Country Update

The WTO Agreement on Trade in Services: Main Issues Faced by SMEs in Laos and Their Solution

Provided by

Lao National Chamber of Commerce and Industry
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SMEs’ Situation in Lao PDR

Since the Lao People’s Democratic Republic has been a member of WTO on February 2nd 2013 and anticipated challenges related to the AEC (Association of Southeast Asian Nations (ASEAN) Economic Community) 2015, a variety of challenges in the business environment hinder further inflow of investment. In particular, a lack of skills and limited human resources consistently represent critical constraints for business. Other inhibitory factors include limited access to financial services, especially for small and medium-sized enterprises; a regulatory environment that can discourage business operations; and anticipated challenges related to South-East Asia’s regional economic integration.

Many enterprises in Lao People’s Democratic Republic, especially SMEs, consider lack of access to finance as a “big” or “very big” challenge. With only a nascent credit market and regulatory framework to cater to investors and financial transactions, Lao People’s Democratic Republic competes with other countries with comparatively more advanced financial services sectors to secure domestic financial resources as well as foreign direct investment.

The advent of the AEC will create a bigger and more integrated market with more business opportunities. At the same time, however, it will increase competition across the region1.

1 Skills, access to finance, regulatory reform, and ASEAN regional integration: Challenges and policy directions for enterprises. Published by Bureau for Employer’s Activities, the Lao National Chamber of Commerce and Industry (2016)
The Small and Medium sized Enterprise (SMEs) are independent enterprises that are legally registered and operated according to the prevailing laws of the Lao People’s Democratic Republic, and are classified into the size categories according to the business sector, the annual average number of employees, the total assets and annual turnover basis.

The government shall issues decision on SME classification in each stage of development as deemed appropriate.

<table>
<thead>
<tr>
<th>Type of Enterprise</th>
<th>Average Annual Number of Employees</th>
<th>Total asset in KIP</th>
<th>Annual turnover in KIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Enterprise</td>
<td>&lt;=19</td>
<td>&lt;=250 million</td>
<td>&lt;=400 million</td>
</tr>
<tr>
<td>Medium Enterprise</td>
<td>&gt;19.99</td>
<td>&lt;=1.2 billion</td>
<td></td>
</tr>
</tbody>
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Table 1: SME classification in Lao PDR

SME Development Policies

In Lao PDR, there are 216,913 enterprises nationwide and SMEs accounted for up to 99.83% of labors are employed by SMEs.

- **The SME Development policies for SME Development Plan 2011-2015:**
  - Improving the regulatory environment and public administration of economic activities.
  - Improving access to finance.
  - Formation of new entrepreneurs.
  - Increasing the provision of Supports and business development services (BDS).
  - Enhancing business linkages between large enterprises and SMEs.
  - Promoting the increase of productivity for upgrading the quality and standard of products and services of SMEs.
  - Enhancing access to markets and enlarging markets for SMEs.

- **SME Promotion activities (by the Law on SME Promotion)**
  - Creating an enabling environment.
  - Accession to finance.
  - Policy on customs and taxations.
  - Creating and developing entrepreneurs.
  - Providing services on business development consultation.
  - Cooperating between SMEs and large sizes enterprises and foreign investment enterprises.
  - Increasing on productivity.
  - Accessing and expanding markets.
  - Business clustering.
  - Allocating business location.
  - Promoting on advanced technology utilization.
  - Using and protecting intellectual property.
  - Providing and accessing to information.2

Trade in Services’ Challenges of SMEs in Lao PDR

Even the Lao Government has put a lot of efforts in solving problems that are obstacles to businesses operations in the past few years, many problems are still remaining and take time...

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2 Department of Small and Medium Enterprises Promotion (DOSMEP), Nong Bone Road, Ban Fai, Xaysetha District, Vientiane Capital, Laos Tel: +856-21-414064, Fax: +856-21-263590, Website: [www.smepdo.org](http://www.smepdo.org)
before all the problems and obstacles are still awaiting responses such as:

- Limits in the competitiveness caused by low technology level, small scale of production, lack of qualified staff, skills and competencies in management. Moreover, high charges in business transaction and the risks that are caused from an enabling environment.
- Lack of unit and capacity in providing assistance and business development mainly the provision on market information, standards and choices in technology, market opportunities, trainings counseling and other services.
- The sector of finance and credit services have not been developed for strengthening and lacking of diversification, mainly the provision on long-term credit for SMEs.
- Limited knowledge on Laws and regulations.
- The linkage between business and production chain has not been developed (value chain, clusters, and the relationship between SMEs and big companies).
- Lack of enabling environment of Laws and regulation to attract investment and business operations.
- Lack of a good attitude towards economic market.

**Access to Financial Services in the Lao PDR More Challenging than in Other South-East Asian Countries**

Data collected on Lao enterprises regarding the raising of capital corroborate data collected at the regional level. In comparison to competing countries in South-East Asia, Lao People’s Democratic Republic has a very low level of access to financial services. More specifically, the World Bank ranks the country on its worldwide scale in the bottom percentile since 2008 in terms of “protecting minority investors”. This is because the country lacks an appropriate legal mechanism to address insolvency. To counter this, the Government recently introduced measures for the non-resource sector to address insolvency, to protect investors, and provide access to credit. As of this writing, however, these measures had yet to be fully implemented.

With neighboring countries such as Bangladesh and Thailand each ranking around 90% and 95%, respectively, for the same indicator, respectively, the current situation presents a serious challenge that Lao People’s Democratic Republic would need to overcome. The longer this vacuum exists, the more difficult it will be to catch up and boost its competitiveness in a widening regional market.

The World Bank also ranked the availability of credit to Lao enterprises extremely low. While the country had improved during the previous seven years to reach approximately 15% in 2014, it still lagged significantly behind the front runners in the regional market: Bangladesh and China both reached 80% in 2014.

The Government has recently taken some corrective actions to improve access to credit information (World Bank, 2015a) which the LNCCI welcomes. It eliminated the minimum threshold for loan sizes entered in the credit registry database, and expanded borrower coverage to a minimum of 5% of the adult population. The scope of information collected and reported by the credit bureau and registry has also been increased.

Though these are positive developments, they

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3 Small and Medium Sized Enterprise Development Plan 2011-2015. Department of Small and Medium Enterprises Promotion (DOSMEP), Nong Bone Road, Ban Fai, Xaysettha District, Vientiane Capital, Laos Tel: +856-21-414064, Fax: +856-21-263590, Website: [www.smepdo.org](http://www.smepdo.org)

are not enough. More work is needed to resolve all the aforementioned challenges if the country is to position itself as a key player in the AEC in the near future.

**IMPACT OF LIBERALIZATION ON THE INSURANCE SECTOR**

In general, the benefits of liberalizing trade in services derive from the reduction of surplus costs associated with the price of services in protected markets. Some barriers raise price margins and involve resource transfers from consumers to service providers; others, like cost-raising regulations, raise costs of all existing and potential firms and create a deadweight loss\(^5\). These costs, however, can be difficult to measure in Laos. Instead, we enumerate the visible benefits to Laos from liberalizing insurance services as follows:

- Increase the insurance industry’s value added and its share of overall economic activity.
- Generate more employment and a multiplier effect on total output.
- Improve the legal and regulatory system of the insurance industry by introducing necessary reforms to make the system more transparent, fairer and closer to international standards.
- Enhance demand for improvements in complementary areas like law enforcement and the court system because of increased attention to motor vehicle insurance coverage and safety campaigns of insurance companies.
- Strengthen consumer safety from broader compulsory automobile coverage and extend requirement to motorcycles.
- Lower risk on personal and business investments as a result of increased insurance coverage.
- Mobilize capital movements and expand investment from larger volume of premiums.
- Promote cross-border movements of people by providing common insurance standards and licensing arrangements.
- Lower insurance premiums for consumers resulting from increased competition among insurers.
- Knowledge transfer and increased demand for accountants, actuaries, information technology, marketing, investments, underwriting and claims adjusters.
- Restructuring of industry to reduce state ownership, introduce an independent regulatory authority, and an insurance commission.

The current challenges facing the insurance industry in Laos, limitations of the legal and regulatory framework, best practices that should be applied to ongoing reforms of the legal and regulatory framework, best practices for commitments of the insurance subsector under GATS, and some of the likely effects that would result from the liberalization of the insurance subsector. While numerous challenges currently confront the industry, there is a great potential for growth in the market. Moreover, the industry is vital to the Lao economy insofar as it facilitates business and investment activities by providing risk management, thereby contributing to the country’s stable economic growth. The growth of insurance operations will also help to improve other areas of the economy, including law enforcement, the court system, capital market developments, and good governance.

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standards.

There are different levels of effort and associated time horizons needed to implement various reforms of the Lao insurance industry. In general, immediate short-term initiatives are unrelated to the operational system of the Government. The more challenging actions often involve a strong institutional base for their successful implementation. They often need institutional support in the form of hardware or training, or the establishment of new entities⁶.

Some Solutions

Lack of access to finance reduces both the capacity of Lao enterprises to reach their full potential and their capacity to invest in core areas (e.g. technology and human resources development). To help enterprises tackle these challenges, some solutions should be recommended the following policy options:

**INCREASE COMMUNICATION AND DIALOGUE ON ACCESSING FINANCE**

Establish a platform where enterprises can inform other key stakeholders such as the Government, donors, financial institutions, and potential individual or institutional investors about their financing needs.

Ensure open and transparent communication to facilitate mutual understanding of each stakeholder group’s key priorities. This will also help to clarify what contributions each stakeholder group can make to produce an optimal and practicable solution.

The Government needs to improve information flow regarding various financial schemes provided by donors or projects, and combine

**EXPAND CRITERIA FOR COLLATERAL**

Make it possible to use vehicles or equipment as collateral when taking a loan, a measure that would provide financial assistance to many enterprises, particularly to small firms.

The Lao Government has already initiated a process to allow the use of movable assets as collateral. In 2013, it set up the Lao Registry Office for Security Interests in Movable Property for individuals and institutions to register their financial interest in movable assets. How much this type of collateral is actually being accepted by financial institutions has yet to be determined, but measures are needed to make the practice more widely accepted and implemented.

**ASSIST ENTERPRISES APPLING FOR FUNDS**

Enhanced awareness and understanding of application procedures and requirements for the aforementioned funds will help enterprises to increase their eligibility for and chance of receiving the funds.

**EXPLORE ALTERNATIVE AND INNOVATIVE FUNDING SOURCES/MECHANISMS**

The AEC will bring about new business opportunities, at the same time attracting new investors and more diverse funding sources such as angel investment and crowd funding. Partnering with sectorial or regional networks to exchange ideas and information will enable enterprises to explore and leverage these new opportunities⁷.

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⁶ Implications of WTO Accession for Insurance Sector of Laos. www.laotradeportal.gov.la

⁷ Skills, access to finance, regulatory reform, and ASEAN regional integration: Challenges and policy directions for enterprises. Published by Bureau for Employer’s Activities, the Lao National Chamber of Commerce and Industry (2016) KhaysonePhomvihane Avenue, Phonephansao Village, Saysettha District, Vientiane Capital, Lao P.D.R, P.O. Box 4596, Tel: (856-21) 453 312, Fax: (856-21) 452 580, Website: laocci.com.
THE LIBERALIZATION OF THE INSURANCE INDUSTRY IN LAOS

It is framed in the context of the Government’s proposed reforms of the financial sector, which includes insurance services. The goals for the insurance subsector are to (a) provide an opportunity for risk-reduction measures by people and businesses as a way to stimulate investment, (b) liberalize the subsector through the country’s commitments undertaken under the GATS, (c) improve the safety of its citizenry through improved social programs promoted by the insurance industry, and (d) strengthen complementary services of other sectors and subsectors to ensure the effective operation of insurance services. Complementary services include law enforcement, the legal court system, banking, capital markets, training and education, and institutional capacity building.

The selection and prioritization of actions should be guided by a set of principles. For the insurance subsector, the guiding principles that emerge from the Government’s interest are transparency, accountability, and pragmatism. Implementing the strategy for liberalizing the insurance subsector is framed within an action plan covering legal and regulatory reforms, institutional restructuring, and liberalization of trade in services. The proposed actions should be supported by social development programs to which insurance companies have committed under their respective agreements with the Government. Education and training programs for CPAs and insurance-related subjects would help to produce local experts who could support the industry and promote its sustained development within the economy.

Strategy for the liberalization of the insurance industry in Laos is framed in the context of the Government’s proposed reforms of the financial sector, which includes insurance services. While it may appear that there are considerable reforms needing to be undertaken, the sequencing and prioritization of those reforms can be framed in the context of the Government’s vision and goals for the subsector.
CUTS International, Geneva

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The Geneva Trade & Business Connexion Forum project is undertaken with funding support from the Australian Aid agency (Australian government).