• Exemption of Customs duties for imports of certain inputs (material, raw material, machinery and equipment) Non-Fiscal Instruments	• Access to finance incentives (Article 13)
• Zero-rated VAT for these imports (materials, raw materials, machinery and equipment)	• Government commendation for investors to have fulfilled tax obligations in a timely manner, contributed to community development or to Lao society, to skills-building or resolving environmental issues
• Zero-rated VAT for use of certain domestic raw materials	
• Exemption of export duties/taxes for export of raw materials	

[30]See Annex 5: Concession Activities of Decree on the Implementation of the Investment Law.
[31]About US$ 138,566 at 27 March 2019.

77. The IPL states that agreement terms depend on the type, size, value and feasibility study of the investment project, but cannot exceed 50 years (unless extended by the National Assembly). There is a review process involving relevant agencies, National Assembly and case-by-case negotiations with the investor. This constitutes a special regime for concession investments, not only for incentives but also for approval and other conditions.

78. The types of incentives and benefits conferred to such investors with concessions vary from contract-to-contract and may include direct and indirect tax incentives as well as land at reduced prices. In addition, some stakeholders interviewed by the mission team reported that provincial authorities in some cases granted tax incentives on an ad hoc basis without a legal basis. Given the opacity of these types of investments, negotiated on a case-by-case basis, it is difficult to formulate more observations or recommendations, except to caution against the case-by-case approach and the risks entailed in terms of governance, but also tax expenditures.

3.2 Eligibility based on magnitude of Investment

79. Criteria (a and b) are cumulative, which means investments must be in one of the nine categories of business sectors under Article 9. Then, they must be of a certain magnitude: financial value or number of local jobs created. To be eligible, the investment must:

- Have minimum investment capital of 1.2 billion kip[31] or more, or
- Employ at least 30 Lao technical staff, or
- Employ 50 or more Lao workers with employment contracts of at least one year.

The above "intensity" criteria are cumulative rather than alternative. If the investment capital is not of 1.2 billion kip, the project can still qualify if it created 30 technical jobs or more for Lao citizens (for instance).

3.3 Incentives based on certain zones or locations

80. Three zones, identified in the IPL (Article 10), determine the duration of incentives for eligible investors: Zone 1: poor and remote areas with socio-economic infrastructure unfavorable to investment, Zone 2: areas with socio-economic infrastructure favorable to investment and Zone 3: SEZs. Table 4 summarizes the duration of incentives when investment in eligible activities or sectors is combined with certain geographic zones. The same duration extension system applies to the incentive of rental or concession fee exemptions for State land (Table 5).

Table 4: Duration of Tax Holidays when combining Investment by Zone and Activity/ Sectors

Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice.

	Duration		
Zone	Normal Duration	Extension for Priority Sectors (Sections 2, 3, 5 and 6 of Article 9 of IPL)	Maximum
Zone 1: Poor and remote areas (unfavorable conditions for investment)	10 years	5 years	15 years
Zone 1: Poor and remote areas (unfavorable conditions for investment)	4 years	3 years	7 years
Zone 3: Special Economic Zones	Undefined in the IPL	Undefined in the IPL	Undefined in the IPL

Table 5: Duration of Rental/Concession Fee Exemption for State Land

	Duration		
Zone	Normal Duration	Extension for Priority Sectors (Sections 2, 3, 5 and 6 of Article 9 of IPL)	Maximum
Zone 1: Poor and remote areas (unfavorable conditions for investment)	10 years	5 years	15 years
Zone 1: Poor and remote areas (unfavorable conditions for investment)	5 years	3 years	8 years
Zone 3: Special Economic Zones	Undefined in the IPL	Undefined in the IPL	Undefined in the IPL

Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice.

81. Given that activities in Sections 2, 3, 5 and 6 of Article 9, of the IPL, receive incentive period extensions (tax holidays and rental fee exemptions), it reveals a policy objective to prioritize investments in eco-friendly agriculture and agribusiness, health, education and skills development. The attempt to be targeted in incentives usage, through linking incentives to specific sectors where GoL prioritizes more investment, is a step in the right direction. However, tax holidays can be distortive and become redundant to investors, particularly in countries with weak investment climates like Lao PDR. Thus, a preferred approach to tax holidays would be through offering performance-based incentives. It is important the GoL ensures there are no commending profit-based incentives, particularly generous tax holidays.

82. As investments in Zone 1 are extended the longest period of tax holidays and rental/concession fee exemptions (up to 15 years), it suggests a policy objective to attract investments to lesser developed regions. SEZ incentives are left undefined in the IPL and will be covered in the following sub-section. As will be explained, the experience with geography-based incentives is negative.

83. As the IPL does not define SEZ incentives, "applicable regulations" were referenced to determine such incentives. According to our research, the main applicable norm is "Decree on Special Economic Zones No. 188" (7 June 2018) (Decree 188). It provides for three types of incentives: fiscal, non-fiscal and others, for two categories of beneficiaries: SEZ developers and investors. Table 15 in Annex 5 summarizes the various SEZ incentives available. Since there are no specific eligibility requirements (sector of investment, exports) for an investor to locate in an SEZ, this essentially creates a parallel incentives regime without differentiated objectives.

84. SEZs, however, offer a range of benefits beyond incentives that include facilitated investor licensing,

registration and access to infrastructure and government land (used as collateral by investors for loans in some cases). SEZs are managed by the private sector, government and under private-public arrangements. More than 500 firms have invested in SEZs, the majority in the services sector, followed by industry and trade. Firms are primarily foreign, with most investments originating from China.

3.4 Private sector perspectives and WBG comments

85. In the following section, we assess the Lao PDR incentive regime based on several factors, including our experience with incentives worldwide, what works and does not work, our knowledge of best international practices and concerns expressed by private sector representatives interviewed in Vientiane. It is also important for the GoL to remember that investment incentives are a policy instrument of limited use. Not every development objective can be accomplished through incentives. Studies show that incentives are generally only effective in countries where the investment climate is already attractive.

86. The incentives regime lacks transparency. Private investors believe incentives are granted on an ad hoc basis with different processes or outcomes depending on personal relationships and vested interests. The general sentiment of the business community is there is a significant gap between de jure and de facto. Our IPL analysis echoes this concern in the sense that it provides for ample discretion and interpretation. Policies frequently change and the legal framework for incentives remains ambiguous. Firms consider the framework for incentives as uncertain and incoherent, with changes introduced without private sector consultation. The legislation itself overlaps with conflicting provisions. The lack of clarity fuels investor uncertainty and hinders the long-term planning of companies.

87. Current incentive regime costs (and benefits) are unclear. In Lao PDR, revenue administration and Customs interviewees reported regular tax expenditure calculations to inform superiors of foregone revenue. While a copy of these calculations was unavailable since our mission on incentives in 2016, this is a positive finding. However, it appears calculations are made at a relatively high level, not shared with the public and currently not used in a systematic way to assess the cost effectiveness of incentives. Tax expenditure assessments are a good start, but a broader assessment of the costs and benefits of the incentive regime is needed, as further explained in the recommendations.

88. The process to receive incentives is lengthy and cumbersome. While in-principle granting of incentives to eligible firms should be almost automatic, businesses reported in practice negotiations with revenue administration were often required to actually obtain them. For Customs and VAT incentives on imports, clearance of a master list of products to be imported is required annually.

89. Inadequate implementation and enforcement of incentives is apparent. Rules appear to lack the level of detail required for implementation and associated implementing guidelines. Regulations are presented in a piece-meal manner. There is an investor perception the lack of transparency around the tax system and different political interests created an uneven playing field for investment projects.

90. Incentives are linked to multiple and sometimes conflicting policy objectives. Efficient incentive programs are clearly connected to specific policy objectives and focus on the types of investment, firms and instruments that can best deliver them. Having a clear policy objective is also key for monitoring and evaluation (M&E). Lao PDR has many, often conflicting, objectives unlikely to be achieved through incentives. For instance, an important policy objective is the promotion of remote, less developed regions. Unfortunately, international experiences of incentives aimed at encouraging investors to locate in specific regions are unfavorable. Investors choose locations based on other more important considerations (proximity to main suppliers/customers or capital city, availability of infrastructure, labor and other inputs). At the same time, the SEZ regime offers a generous package of incentives to investors. While some SEZs are located in remote areas, most SEZ activity occurs in already developed areas. And the concessions regime provides another avenue for investors to circumvent the geographical targeting regime.

91. Choice of incentive instruments is problematic. Lao PDR currently relies heavily on tax holidays and exemptions to Customs duty and VAT for its investment incentives. As discussed in Annex 5, tax holidays are considered a weak instrument to deliver incentives as they are based on an upfront award, rather than actual investor performance against a policy objective. Once an approval is obtained, it is difficult for the government to effectively control and enforce compliance of the promises made to obtain the tax break. Tax holidays also tend to favor firms with relatively high upfront profits and a limited time horizon in the country. A long-term investor willing to accept losses in the first years of operation, with the prospect of recovering them over a long cycle, benefits less from tax holidays.

92. In theory, VAT and Customs duty exemptions can be justified for export-oriented firms on the grounds that, once the final product is exported, VAT credit and Customs duties on inputs would be reimbursable in any case. While a reimbursement system is preferable in terms of potential abuse, an ex-ante exemption can help export-oriented firms avoid cash-flow problems while waiting for reimbursements. For non-exporting firms, VAT exemptions are more difficult to justify: the VAT burden is ultimately passed onto the final consumer. Customs duties can also distort competition and implicitly incentivize the use of imported inputs over domestically produced ones. While access to imported inputs is an important determinant of firms' competitiveness, it is better achieved through overall low tariff rates on goods that serve as inputs than by exemptions for some firms. Finally, while VAT and Customs exemptions may generally be attractive to the beneficiary, like income tax holidays, they are not directly linked to a given policy objective, but based on an upfront approval.

93. On the other hand, merit-based instruments such as investment tax credits, allowances and accelerated depreciation are directly linked to the level of investment that a company undertakes (see Annex 5 for a brief description of different types of tax instruments and their respective pros and cons). These incentives tend to be more effective and less distortive when the purpose of an incentive is to promote investment. For other policy objectives – such as job creation, training provision and R&D – the incentives can be directly linked to measurable actions by the investor vis-à-vis the objective, rather than an ex-ante promise or agreement.

94. When incentives are used to attract FDI (location incentives), it is key to understand the investor's motivation and target incentives for optimal outcomes. Global experience suggests the effectiveness of incentives strongly depends on the motivation of the investor undertaking the investment in the first place. As presented earlier, the Dunning investment typology (1993) differentiates four types of FDI based on the investor's motivation: natural resource-seeking, market-seeking, strategic asset-seeking, and efficiency-seeking investments. All four can have important benefits for the host economy. Efficiency-seeking investment is often seen as the most transformative: it brings the most opportunities for job creation with higher skills, technology transfers and integration of the country into GVCs. Leaving aside strategic-asset seeking (not relevant for Lao PDR), Figure 41 illustrates how three types of foreign investment respond to incentives, but also the quality of the investment climate a host country offers. Efficiency-seeking investors – whose investment decisions are primarily driven by the motive to save costs – are more likely to be responsive to tax and financial incentives. However, such investors also tend to be the most demanding and concerned about investment climate quality and particularly first-rate logistics to connect with global markets. In Lao PDR, most incentives are available to investors regardless of motivation for entering the country. Sectoral priorities under the IPL seem to mainly follow the government's development priorities, yet do not appear based on an assessment of the type(s) of FDI needed to transform the nation's economy (efficiency-seeking). It is possible that many incentives offered to investors are 'redundant' in the sense they are given to investors who would enter the country in any case (given the high share of market- and natural resource-seeking investors).

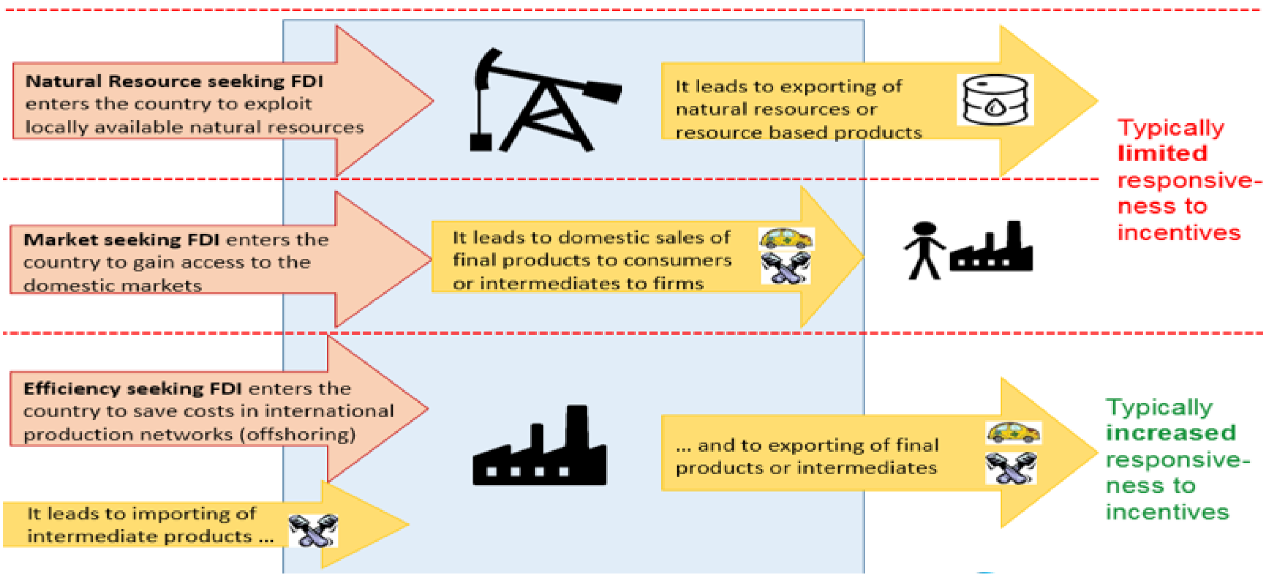
3.5 Recommendations for Lao PDR's Incentives Framework

95. **Based on our assessment and the above context, the key issues and recommendations are as follows and can be summarized in Table 6:**

Preliminary steps (to reform the current incentive regime and design a new one):

- Identify **critical constraints** and market failures facing the **private sector** and determine whether they can be addressed or mitigated through incentives or other more appropriate or effective ways. The constraint identification is a valuable input in itself as it can give fresh impetus to improving the overall investment climate (including, but going beyond, Doing Business reforms).

Figure 41: Different Types of FDI, Investor Motivations and their Impact on Incentives



Source: Investment & Competition unit, Macroeconomics, Trade and Investment Global Practice.

- **Identify** and **prioritize** a limited number of clear **development objectives** and results the incentive regime should pursue. Incentives should not be designed without specific objectives in mind. Future incentive regime impacts cannot be easily assessed if clear objectives and results are not adopted ex-ante.
- **Establish a robust consultative process** involving the government, legislature and private sector to define policy objectives for the incentive regime, discuss the pros and cons (costs and benefits of the current regime) and expectations of the new regime. Public-private dialogues (PPDs) and consultative processes should become standard operating procedures in all areas of reforms.

Designing reforms for the incentive regime:

- **Align incentives with the new FDI policy/ vision** that should be formulated by the GoL (as recommended by this Diagnostic study) and link them to specific development objectives and results mentioned in the preliminary steps above.
- **Consolidate all tax incentives currently scattered in various laws and regulations into the Tax Law.** All incentives available to investors should be clearly laid out in the law rather than referring to implementing regulations or decrees. Inconsistencies or formulations open to interpretation should be avoided in the legal text to avoid uncertainty and discretion.
- **Clarify the respective roles of the IPL and SEZ regime.** SEZs can be used as a more targeted vehicle to deliver incentives to priority clusters of firms, but can only fulfill this role if access is restricted. If not the case, aligning tax incentives offered in SEZs to the general system under the IPL would be the preferable option.
- Replace current incentives instruments **with incentives** that are **more targeted** and **less harmful** and **expensive** than tax exemptions. Consider using **non-fiscal incentives** (targeted means that incentives should be designed to realize certain objectives and types of investments, address certain market failures or incite behaviors the GoL wants to promote).
- **Discontinue the practice of negotiating individual incentives packages** (for instance, through concession agreements) and move towards a system where all available incentives and conditions for firms eligible to receive them are clearly laid out in the applicable law and apply to all qualifying firms.
- **Procedures for granting tax incentives** should be **analyzed and clarified,** possibly through a detailed process mapping exercise. Moving forward, a clear and automatic approval system for tax incentives should be designed and implemented.
- **Reconsider the current approval system for import incentives.** In the short run, a system could be introduced where certain types of goods that are clearly production equipment or inputs can be imported without advance clearance or controls by exempt companies and further approval is only required for 'dual use' goods that could also be used for consumption purposes (such as vehicles and fuel). A broader reform effort could aim to replace the current system of tariffs and exemptions with a much simpler approach. This would see all goods clearly identifiable as production equipment or inputs subject to zero tariffs and exemptions are removed. This would greatly enhance the ease of Customs administration and procedures for investors, government and create a more business-friendly environment. In particular, this will support efficiency-seeking investors who depend on the ability to quickly import and export within global production networks. A useful analytical exercise to inform these reform options could be carried out by looking at detailed transaction level export data to identify products, which under the current system, have been routinely approved as exemption imports (and put under a zero tariff), those for which exemptions are routinely declined and those where more case-by-case scrutiny is exercised.
- Adopt **M&E systems for all incentives** granted. Such systems would be based on clear policy objectives and track performance of beneficiaries versus non-beneficiaries.

Parallel and complementary reforms:

- Implement significant and parallel improvements

Table 6: Incentives Recommendations

KEY ISSUES	RECOMMENDED ACTIONS
Lack of clarity on whether the current incentive regime adequately responds to constraints facing private investors in Lao PDR.	*Step 1:* Identify through an investor perception survey or PPD process: (a) the critical constraints facing the private sector and (b) what investors think of the current incentive regime. *Step 2:* Assess whether the key constraints identified in Step 1 can be addressed or mitigated through investment incentives or better ways to "fix" these constraints. Link this to the broader, more comprehensive effort to improve the overall investment climate.
Current incentive regime is not targeted, lacks transparency, and there is a lack of clarity on the current costs but also benefits of the current incentive regime.	*Step 1:* Assess the cost-effectiveness of the current regime: • Conduct a robust costs and benefits analysis (CBA) of the current incentive regime, beyond a simple tax expenditures assessment. • Make the CBA a regular assessment (every two years for instance) under law. • Publish the results of the CBA. *Step 2:* Initiate a process to reform and redesign the incentives regime. In particular, the reform should: • Define clear development objectives and specific results that the incentive regime should achieve. • Design a "SMART" incentive regime aligned with the new FDI strategy, with clearly defined development objectives or results, that is more cost-effective and transparent with more targeted and non-fiscal incentives. • Consolidate incentive regimes into the Tax Law • Clarify the respective roles of IPL and SEZ regime. • Discontinue the practice of negotiating individual incentive packages (concession agreements). • Streamline procedures for granting tax incentives, relying on objective criteria. • Adopt an M&E system for incentives.

to the investment climate as a condition for incentives and investment promotion to be effective. The constraint identification process, recommended above, will be a critical tool to this. The SEZ incentive program can be used as a vehicle to deliver investment climate reforms more quickly in a limited geographical space as a starting point to broader reforms.

- Establish a **broader and more systematic quantitative and qualitative assessment** of the incentive regime. Costs should be measured not just economy-wide, but individually for each sector and incentive program—so they can be clearly linked to the broader program's benefits and policy makers can take informed decisions on its performance. The specific recommendations are:
  - » Expand from a simple tax expenditure evaluation to a **more comprehensive assessment of costs and benefits** of the incentive regime.
  - » Mandate that the **costs/benefits assessment be conducted on a regular basis** (annual or biennially). Incentives have real costs to the government in terms of foregone revenue, as well as indirect costs (distortion costs, compliance costs for taxpayers, administrative costs for government). Policy makers lack awareness of the real costs of incentives. It is, therefore, important to carefully monitor and publish the costs of incentives in terms of foregone revenue.
  - » **Make the assessment public:** a growing number of countries publish cost-benefit (or at least the tax expenditure) assessments as an annex to annual budget laws.
  - » Further strengthen the analysis by **differentiating** revenue losses under the general investment law from those under SEZ exemptions and concessions, as well as by economic sector.

CHAPTER 4

Investment Promotion and Facilitation

96. Investment facilitation and transparency are important for businesses. Companies need information on government measures within the location of their investments, particularly with regards to investment measures (new restrictions, liberalization or licensing requirements). Investors interviewed for this report in Lao PDR confirmed that transparency and facilitation ranked high in priorities when making investment decisions.

97. It is important Lao PDR instills proper institutional arrangements that support investment policy and promotion. International experience reveals a wide range of possible institutional frameworks and the need for robust coordination. Worldwide, a wide range of public-private institutions are tasked with attracting and/or facilitating investment. Investment promotion functions are typically undertaken by separate bodies within government, often called investment promotion agencies (IPAs). Even in countries with specialized IPAs, it is not unusual to see certain sectoral ministries or agencies, at local or provincial levels, and SEZs also undertaking investment promotion. In some cases, these additional agencies have strong coordination with the IPA. In others, poor cross-agency coordination results in duplicative efforts.

98. Lao PDR's promotion landscape should be grounded in clear national strategies and well-coordinated actions across government. A complex promotion structure can lead to wasteful overlaps, stakeholder conflicts, investor confusion and frustration, and service gaps. A good national FDI attraction strategy, if well implemented, should shape the institutional landscape to ensure promotional and regulatory objectives are balanced and various promoting institutions operate in a complementary way. The national IPA normally plays a coordination role to ensure national consistency in promotion messaging and services that investors receive. To this end, it is pertinent that investment policy and promotion institutional arrangements are coherent, effective and private sector-focused. Different participating agencies should be complementary, capitalize on any synergies, and have clear and aligned messages for potential investors.

99. A coordinated, efficient institutional framework for investment attraction using multiple approaches could be built by Lao PDR. However, institutional frameworks delivering stellar results share numerous common characteristics[32]. Notably, political commitment plays a key role in initiating and ensuring sustainability in long-term coordination, collaboration and efforts to align initiatives of different institutions. Any initiative involving different government agencies must be clearly supported by high-level political will and authorities.

100. Lao PDR needs a strategic FDI framework with a clear action plan. Clear alignment with a national level strategy stating key shared objectives and measurable progress towards desirable FDI attraction and retention is essential. Organizations part of the collaborative framework for investment policy and promotion must share and endorse the (foreign) investment strategy that should include tactical and operational instruments to facilitate FDI attraction. A clear implementation action plan is required to guide day-to-day actions.

101. Adequate resources are necessary to undertake these promotion efforts, with a strong lead institution to deliver the agreed strategy. This entails sufficient staff, operating budget and resources to deliver activities agreed in the action plan. A national institution must take the initiative for the successful implementation of an effective cooperative framework to deliver coherent signals to potential investors. One agency in charge of getting the ball rolling is essential, in other words a lead agency. Strong lead agencies embody the following aspects:

- Political or legal empowerment (preferably both)
- Strong commitment to fostering and coordinating close cooperation across the network of organizations, and a clear understanding of its benefits for the country
- Committed leaders supported by committed public officers in the institution
- Mandated authority over investment promotion-related issues
- Appropriate communication and information sharing with all involved organizations
- Sufficient right human and financial resources as well as technical and managerial capacity
- A strong customer-focus aimed at satisfying potential and established investors' needs.

[32] Premkumar 2000; Weiss 1987; Herzberg and Wright 2006; Serrano 2003, Ilias, Shayerah, Charles E. Hanrahan, M. Angeles Villarreal. 2013.

102. Accountability and measurement of performance. Any institutional arrangement needs to design and implement a relevant M&E framework (output, outcome and impact metrics) to provide robust quantitative information enabling assessment of its overall performance.

103. A variety of lead agency models can be effective. Lead agencies can be large or more modestly sized, depending on available resources and FDI market size. Countries must designate the lead agency in a way that is appropriate to their specific circumstances. Successful practices show the need for a lead agency to be a governmental body and for its leadership role to be accepted and fully supported by the institutional landscape and key government departments to ensure adequate funding and capacity. In other words, it is recognized as carrying the national mandate as the lead or coordinating body for investment promotion. The lead agency may take the form of a single quasi-independent agency given specific 'lead' responsibilities, or indeed be a separate unit within an agency with wider investment functions. Figure 42 lists the best practice characteristics of best practice IPAs.

104. A key question for any IPA is its core functions. Often IPAs carry "add-on" mandates, such as OSS or investment-related regulatory and administrative functions (incentives). However, one of the most fundamental best practice principles in investment policy is the separation of regulatory and promotional functions. Even the most investor-friendly regulatory environment requires regulators and administrators to implement government policies that impose requirements on investors or define what an investor can do.

105. A combined promoter-regulator agency potentially faces a conflict of interest, when its performance is judged on how many investors it attracts and how well it prevents the "wrong kind" of investments. Similarly, investors are likely to question the motives of such an institution if it acts as a promoter. Consequently, a promoter-regulator may find it challenging to get the access it needs to effectively promote investment opportunities and provide aftercare.

Figure 42: Common Characteristics of Best Practice IPAs

- Attached or linked to a high-level Government office (such as that of the President or Prime Minister) with central Government granting a high level of priority to investment (or FDI).
- Institutional and financial autonomy (or semi-autonomy) to emulate private sector-like flexibility to execute the strategy and avoid undue political influences.
- Strong collaboration and information flows with private sector.
- Clear mandate focused on:
    - » Attracting investors, facilitating their entry, securing retention and expansion, and translating activities into more and more benefits for the local economy through the professional, proactive, and persistent provision of well-designed services and excellent customer services
    - » Advocating reforms for a better the investment climate.
- Regulatory functions (including the One-Stop Shop) are performed by a separate Governmental institution to ensure proper delivery of these essential functions without compromising IPA's equally essential promotion role.
- Focused investment promotion efforts on strategic sectors/industries having the best competitive opportunities to yield the highest benefits to cost.
- Mix of employees with public and private sector experience that ensures the IPA is relevant to both its public sector stakeholders and private sector clients.
- Sufficient and sustained funding to perform their mandates, without having to struggle every year or charge fees, providing continuity of strategic efforts and direction.

Source: Adapted from "Best Practices for Investment Promotion," Robert Whyte and Armando Heilbron, World Bank Group.

106. This argues against IPAs acting as statutory OSSs with the authority to issue licenses and permits, although it leaves room for IPAs to provide facilitation services to assist investors through entry and operations processes. While Figure 42 clearly indicated that the most effective investment promotion agencies are those that are fully dedicated to promotion and do not have regulatory functions, Table 7 confirms this point (areas highlighted in red) while indicating what are the most important functions of an effective IPA (highlighted in green). Any mandate should clearly establish the IPA as a tightly focused marketing body to attract FDI into the country and as a good service provider to investors.

107. Core investment promotion functions are focused on the attraction, retention and growth of foreign investors (including joint ventures). They do not include domestic investment, SME development or business start-ups (unless foreign-owned). These functions consist of sector targeting and outreach for FDI (including joint ventures), foreign investor facilitation and aftercare, investment policy advocacy and creating linkages between foreign and domestic firms.

108. Another challenge is the relationship between the IPA and country's OSS. This depends on the nature of the OSS, but great care is needed to define this relationship. For many governments, the IPA appears an obvious place to locate the OSS. However, if the latter is a centralized approval and permitting body then it runs the same risks as described above (paragraph 101). In general, investors reported being wary of investment agencies or authorities that simultaneously facilitated entry into the country and reviewed applications for registration, permits and incentives. Agencies that carry both functions, facilitation and reviews of application forms, tend to focus more attention and resources on the OSS. As a result, promotion effectiveness suffers. As such, the World Bank's advice is that such an OSS in Lao PDR should be placed at arm's length from the IPA, preferably reporting to another government body.

109. WBG experience indicates that the account manager model is the OSS model most likely to be successfully implemented by an IPA. Even in weak investment climates, where government procedures are presumably most burdensome, IPAs have demonstrated making important differences in

Table 7: Distinguishing between What IPAs Can and Should Do

		Must do (Core mandates)	May do as additional functions, but require independent set up and resources	Incompatible with Investment Promotion
Investment promotion	Marketing			
	Information provision			
	Facilitation of meetings, site visits, and government procedures			
	Investor aftercare			
	Advocacy			
Promotion of:	Exports			
	Outward investment			
	SME linkages to FDI			
	SME development			
Administration/regulation	Administration of government procedures (e.g., One Stop Shop, licenses, incentives)			
	Manage state land or assets			
	Administer/negotiate government concessions (e.g., infrastructure, extractive industries)			
	Administer public-private partnerships			

Source: WBG-Investment Policy & Promotion unit investor attraction and retention through application of the account manager model.

110. IPAs have an important role to play in the design and implementation of FDI linkages programs. Since IPAs tend to be the main contact point for foreign investors in a host economy, they are best placed to understand the localization and sourcing needs of investors. As such, investor feedback is critical and to better target linkages support services in becoming more efficient and sustainable.

111. A recent survey[33] conducted by the WBG shows that three services are offered, in particular, by a substantial share of "high-performing IPAs" receiving higher levels of FDI. These services are designed to link: (i) foreign companies to domestic suppliers, (ii) domestic companies to foreign technologies and (iii) foreign companies to domestic technical, vocational or educational institutions. The IPL 2016 establishes the Investment Promotion and Management Committee (IPMC) as the central investment body. However, similar committees exist at provincial level. Moreover, the committee does not include private sector representation, contrary to good practice, that would add credibility to the body and ensure business perspectives and interests are accounted. The IPL 2016 adopts recommendations to establish an OSS for investors. However, the nature of the OSS or one-stop service for investment is diluted as there are three different types of OSS, one each for the MPI, MoIC, SEZs, and Specific Economic Zones.

112. To promote investment, the GoL established the IPMC as the main investment promotion and approval authority. The IPMC was established through the Decree on the Establishment and Operation of the Investment Promotion and Management Committee No. 05/PMO on 5 January 2018. There are two levels of IPMC: the IPMC at central level and provincial level.

113. However, approval for Controlled Business and Concession Business may have adverse impacts on the country. Furthermore, approval for SEZ development remains under the IPMC at central level. The IPMC is required to approve any modifications to initial investment projects, such as transfers of shares, changes to company objectives and use of concession and/or investment rights as guarantees. The IPMC has authority to suspend or cancel investment licenses if requirements of the investment licenses are not met. Additionally, the central-level committee can organize meetings with domestic and international investors to inform them of new regulations or policies that may impact the local investment climate, and discuss obstacles encountered by investors to seek solutions to accommodate investments in Lao PDR.

114. The committee must meet at least twice a month and may be convened as deemed necessary. The decree provides that a quorum is met when at least half of the committee members join the meeting and when members who represent the relevant government agency or have expertise in issues to be considered during the meeting, are present. To avoid absences, the decree provides members with the possibility to appoint a representative or proxy to attend IPMC meetings at the provincial levels, depending on the nature and amount of investment. Compositions of the central-level and provincial-level members are outlined in Table 8.

115. The IPMC also supports central and local governments in various investment promotion duties. Firstly, assisting researching and drafting of policies, strategic plans or regulations to support and manage private sector investment. Secondly, proposing amendments to laws and regulations to central or local government. Thirdly, monitoring adoption and implementation of policies, plans and resolutions by central and local governments. In terms of foregone revenue researching and drafting policies, strategic plans and regulations to promote further private sector investment, before submitting to central and/or local government for consideration. Lastly, seeking arbitration from central government on issues or projects the committee cannot reach consensus on.

116. To further promote investment, Lao PDR established the OSSO at the MPI and Lao Services Portal at the MoIC. The OSSO was set up at central and provincial levels and includes representatives of various relevant government agencies. The one-stop service for investment has several functions,

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including dissemination of investment information. Although it is not clearly provided for in the IPL, it can be assumed the one-stop service for investment is also responsible for providing advisory services to investors.

117. However, the nature of the OSS or one-stop service for investment is diluted when there are three different types of one-stop service, one each for the MPI for Concession Businesses, MoIC for General Businesses, and the SEZs and Specific Economic Zones. This infers the process and procedures lack coherence, are not easily digestible for investors nor meet ACIA standards for streamlined and simplified procedures in investment applications and approvals. In addition, investors are required to first identify the type of investment, the respective ministry, agency and processes at each one-stop service for investment.

Table 8: IPMC Members

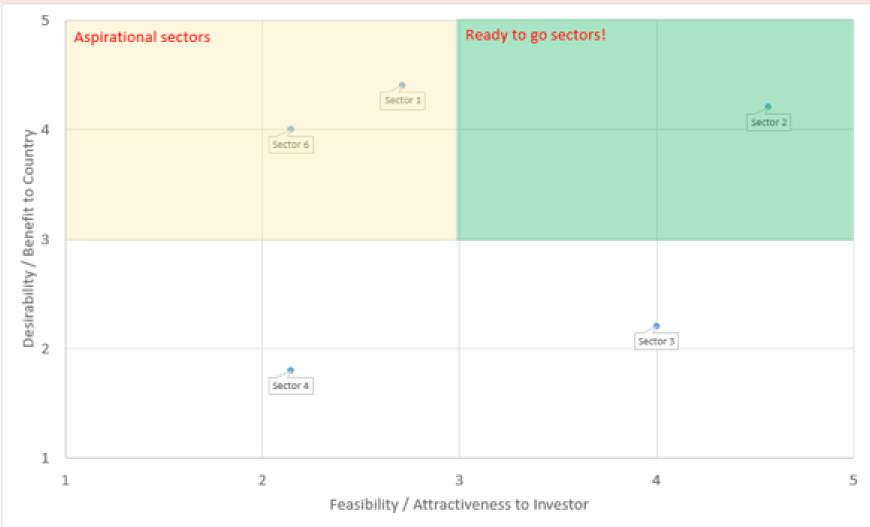
Central-level members		Provincial-level members	
1.	Deputy Prime Minister: serving as the committee president	1.	Governor, serving as the president
2.	Minister of Planning and Investment: serving as the committee vice president and permanent committee member	2.	Deputy governor, serving as the vice president
3.	Minister of Industry and Commerce: serving as the committee vice president	3.	Head of the Department of Investment Promotion, serving as a permanent committee member
4.	Vice Minister of Planning and Investment	4.	Head of the Department of Industry and Commerce, serving as the committee vice president
5.	Vice Minister of Finance	5.	Head of the Department of Finance
6.	Vice Minister of Natural Resources and Environment	6.	Head of the Department of Natural Resources and Environment
7.	Vice Minister of Energy and Mines	7.	Head of the Department of Energy and Mines
8.	Vice Minister of Agriculture and Forestry	8.	Head of the Department of Agriculture and Forestry
9.	Vice Minister of Labor and Social Welfare	9.	Head of the Department of Labor and Social Welfare
10.	Vice Minister of Public Works and Transport	10.	Head of the Department of Public Works and Transport
11.	Vice Minister of Information, Culture and Tourism	11.	Head of the Department of Information, Culture and Tourism
12.	Vice Minister of Public Security	12.	Head of the Department of Public Security

Box 2: Investment Sector Scan: Prioritizing Sectors for FDI Promotion

The World Bank Group's Investment Sector Scan (ISS) aims to identify high-potential sectors for FDI promotion and areas for possible investment climate reforms. A dynamic private sector which invests, innovates and creates jobs is critical to the achievement of Lao PDR's development objectives. Investment, including FDI, can facilitate the entry of capital, technology and know-how, diversification into new sectors and activities, foster the integration of domestic firms into GVCs, among other benefits. Yet, the likelihood of these positive effects depends on the ability of the host country to anticipate and ensure supply-side conditions are commensurate with the needs and demands of investors. Thus, a sound policy framework for investment is critical to deliver positive impacts over the host economy. A country needs to be competitive in terms of various capabilities, including aspects of the investment climate, to successfully attract investment to a given sector or business activity.

To assist with this task, **the ISS maps sectors by both their ability to contribute to a country's national development objectives, as well as their potential for investment attraction.** The purpose of the ISS is not to 'pick winners', but rather to identify opportunities and challenges across sectors, facilitate discussion with stakeholders on investment policy prioritization as well as more effective policy implementation and enhanced investor targeting and mobilization, considering a country's national development goals. While some types of reforms might be horizontal in nature, for example improvements in infrastructure or public institutions, they may also contribute to specific needs of such priority sectors. As such, the flexibility of the ISS makes it useful for both supporting targeted investment promotion in 'Ready to Go' sectors, and for sequencing of priority sectors by identifying 'Aspirational' sectors, which are those that have high potential but need targeted policy reforms to transform their potential into reality (Figure 43). The result would be sharpened investment targeting by sector and sub-sector, thereby improving allocation of limited resources available at the IPA and a list of priority areas for investment policy reform and strategy implementation.

Figure 43: Investment Sector Scan Scoring Matrix



Source: Investment & Competition Unit, MTI Global Practice

CHAPTER 5

Conclusion and Investment Reform Action Plan for Lao PDR

5.1 Investment Policy Statement

118. The Investment Policy Statement is a critical document for the GoL to adopt as soon as possible. Importantly, the IPS signals a shift in policy through its new proposed strategies. Specifically, the IPS is a strong signal that Lao PDR is pursuing a new drive to attract FDI. The IPS is aimed at assuring investors and guiding GoL agencies (national and local levels) on the new national FDI strategy. This high-level document is typically followed by investment legislation used to operationalize and implement investment policies.

119. A reform action plan is a document that captures the recommendations for reforms and organizes them by order of priority, relative to a timeline. Specifically, this plan addresses the 'how' question along the five stages of the Investment Lifecycle. It achieves this end by outlining the responsible entities and resources needed within short-, medium- and long-term timelines. The reform action plan is a powerful tool for the GoL to build consensus around numerous policies, legal or institutional changes. Importantly, the reform plan is an iterative process, with follow-ups to ensure that reforms are being implemented and responsible entities are held accountable to assigned tasks.

5.2 Timeline of Proposed Reform Action Plan

120. Table 9 presents the reform priorities and outlines recommendations into a specific action plan for Lao PDR:

Table 9: Reform Action Plan for Lao PDR

Stage of Investment Lifecycle	Reform Action	Timeline[34]
Vision and Strategy	Develop an official Investment Policy Statement that articulates the new FDI vision and strategy for Lao PDR.	
Entry and Establishment	Initiate a program to identify and reduce (or eliminate when possible) the main de jure and de facto restrictions that prevent the entry and participation of foreign investors in Lao PDR.	
	Revisit the institutional framework for investment with a view to simplifying it, by: • Reducing the number of entities involved in the investment process and consider consolidating all investment entry regimes and processes under one ministry (possibly MPI) • Improving intra-governmental coordination and exchanges of information to further streamline the entry processes • Clarifying the role and responsibility of each institution involved in the process.	
	Revisit the entry process and in particular seek to reduce the extent of screening by: • Identifying a small number of strategic sectors where investors will be subject to screening • Clarifying that investments in all other sectors can enter automatically, without screening and by proceeding directly to enterprise registration • Reducing the room for discretion and ad hoc actions.	
	Consolidate all the statutory restrictions to entry of foreign investment and liberalize equity restrictions in a Negative List under the IPL. Use standard classifications to designate sectors and activities in the negative list.	

Protection	A forthcoming revision of the IPL needs to improve the statutory or de jure protection extended to investors (aligning them with best practices and high-standard IIAs), in particular: • Add or strengthen real guarantees of National Treatment (NT) and Most Favored Nation (MFN) • Introduce the concept of Fair and Equitable Treatment (FET) in a well-defined and specific way that does not create excessively broad obligations for Lao PDR • Amend the expropriation clause to include indirect expropriation to the guarantee (using ACIA as an example) • Strengthen the profit transfer guarantee • Strengthen the dispute settlement clause.	
	Initiate a study of the de facto investor protection that: a. Reviews how these guarantees work in practice (for instance how expropriation is conducted, how compensation is computed, how profits/funds are transferred in and out of the country, how arbitral awards are enforced) and b. Recommends changes to the processes, procedures or practices to enforce the guarantees.	
	Consider joining ICSID, as many countries have in the region.	
	Implement an Investor grievance mechanism in a phased manner, starting with a tool to identify grievances and their typology and progressively move towards a full-fledged grievance management mechanism.	
Incentives	Identify through an investor perception survey or use of a public-private dialogue process: (a) what are the critical constraints facing the private sector and (b) what investors think of the current incentive regime.	
	Assess whether the key constraints identified in the survey can be addressed or mitigated through investment incentives or if there are other and better ways to "fix" these constraints. Link this to the broader, more comprehensive effort to improve the overall investment climate.	
	Assess the cost-effectiveness of the current regime through a costs and benefit assessment of the current incentive regime.	
	Initiate a process to reform or redesign the incentives regime, with reforms focused on clear objectives, transparency and in accordance with the Tax Law and Investment Promotion Law that include targeted and non-fiscal incentives.	
Promotion and Facilitation	Formulate a clear investment promotion strategy aligned with the broader Investment Policy/Vision that also needs to be developed.	
	Build the capacity of the investment promotion institution and its staff in certain critical areas.	
	Focus promotion efforts on two sectors with real potential for more FDI.	
	Tackle key constraints to FDI in the two priority sectors.	

[34] This column is left intentionally blank as this question should be discussed during the dissemination and consultation process of the draft Report in Lao PDR.

Annex 1: Investment Competitiveness Benchmarking Results

This annex presents the heatmap results produced by the ICB analysis. All heatmaps follow the legend described in Table 10 of Annex 2. Each heatmap presents results of Lao PDR's current country performance relative to successful countries by activity and sector.

Figure 44: Food & Tobacco Sector - Investment Climate Results

Benchmarking analysis of Lao PDR's performance by sector & activity relative to successful countries

	DEMAND	PRODUCTION FACTORS			KEY INPUTS			INSTITUTIONS			
Business Activity	domestic and / or global market	labor and skills	geography and natural resource	existing capabilities	energy	transport	finance (cost and availability)	regulatory barriers	rule of law and property rights	market contestability	macro and political stability
Education & Training	4	11	4	12	6	7	7	4	9	7	6
Headquarters	2	5	1	10	3	6	7	0	6	5	2
Shared Services Centre	2	3	1	10	3	5	5	2	6	4	2
Research & Development	2	3	1	5	2	5	4	0	6	4	2
Design, Development & Testing	2	2	0	8	3	5	3	0	4	3	2
Logistics, Distribution & Transportation	2	1	0	2	1	4	2	0	1	3	2
Sales, Marketing & Support	1	2	0	1	0	1	2	0	1	0	1
Retail	0	0	0	0	0	0	0	0	1	0	1
Manufacturing	0	0	0	0	0	0	0	0	0	0	0

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 45: Food & Tobacco - Business Environment Results

Benchmarking analysis of Lao PDR's performance on select Doing Business indicators relative to successful countrys by sector and business activity

Business Activity	Cost to start a business (% of income per capita)	Cost required to receive a construction permit (% of warehouse value)	Cost required to register property (% of property value)	Quality of the land administration index (0-30)	Time to export: Border compliance (hrs)	Time to import: Border compliance (hrs)	Profit tax (% of profit)	Time to pay taxes (hrs/year)	Total tax rate (% of profit)	Commencement of proceedings to resolve insolvency index (0-3)	Cost to enforce contracts (% of claim)
Manufacturing											
Retail											
Design, Development & Testing											
Logistics, Distribution & Transportation											
Sales, Marketing & Support											
Headquarters											
Research & Development											
Shared Services Centre											

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 46: Alternative/Renewable Energy - Investment Climate Results

Benchmarking analysis of Lao PDR's performance by sector & activity relative to successful countries

	DEMAND	PRODUCTION FACTORS			KEY INPUTS			INSTITUTIONS			
Business Activity	domestic and / or global market	labor and skills	geography and natural resource	existing capabilities	energy	transport	finance (cost and availability)	regulatory barriers	rule of law and property rights	market contestability	macro and political stability
Logistics, Distribution & Transportation	4	16	5	14	9	7	8	9	11	10	4
Design, Development & Testing	4	15	5	14	9	7	8	4	11	10	4
Headquarters	4	13	3	14	9	7	8	4	10	9	4
Manufacturing	2	3	1	7	3	4	3	0	5	3	2
Sales, Marketing & Support	2	2	0	4	3	5	3	0	4	3	2
Electricity	0	0	0	0	0	0	0	0	0	0	0

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 47: Alternative/Renewable Energy: Business Environment Results

Benchmarking analysis of Lao PDR's performance by sector & activity relative to successful countries

	DEMAND	PRODUCTION FACTORS			KEY INPUTS			INSTITUTIONS			
Business Activity	domestic and / or global market	labor and skills	geography and natural resource	existing capabilities	energy	transport	finance (cost and availability)	regulatory barriers	rule of law and property rights	market contestability	macro and political stability
Logistics, Distribution & Transportation	5	16	3	14	9	7	8	7	12	9	8
Education & Training	4	16	5	14	9	7	8	9	11	10	4
Design, Development & Testing	4	11	3	13	6	7	5	5	11	9	4
Shared Services Centre	2	2	3	10	3	5	6	1	6	4	2
Customer Contact Centre	2	3	1	10	3	5	7	0	6	4	2
Headquarters	2	2	0	5	0	2	4	0	5	3	2
Sales, Marketing & Support	0	1	0	0	0	1	0	0	1	0	1
Business Services	0	0	0	0	0	0	0	0	0	0	0

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 48: Financial Services - Investment Climate Results

Business Activity	Benchmarking analysis of Lao PDR's performance by sector & activity relative to successful countries											
	DEMAND	PRODUCTION FACTORS			KEY INPUTS			INSTITUTIONS			
	domestic and / or global market	labor and skills	geography and natural resource	existing capabilities	energy	transport	finance (cost and availability)	regulatory barriers	rule of law and property rights	market contestability	macro and political stability
Logistics, Distribution & Transportation	5	16	3	14	9	7	8	7	12	9	8
Education & Training	4	16	5	14	9	7	8	9	11	10	4
Design, Development & Testing	4	11	3	13	6	7	5	5	11	9	4
Shared Services Centre	2	2	3	10	3	5	6	1	6	4	2
Customer Contact Centre	2	3	1	10	3	5	7	0	6	4	2
Headquarters	2	2	0	5	0	2	4	0	5	3	2
Sales, Marketing & Support	0	1	0	0	0	1	0	0	1	0	1
Business Services	0	0	0	0	0	0	0	0	0	0	0

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 49: Financial Services - Business Environment Results

Business Activity	Benchmarking analysis of Lao PDR's performance on select Doing Business indicators relative to successful countrys by sector and business activity										
	Cost to start a business (% of income per capita)	Cost required to receive a construction permit (% of warehouse value)	Cost required to register property (% of property value)	Quality of the land administration index (0-30)	Time to export: Border compliance (hrs)	Time to import: Border compliance (hrs)	Profit tax (% of profit)	Time to pay taxes (hrs/year)	Total tax rate (% of profit)	Commencement of proceedings to resolve insolvency index (0-3)	Cost to enforce contracts (% of claim)
Business Services											
Sales, Marketing & Support											
Headquarters											
Customer Contact Centre											
Shared Services Centre											

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 50: Hotels & Tourism - Investment Climate Results

Business Activity	Benchmarking analysis of Lao PDR's performance by sector & activity relative to successful countries										
	DEMAND	PRODUCTION FACTORS			KEY INPUTS			INSTITUTIONS			
	domestic and / or global market	labor and skills	geography and natural resource	existing capabilities	energy	transport	finance (cost and availability)	regulatory barriers	rule of law and property rights	market contestability	macro and political stability
Headquarters	4	12	5	13	9	7	8	4	9	10	4
Customer Contact Centre	4	6	4	10	4	7	7	2	8	6	3
Sales, Marketing & Support	2	1	0	1	0	1	1	0	1	0	1
Construction	0	1	0	0	0	1	0	0	1	0	1

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Figure 51: Hotels & Tourism - Business Environment Results

Business Activity	Benchmarking analysis of Lao PDR's performance on select Doing Business indicators relative to successful countrys by sector and business activity										
	Cost to start a business (% of income per capita)	Cost required to receive a construction permit (% of warehouse value)	Cost required to register property (% of property value)	Quality of the land administration index (0-30)	Time to export: Border compliance (hrs)	Time to import: Border compliance (hrs)	Profit tax (% of profit)	Time to pay taxes (hrs/year)	Total tax rate (% of profit)	Commencement of proceedings to resolve insolvency index (0-3)	Cost to enforce contracts (% of claim)
Construction											
Sales, Marketing & Support											
Customer Contact Centre											
Headquarters											

Source: Author's own calculations, based on various global indicator sources & Financial Times fDi Markets database, 2017.

Annex 2: Investment Competitiveness Benchmarking Methodology

1. The ICB is a tool that aims to identify sector-specific constraints in a country, by comparing the country's performance on any given indicator to the performance of all other countries that have attracted FDI to a given sector and business activity. The underlying intuition is that if a given indicator (eg: electricity supply) is relevant for a sector (eg: business services), only countries with good electricity supply will see successful foreign investment in business services and thus, the benchmark will be relatively high. For other sectors that depend less on electricity supply, such as agriculture, countries with poor electricity supply may nevertheless see successful foreign investment, and thus, the benchmark will be lower.

2. Results are reported in the form of heatmaps by sector and business activity, using classifications defined by the Financial Times' fDi Markets database. To construct the heatmaps by country, sector, and business activity for a given indicator, first the data on the number of FDI projects by sector and business activity is analyzed, and countries are defined as successful in a sector and activity if they exhibited at least three investment projects from 2011 to 2016. Second, a set of 136 country-level indicators are used to determine a country's range of performance on a given indicator. Heatmaps follow the reverse ordinal scale as the ISS, from 0 (best) to 5 (worst).

Table 10: Description of Heatmap Scores

Score	Color	Description
0	Dark green	Lao PDR ranks above the 30th percentile of all countries in the world that have successfully attracted FDI in each sector. The characteristic measured by this indicator would likely be seen by investors as a strength in the country's value proposition for investors in this sector.
1	Light green	Lao PDR ranks above the 10th, but below the 30th percentile of all countries in the world that have successfully attracted FDI in each sector. The characteristic measured by this indicator would likely not be a strength, but does not represent a significant obstacle to investment in this sector either as other countries in the world with the same level performance have still been able to attract FDI in the sector.
2	Yellow	Lao PDR ranks below the 10th percentile of all countries in the world that have successfully attracted FDI in this sector, but above the 90th percentile of unsuccessful countries that fall below the minimum performance of successful countries on this indicator. The characteristic measured by this indicator may be a weakness by investors in this sector, but even relatively small improvements could address this shortcoming.
3	Light red	Lao PDR ranks below the 90th percentile, but above the 70th percentile of unsuccessful countries that fall below the minimum performance of successful countries on this indicator. The characteristic measured by this indicator is likely to be a weakness by investors in this sector, and significant improvements would be needed to address this shortcoming.
4 +	Dark red	Lao PDR ranks below the 70th percentile of unsuccessful countries that fall below the minimum performance of successful countries on this indicator. The characteristic measured by this indicator is very likely to be seen as a strong weakness by investors in this sector, and very significant improvements would be needed to address this shortcoming.

Table 11: Investment Competitiveness Benchmarking: Pillar Indicators and Sources

		INDICATOR	SOURCE
DEMAND		Domestic market size index, 1-7 (best)	World Economic Forum Global Competitiveness Index
		GDP per capita (current US$)	World Development Indicators
		GDP growth (annual percent)	World Development Indicators
		GDP growth - 5Y forecast	IMF WEO
		Foreign market size index, 1-7 (best)	World Economic Forum Global Competitiveness Index
		regional GDP per capita (countries within 1000k of capital, current US$)	World Development Indicators
		regional GDP growth (countries within 1,000k of capital, annual percent)	World Development Indicators
		GDP, PPP (bln current international $) distance weighted	World Development Indicators
PRODUCTION FACTORS	Labor and skills	Labor force, total	World Development Indicators
		Labor force participation rate, female (percent of female population ages 15+)	modeled ILO estimate
		Adult literacy rate, population 15+ years, both sexes (percent)	World Development Indicators
		Primary education enrollment, net percent	World Economic Forum Global Competitiveness Index
		Secondary education enrollment, gross percent	World Economic Forum Global Competitiveness Index
		Tertiary education enrollment, gross percent	World Economic Forum Global Competitiveness Index
		Quality of educational system, 1-7 (best)	WEF: Global Information Technology Report
		Quality of management schools, 1-7 (best)	WEF: Global Information Technology Report
		Quality of math & science education, 1-7 (best)	WEF: Global Information Technology Report
		Extent of staff training, 1-7 (best)	WEF: Global Information Technology Report
		Availability of scientists and engineers, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Country capacity to attract talent, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Country capacity to retain talent, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Ratio of the minimum wage to the average value added per worker	Doing Business
		Pay and productivity, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Annual labor productivity growth (percent)	ES PERFORMANCE
		Cooperation in labor-employer relations, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Flexibility of wage determination, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Hiring and firing practices, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Redundancy costs, weeks of salary	World Economic Forum Global Competitiveness Index
		Labor tax and contributions (percent of profit)	Doing Business

INPUTS	Geography and natural resources	Arable land (percent of land area)	World Development Indicators
		Access to land	World Bank Enterprise Surveys
		Total internal renewable water resources per capita (m3/inhab/year)	FAO Aquasta
		Urban population (percent of total)	World Development Indicators
		Population density (people per sq. km of land area)	World Development Indicators
	Existing capabilities	Manufacturing Value Added per capita	Competitive Industrial Performance Index
		Capital per worker (in 2011 US$)	Penn World Tables
		Medium- and High-Tech Manufactured Exports share in total manufactured exports	Competitive Industrial Performance Index
		Production process sophistication, 1-7 (best)	World Economic Forum Global Competitiveness Index
		State of cluster development, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Local supplier quality, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Local supplier quantity, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Prevalence of foreign ownership, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Availability of latest technologies, 1-7 (best)	WEF: Global Information Technology Report
		Capacity for innovation, 1-7 (best)	WEF: Global Information Technology Report
		Business Sophistication	World Economic Forum Global Competitiveness Index
		Company spending on R&D, 1-7 (best)	World Economic Forum Global Competitiveness Index
		PCT patents, applications/million pop.	WEF: Global Information Technology Report
		Firm-level technology absorption, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Percent of firms with an internationally-recognized quality certification	World Bank Enterprise Surveys
		Percent of firms using technology licensed from foreign companies	World Bank Enterprise Surveys
	Energy	Electricity production, kWh/capita	WEF: Global Information Technology Report
		Access to electricity (percent of population)	World Development Indicators
		Number of electrical outages in a typical month	World Bank Enterprise Surveys
		Duration of a typical electrical outage (hours)	World Bank Enterprise Surveys
		Losses due to electrical outages (percent of annual sales)	World Bank Enterprise Surveys
		Quality of electricity supply, 1-7 (best)	WEF: Global Competitiveness Index
		Cost (percent of income per capita) required to get electricity	Doing Business
		Procedures (#) required to get electricity	Doing Business
		Time (days) required to get electricity	Doing Business
	Trans port	Quality of air transport infrastructure, 1-7 (best)	World Economic Forum Global Competitiveness Index

INSTITUTIONS	Finance	Quality of port infrastructure	World Economic Forum Global Competitiveness Index
		Quality of railroad infrastructure, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Quality of roads, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Fixed broadband Internet subscriptions/100 pop	World Economic Forum Global Competitiveness Index
		Logistics competence	Logistics Performance Index
		Timeliness of international shipments	Logistics Performance Index
		Tracking and tracing of shipments	Logistics Performance Index
		Domestic credit provided by financial sector (percent of GDP)	World Development Indicators
		Bank non-performing loans to total gross loans (percent)	World Development Indicators
		Commercial bank branches (per 100,000 adults)	World Development Indicators
		Getting Credit	Doing Business
		Availability of financial services, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Ease of access to loans, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Financing through local equity market, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Affordability of financial services, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Soundness of banks, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Regulatory barriers and taxation	Burden of government regulation, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Bureaucracy Quality (L)	ICRG
		Senior management time spent dealing with the requirements of government regulation (percent)	World Bank Enterprise Surveys
		Cost to start a business (percent of income per capita)	Doing Business
		Cost required to receive a construction permit (percent of warehouse value)	Doing Business
		Cost required to register property (percent of property value)	Doing Business
		Quality of the land administration index (0-30)	Doing Business
		Time to export: Border compliance (hrs)	Doing Business
		Time to import: Border compliance (hrs)	Doing Business
		Profit tax (percent of profit)	Doing Business
		Time to pay taxes (hrs/year)	Doing Business
		Total tax rate (percent of profit)	Doing Business
	Rule of law and property ri...	Government effectiveness score (-2.5 to 2.5)	Worldwide Governance Indicators
		Corruption (F)	ICRG
		Bribery incidence (percent of firms experiencing at least one bribe payment request)	World Bank Enterprise Surveys

	Bribery depth (percent of public transactions where a gift or informal payment was requested)	World Bank Enterprise Surveys
	Law & Order (I)	ICRG
	Reliability of police services, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Commencement of proceedings to resolve insolvency index (0-3)	Doing Business
	Cost to resolve insolvency (percent of estate)	Doing Business
	Strength of insolvency framework index (0-16)	Doing Business
	Cost to enforce contracts (percent of claim)	Doing Business
	Recovery rate (cents on the dollar)	Doing Business
	Efficiency of legal system in settling disputes, 1-7 (best)	WEF: Global Information Technology Report
	Judicial independence, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Strength of legal credit rights index (0-12)	Doing Business
	Efficiency of legal system in challenging regs, 1-7 (best)	WEF: Global Information Technology Report
	Intellectual property protection, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Strength of investor protection, 0-10 (best)	World Economic Forum Global Competitiveness Index
Market contestability	Anti-monopoly policy	Bertelsmann Transformation Index
	Market-based competition	Bertelsmann Transformation Index
	Private enterprise	Bertelsmann Transformation Index
	Effectiveness of anti-monopoly policy, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Extent of market dominance, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Intensity of local competition, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Prevalence of trade barriers, 1-7 (best)	World Economic Forum Global Competitiveness Index
	Tariff rate, applied, simple mean, all products (percent)	World Development Indicators
	Business impact of rules on FDI, 1-7 (best)	World Economic Forum Global Competitiveness Index
Macroeconomic and political stability	General government final consumption expenditure (percent of GDP)	World Development Indicators
	Economic Risk Rating	ICRG
	Financial Risk Rating	ICRG
	External debt stocks (percent of exports of goods, services and primary income)	World Development Indicators
	General government gross debt (percent of GDP)	World Economic Outlook
	Risk for Debt Service	ICRG
	Current account balance (percent of GDP)	World Development Indicators
	Total reserves in months of imports	World Development Indicators
	Inflation	WEO
	Risk for Inflation	ICRG

		Political stability score (-2.5 to 2.5)	Worldwide Governance Indicators
		Voice & accountability score (-2.5 to 2.5)	Worldwide Governance Indicators
		Political Risk Rating	ICRG
		Government Stability (A)	ICRG
		Public trust in politicians, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Business costs of crime and violence, 1-7 (best)	World Economic Forum Global Competitiveness Index
		Ethnic Tensions (J)	ICRG
		External Conflict (E)	ICRG
		Internal Conflict (D)	ICRG
		Military in Politics (G)	ICRG
		Religious Tensions (H)	ICRG

Annex 3: Financial Times Sector and Activity Classifications

Table 12: Activity Classifications

Sector	Definition notes
Aerospace	Aerospace (except space/defense). Goes under transport equipment cluster.
Alternative/Renewable energy	Solar/fuel cells for energy Alternative Fuels, Wind energy, Nuclear, Bio-fuels, etc. Goes in Environmental Technologies Cluster.
Automotive Components	All automotive components (except auto electronics may go into electronics sectors (with cluster = transport 73). Goes in Transport Equipment Cluster.
Automotive OEM	Passenger cars, sports cars, trucks, buses, etc. Goes in Transport Equipment cluster. Engines go into Engines & Turbines sector, TE cluster.
Beverages	All beverage products. Goes in Food, Beverage & Tobacco cluster.
Biotechnology	Drug discovery, bio-agricultural, bio-engineering, genomics, etc. (except bioin-formatics which is Software & IT sector). Goes in Life Sciences cluster.
Building & Construction Materials	Cement, concrete, bricks, plaster, etc. Goes in Construction Cluster.
Business Machines & Equipment	Disks/drives, PC's, printers, servers, etc. Goes in ICT Cluster.
Business Services	Advertising, BPO, consultancy, education, legal, recruitment. Typically, prof ser-vices go in prof services cluster and advertising and education go in creative industries cluster.
Ceramics & Glass	Ceramics, tiles and glass products
Chemicals	Agrochemicals, paints, soaps, etc. Typically, physical sciences. Petrochemicals go in Energy cluster.
Coal, Oil & Gas	Coal, petroleum and gas products. Note that transmission and pipelines and anything transportation related should go into transportation sector and storage, distribution, terminals into warehousing & storage sector (and cluster should be energy) and support activities for energy should most go into Business Services sector. Typically, energy cluster.
Communications	Telecom services + Telecom equipment + radio and TV broadcasting services. Generally, telecom companies R&D projects are most software development, but they should be entered under this sector, not software and IT. Sat/Nav pro-jects go into Space & Defense sector. multi-media related projects go to Creative Industries cluster. Typically, ICT cluster.
Consumer Electronics	Audio/video electronics, cameras, home entertainment, etc. Typically go in con-sumer goods cluster.
Consumer Products	Accessories, cutlery, DIY, jewelry, toys, etc.
Electronic Components	ATMS, batteries, imaging, home appliances, LCD, wires, etc. Typically go in ICT & Electronics cluster ATMs, credit cards go in FS cluster.
Financial Services	Brokerage, financing, mortgages, insurance, VC, etc. Typically go under financial services cluster.
Food & Tobacco	Agriculture, bread, coffee, fish, meat, etc. Typically go in Food, Beverages and Tobacco cluster.
Healthcare	Hospitals, dentists, labs, vets, etc. Typically, in life sciences cluster.
Engines & Turbines	Industrial as well as transport engines and turbines. Transports goes under transport equipment cluster. Industrial goes under industrial cluster.

Industrial Machinery, Equipment & Tools	Agricultural machinery, boilers, compressors, machine tools, power tools, etc. Typically go under Industrial cluster. Turbines for wind farms go in Env Tech clus-ter.
Leisure & Entertainment	Amusement parks, casino, media, museums, restaurants, theatres, etc. Typically, in the creative industries cluster.
Medical Devices	Medical equipment supplies. Typically, in the Life Sciences cluster.
Metals	Aluminum products, copper alloys, gemstones, metal ore mining, etc. Mfg. of products goes into relevant clusters. Mining goes into physical sciences cluster.
Minerals	Minerals. Typically go in physical sciences cluster.
Non-Automotive Transport OEM	Motorcycles, trains, watercraft, etc. Typically go in transport equipment cluster.
Paper, Printing & Packaging	Packaging, labelling, printing, paper bags, etc. Typically goes in wood, apparel and related goods cluster.
Pharmaceuticals	Cardiovascular, clinical research, generics, infections, nutrition, respiratory, etc. Typically go in the Life Sciences cluster.
Plastics	Plastic compounds, film/coatings, containers/packaging, etc. Many packaging plastics projects are related to Food cluster, Consumer products cluster and industrial cluster. Windows/doors go in Construction cluster. Some plastics pro-jects go in wood, apparel & related cluster when they are for textiles sectors.
Real Estate	Department stores, offices, residential, etc. Typically go under real estate clus-ter.
Rubber	Rubber, resin/synthetic rubber and tires, etc. Tires typically go under transport equipment cluster. Rest of the projects are typically physical sciences.
Semiconductors	Capacitors, chip design, microchip, wafers, etc. Most projects in ICT cluster. Some in Creative Industries (e.g. multimedia chips).
Software & IT services	Enterprise application software, software infrastructure, information manage-ment software, etc. Note that all digital media projects should go under creative industries cluster, all FS/ banking projects go under Financial services cluster; all Enterprise Application Software (industrial, supply chain) should be entered under relevant cluster - mainly Transportation, Warehousing, Industrial, and Transport Equipment.
Space & Defense	Space/defense and satellite/navigation. Space & defense should go into Transport Equipment or ICT cluster depending on the project
Textiles	Leather, furnishings, footwear, artificial/ synthetic fibers, etc. Typically go under wood, apparel and related goods cluster
Hotels & Tourism	Hotels, tourism/travel services, etc. Typically goes in Tourism cluster.
Transportation	Air express, freight, port, trans-shipment, etc. Typically goes in Transportation, Warehousing & Storage cluster.
Warehousing & Storage	Logistics/distribution center, warehouse, etc. Typically go in Transportation, Warehousing & Storage cluster. Gas terminals entered in this sector, with cluster Energy.
Wood Products	Chipboard, flooring/panels, houses, furniture, pulp mill, etc. Typically go in Transportation, Warehousing & Storage cluster.

Source: Henry Loewendahl, Financial Times, "fDi Markets Database", 2017.

Business Activity	Definition
Research & Development	The discovery, design, or development of a product- technical design center
Business Service	When the sector is business or financial services and the project is opening an office, the business activity is Business Services
Construction	Building of a hotel, business park, or residential property. Does NOT include building of a manufacturing plant
Customer Contact Center	Call center, contact center, telemarketing center, customer help desk, cus-tomer care center, enquiries center, customer advice center, CRM center
Design, Development & Testing	Project which is involved in designing, developing or testing a product. Soft-ware companies opening development center normally under this as are in-volved in testing. To be included as R&D it must involve applied or pure re-search
Education & Training	A facility providing training services or education courses. Includes internal training services for company and outsourced staff
Electricity	A utility generating electricity- wind/solar/hydro/coal-fired/gas-fired power plant
Extraction	An operation that is extracting any substance from the earth (mining oil or gas). Does NOT include the processing of the substance
Headquarters	A divisional, national or regional HQ for the company.
ICT & Internet Infrastructure	Providing the infrastructure for the ICT sector-broadband infrastructure, in-ternet data centers, data recovery centers, etc.
Logistics, Distribution & Transportation	Operation providing transportation and/or storage of goods-logistics hub, warehouse, distribution center, cargo terminal, etc.
Maintenance & Servicing	Providing maintenance, repair and servicing of products-automobile and air-craft maintenance, watch repair, etc.
Manufacturing	Production or processing of any good- manufacturing plant, processing plant, smelter, etc. Also, includes operations where produce is grown i.e. Fish farm, winery, forestry, etc.
Recycling	This is for any operation which is involved in recycling
Retail	Opening of a clothing store, supermarket, restaurant, opticians or any retail operation, ie: any operation where a customer physically goes into a shop to buy something.
Sales, Marketing & Support	An operation that will develop sales, market company's products/ services and provide customer support but does NOT include retail operations. Overseas sales office, representative offices, etc.
Shared Services Center	Center providing administrative/ transactional type processing services to either internal business units or external clients (outsourced)-accounts pro-cessing, claims processing, invoice processing, BPO center. MUST BE A DEDI-CATED CENTER.
Technical Support Center	Center providing technical support to clients or internal business units- IT support center, IT helpdesk, technical center.

Source: Henry Loewendahl, Financial Times, "fDi Markets Database", 2017

Annex 4: Investor Grievance Management mechanism

The Investor Grievance Mechanism (IGM) essentially provides the minimum institutional infrastructure that enables governments to identify, track and manage grievances arising between investors and public agencies as early as possible. Reforms are undertaken to enable a designated lead agency within the government to manage and implement IGM. IGM ensures that the government responds to investor grievances in a suitable manner and in accordance with the country's international investment agreements, laws and regulations. The lead agency is equipped with adequate legal training and authority to serve as a 'secretariat' of IGM, facilitating the use of international and domestic investment law as a tool to persuade public agencies that generate investor grievances to consider whether their actions are, in fact, in conformity with the applicable investment frameworks well before grievances escalates into a dispute. It should be noted that investment aftercare is much broader than IGM in that the latter is "focused on identifying, tracking and managing conflicts arising from the application of investment protection guarantees." In this sense, IGM can be said to be a more focused subset of investment aftercare.

There is no ideal 'best practice' IGM. However, many countries have started to establish their own versions of dispute prevention and general aftercare systems, which provide the following valuable good practice elements for designing IGM:

» Lead Agency:

There should be a government agency with power and attributions conferred by law and/or regulations, responsible for implementing IGM. The lead agency may be an existing government ministry/agency or may need to be newly created. In particular, the lead agency should be able to obtain information from relevant government agencies that interact with investors/cause grievances and provide a channel for information sharing among government ministries/agencies. The lead agency can be established at a sectoral, sub-national or a national level, depending on the political-economy and requirements of the country. Countries like Republic of Korea have been able to appoint a fairly independent national lead agency, appointed directly by the president. Other countries, such as Bosnia and Herzegovina, have relied on a collaborative system involving multiple agencies at sub-national levels.

» Information Sharing:

Information sharing should enable the lead agency to coordinate the diffusion of relevant information to those agencies more likely to generate or become involved in grievances. Information sharing may involve substantive information on the contents and breadth of the obligations included in the different IIAs, or informing the highest possible number of governmental departments about the existence and purpose of the lead agency so the latter knows who to call in case of doubt regarding the consistency of their measures/actions with IIAs, or if a conflict with a foreign investor arises. For example, in Colombia a focus area of the dispute prevention strategy is training, information sharing on IIA commitments and on what these commitments mean for a public official's daily routine and decision making. Similarly in Mexico, the Secretaries of Economic Development organized training sessions and capacity-building efforts at a regional and municipal level, to create awareness of the commitments undertaken by Mexico with regard to foreign investors in IIAs.

» Early Alert Mechanisms:

Early alert mechanisms enable the lead agency to learn about the existence of a grievance as early as possible (e.g. through the private sector). In some countries representatives of the Lead Agency make regular visits to companies to gather information on existing grievances. This is the case in Republic of Korea and in Bosnia and Herzegovina. In other countries, investors need to report a grievance to the lead agency on their own. Some countries also use online technology tools as early alert systems. For example, Peru has designed an online tool for government agencies to register grievances. Gradually, this tool will be made available to investors to enable them to register grievances.

» Problem Solving Methods:

IGM should provide for problem-solving methods for the parties to seek an interest-based solution to the grievance (fact finding, obtaining third party expert opinion). In most existing models, consultation with investor and regular follow ups have been used to resolve investor grievances.

» Political Decision-Making:

Once the problem-solving process has enabled the parties to find a solution to the grievance, it is paramount that such solution receives the approval of the adequate political authority of host State and the investor. To achieve this goal, alternatives currently being considered in various countries entail the establishment of political bodies, such as Ministerial Councils, to monitor the effective implementation of solutions agreed by the lead agency, which will be an administrative body. High-level political endorsement would guarantee that the measure providing a solution to the problem would be effectively implemented.

Political risk and investor protection related grievances often involve multiple levels of government and can relate to controversial government conduct. Having high level political support is thus essential for resolving such grievances. In Mongolia for example, it was decided to have an Investor Protection Council (IPC) under the Prime Minister's office. In Bosnia and Herzegovina, problem-solving and political decision making is voluntarily done by the lead agency (which is a group of representatives from relevant government agencies). The sub-national government agencies are very powerful and act quite independently. The thrust for political decision-making to solve investor grievances is peer pressure from other government agencies and not one "superior" agency.

» Enforcement of decisions:

Closely related to political decision making is the need to ensure that the consensual solution to the grievance agreed by representatives of governments and investors is not ignored or disrespected by one of the many other agencies (e.g. Ministerial Councils enforce).

IGM is designed based on a country's political, economic and legal/institutional framework. The capacity of the government and resources available also determine the type of IGM that can be designed for a country. In some countries, a centralized IGM may be set up, while in others a sub-national approach is more fitting. In some countries majority grievances arise in a specific sector and thus governments choose to design a sectoral IGM.

In Bosnia and Herzegovina, the aftercare initiative gradually evolved into a more targeted and effective IGM. Rather than pursuing a top down approach, a more organic approach was followed involving representatives of the private sector and sub-national government agencies. Bosnia and Herzegovina has a strong federal structure with sub-national entities functioning fairly independently. The Collaborative Network, which is the lead agency, is essentially constituted on a voluntary basis and so far does not have a single law/regulation governing it. Peer pressure from each other motivates and pushes governments to address investor grievances in an effective manner. The investment promotion agency can also submit a report on pending investor grievances to the council of ministers for their consideration.

A more sophisticated model is Republic of Korea's Office of Foreign Investment Ombudsman (OFIO) that is commissioned directly by the president and heads the Investment Aftercare Division. The Investment Aftercare Division is staffed with nine experts in the fields of taxation, labor, finance, accounting, law, construction, IT. The experts, also called "Home Doctors", provide foreign-invested companies one-on-one service in investigating and resolving a wide range of grievances. In the Korean model, "grievances" are very broadly defined and OFIO addresses all types of grievances, ranging from corporate management to the living environment of foreign investors. Unlike Republic of Korea's general aftercare system, typically SIRM focuses only on key investor protection guarantees. Having a more targeted approach helps countries with more limited resources react more effectively to investor grievances.

Annex 5: Tax Incentives

Table 13: Description of Different Types of Tax Incentives Instruments

Instrument	Description
Tax Holiday	Temporary exemptions of a new firm or investment from certain taxes. They typically cover direct taxes such as the Corporate Income Tax (CIT).
Concessionary/ preferential rates	Reduced rates that act as a partial exemption from the standard corporate tax rate.
Tax credit	Deductions of a certain fraction of an expenditure from the tax liability.
Tax allowance	Deduction of a certain fraction of an expenditure from taxable profits (in addition to depreciation). If the CIT rate is uniform across firms, investment allowances and investment tax credits are equivalent.
Accelerated depreciation	Depreciation at a faster schedule than available for the rest of the economy.
Loss carry forward	Provisions allow a company or an individual to apply the current year's net operating losses to future years' profits in order to reduce tax
Export-oriented indirect tax incentives	Often come in the form of exempting export-oriented industries from import duties, excises, and Value Added Tax (VAT) on imported inputs used in the direct production of exports

Source: WBG IPP Team.

Table 14: Tax Incentives: Advantages and Disadvantages of Different Instruments

Pros	Cons
Income Tax holidays and Concessionary rates	
'Signaling effect' to investors and easy to communicate / advertise	Mainly benefit 'footloose' investment with a short time horizon or those that would have been profitable in any case. No benefit for long-term investors with negative profits during first years of operation.
Investors appreciate less interaction with tax authority	Liberating investors from tax filing obligations makes costs more difficult to track and less transparent
	Tax holiday is granted based on an up-front promise by the investor → no direct link to desired outcomes such as investment level, jobs
	Prone to abuse through profit shifting within firms → create opportunities for tax avoidance

Export oriented Indirect Taxes (e.g. VAT and Customs Exemptions)	
Are consistent with the principle of destination-based taxation → relieve inputs used in the direct production of export from burden of indirect taxation	Prone to abuse (leakage risk) → diversion of imported zero rated good to other purposes;
Can increase firm competitiveness by easing access to imported inputs	Distort competition and put domestic suppliers at a disadvantage
	Inconsistent with VAT cascading for domestically sold goods
	No direct link to desired outcomes such as investment level, jobs
Investment / Employment / R&D Tax Credits and Allowances	
Directly tied to policy objective → amount of benefit to investor is a direct product of new investment / jobs / R&D	More challenging to administer
Tax revenue is more transparent and easier to control → less prone to abuse, more transparency on fiscal costs	Distorts production technology towards supported factor (not a con if this is the desired policy objective)
Accelerated Depreciation	
Favors long-term capital intensive investment	More challenging to administer
Tax revenue is more transparent and easier to control → less prone to abuse, more transparency on fiscal costs	Distorts production technology towards capital (not a con if this is the desired policy objective)
Fiscal losses tend to be smaller as revenue foregone over the accelerated depreciation period is eventually recovered	
Loss Carry Forward	
Encourages investment in areas which have higher initial cost and longer-term profit horizons	More challenging to administer

Figure 52: Good Practice in Cost-Benefit Analysis

Source: WBG/IPP Team

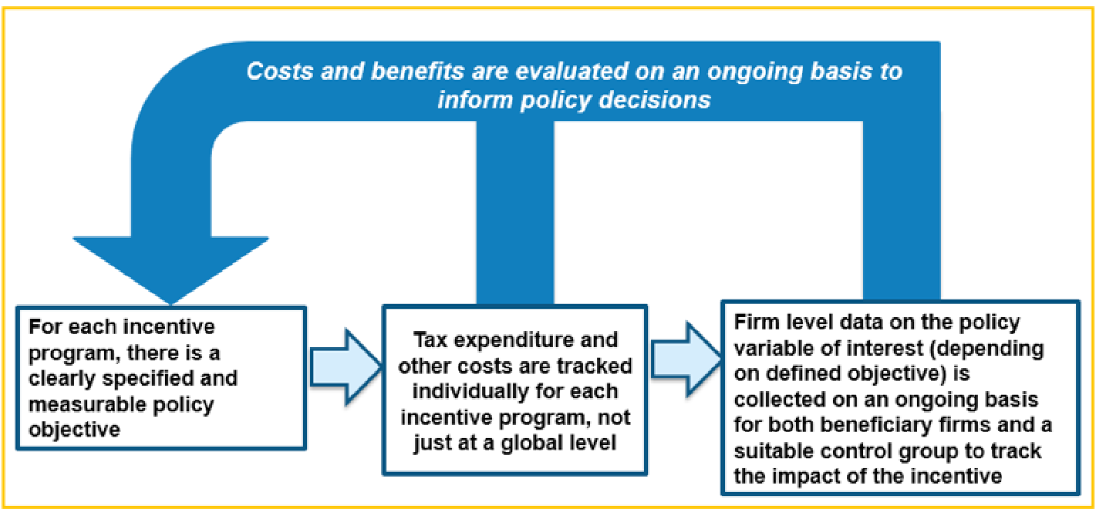


Table 15: SEZ Incentive Packages

	Incentives for SEZ Developers (Articles 40-42 of Decree 188)	**Incentives for Investors (Articles 43-45 of Decree 188)**
Fiscal Incentives		
Exemption of Import Tax and Duties	On imported and exported goods (subject to provisions stipulated in the IPL)	On imported and exported goods (subject to provisions stipulated in the IPL)
Tax holidays on Corporate Income Tax	For manufacturing, services, tourism development industry, health service sector, education, sport, and real estate development. Granted based on location: -Zone 1 is 16 years -Zone 2 is 8 years.	SEZ investor investing in a promoted sector listed in Article 9 of the IPL 2016 can receive 2 additional years of tax holiday in zone 1 (10 + 2 = 12 years) and zone 2 (4 + 2 = 6 years). Upon the end of tax holiday period, SEZ Investor will pay profit tax at 35 percent of full rate for 5 years. After that investor will pay the full rate.
VAT exemption	For road construction, electricity and water supply installation, drainage system and waste management system construction. Other infrastructure construction is granted 50 percent of VAT rate (under VAT Law)	Construction of manufacturing for export will be granted 100 percent VAT exemption and pay 50 percent of the full VAT rate for electricity and water supply consumption for construction. Construction of infrastructure supporting investment activity not for 100 percent export shall pay 50 percent of the full VAT rate.
Non-fiscal incentives		
Land	SEZ developers have the right to use land in SEZs and lease, hand-over and transfer the portion of land in the SEZ to investors (based on the development master plan endorsed by Zone Management Committee).	SEZ Investor has right to use, lease, handover or transfer the leased portion of land based on term and period stated in the lease contract but not more than the period of development contract. Owner of property located in SEZ has right to ownership of land and property over the period of contract and can sell, handover, transfer or inherit. Upon the end of the contract, the land will return to the government. Foreigners who received a property right for residential building within SEZs pay upfront above US$ 100,000.
Other incentives		
	• Developers can receive other incentives as determined in the IPL. • Developers can receive additional incentives based on the negotiation/ contract (depending on location uniqueness or remoteness, and sector with special support by the government).	Investors in SEZs are eligible to receive any tax incentives determined in the IPL. Foreign investors who received the property right through leasing and have stayed in the country more than three months will be granted the multiple-entry visa. The investor's spouse and children will be granted the multiple-entry visa for 10 years and that is extendable. Also, they will be eligible for any facilitation provided by the government in each period.

Source: WBG/IPP analysis.

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