

The effect of investment policy to fdi in laos



The Foreign Direct Investment play very important role in many developing countries in generating capital, job employment and technology transferring. As a trend of FDI moves forward to country which rich in natural resources and have advantage in cheap labor, in the case of Lao PDR also no exception. The Lao People's Democratic Republic is a landlocked country, which is located in Southeast Asia and bordered with five countries namely: Cambodia, China, Myanmar, Thailand and Vietnam. Its land area is approximately 236, 800 square kilometers. Lao PDR, however, is only lightly populated with 6. 7 million people with an average growth of 2. 8 percent annually, which has been thinly spread across the country. Roughly 80 percent of population is involved in agriculture, forestry and fishing, producing half of the country's GDP (52 percent of GDP), while industry and service sectors have been positively expanded with a share of 22 and 23 percent of GDP, respectively. Recently, Lao PDR is on the process of transferring its economy from centrally planned economy to market-oriented economy. Its GDP growth is around 8 percent annually. However, Lao PDR is classified as a " least-developed country" by the United Nations.

Lao PDR has tried to accelerate the economic development for many years to eradicate poverty and improve its people's living conditions. Since 1986, the government of Lao PDR has thus decided to launch its economic reform, namely " New Economic Mechanism". Basically, new reform is based on the transformation from the centrally planned economy to the market-oriented economy. In 1989, Lao PDR has completely opened up its country to the world. Its reform is comprised of five principles: 1) price determination and resource allocation are based on the market; 2) domestic and foreign trade

is liberalized as well as the distribution of goods and capital; 3) public enterprises are privatized and local authorities are given more autonomy in decision making; 4) command-based economic planning is replaced by guidance-based planning; and 5) foreign investment is actively introduced.

With the Investment Law in 1994 onward the government of Laos PDR has paid attention in attracting Foreign Direct Investment by improving business environment, political stability and macroeconomic policy, its commitment to be member of WTO and AFTA which giving foreign investors in flavor of investment incentive especially in tax policy and land policy. However with the implementation of Investment Law in 2004 which given huge investment incentive to foreign investors especially tax incentive, as the resulted in 2005 onward the FDI inflow has been significantly increased especially in mining sectors and hydropower sectors. In 2006 the FDI inflow rose up to US\$187 million and in 2007 increased more than 37 percent or US\$ 1, 180 million.

However by comparing Laos with its neighbor in term of FDI inflow which still in small amount even the investment policies are not much different, thus my motivation is to study and analyze investment incentives to attract foreign investors especially the effect of investment policy to FDI inflow in recent year before and after 2004 (1998 to 2004 and 2004 to 2010) to draw out investment strategic policy for recommendation to Lao government in the future with all aspects as short term and long term for implementation investment law.

Literature Review

<https://assignbuster.com/the-effect-of-investment-policy-to-fdi-in-laos/>

Investment policies: Tax incentives, the subject of this study, can be defined as any incentives that reduce the tax burden of enterprises in order to induce them to invest in particular projects or sectors. Tax incentives would include, for example, reduced tax rates on profits, tax holidays...etc

Foreign direct investment (FDI) is increasingly being recognized as an important factor in the economic development of countries. Besides bringing capital, it facilitates the transfer of technology, organizational and managerial practices and skills as well as access to international markets. More and more countries are striving to create a favorable and enabling climate to attract FDI as a policy priority. In addition to reducing the restrictions on the entry of FDI, they are actively liberalizing their FDI regimes.

There are many scholars wrote about the relation of investment and its policy, how it attracting FDI, thus many developing countries tried to develop their own policies to promoting investment and attracting FDI. Tax incentives as the good example of FDI promotion in many developing countries, however it is questionable that, How did the investment policy effect to FDI inflow? Are the investment policy effectives? How the other investment incentive offers in term of attracting FDI? What are the challenges for investment policy given? What are the negative and positive of investment policy?

The role of incentives in promoting FDI has been the subject of many studies, but their relative advantages and disadvantages have never been clearly established. There have been some spectacular successes as well as notable

failures in their role as facilitators of FDI. As a factor in attracting FDI, incentives are secondary to more fundamental determinants, such as market size, access to raw materials and availability of skilled labor. Investors generally tend to adopt a two-stage process when evaluating countries as investment locations. In the first stage, they screen countries based on their fundamental determinants. Only those countries that pass these criteria go on to the next stage of evaluation where tax rates, grants and other incentives may become important. Thus, it is generally recognized that investment incentives have only moderate importance in attracting FDI.[1]

In some cases, and with some types of investment, however, their impact may be more pronounced. For some foreign investors, such as footloose, export-oriented investors, tax incentives can be a major factor in their investment location decision. Also, among countries with similarly attractive features the importance of tax incentives may be more pronounced. In addition, Governments can quickly and easily change the range and extent of the tax incentives they offer. However, changing other factors that influence the foreign investment location decision may be more difficult and time consuming, or even outside government control entirely. For these reasons, investment experts, particularly from investment promotion agencies, view incentives as an important policy variable in their strategies to attract FDI for economic development.[2]

According to the report of “ Checklist for Foreign Direct Investment Incentive Policies, OECD, 2003” which based on material assembled by Hans Christiansen, the conditions sought by foreign enterprises are largely equivalent to those that constitute a healthy business environment more

<https://assignbuster.com/the-effect-of-investment-policy-to-fdi-in-laos/>

generally. However, internationally mobile investors may be more rapidly responsive to changes in business conditions. The most effective action by host country authorities to meet investors' expectations is:

Safeguarding public sector transparency, including an impartial system of courts and law enforcement

Ensuring that rules and their implementation rest on the principle of nondiscrimination between foreign and domestic enterprises and are in accordance with international law

Providing the right of free transfers related to an investment and protecting against arbitrary expropriation.

Putting in place adequate frameworks for a healthy competitive environment in the domestic business sector.

Removing obstacles to international trade.

Redress those aspects of the tax system that constitute barriers to FDI.

In the Morisset's article (2003, p. 253), the impact of tax incentives on FDI is not obvious that it can help in promoting investment. In the past few decades the numerous studies of international investors have indicated that the tax incentives are not major factor in their investment location decision. More important factors such as infrastructure, political stability, labor and the cost of production

However investment policies also have encouraging in attracting on FDI as well, the good example is Ireland's tax incentives have been recognized as <https://assignbuster.com/the-effect-of-investment-policy-to-fdi-in-laos/>

the key in attracting foreign investors in the last twenty years. Moreover in reason years there has been growing evidence that tax rates and incentives influence the location decisions of the companies within the regional economic groups, such as European Union, North America Free Trade Area and Association of Southeast Asian Nations. In Zhang's article (2005) stated that the factors that created the investment climate and determine its attractiveness for FDI are numerous and complex. Thus investment policies effect the decision of foreign investors to some extent

Purpose of the Research

The objective of this paper is to analyze the effective of investment policies offers in attracting FDI into Laos and the main study shall be identify and comparing the issues of using incentives Vs investment policies to draw out investment strategic policy for recommendation to Lao government in the future with all aspects as short term and long term for implementation investment law. Thus the scope of the thesis is based on investment policies apply to foreign direct investment in Laos.

Research Question

How did the investment policy effect to FDI inflow?

Are the investment policies effective?

Research Method

The data and information are mainly from the concerning Ministries in Laos as essential

The scope of the thesis is not covering in all aspects of economic development in the country, it will focus only FDI strategic policy or investment policy and FDI related topic

This paper focuses on the effectiveness of the incentives especially investment policies applied for the foreign investment in Laos

The study will be conducted in three selected provinces, namely in Vientiane capital, Savannakhet and Champasack provinces. In this connection, finalized selection of the target provinces and the number of provinces will be discussed with my supervisor and researchers for guidance and inputs.

Intra-case studies (4 cases), before and after 2004 (time series)