INDUSTRY NOTES – AGRO-PROCESSING LAOS

I. GENERAL INFORMATION ABOUT LAOS

A landlocked nation in Southeast Asia occupying the northwest portion of the Indochinese peninsula, Laos is surrounded by China, Vietnam, Cambodia, Thailand and Burma. With land area of 89,112 sq mi (230,800 sq km), Laos is a mountainous country, especially in the north, where peaks rise above 9,000 ft (2,800 m). Dense forests cover the northern and eastern areas. The Mekong River, which forms the boundary with Burma and Thailand, flows through the country for 932 mi (1,500 km) of its course.

Economical Overview

The government of Laos, one of the few remaining one-party communist states, began decentralizing control and encouraging private enterprises in 1986. The results, starting from an extremely low base, were striking – growth averaged 6% per year from 1988-2008 except during the short-lived drop caused by the Asian financial crisis that began in1997. Laos' growth rate exceeded 7% per year during 2008-2012. Despite this high growth, Laos remains a country with an underdeveloped infrastructure, particularly in rural areas. It has a basic, but improving road system, and limited external and internal landline telecommunications. Electricity is available 75% of the country.

Laos' economy is heavily dependent on capital-intensive natural resources exports. The labor force, however, still relies on agriculture, dominated by rice cultivation in lowland areas, which accounts for about 30% of GDP and 75% of total employment. Economic growth has reduced official poverty rates from 46% in 1992 to 26% in 2010. The economy also has benefited from high-profile foreign direct investment in hydropower, copper and gold mining, logging, and construction though some of the projects in these industries have drawn criticism for their environmental impacts.

Laos gained Normal Trade Relations status with the US in 2004. On the fiscal side, Laos initiated a VAT exempts tax system in 2010. Simplified investment procedures and expanded bank credits for small farmers and small entrepreneurs will improve Laos' economic prospects. The government appears committed to raising the country's profile among investors, opening the country's first stock exchange in 2011 and participating in

regional economic cooperation initiatives. Laos was added to the WTO in 2012. The World Bank has declared that Laos' goal of graduating from the UN Development Program's list of least-developed countries by 2020 is achievable.

Economical Key Facts Laos

Currency:	Kip (LAK)
Exchange rates:	1USD = LAK8,013
GDP (billion USD):	USD19.52 billion (2012 est); USD18.02 billion (2011 est); USD16.68 billion (2010 est)
GDP – real growth rate:	8.3% (2012 est); 8% (2011 est); 8.1% (2010 est)
Inflation Rate:	4.3% (2012 est)
Major Trading Partners:	Thailand, China, Vietnam,
Major Imports:	machinery and equipment, vehicles, fuel, consumer goods
Major Exports:	wood products, coffee, electricity, tin, copper, gold, and cassava
Key Industries:	mining, timber, electric power, agricultural processing, rubber, construction, garments, cement, and tourism
Unemployment Rate:	

II. SMALL AND MEDIUM ENTERPRISES

SME Definition

Small and medium sized enterprises (SMEs) are independent enterprises that are legally registered and operating according to the prevailing laws of Laos and are classified according to number of employees, total assets and annual turnover.

Small enterprises are those having an annual average number of employees not exceeding 19 persons or total assets not exceeding LAK250 million or an annual turnover not exceeding LAK400 million. Medium sized enterprises are those having an annual

average of employees not exceeding 99 persons or total assets not exceeding LAK1.2 billion or an annual turnover not exceeding LAK1 billion.

Table 1. Classification of SMEs

	No. of Employees	Total Assets	Annual Turnover
Small Enterprises	<20 employees	Less than or equal to LAK250 million	Less than or equal to LAK400 million
Medium Enterprises	<100 employees	Less than or equal to LAK1.2 billion	Less than or equal to LAK1 billion

III. SME-RELATED LAWS

There is currently no SME Basic Law in Laos, however the following are laws relating to SMEs:

Enterprise Law

The Enterprise Law came into effect in April 2006. It replaces the previous 1994 Business Law. The Enterprise Law governs all enterprises in Laos, including companies, partnerships and sole traders. It sets out in detail the process for incorporation of such entities and provides the corporate governance-type rules on the operation of the board of directors of companies.

Law on Industrial Processing

The objectives of this law are to identify the principles, regulations and measures on the promotion and management of Laos' Industrial processing so as to be competitive internationally and to develop continuously both in terms of quality and quantity with the aim of increasing goods processing, create employment and improve people's livelihoods. Thus, contributing to the development of the basic factors for the development of industry and modernization.

This law is currently being revised. One of the main purposes of the amendment is to ensure that factories in Laos are being equipped with modern technology in order to process raw materials efficiently.

Law on SME Promotion

The National Assembly passed the Law on SME Promotion in December 2011. The purpose of this law is to establish policies and measures to create a facilitating, enabling environment and condition for entrepreneurs in registering, operating, and development of SMEs. The government supports the promotion of SME development by focusing on the competitive enhancement in the areas of production, commerce, and services through provision of financing, techniques, technology, marketing and research.

Activities for SMEs promotion include the following:

- Creation of enabling environment
- Access to finance
- Tax exemption
- Entrepreneurial development
- Business development consultation
- Cooperation between SMEs and large enterprises or foreign investments
- Productivity enhancement
- Market access and penetration
- Business association
- Location of business
- Utilization of modern technology
- Intellectual property protection
- Access to information

IV. GOVERNMENT REGULATORY BODIES

Small and Medium Sized Enterprise Promotion and Development Office

The Small and Medium Sized Enterprise Promotion and Development Office (SMEPDO) is the official government regulatory body for Laos, under the supervision of the Ministry of Industry and Commerce. It was established under Primer Minister Decree No. 42/PM or the Decree on the Promotion and Development of SMEs. The main objective of SMEPDO is to promote the establishment and sustainable development of SMEs in Laos.

Small and Medium Sized Enterprise Promotion and Development Committee

The Small and Medium Sized Enterprise Promotion and Development Committee (SMEPDC) was established under Prime Minister Decision No. 23/PM in March 2005. SMEPDC is chaired by the Minister for Industry and Commerce and consists of 26 members, 17 of whom are from the private business sector. SMEPDO acts as the secretariat of SMEPDC.

V. SME POLICY FRAMEWORK

The focus of government policy shifted to those sectors in which long-term and competitive growth potential exists; a lower income section of the population is engaged; and there is scope for market development interventions. Several agro-related production value chains is included. Two outcomes can be expected: an increase in the incomes of primary producers (such as farmers, garment workers and weavers) and an increase in the number of low-income people participating in the growth of these sectors.

Over the past few years Laos has become a better place to do business for both domestic and foreign firms. This includes implementation of the Enterprise Law in 2006, which among other things introduced the concept of doing business is a right rather than a privilege of Lao citizens as defined in the Constitution. It also changed the previous “permit regime” to a “registration regime.”

SME Development Plan 2011 –2015

Direction

The strategy of SMEs requires them to upgrade and modernize so that they can be integrated into the production system. They should be able to trade their produce with other locales, provinces and countries. They will also be expected to compete under the free trade agreement to be enforced within ASEAN by 2015.

Main Targets

- Strive to increase the growth of domestic product to 15% per annum
- Attempt to achieve growth of 13% in SMEs
- Endeavor to increase the rate of employment growth to more than 10% per year
- Attempt to have 85% of the total business sector workers engaged in SMEs

To achieve these targets, there is need to concentrate on the following:

- Provide a more enabling regulatory environment for business operations by reviewing and improving regulations and procedures considered as business impediments, and putting in place appropriate mechanisms for evaluating the impacts of regulations on existing and new businesses.
- Improve SMEs' access to funds, by creating an enabling environment for financial institutions to lend to them. The aim is to diversify financial products and services, particularly giving out credit without stringent collateral agreements, and on a long-term basis; for example through loan guarantees, group investment funds, or lease/purchase of machinery and equipment.
- Create new entrepreneurs by promoting and supporting youth, academics and women to become entrepreneurs, establishing a centre to incubate business (and a mechanism to provide concessions to SMEs), and provide comprehensive training and consultation to those starting out in business.
- Expand assistance and service delivery in business development.
- Strengthen SMEs by gathering and disseminating information regarding business cooperation, business and investment opportunities, and business conduction at a

smaller scale, as learned from the experiences of larger enterprises. Mechanisms, policies and incentives will be created to attract larger enterprises to source goods and services produced by SMEs.

- Increase productivity though raising the quality and standard of goods produced by SMEs. An n operational plan will be formulated at the national level to raise the SME productivity and the quality of workers therein.
- Facilitate access to markets and expand markets for SMEs.
- Strengthen entrepreneurs and build up Lao businesspeople to be stronger and competitive.

Programmes and Priority Projects

In order to achieve the above-mentioned targets, the SME development strategy will concentrate on the implementation of 7 programmes and some prioritized projects including project on SME development, costing LAK8.78 billion, of which LAK5 billion is from domestic investment and 3.78 billion kip is from international investment (concentrate on grants) and other projects.

Measures

- Strengthen coordination with all economic agencies, conduct activities with focal points, avoid duplication of activities, and reduce the responsibility gap.
- Identify and mobilize the sources of funds and allocate them in an appropriate manner.
- Increase and pinpoint the roles and responsibilities of each of the concerned organizations at the central and provincial levels.
- Raise private and stakeholder contributions, create facilities for entrepreneurs, find new markets, and strengthen the competitiveness of Lao-made products.
- Provide trainings for Lao business people on vocational, law, information, and marketing.
- Turn company property into capital, change the status of Ltd. Companies to public companies to register on the Lao stock market.

VI. SME FINANCE FACILITIES

SME Fund

SMEs in Laos can obtain loans from the government's SME Fund through Lao Development Bank. The SME Fund has provided LAK14 billion to the Lao Development Bank (LDB) over five years (starting September 2012), at an interest of five percent per year. LDB expects to release loans to about 70 SMEs, drawing from the LAK14 billion fund.

The SME Fund is focused on supporting SMEs in the agricultural processing, handicraft production and tourism services sectors. Small enterprises can receive a loan of up to LAK250 million and medium enterprises can obtain a loan of up to LAK500 million. LDB releases the loans to SMEs at an interest rate of 9 percent per year for a loan of a year or less, and 10 percent per year for loans of more than one to three years.

Commercial Banks

With rapid liberalization and expansion of the banking sector leading to a significant increase in the number of fully incorporated commercial banks and branches of foreign and domestic banks, access to finance for businesses is expected to improve in the medium and long term.

SME Banks

The government of Laos will encourage businesses to establish commercial banks, which will only deal with SMEs. The government issued the new SME bank investment promotion policy since despite the growing number of commercial banks in Laos SMEs are still facing difficulties in accessing credit. The establishment of the banks will focus on the provision of loans for firms exporting goods from Laos.

VII. AGRO-PROCESSING INDUSTRY – LAOS

Efforts are being made by the government of Laos to prioritize agro-processing as a channel for economic growth, based on the country's substantial agriculture and forestry potential.

According to Ministry of Industry and Commerce Head, Bounmy Manivong, more than half of the Lao population is engaged in agricultural production. They rely on natural resources with minimal technology at their disposal, thus resulting in low quality products that generate little income. Prices are often unstable due to lack of balance between supply and demand.

Agro-processing industry is the key to resolving these problems. Agricultural production is seasonal in nature, so agro-processing can play an important role in stabilizing and regulating production and consumption, absorbing raw materials from agriculture and helping to insure a stable market for farmers.

Agro-processing has a potential to grow, because of the fertile soil which supports many crops and livestock. However, this sector faces difficulties, as most farmers are not oriented towards producing for the markets. In addition, there are difficulties related to scarce raw materials in some seasons, as the transport system is not adequately equipped to transport raw materials over long distances. There are also market-oriented issues – many farmers find it more profitable to sell their products along the border, as the price is higher compared to the price paid by local agro-processing or food-processing industries.

VIII. LAOS AGRO-PROCESSING INDUSTRY STATUS

A. INFRASTRUCTURE

Overall, Laos has a weak physical infrastructure. There are three international airports, having few international flights. To date, Laos has no railways. The major roads connecting urban areas, in particular Road 13, have been significantly upgraded in recent

years, however villages far from major roads can be reached only through unpaved roads that may not be passable year-round. High transit costs are reducing the competitiveness of the export-oriented manufacturing sector.

There is limited external and internal telecommunication, but mobile phones have become widespread in urban areas.

The government of Laos has put utmost effort to electrify 90% of the total household by 2020. As of 2010, the electricity coverage is more than 70%.

B. OFFSHORE ATTRACTIVENES FACTOR

The Lao National Chamber of Commerce and Industry has drawn up a list of reasons why foreign companies would be well advised to invest in Laos. These are summed up below:

- Political Stability – The Lao People's Revolutionary Party and the government have created political stability and committed to spur private investment, believing the private sector to be the driving force of economic growth.
- Natural Resources – Laos has an abundance of natural resources including water, minerals, sources of energy and forests, which can be developed using the proper technology and converted into commodities for export to international markets.
- Labor Cost – The minimum wage, which the government recently approved, is just 624,000 kip per month, which is much lower than that paid in Thailand and other ASEAN nations.
- Location – Laos is situated in an area of economic growth, sharing its borders and common interests with Thailand, Cambodia and China. Laos offers a solid base from which investors can expand into the region.
- Land-Link – Laos is a land link within the ASEAN region and has access to a market of 500 million people, including Southern China. Laos plans to buils a high-speed railway from Vientiane to the Chinese border. There are also plans to build a high-speed railway in Savannakhet, which will provide a transit route for goods being shipped between Thailand and Vietnam.
- Special Economic Zones – The government has established 10 Special Economic Zone, which come with a number of investment incentives.

- Trade Agreements – Laos enjoys privileges from 42 countries under the Generalized System of Preferences and has Normal Trade Relations with the US because it is classified as a Least Developed Country. In addition, the European Union and Japan have granted Laos trading privileges such as tax exemptions on imports where more than 200 listed items fall within a special quota. This means Lao products can access global markets with lower tariffs or completely duty-free.
- Tax - Laos offers investors various tax breaks including tax exemptions and tax holidays, and waives import tax on raw materials required for processing and re-export. Investors are also exempt from paying export tax.

C. TAX AND REGULATORY INCENTIVES

The 24 percent profit tax rate applies to both domestic and foreign businesses, except for companies registered in the Lao Stock Exchange, which benefit from a five percent reduction of the normal rate for a period of four years from the date of registration in the Stock Exchange. After this period, the normal profit tax rate applies.

SMEs pay lump-sum tax at progressive rates between three and seven percent, depending on the nature of the business and its revenue. A tax exemption is provided where the annual revenue is less than LAK 12 million.

The Law on Investment Programme provides special tax incentives for investors in Laos. These incentives are summarized below:

- Reduced tax rates for a company that has an investment agreement with the Government of Laos
- Certain investment incentives may be made available to investors where the relevant project relates to encouraging specific sectors or is located in certain regions.
- If a foreign enterprise is granted an initial tax exemption period of two to four years and suffers losses in that period, it may be permitted to carry the losses

forward. The losses may then be deducted from taxes levied on profits in the following year, or carried forward for up to three years.

- Raw materials and intermediate components that are imported in order to achieve import substitution are eligible for special duty reductions.

D. SECTOR SIZE

According to the Economic Census of 2006, food processing sector had 15,804 enterprises in 2006, of which 28 enterprises were large factories, employing more than 100 workers. 171 units were classified as medium-sized employing 10-99 workers. The rest or 15,625 businesses were classified as small enterprises, employing less than 10 workers.

IX. LAOS AGRO-PROCESSING INDUSTRY PERFORMANCE

The industry and manufacturing sector is important due to having contributed in terms of value added and job creation. The manufacturing sector has grown quickly with an average of 9.4% per year between 2006 and 2010. Manufacturing is a relatively low investment sector, having a high rate of job opportunity compared to other industrial sectors. Some of the main sectors in manufacturing have had a steady growth, such as garments and textiles, wood and food processing. The total number of manufacturing enterprises is 24,331, accounting for 19.2% of the total number of enterprises.

Figure 1. Average share of value added in the industrial sector 2006-2010

Source: Statistics Department, Ministry of Planning and Investment

Processed agricultural products are currently limited to coffee, tea, processed fruit and vegetables, beer and tobacco. Coffee in particular has been a success story for the economy. The export earnings from this sector have grown from less than USD13 million in 2006 to USD40 million in 2010, the majority of which is destined for the EU market. With the growth in demand for organic coffee, the industry has the potential to support the country's export diversification into high-value agro-processing activities.

Share of Employment

The total labor force of Laos, reported in aseanaffairs.com in September 2011, is 3.7 million. The age group is between 16 and 65. Among the labor force, 76.6% work in agriculture and forestry sector, 7.8% in industry and construction; and the remaining 15.6% in service sector. Approximately 300,000 people work in business sector, and 167,100 people work for the government. Table 2 below shows the share of labor by sector from 2005-2010.

Table 2. Share of labor by sector

Sector	Year		Estimate
	2005	**2010**	**2006-2010**
Agriculture-forestry	78.5%	75.1%	73.9%
Industry	4.8%	5.5%	9.3%
Service	16.7%	19.5%	16.9%

Source: National Socio-Economic Development Plan 2011-2015

X. FUTURE DIRECTION OF LAOS AGRO-PROCESSING INDUSTRY

Agro-processing is one of Laos' main potential sectors along with hydropower, mining and construction materials. The use of modern technologies in agro-processing is still in the nascent stage, and both government and farmers face challenges in progressing in this area.

One of the directions of the Laos National Socio-Economic Development Plan 2011-2015 is to develop industry and commerce in both quality and quantity; maintain balances between demand and supply; and enhance the capacity of industry and commerce to compete in domestic and export markets, especially in agro-processing. Small and medium enterprises have a special role to play in promoting industrialization and modernization, in turn resulting in rapid economic growth. The aim will be to attract domestic and foreign investments to invest greater quantities in the processing industry for which industrial zones and industry-associations will be created at different levels.