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Doing Business in Lao PDR: Constraints to Productivity

Overview

New available data suggests that the Lao business environment is not improving, and might be deteriorating. The main constraints named by firms surveyed in the 2016 Enterprise Survey are the practices of the informal sector, with 40 percent of respondents identifying this issue, followed by tax rates at 33 percent and transportation at 23 percent. This represents a shift from 2012, when no areas were cited more than 20 percent, and the top were corruption, electricity, and worker education. In addition, analysis of firm productivity data indicates that labor productivity in Lao PDR remains low, with median levels of labor productivity around US $4600, lower than regional peers. This has not shown statistically significant variation from the previous surveys. Of greater concern, the highest performing firms among those in Lao PDR, ranked at the 90th percentile domestically lag drastically behind firms at the same percentile in neighboring countries.

Context

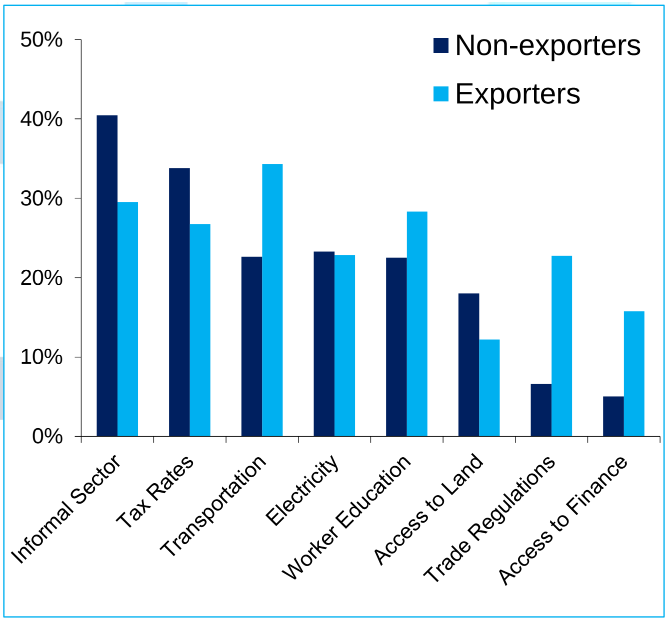
Lao PDR has demonstrated impressive economic growth for the past decade, with GDP growth averaging 7 percent, largely concentrated in the natural resource sector. However, this has been accompanied by a less than proportionate decline in poverty and rising inequality. The investment climate remains challenging, with high costs, and Lao PDR was ranked 139 out of 190 in the 2017 *Doing Business* report. In the Global Competitiveness index, Lao PDR was ranked 93 out of 138. Issues exacerbating these challenges include weak regulatory effectiveness, control of corruption and rule of law, with a largely “deals based approach,” which reduces predictability and transparency. This brief aims to analyze the perceptions of these challenges by firms doing business in the country, using data from the 2016 Enterprise Survey.

The Enterprise Survey is conducted by the World Bank Group and its partners across all geographic regions, and covers small, medium and large firms in the non-agricultural, formal, private economy. This survey focuses on many aspects of the business environment that are relevant in determining whether an economy’s private sector will thrive or not. Lao PDR data collection was done from January-June 2016, and previous years’ surveys were completed in 2012 and 2009.

Constraints to the Lao PDR Investment Climate

The main constraint to the investment climate identified by firms was the practice of firms in the informal sector, with 40 percent of respondents identifying this issue. Coming in second was tax rates, cited as a constraint by 33 percent of firms. Large percentages of firms also mentioned that transportation, electricity, and inadequately educated workers are major problems. Yet, there were some variations across different types of firms. Large firms were more likely to consider workers’ education a problem, while transportation was proportionally a bigger issue for medium firms, and tax rates for smaller firms. Regionally, firms in the north and south of the country were more likely to identify key issues as major problems than firms located in the central region or Vientiane. Firms in Vientiane were less concerned about infrastructure than the others.

Figure 1: % of firms saying issue is a serious problem



Exporters and foreign firms are also differentiated in the survey, as these types of businesses are significant to indicate a country’s ability to compete in an international market. Exporters were more highly concerned about transportation and trade regulations than non-exporters. Transportation was the highest concern for exporters, at 34 percent, compared to 23 percent of non-exporters, while trade concerned 23 percent of exporters, in contrast with only 7 percent of non-exporters. For foreign firms, tax rates and access to land were of higher concern than for domestic firms. 53 percent of foreign firms stated that tax rates were a major issue, compared to only 32 percent of domestic firms. Access to land was an issue for 37 percent of foreign firms, but only 16 percent among domestic firms.

Although corruption was only cited as a serious problem by 2 percent of firms (but 8 percent of exporters), the survey reflected a high actual incidence of corruption, thus the results could indicate an acceptance of the status quo, rather than the absence of corruption as a limiting factor. 49 percent of firms reported being requested or expected to give gifts or informal payments for construction permits and 74 percent for government contracts, both of which are higher rates than the average for the region and for countries with similar incomes.

Women-owned firms have slightly different concerns, with female-owned firms reporting that they tend to be less concerned about competitors in the informal sector, or transportation. In fact, only 17 percent of women-owned firms stated that transportation was a serious problem, compared to 28 percent of firms with no female owners. However, 40 percent of female-owned firms said that tax rates were a serious issue, compared to 32 percent of non-female owned firms, and 23 percent of women-owned firms reported that access to land was a constraint, compared to only 16 percent for non-female-owned firms. Overall, Lao PDR performed higher than the rest of the East Asia and Pacific region for key gender indicators, with a higher percentage of firms with female top managers, majority female ownership, and full-time female workers.

Changes from Previous Surveys

Concerns about the business environment seem to have increased between the 2012 and 2016 surveys and the biggest constraints have remained consistent, while priorities have somewhat changed. Firms were far more likely to indicate that many areas of the investment climate were serious problems in 2016 compared to 2012, although part of this increase could reflect an increased willingness to voice concerns. However, when asked to nominate only the biggest constraint, answers were more consistent over time, with the informal sector, tax rates, and worker education consistently mentioned as biggest concerns.

For exporters, access to finance was no longer mentioned as a leading problem, and practices of the informal sector are now raised as a major issue. The inadequately educated workforce has remained a high concern for exporters. Additional analysis to better understand what companies refer to when complaining about the “practices of firms in the informal sector” is currently underway.

Firm Productivity

Labor productivity remains low in Lao PDR. Using firm-level data, it is estimated by subtracting raw materials and intermediate inputs from sales and dividing that amount by the number of full time permanent workers. The median level of labor productivity is around US $4,600, which is about 10% lower than in Cambodia or and less than half of in Vietnam. In the garment sector, Lao PDR performs similarly to the comparator countries at the median level, however it lags in the food processing sector. Retail and service firms also appear to be relatively unproductive in Lao PDR. There has been no statistically significant variation in overall productivity between 2009 and 2016.

While labor productivity at the median firm seems comparable to similar firms in neighboring countries, more productive firms in Lao PDR lag far behind more productive firms in the region. One would expect the more productive Lao firms to compete in the region, but the data suggests that the country’s top firms are not competitive with top firms of neighboring countries. For example, firms among the top 10 percent of productivity in Lao PDR produce only around $20,967 per worker, compared to the $61,646 in Vietnam and $93,378 in Cambodia that the 10% of most productive firms produce in those countries. In fact, over three quarters of firms in Vietnam are more productive than the median firm in Lao PDR.

Firms appear not to be very capital intensive, although it is possible that capital is systematically underreported. Firms have little capital per worker, suggesting that they are instead more labor intensive. Wages are low, however relatively high when compared with production, suggesting that workers have low human capital (i.e. are less educated or trained). This is confirmed by firms’ concerns about availability of skilled labor and low education of workforce. Only about 10 percent of the workforce in Lao PDR have completed upper secondary and 5 percent have achieved vocational or tertiary degrees, as of 2013. Indications of low human capital are corroborated by data on the poor quality of schooling. Post-secondary graduates in Lao PDR performed almost on par with people with only primary schooling in Vietnam, (according to the 2011/2012 STEP Household survey, as reported in 2014 Lao PDR Development Report). Contributing causes to low labor productivity could be use of old technologies, poor management practices, and a weak investment climate.