

Internal Report - short

Analysis of Investments of China and other neighboring Countries and their Influence on the Development Context in Lao PDR

by Rosmarie Sommer

1. The Perceived Atmosphere

The Lao PDR has been in the limelight last year as the venue of the prestigious South East Asia Games where 3000 athletes from all over the region have met in friendship and competitive spirits over sports. China has been the generous donor to provide grant assistance including technical advice and skilled labor to build the new National Stadium and other associated infrastructures, including the residential buildings for the sportsmen and women. Lesser known is the deal that the Govt. of Laos, in turn, had to provide a significant amount of land for the construction of real estate to be built in a wetland vital for the capital of Vientiane as a protected area and natural drainage for used urban water. A significant number of families will be relocated for this project, with unknown compensation and impact to the environment. And:

Part of the original deal with China was that as many as 50,000 Chinese workers and their families would be part of a "New City Development" scheme around the stadium in Vientiane (Yale Global online Magazine, 15 Dec 2009).

Like the Lao families concerned with the Chinese developers, the media report similar deals from many parts of the country. Chinese influence takes place along at least 3 vectors: aid, trade and investment. And the Chinese bias in the following selective mirror of news clips is no coincidence.

Some Laotians are concerned that a new law making it easier for foreigners to invest in the country and buy land puts the country in danger of being overrun, particularly by Chinese investors who have poured more than USD 2 bn into Laos the last nine years (Al Jazeera , 15 Aug 2009).

By 2007 China was responsible for nearly 40% of investment projects in Laos (Asia Times Online, 19 Sept 2009).

While China has always influenced Laos politically, its economic drive and scale is recent and constitutes a new era of international influence in the country. This list could be extended, but there is also a flip-side to it. *"Positive aspects to these investments are certainly the technology and knowledge transfer and income generation opportunities also in remote areas"* (GTZ, 2010). While the collective foreign investment accelerates change in the country, it provides also employment, boosts business and helps to modernize the economy. In the case of Chinese relations, these go well beyond commercial interests and also include political comradeship, cultural ties and economic support, e.g. during the Asian financial crisis in the late 90ties. The key driver of Chinese investment policy abroad is emphasizing trade over aid (Braeutigam, 2010), and FDI is often mixed with ODA (GTZ, 2010).

In short, what preoccupies the friendly Lao citizens is the magnitude and the all-embracing nature of the in-coming economic activities by the northern neighbor.

Since 1988, the Government of Laos granted investment permissions to Chinese and Lao-Chinese ventures for 318 projects, valued at about US\$ 3.57 bn (Phouthonesy, 9 Sept 2009).

In total, the Lao Government has granted 1255 investment permits to foreign companies with total investment of US\$ 11 bn: 35% hydropower, 25% mining, 12% service sector, rest other sectors (Phouthonesy, 9 Sept 2009).

In Boten, investors have built hotels, resorts, golf courses, a trade center, warehouses, transportation stations, an entertainment center and a minivan depot under the project named "Golden Land of Boten" (VOA News, 4 Dec 2009).

The Soochow University of China's Jiangsu Province awarded honorary PhD to President Choummaly Sayasone and Prime Minister Bouasone Bouphavanh, in recognition of their outstanding leadership in national development and the development of relations between Laos and China to a higher level (KPL Lao News Agency, 4 Feb 2010).

Lao residents in Vientiane regret that entire neighborhoods are meanwhile controlled by Chinese business. The same takes place in parts of the Luang Namtha and Phongsali Provinces, where Chinese currency and language dominate daily life. Land is often sold outright for very low rates by local residents and farmers, concessions are granted to foreign investors at conditions far below those in China or Vietnam, which makes land-intensive business attractive in Laos. Wealthy Chinese are increasingly visible, e.g. as motorized tourists in Luang Prabang during Chinese New Year with latest models of off-road vehicles.

History of International Engagement in Laos

(Phraxayavong, 2009)

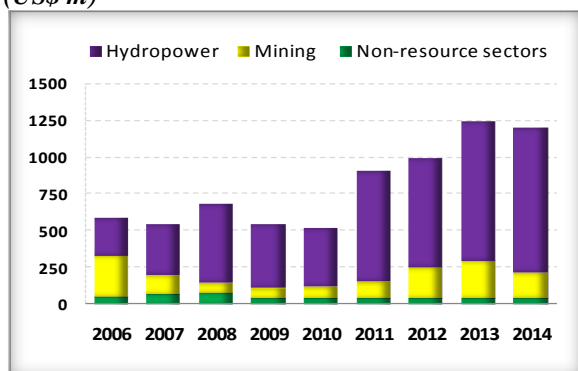
- Era of the French Administration in the 1950ties
- American military dominated assistance targeted to defeat communism from 1968-75
- Communist bloc's economic rescue and related political upheaval 1976-85
- Dominance of financial institutions and western bilateral donors during Lao's economic opening 1986-2005
- Ascendant influence of neighboring countries, notably China, Thailand and Vietnam from 2005.

Beyond decades of foreign aid, driven largely by the strategic and political considerations of one-time "friendly nations to Laos", the effects of commercial trade and foreign investment at significant scale only caught up in the new millennium and constitute today the main engine of growth in the country.

2. Comparative Scales of Foreign Engagement in Lao PDR

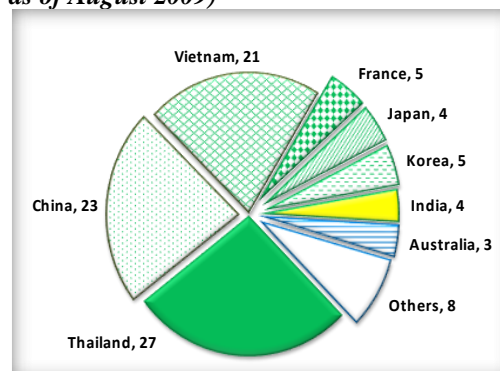
Between 2003 and 2008, actual investments increased from USD 110m to about USD 770m. (World Bank, 2009).

Actual Foreign Direct Investment (FDI) (US\$ m)



Source: MPI and staff estimates and projections

Share of accrual FDI by country (% of total, as of August 2009)



Source: Lao authorities (MPI) and staff calculation
Note: Accrual FDI is based on approved FDI data from MPI

The majority, i.e. 80% of FDI goes to natural resources sectors (see upper part of pillars in Fig. left above). During 1988-1999, Thailand was the prime source of foreign investment (50% of total), followed by the US (25%) and China well behind with only 1.5%. In 2007/2008 Chinese investment amounted to USD 107 m in after topping foreign investment in Laos in 2006/2007 with a total investment of USD 455 m. This figure put China ahead of Vietnam and Thailand whose investment in Laos was USD 155 m and USD 92 m

respectively (Phouthonesy, 9 Sept 2009). According to World Bank in 2009, China was the number two investor in Laos after Thailand and before Vietnam. The figures in Vientiane Times on 31 Oct 2009 however show Vietnam as the top investor to Laos with US\$ 1.4 bn, second China with US\$ 932 m, third Thailand with US\$ 908 m for the 'last 9 months'. This confirms the need to assess carefully the reference period for which the data are computed.

While **Chinese** relations to Laos go back to the 1960s, its aid was intermittent. Relations deteriorated from 1975 when Laos sided with Vietnam in its own conflict with China. Cooperation with China was reformalized in 1990 only. With Jiang Zemin visiting Laos in 2000, the friendly Lao-Sino relations went into new dimensions, reaching the stage of *"the full round of cooperation between the two neighboring countries in the interests of the two peoples and conducive to peace and development in the region"*(VT, 16 Nov 2000). Meanwhile, China and Laos agreed on informal preferential measures for trade and investment, giving the northern neighbor an advantage over other countries in access to mining, agribusiness of hydropower licenses (LU, 2009). The Lao government pursues a course of balancing Thai's dominance in foreign economic relations by enhancing trade and investment with China and in particular, the Yunnan Province (4 fold trade increase from 2004-2008).

A continued challenge lies in the fact that the scale of Chinese investments abroad remain difficult to assess. "Although China has become increasingly transparent about many aspects of its governance and policy making, aid figures remain state secrets. (...) The tradition of secrecy fuels misunderstandings, rumor and speculations" (Braeutigam, 2010).

The **Thai** assistance was mostly technical in nature and became significant from the mid 90ties, following the change of course towards market economy principles. Well beyond the official aid, Laos has benefited through higher education, access to thriving Thai labor markets and cross-border trade as well as the access to commercial soft loans.

Vietnam is another major competitor for regional influence and 'soft power' over Laos. Ten out of eleven members of the current Standing Committee of Laos' Politburo speak Vietnamese fluently. But the generation change within the Vietnam Communist Party will gradually diminish the political influence. Fraternal feelings are much stronger among the older than the younger generation (Jamestown Foundation's China Brief, 6 July 2005).

3. Effects of Growing Chinese Influence in the Lao PDR

Different observers vary considerably in judging the effects of Chinese investments in Laos. A nuanced assessment would have to consider and specify at least the following aspects:

Positive effects

- Improved inter- and intrastate transportation infrastructure and connectivity
- Energy generation, value addition to natural resource capital based products
- Job creation in rural and urban areas, labor income
- Availability of affordable consumer goods
- Technological modernization, information and knowledge exchange
- Increased taxation and government revenue

Negative effects

- Corrupt practices of land acquisitions; inadequate or no compensation for requisitioned lands
- Continued relocation of villages to make way for land intensive investments
- Low product quality and technology
- Minimal workers safety standards, low wages, social security often absent
- Environmentally destructive technologies, disruption of ecosystem integrity, threat to the Mekong river basin fishery potential due to unilateral erection of dams in upper catchment

- Prostitution, HIV/Aids, gambling, trafficking of drugs, arms and humans along new road transit corridors, criminality

There is a clear problem of attribution of these negative effects to Chinese influence only. Externally induced as well as local demand for such services is coming from both southern China, northern Thailand as well as from migrating businesses within Laos. There is evidence also of a spill-over of illegal activities from Myanmar into the Golden Triangle area to Bokeo and Luang Namtha Provinces.

The challenge for the Government of Laos is multiple. It includes to acknowledge these trends as social and environmental costs of economic development, to find ways to control mushrooming illegal practices, to establish and enforce accountability with traders and investors, to secure tax revenue for financing infrastructure and measures to address the negative impacts, to invest in local human resource, e.g. for local level processing skills to retain an increasing share of benefits within the region. The present resource based boom provides only a window of opportunity of some decades before resource exhaustion will take over. Foreign investors then will seek other green pastures, and local authorities will be left with the task to put the economy on a new footing. Unless this boom is underpinned now by developing the other sectors such as human resource development, services, tourism or advanced processing industries, it is likely that the gold rush will leave behind a desert.

4. How could SDC more effectively interact with Chinese Investors and Developers in Lao PDR ?

SDC is less directly exposed to Chinese influence than other donors for its geographical emphasis on other than northern border provinces. However, the gradually changing equation between private trade and investments, ODA and political cooperation in the country are an invitation to the entire international community in Laos to find answers to this question. Further, the future SDC program is spanning over larger parts of the northern uplands (e.g. Northern Uplands Development Project NUDP), thus the issue will be even more relevant.

A formal dialogue of China within existing donor coordination platforms does barely take place up to now, although China sits on the Round Table discussions and participates in UN-led initiatives.

Approaches for SDC may include:

- Strengthen the engagement within relevant regional level bodies such as ASEAN, GMS or regional level research for development networks in which Chinese participation is vigorous;
- Knowledge exchange over sectors of common stakes (e.g. integrated land management planning; technology exchange)
- Sponsor exposures to Chinese leading innovators with high social and environmental standards to promote peer learning (e.g. WWF waste water treatment in wetlands)
- Collaboration on regional trade and improvement of standards (SECO)

5. Future Challenges

The Lao MPI perceives its economy in a take-off mode, expecting acceleration of the engines to attain optimal speed and cruising levels (MPI, Round Table Meeting Nov. 2009). A total investment of around USD 15 billion is proposed for the next 5 year Plan 2011-2015, of which 2/3 from the private and 1/3 of the public sector, still strongly supported by ODA. The Long term goal is to leave the LDC status by 2020.

The Yunnan Province of China has designed a Plan for Industrial Economic Development and Cooperation in Northern Lao PDR (Northern Plan) until 2020 (Shi, 2009), endorsed in 2008 by the Government of Laos. The plan stipulates leveraging industrial competitiveness, boosting transport and energy infrastructure, strengthen the market environment and technology exchange and introducing sustainable resource use

technologies. The plan includes 2'000 km of new roads, a railway network connected to Southern China rails, a container based inland river network, airport expansion, a mobile connection network, the development of up to 270'000 ha of irrigated paddy and 100'000 ha of maize production, the exploitation of up to 386 mineral deposits and the erection of 260 MW installed power capacity.

Although funding is not addressed in the plan, a remarkable new approach is the declared intent of the plan designers to work *“in cooperation with the international community (...), promoting participatory approaches, seeking synergies with poverty alleviation (...) and employing latest environmentally sound technologies to ensure resource sustainability.”* They seek co-funding arrangements with ODA, commercial partnerships, international and domestic credits, resources from strengthened tax revenue and land concessions and better public financial management, all pooled into a national level fund. It is assumed that recent airport related investments constitute already early components of the above Plan, subsidized by the China Government in anticipation of future dynamics.

Vietnam and Thailand are likely to continue to compete with Chinese commercial investments in Laos. Vietnam may have the political edge of proximity to the Government of Laos for some more time while Thailand's technology advantage is shrinking rapidly due to Chinese progress. The development sustainability and reforms in society and governance remain priority challenges for ODA-partnerships in Laos. Progress however will depend increasingly from closer coordination and linkages with private investment and trade actors in the country.

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Annex

List of Foreign Investment with Lao PDR for 2009, reported by Vientiane Times weekly summaries
(Excerpts only – no comprehensive overview)

Official ODA-data on Chinese aid in the Lao PDR are publicly not available.

Country	Date 2009	Nature of influence/mechanism	Scale in US\$ m (nm = not mentioned)
China	12.12.	Chinese investor started 2004 apple plantation, now stopped because trees did not bear fruits, 15ha	0.5
	14.11.	Agreement of unlimited flights between the Chinese and Lao international airports, cooperate in human resources develop. In aviation sector, shared research on air emergency responses and continue of using aircraft manufactured in China by Lao PDR	-
	31.10.	Lao PDR receives 3 prizes for preparing the 6th China-Asean Expo in Nanning	nm
	31.10.	Grant for Bridge between Lao PDR and Thailand (Bokeo – Chiang Rai Prov.)	20.0
	03.10.	Luang Prabang prov. seeks to streamline immigration procedures between LP prov. and Xieng Houn city in Yunnan prov. by using only border pass when crossing border	nm
	26.09.	Grant for building of hospital by Chinese business man (Bokeo and Oudomxay prov.)	4.0
	26.09.	Grant for Lao National TV news channel station	10.0
	19.09.	8 cooperative agreements signed	
		- Special loans	172.0
		- Grant from Chinese Government: for economic technical cooperation: construction of electricity load dispatch centre, machines and technology to inspect goods for import and export	12.5
		- Special credit loan: for building of new airport Luang Prabang prov.	86.4
		- agreement to work on Kong Zi Institute in Lao PDR	nm
	13.06.	- agreement on border transport at Boten-Bohan checkpoint	nm
	13.06.	BCEL and Fudian Bank of China agreed to cooperate in offering services for business trading and investing in Laos PDR and China (provide modern money transfer and establishment of a joint commercial bank in Laos in the future)	
	09.05.	The large scale private international Chinese enterprise Yincin Comp. Ltd. opened new dealership and unveiled the 'Great wall' brand of China	nm
	25.04.	Contract by Chinese comp. CAMCE for feasibility studies for new airport in Viengxay distr. Huaphan prov., for renovation of existing Huayxai airport in Bokeo prov. and XienKhuang airport in Xieng KuKhuang prov.	nm
	07.03.	Chinese comp. Doknyiewkhan has completed 80% of construction of a casino and 4star hotel in Tonpheung district Bokeo prov. , in the Golden triangle area of Laos/Myanmar and Thai. 827 ha concession over 50 years in distr. special economic zone.	40.5
24.01.	Grant for resurfacing Road No. 13 from Nateuy fork in Luang Namtha distr. LN prov. to Xay distr. in Oudomxay prov.	nm	
24.01.	Chinese entrepreneurs want to stop planting rubber in Laos because of falling rubber prices	nm	
Vietnam	26.12.	Vietnamese company plans to develop area surrounding the Tha Wetland, for land compensation	1.5
	05.12.	The Champasak Prov. Assoc. of Travel Agents works together with Ho Chi Minh City Tourism Assoc.	nm
	24.10.	Rubber plantation and factory by Vietnamese State enterprise, 20'000ha by 2015	35.0
	10.10.	Former Star Telecom, now Unitel = joint venture between Telecom. Enterprises of Lao and Vietnam	nm
	10.10.	Vietnamese businessman builds factory for ceramic construction materials	nm
	12.09.	Agricultural company cooperates in crop plantation for export to Vietnam's	nm

	29.08.	restaurants Grant for new internal border checkpoint	1.6
	04.04.	Loan for building of Road 2 E	43.0
	07.03.	Vietnamese together with Laos will install 265 of total of 826 border posts along the countries shared border	nm
	02.01.	Long Than 18 hole Golf course and luxury hotel of 500ha 15 km outside Vientiane city will be developed, 2009-2020	1000.0
Thailand	05.12.	Green light by Government of Lao to Lignite-Fired Power Plant of Ratchaburi Electr. Generating Holding Public Comp. Bohpul Power Ltd. Lao Holding State Enterprise	4000.0
	28.11.	Thai Biogas Enery Co Ltd plans to build first Biogas plant next year for the first starch factory in Laos, reservoir renovation	0.6
	18.07.	Memorandum of Understanding between Connexia Co Ltd. of Thailand and Electricité du Laos to backbone a fibre optic cable installation project in Laos	30.0
	13.06.	Lao music label Indee records cooperate with Sony Music Thailand	-
	13.06.	Concession for sugar cane growing in Khammuan and Savannakhet provinces 10'000ha/40 years	70.5
	14.02.	Friendship bridge connecting Khammuan prov. to Nakhon Phanom in Thailand	-
	07.02.	Thailand resumes imports of sweet corn from Laos, but is imposing high tariffs on the crop	-
	10.01.	Thailand has extended a ban on the import of sweet corn from Laos, denying corn producers in the border area the opportunity to compensate their investment	-