FDI ATTRACTION FOR INDUSTRIAL DEVELOPMENT – EXPERIENCE FROM DEVELOPED COUNTRIES AND APPLICATION LESSONS FOR LAOS

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Abstract - This paper includes experience in attracting FDI into the industrial branch of some countries in the world such as newly industrialized countries (NICs), China and ASEAN countries (Malaysia, Thailand and Vietnam). These countries have the same starting point as Laos in terms of natural, economic and social characteristics, and they have been very successful in FDI attraction to develop their industry. On this basis, with reference to the specific characteristics of Laos' economy, the paper draws some lessons for Laos to attract more FDI into its industrial sector, including the improvement of the investment environment, administrative procedure reform, the opening of some fields, the construction of industrial zones (IZs), export processing zones (EPZs), investment incentives, investment promotion, human resource development, infrastructure and support industries (SI).

Key words - industry branch; export processing zones; industrial zones; investment environment; FDI.

1. Introduction

The economy of Laos and its industry are still behind the development due to the restriction of FDI companies and the weakness of domestic companies. Therefore, learning from other countries in the region, particularly ASEAN countries is useful for the improvement of the competitiveness of FDI attraction into Laos. These are countries with similar charactertistics in geography, natural resources and society. Moreover, the industrialization in these countries began from their industrial – agricultural structures. However, they have reformed, constructed legal bases and created attractive investment environments for FDI. These lessons will be selectively applied into Laos to attract more FDI for its industrial development.

2. Expericences in attracting FDI to develop the industry from some countries in the world

2.1. Experiences from NICs

NICs are idential to Laos in the first stage of the industrialization, in which the economy was unbalanced, underdeveloped and exshauted after the war; income per capita was low; natural resources were poor; the weather was bad; small land was occupied by a large population; main advantages inluded sea ports and cheap labour. However, with appropriate policies in economy development and attracting FDI, these countries became newly industrialized countries with high ecocomy growth rates, specifically in Singapore, this rate was 12.2% p.a (1965–1980), industry constituted 29.1%GDP in 1990; in Korea, the growth rate was 16.6% p.a (1965–1980), industry accounted for 40% of GDP in 1990; in Taiwan, these figures were above 7% p.a (1988–1991) and 42.3% GDP, respectively. Export turnovers of industrial products in these countries during 2000-2003 were more than 60% GDP on average, in which, more than 50% was exported to the American market [5]. Experiences that can be applied to Laos are as follows:

- *Maitaining the stability of policical and social situations.* In the Cold war time between Socialism and Capitalism, when many countries fell into war or strained relationships with capitalist countries, these countries took the chance, kept the policical and social situations stable in order to attract FDI. Thus, this is a precious experience for Laos.

- *Culivating the strength in labour and natural resources.* Abundant and cheap labour is the advantage of these countries in attracting FDI. Nevertheless, they are different in natural resources and geographical locations. For example, exploiting its advantage of locating in the centre of an international marine route, Singapore becomes an ideal transhipment port and an atttractive general trade zone for investors.

- *Enhancing the infrastructure to create a convenient environment for FDI to be used effectively.*The weakness of the infrastructure not only discourages foreign investors but also destroys the advantages of FDI. Therefore, the government ought to much attention to investing in its infrastructure and education system. The investment in infastructure in Korea (1960–1990) was 8.7%/GDP, in Taiwan (1970–1990) it was 9.5%/GDP [6].

- *Successfully forming EPZs to attract FDI.*These countries regard EPZs as an effective solution for new technology diffusion into the country and promoting the right orientation of other ecomomics. In Taiwan, FDI reached 13.8 billion USD (1951–1993), in which, electronics constituted 54.7%, manufacturing 35.5%, non-metal production and chemical 17.9% in 1970. Korea attracted 67 billion USD until 2002, most were manufacturing, electronics (46% industrial products). Singapore attracted more than 41 billion USD (2002-2003), mainly electronic parts manufacturing (37% industrial products). Hongkong got 13.5 billion USD up to 1993 (electronics was more than 53% industrial products) and became the 10th FDI attraction point in the world [5]. The experience revealed that many EPZs might not be effective but the determination and selection of the right partners in finance, engineering and technology was much more important.

- *Actively exploiting knowledge and technology from foreign countries through FDI.* This is considered as the key for the rapid development of the economy in general and the industry in particular. The transferring of technology not only depends on the investors but also the specialists in the countries; hence, these countries focus on three directions in exploiting the technology factor of FDI: (1) determining and searching for solutions so that the flow of FDI into the domestic country is the most and the fastest; (2) establishing a mechanism for the investors to transfer the technology; and (3) form an expert team, domestic workers qualified to receive foreign technology.

- Establishing a flexible mechanism in the relationship between various economic sectors to mobilize domestic capital and FDI for industrial development. State-owned enterprises in these countries account for only a small percentage, yet they have important roles, which focus on sectors where privatization has not been done, such as the industries of petrochemicals, steel, ship-building, and raising private capital, FDI to develop other sectors. FDI enterprises have different degrees of importance in the NICs' economy: this rate in Taiwan, Korea is low, but that in Singapore and Hong Kong is quite high; enterprises with 100% foreign capital accounted for 16.7 % of the base, 55.9 % of production and 42.7 % of workers in Singapore in 1981 [5].

In summary, besides appropriate ways of industrialization, NICs countries have exploited FDI factors effectively to provide them a push for taking off, and become a phenomenal growth in the industry.

2.2. Experiences from China

The Chinese industry has thrived since the Foreign Investment Law was issued (1979). Until 2002, 414,000 FDI projects were licensed with 816.66 billion USD registered capital and 438.78 billion disbursements. China became the second receiver of FDI in the world (1993-2001) and the largest in 2002 (more than 50 billion USD, surpassing the US) [7], and reached 100 billion USD in 2005. Besides its large-scale advantage, China has made efforts to improve and enhance the competitiveness of the investment environment. Lessons learned from China were as follows:

- *Increasingly investing and developing the infrastructure.* Infrastructure investment in China (2003 - 2004) accounting for 8%/GDP on average [6] has formed a clear infrastructure system, connecting ICs, IZs and EPZs with the national infrastructure system. During the 90s, China constructed IZs, EPZs in areas with low levels of industrialization, far from the urban but still attractive to FDI because of the convenient connection with the national infrastructure system, which help reduce costs and time. Localities with better infrastructure (the coastal cities) attract more FDI [8].

-*Improving the regulatory environment.* China is always concerned about the interests of foreign investors by regularly amending and supplementing the Law on Foreign Investment. Many provisions are removed to match international practices. In 2001, foreign investment guidelines were issued, in which, many projects related to the liberalization of the services sector (banks, insurance, commerce, international trade, tourism, communications, transportation, accounting services, finance and regulation) were proposed to conform with WTO rules. The mechanisms and policies to attract FDI have now become more open after three times of amendments (1979-1990; 1991-2000; and 2001 till now).

- *Developing high-quality workforce* by positively reforming education and training system at all levels, sending people for training abroad since 1978 and attracting foreign experts to meet the high-quality employment requirements of investors. The number of people trained abroad in 1990 was 280,000, in OECD countries in 1998 was 86,000, in 2001 was 124,000, in the US in 2007 was 54,000 [8]. 480,000 foreign experts and 290,000 experts from Hong Kong, Macao, Taiwan came to work in these countries in 2003 and 2004.

- *Gradually expanding the category for incentives.* The innitial list of 186 priority industries was expanded to 262 and the limit investment industries were reduced from 112 to 75 [3].

- *Cautiously testing and successfully operating special economic zones*. These economic zones are convenient for economic exchanges with the outside (Shenzhen, Shantou bordering Hong Kong, Zhuhai bordering Macau, Xiamen near Taiwan and Hainan island). The special preferential regime and the syncly invested infrastructure in these zones have attracted FDI with modern technology, which boost exports, especially FDI from overseas Chinese. Approximately 50% of FDI in China from the Chinese in Hong Kong, Taiwan, Macau and Singapore was invested in these zones in 2004.

- *Effectively using preferential tax policies.* Besides policies on supporting infrastructure construction, land rent reduction, relocation costs and clearance, tax policies are very preferential and specific for each branches, regions and forms of investment. Five economic zones, 14 coastal cities and disadvantaged areas have very preferential tax policies. Corporate income tax of 15% in the sector is encouraged, investment in disadvantaged areas is exempt from tax for 2 years after earning interest and pay 50% only in the next 6 years.

- *Encouraging the development of SI.* SI such as automobiles, textile and electronics developed rapidly thanks to the development strategy of SI flexibility, namely: (1) creating market conditions such as calling for FDI assembly, which created cost advantages for attracting big businesses and promote these businesses find local partners, (2) building the conditions for the development of domestic industrial enterprises (SMEs), and (3) establishing the support of information, human resources, and legal to form and develop links and components market [1]. In addition to financial support, technology and training for SMEs, China encouraged FDI to be invested in the manufacturing industry and SI through incentives and proactive solicitation to companies capable of technology and market, and IZs establishment.

- *Encouraging FDI investments into exports and disadvantaged areas*. FDI enterprises which directly exported products manufactured abroad were classified into corporates and encouraged to invest. If export sales in these corporations accounted for 70% of sales, tax on sales would be reduced to 10% [8]. Moreover, foreign investors had more preferential tax policies for 10 years if the investment projects were carried out in disadvantaged areas. Foreign investment projects on the approved and limited investment list will benefit significantly when investing in these regions.

In short, China is considered as a typical example of business environment improvement so that Laos can learn from its experiences to increase competitiveness in attracting FDI for industrial development in the current trend of international economic integration.

2.3. Experiences fromASEAN countries

2.3.1. Experiences from Malaysia

Malaysia has adopted many policies and measures to encourage FDI for development industry, specifically:

- *Continuously completing the law system and improving the investment environment*. Important legal documents regulating relations related to FDI and creating a solid legal basis for business activities were enacted and amended such as the Companies Act (1965), Industrial Coordination Law (1975), Investment Promotion Law (1968, 1986), Law on Industrial Assurance (1978), Income Tax Law (1967), Excise Tax Law (1967), Sales Tax (1972), Excise (1976), Commercial Law (1972), and Customs Law (1967). Furthermore, the investment environment in the country and the necessary conditions for investment activities have always been emphasized, done regularly and synchronized with a clear mandate by the government [4].

- *Issuing many preferential FDI policies specifically and transparently*, including policies to liberalize shares ownership, applying fiscal incentives (from 1986), FDI incentives through tax exemptions, tariff protection, encouragement of FDI in finance, banking, insurance, loosening regulations on real estate ownership to foreigners, development of road, rail, sea and air infrastructure. In addition, there were incentives for large investment, high-tech, export-oriented projects and FDI in underdeveloped areas.

- *Actively promoting investment with various forms*. Regularly holding investment seminars at home and abroad to help foreigners know about investment policies, sending high-level delegations to introduce opportunities, mobilize investment abroad (the target countries), publishing multilingual publications, in conjunction with industrial and commercial organizations in other countries to introduce investment opportunities [2].

2.3.2. Expericences from Thailand

Thailand has adopted policies and laws to encourage FDI, which are expressed in three specific laws:

- Foreign Business Act (1972) defined the rights of foreign investors. *The percentage of foreign capital contribution must be more than 50%; foreign investors were permitted to invest into the sector of group C (list of branches was divided into 3 groups namely A, B, C; investment into group B was possible with the permission of the Thailand Investment Commission). This law amendment (1999) allowed foreign investors to invest in sectors such as construction, advertising and accountancy; legal consultancy and capital contribution ratio was decreased. In the early stage, Thailand's attitude towards FDI was different. The government did not provide incentives to FDI in areas that local firms have strength. However, Thailand then started to pay more attention to FDI by changing share ownership restriction ratio of foreign investors, allowing foreign companies to own 100% equity when exporting 100% of production, companies that exported at least 20% of production were eligible for duty free.*

- *Investment Promotion Law (1977, amended in 1991 and 2001) in order to create incentives for domestic and foreign investors in Thailand.* This law was divided into 3 preferential regions: region 1 included Bangkok and five developed provinces surrounding Bangkok, region 2 is 12 provinces around Bangkok and region 3 is the remaining provinces. Enterprises investing in region 1 were tax-free for 3 years, reduced 50% of equipment import duty. Enterprises investing in region 2 were tax-free for 3 years, and 7 years for projects in the technology. Enterprises investing in region 3 were excempted from tax for 8 years, tax-free import of equipment and materials for manufacturing for the purpose of exports for 5 years.

- *Industrial Zone Act (1979) creating incentives for investors in the IZs.* This law grouped IZs into 2 categories: popular IZs to serve common industrial projects, and EPZs to serve the direct industry and other industries to export with more incentives. Besides, in order to improve the competitiveness to attract more FDI, Thailand provided equipment import tax exemption for 61 operations, 8-year income tax exemption for 19 SI sectors, duty free imports of raw materials or income tax for a number of projects in region 1 and 2 which previously not entitled, signed investment protection agreements with 21 countries, signed the agreement on avoidance of double taxation with 40 countries [8].

2.3.3. Experiences from Vietnam

Vietnam has been very successful in attracting FDI in recent years and the lessons to be drawn are as follows:

- *Actively improving the legal environment towards facilitating FDI.* Vietnam Foreign Investment Law (1987) has been amended several times. The first time (1990) allowed private economic organizations in the country to have the legal status to do direct business cooperation with foreign partners, expanded the form of joint venture (with multiple stakeholders), allowed joint enterprises to benefit from financial incentives as manufacturing export goods enterprises. The second time (1992) allowed private businesses to cooperate with foreigners, regulated investment into EPZs, added BOT (specific rules of management and finance); the operational period was extended to 70 years; foreign-invested enterprises were entitled to open loan accounts in foreign countries. The third time (1996) adjusted the field and areas of priority, the role of technology assessment organizations, new regulations on the transfer of capital; FDI enterprises could choose to apply accounting regulations in accordance with the law of Vietnam or international standards; joint-venture businesses could forward losses by using profits in the next year (no more than 5 year); regulated capital proportion of foreign investors in the joint venture was not less than 30% of the legal capital; the legal capital of enterprises with foreign investment must be at least 30% of the capital; enterprises with foreign investment were allowed to transfer earnings abroad with tax rates from 5% to 10%. To restrict foreign workers and managers, the government adopted income regulatory tax (0% - 50%). In the fourth time (2000), in order to create favourable conditions for attracting FDI, the government allowed foreign-invested enterprises to open accounts in foreign banks, 100% foreign-invested enterprises might transfer losses, change the decentralization in FDI for the local and branches. In the fifth time (2005), the investment law was formed to unify the investment environment for domestic and foreign investment.

- *Developing policies encouraging FDI that is competitive compared to other countries in the region*. Corporate income tax in Vietnam was quite low in the region (25% popularity, preferentials from 10%, 15%, and 20%, the period of tax exemption was long, which can be up to 8 years). Import duties exemption for goods imported were applied to create fixed assets (construction materials equipment which cannot be produced domestically). FDI enterprises could forward losses but not exceed 5 years from the time of incurred losses. Investment projects in the encouraged regions, manufacturing of components, mechanical, electric and electronic parts were excempted from income tax for 5 years. Import tax exemption for materials and raw materials were used to produce export products, 0% value-added tax rate was used for enterprises with foreign investment selling manufacturing products to foreigners in Vietnam and appointed to deliver in Vietnam, land tax exemption for investment projects came under the statute BOT, BT and BTO.

3. Lessons drawn for Laos

Laos industry was formed in the 1970s but developed mainly in Vientiane and produced goods to primarily serve domestic consumer demand. In 1975, the nationalization of the factory hindered the industry growth due to lack of capital and technology. In 1986, Laos advocated to opening and innovation. However, serious imbalance, unstable finance, high inflation, difficult living conditions, low GDP, low investment efficiency made the economy in general and Laos industry in particular fell into a serious crisis. To rapidly mobilize domestic and foreign capital, change the economic structures and industrial structures, Laos specified a renovation policy by enacting the Law on Foreign Investment (1988). Nevertheless, FDI activities were still new and did not attract foreign investors to the potential of Laos. From the successful experiences of the countries, lessons for Laos to increase the competitiveness to attract FDI in the industry are as follows:

3.1. Improving the investment environment

A stable and healthy investment environment is the most important factor to attract FDI because it nourishes the intention, forms and decides the existence of investment decisions. To maintain a stable investment environment, it is crucial to:

- Maintain the stability of the security, political, social environment and enhance the role of the government. These are considered to be important conditions to ensure the effectiveness in the investment actitives. This lesson is also shown quite clearly in Thailand about the decline of FDI due to political instability in recent years.

- Ensure macroeconomic stability. This is a crucial factor in attracting FDI because it creates a stable investment environment and avoids risks for investment.

- Improve and change the regulatory system to be more flexible, simple in encouraging FDI policies and institutional frameworks to be closer to the developed countries, reducing the vague distance to avoid risks for foreign investors. Tax is among incentives to be regarded as an important tool to mobilize resources for economic development and create a fair competitive environment. Besides, it is necessary to use other policies such as land leasing policy, clearance policy flexibly and reasonably. These policies should be transparent and specific.

- Carefully prepare the financial foundation such as the state budget, residence capital mobilization, outside capital to invest in infrastructure and create a favourable investment environment. This is the lesson from China in attracting FDI in disadvantaged areas.

3.2. Enhancing administrative reform

Reforming the administrative procedures towards creating favourable conditions for investment activities is considered an urgent requirement to improve the business environment. This is the lesson learned from the transformation economies like China and Vietnam. They have created FDI attraction thanks to positive reforms of administrative procedures on the following aspects:

- Robustly Reforming appraisal and licensing, improving the service efficiency of government agencies, focusing on after-licensed services, removing barriers, equal treatment, guaranteed and transparent commitment and government regulation.

- Strengthening the role of the authorities in foreign investment is needed to create an attractive investment environment, ensuring the correct orientation of foreign investment, efficiently exploiting the resources, protecting environmental resources, employees and sustainable development. All levels of the government examine, supervise and accompany foreigners to guide, facilitate, remove obstacles, comply with their commitments, and resolutely retrieve delayed and suspended projects.

3.3. Gradually and rationally opening each area, optimizing the structure of foreign investment

This is the policy that China has successfully applied. The government initially allowed foreign investors in labor-intensive sectors (textiles, garments, processing), then gradually expanded the scope of the market to energy, raw materials, tried to improve the structure of FDI and encouraged foreign investors to invest in high-tech industries, unified regulatory environments, provided incentives for domestic and foreign investment, opened little by little investment conditions (export, localization, development of resources), allowed foreign investors to invest in sectors that law did not restrict, diversified forms of FDI, eliminated capital restrictions. Therefore, Laos should have policies to encourage FDI in each area, each period and improve FDI structure towards encouraged sectors and high-tech industries.

3.4. Gradually and firmly building up economic zones, and the key areas

Attracting further FDI through constructing and developing centralised IZs and EPZs are to be done firstly in key economic areas, then this should be spread to other areas. This is the lesson successfully applied in Vietnam and China. These countries formed IZs and EPZs in coastal regions, where there were favourable conditions for production and business activities of foreign investors. Furthermore, attractive particular mechanisms and policies in these zones helped foreign investors establish factory easily and conveniently as well as reduce operating costs. Thus, these areas attracted considerable FDI of the whole economy.

3.5. Implementing incentives to attract more FDI is competitively and reasonably

Pioneering countries carried out effective policies in attracting FDI such as tax incentives, land rent, administrative reform, employee training costs support, infrastructure investments, tax support for projects using high technology, special tax rates for encouraged investment areas and protectionist policies elimination. These are tools applied in most countries to promote investment. However, in the conditions of current globalization, Laos needs to consider the advantages and disadvantages of each sector and region in comparison with other countries to offer competitive, specific and transparent preferential policies.

3.6. Actively pursuing investment promotion

Countries like Malaysia, Thailand and Vietnam have actively organized investment promotion, established representative offices in some key countries and held national and international conferences and seminars to introduce the advantages of the country as well as sectors, industries and projects needed priority in attracting FDI. Thereby foreign investors were able to obtain more information and support during their investment.

3.7. Developing the human resources

NICs highly appreciate education of humans because they are the subject of all creation. Moreover, humans are important objects in receiving, transferring technology between foreign investors and host countries. Therefore, it is necessary to improve the quality of human resources, develop and basically innovate the education and vocational training in the direction of meeting labour market needs, foreign investors, the economy and employment requirements for workers. Developing and improving the labour market should approach international standards on education, vocational training, labour and employment consistent with international practices and commitments of the country in the integration process. In cases no training could be applied, policies are required to attract human resources. Besides, it is necessary to raise the level of public authority staff, especially project appraisal and foreign investment management officers.

3.8. Investing in infrastructure development

Experience from China shows that they succeeded in attracting FDI due to their infrastructure development. With a low base, the infrastructure investment needs of an underdeveloped country like Laos was very large. whereas the budget is limited; hence, in order to solve the conflict between budget limits and requirements of infrastructure rapid growth, there should be a mechanism to mobilize all resources in the country and abroad. With limited financial resources, the state's investment focused on key infrastructure projects, which motivated regional development, then expanded to private investments in the sector, and important projects with difficult capital recovery and less attractive to investors. In addition to actively seeking funding from foreign governments to invest newly and modernly in important transport infrastructure such as highways, airports, ports, railways, it was crucial to have policies encouraging private and foreign investment in this field on the basis of resolving the difficulties of investors.

3.9. Developing SI

With the trend of business globalization, MNEs only keep important stages and intermediate products provided by the outside. So international production location is determined by factors that create global business activity efficiency. Investors will choose a favourable location for intermediate products as well as SI is the key to attract FDI into the industry. Experience from China was focusing on attracting FDI through simple procedures, taxes and reducing ownership restrictions accompanied with localization rateregulations. These policies helped the domestic industry receive technology transfer from FDI. However, regulations on localization rate are difficult to implement today due to the violation of rules for commerical liberalization. Therefore, some countries focus on the development of IZs support, business incubators and ICs. IZs support are being developed in Malaysia and Thailand.

4. Conclusion

This paper outlines the lessons learned to attract FDI into the industry of some countries such as NICs, China and ASEAN countries. Thereby, lessons to attract FDI into Laos industry have been drawn as follows: (1) improving the investment environment through maintaining stable security, political and social environment, creating macroeconomic environment stability and reforming the legal system; (2) reforming administrative procedures; (3) gradually and reasonably openingthe industries and sectors; (4) investing in building IZs and EPZs in advantaged areas; (5) effectively applying investment incentives; (6) enhancing investment promotions; (7) developing human resources; (8) investing in infrastructure development; and (9) developing SI./.

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