

## Chinese Enterprise's Direct Investment Risk and Opportunity Analysis for Laos in "The Belt and Road" Policy

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### Abstract

**The proposal of "The Belt and Road" policy strengthens Chinese enterprises' confidence to invest in Lao PDR and broadens cooperation between China and Lao PDR. The article analyses the risks and opportunities of direct investment in Laos by Chinese enterprises, and get the conclusion that in the long term, the opportunity for Chinese enterprises to invest directly in Laos is greater than that of risk.**

### Keywords

**Chinese Enterprise, Direct Investment risk and opportunity, "The Belt and Road" policy.**

### 1. Introduction

In 2015, Chinese government published *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*. It mentioned the strategic thinking that start cooperating with countries along the road in the aspects of politics, economy and culture. ASEAN was designated as the major execution zone. Laos is in this zone. According to this, the proposal of "The Belt and Road" policy strengthens Chinese enterprises' confidence to invest in Lao PDR and broadens cooperation between China and Lao PDR. As a newly growing country and one of the most attractive countries for investment, Lao PDR has a number of advantages. On the other hand, risks and challenges are also existed. How to ensure the safety of investment is an urgent topic to research.

### 2. Risk analysis of Chinese enterprises' direct investment in Laos

Lao natural resources, labor price and geographic location are appealing for Chinese enterprises' direct investment. By contrast, there are a number of differences between China and Laos in laws, policies, culture and so on. In the aspect of investment safety, Chinese enterprise's direct investment in Laos still has some risks.

#### 2.1 Investment Related Laws Are Not Perfect

In order to cater globalization, Lao made some adjustments in laws and investment policies. It improved investment environment, but not good enough. In other countries, every contract is valid. However, a contract is regarded as a negotiation in Laos. Once some conflicts of interest happened, the contract could not be valid. It illustrates that the contract law not perfect enough in Laos. As a result, Laos could not ensure fairness and justice in international business. According to some related investigations, the implementation of commercial contract in Laos is worse than China, Thailand and some other countries.

By researching Lao investment laws, the writer found that some phenomenon of different definitions had been occurred frequently, even some definitions are contrast with each other. Take tax for example, in some laws of international business advocate decreasing duties and being free of duties to some goods. On the other hand, there is no record of this in tax laws. Meanwhile, actually, some preferential tax measures did not take into effect. All of these bring some adverse effects to FDI in Laos.

Generally speaking, Laos has not established a relatively perfect law system in investment. Therefore, FDI in Laos lacks a dependable guarantee. Without a relatively fair and free environment for FDI, to

some extent, many foreign enterprises could not rely on laws, especially in agriculture and communication fields. Finally some preferential measures did not take into effect at all.

### **2.2 The Government Is Running Slowly**

Realities of Laos are complex. Moreover, the management system of government is messy. Therefore, the government functions of Laos did not behave well. The government runs slowly. Some related data shows that Laos is the hardest place to do commerce. Inefficient government, long approval time for projects and tedious procedures are three main reasons. All of these factors increase financial costs risks for investors..

Laos' resources, labor price, geographic location and so on are appealing to Chinese enterprises. Laos could offer a lot of opportunities for China. However, Chinese investors invested in Laos little because of many regulations in Culture, laws and things like that. In recent years, the corruption in Laos is becoming more rampant especially in grass-roots units. Therefore, some foreign investors have to offer bribes in order to save time. This greatly hits investors' interests and passion.

### **2.3 Infrastructure construction is relatively backward**

Nearly two-thirds of Laos are mountain areas, because of topography. It counts against construction of communication and Traffic facilities. In terms of communication, Laos is relatively backward. At present, Laos does not have advantages of diversified development in media so that Chinese government and enterprises could not obtain related information in time. As a result, it is hard for both sides to communicate with each other. In terms of transportation, land, waterage and air freight are three main means of transportation in Laos. However, all of these are not perfect enough. Because of the topography, Laos has not formed a large-scale highway Network.

When investors build factories in Laos, power system is one of the most important factors they care. As the promotion of "the Belt and Road" policy, a number of Chinese enterprises has constantly invested power projects in Laos. However, as all of these projects require a lot of cables and consumables, at present, Laos' power system could not support these projects. Although Laos signed agreements with some other countries, with affections of raw materials, technologies and so on, these projects did not start at all. At the moment, Chinese enterprises' direct investment centers on some infrastructures. Due to high costs and long income cycle, if Chinese enterprises could not make it a big scale, they may be trapped.

### **2.4 Labor Structure Is Simple and Weak**

Nowadays, there are only 3 million labor forces in Laos.80 percent of them center on agriculture. The country is absent of diversified talents to develop industry. Meanwhile, because of the low education level, many labors are weak. What is more, since Laotians believe in Buddhism and the climate is hot, they are lazy and work inefficiently.

This situation leads to difficulties finding qualified labors and mixing people with production factors. Because of this, Chinese enterprises need to bring Chinese labors to Laos. Nevertheless, Laos' government is indifferent with importing labors. Imported labors are only allowed to do jobs that Laotians cannot do. In result, Chinese enterprises have to spend some expenses training Lao's labors. By doing so, it increases investor's operational costs and restricts attractions for Chinese enterprises.

### **2.5 The Market Is Small, Enterprise Competition Is Fierce**

Laos has a population of 6.38 million (in 2011), the population of Laos is less than NanNing (the provincial capital of GuangXi Province). The most populous province in Laos is Savannakhet. It has a population of 0.87 million. Besides, Vientiane, Luang Prabang and some other economically developed areas also have great populations. In the aspect of population structure, not only more than 70 percent of Lao's population is agrarian population, but also population density is low. The population density of Laos is 27 persons per square kilometer. This situation leads to a small-scale market. Accordingly, the competition of Laos' market is very fierce.

In recent years, as continuing economic growth of Laos and the implementation of “the Belt and Road” strategy, many countries try to capture market of Laos. In addition to China, Japan and other Asian countries, the West starts to invest in Laos. The competition has heated up in its final days especially in contracting projects. Comparatively speaking, during the process of investing in Laos, China, Vietnam and Thailand are the three most competitive countries. The advantages of Chinese enterprises are low costs and high technology. Thailand enterprises’ strengths are geography and humanity. Vietnam enterprises’ advantages lie in special politic relations with Laos’ government.

### **3. Opportunity Analysis of Chinese Enterprises’ Direct Investment in Laos**

#### **3.1 Favorable Macro Environment**

To begin with, Lao government implements a relatively loose principle towards FDI. In order to appeal FDI, Lao government drew up preferential tax conditions for investment. Since Lao government drew up *Law of Laos on Foreign-capital Enterprises*, Lao government has been revising and supplementing. Furthermore, the government also published some bills and by-laws, which include *By-law of promoting and administrating Foreign Investment* (2001) and *Law of promoting and Investment* (2009). The promulgation of a series of laws and regulations set foreign investors’ minds at ease and created a favorable and safe macro environment for them. In the meantime, Lao government confirms and protects national treatments of foreign investors from the law. With a favorable environment for investment, A number of Chinese enterprises are willing to invest in Laos. For one thing, China carries out “Go Global” Strategy and export capital that has been accumulated for many years to Laos. For another, China also transfers some overcapacity industries to Laos, for example, steel and cement. It is beneficial for infrastructure construction in Laos.

In terms of politics, the ruling party of Lao—Lao People's Revolutionary Party is the sole party in this country. Consequently, unlike Syria and other war-torn areas, the political situation of Lao is quite stable. Investors would feel safe when they invest in Lao. What is more, as a member of ASEAN, Lao never invades islands and reefs in the South China Sea. In past years, Lao kept good relations with China in economy, politics, trade and things like that. Chinese and Lao regard each other as a long-term, stable and comprehensive strategic partner. It lays a good foundation for Chinese enterprises' direct investment in Laos.

In the respect of investment, when an investor decides to invest an industry in a country, the key to his decision is if this country has unique advantages. Investors pursue maximum profits. In recent years, Lao GDP growth has been keeping at 8%. With the overall slowdown of world economic growth, it is hard to achieve this. High speed and steady economic growth of Laos creates a good economic environment for foreign investment.

#### **3.2 Special Geographic Location**

Among Southeast Asian nations, Lao is the only inland country. Lao is adjacent to China, Vietnam, Thailand, Burma, Cambodia respectively. The altitude of Lao is the highest among Southeast Asian nations. Therefore, Lao is called the Roof of South Asian Peninsula and Southeast Asia Crossroads. Despite the fact that Lao economy is relatively backward, its abundant natural resources and special geographic location offer constant power for its economic development. As the construction of Trans-Asian railway and highway and the progress of water carriage in Mekong River, Laos will be the most convenient passageway that links southwestern China with Southeast Asian countries. It will obviously offer constant power for Lao economic progress. The establishment of CAFTA (China-ASEAN Free Trade Zone) and the implementation of “the Belt and Road” Strategy will strengthen links between southwestern China and Southeast Asian countries, achieve personnel exchanges and compress circulation of commodities. During this period, the traffic status of Lao will be consolidated and prominent. Lao economy will also be developed by other countries’ economic radiation.

#### **3.3 Abundant Natural Resources, Cheap Production Factors**

In the aspect of resource, China is a country that has abundant natural resources in total, while per capita is low. Per capita of natural resources in China is about one fourth of per capita of the world.

Compared with China, Per capita of natural resources in Laos is rich, especially minerals, hydropower and so on. Among all kinds of natural resources, only timber resource is being elementary exploiting. Other resources, take mineral resource for example, potassium, aluminum, copper and iron ore are undeveloped. We can see from Theory of Comparative Advantage that these resources are advantageous. According to this theory, Laos should preferentially develop these advantageous resources. Therefore, the most attractive factor for Laos to attract Chinese investors is Lao comparative advantages. Hence, according to Factor Endowment Theory, Lao should rapidly develop and support FDI to exploit timber resources, mineral resources and so on.

Laos is located in the Indo China Peninsula where is at the edge of Asiatic plate and Indian Ocean Plate. The geographic difference is great. With Mekong River flows through, Lao has a rich hydropower resource.

In the matter of production factor, Lao is a country that much land and few people. So the land price of Laos is inexpensive. As Lao is the country that has the lowest population density in Southeast Asia, the labor price of Laos is also inexpensive. The lowest salary in Lao is about 3 dollars per day. Cheap land price and labor price are two main factors that attract Chinese enterprises' direct investment.

### **3.4 Fast Economic Growth, Obvious Location Advantages, Chinese Enterprises Could Enter Other Markets through Lao**

Lao economy has grown rapidly since the beginning of the 21st century and Lao GDP growth has been maintained at 7%. In 2008, US Subprime crisis finally became a financial crisis. Lao did not survive in this crisis either. During the period of 2008 and 2011, the economic growth of Lao was slowed down. Then, Lao government made the best use of macroeconomic control and took measures to intervene. From 2011, the economic growth of Lao came back to 8.5%, which almost is a miracle to a Southeast country. Ultimately, Lao became a representation of rapid economic growth in Southeast Asia.

As a member of ASEAN, from 1998 to 2008, according to the preferential tariff rate agreement of ASEAN, the tariff of imported goods in Lao decreased yearly, in 2005, it even decreased to zero. Meanwhile, Lao signed a lot of reciprocal agreements with other ASEAN countries, EU, US and so on. By doing so, exported goods of Lao could be qualified for tariff exemption only the most undeveloped country could be qualified. With this opportunity, Chinese enterprises could invest directly and build factories in Lao. Then they can export products through Lao. Finally, it will be much easier for Chinese enterprises and products to enter developed countries.

### **3.5 Hotspots of Chinese Enterprises' Investment from 2016 to 2020**

In addition to traditional hydropower industry, agriculture and mineral industry, Hotspots of investment that Chinese enterprises could choose are as follows.

#### **3.5.1 Construct infrastructure of tourism**

Tourism resources of Laos are quite rich. Humanistic culture is a representation of Lao tourism. For instance, Ancient Town of Luang Prabang, "Little Guilin" Vang Viang, Kwang Si Waterfall and so on. Lao is regarded as one of the best tourist destination in the world. In 2004, inbounds tourists of Lao were about 4.16 million, which is pretended to be 5 million in 2020. The more tourist population is, the greater economic volume of tourism industry will be. What is more, tourism resources of Laos are in the initial stage of development. Chinese enterprises could help Lao construct tourism brand and infrastructure of tourism.

#### **3.5.2 Construct infrastructure of telecommunication**

For one thing, the infrastructure of telecommunication is relatively backward. Broadband coverage of Lao is even no more than 1%. For another, totally, there are four giants of KDDI in Lao. However, because Laos has a small population and the market volume is not large, it leads to high communication and broadband industry expense but low rate of return on investment. With the guide of "the Belt and Road" Strategy, Chinese enterprises could choose to invest telecommunication

industry, which is greatly potential in Lao. Chinese enterprises could cooperate and share market resources of telecommunication with Lao KDDIs.

### 3.5.3 Construct banking business

Banking industry and financial service industry are at the elementary level and lack of capital market factors. Therefore, it results in a situation of inefficiency and lag. In Lao, the construction of banking system is not complete. The quantity of bank is small. The loan rate is high. All of these situations seriously impede the economic growth of Lao. Lao decreased access restrictions of foreign enterprises in banking business. At present, with the implementation of “the Belt and Road” Strategy and the establishment of Asian Infrastructure Investment Bank, some powerful bank of China may take this chance to occupy Lao market by helping local banks improve financial technology and service level. By doing so, it is beneficial for the internationalization of RMB.

Lao loose access policies for foreign enterprises and the great potential of market attract a number of enterprises to invest, which bring a lot of advanced technologies and capitals to Lao. As Lao became the 158th member of WTO, Lao officially joined the system of globalization. It improved Lao status and influence in Southeast Asia, even appeal Chinese enterprises to invest in Lao.

## 4. Tag

Generally speaking, with the implementation of “the Belt and Road” Strategy, the scale of investment and the number of investment projects are constantly increasing. The return of investment is high in Lao. As for reasons, for one thing, transportation between China and Lao is convenient. For another, the political system and the social-economic structure are stable. In addition, Chinese and Lao economic advantages could complement each other. Finally, Lao has advantages of rich natural resources and cheap labor price. With the background of labor price rising in China, all of these advantages appeal Chinese enterprises to invest in Lao.

On the contrary, there are some obstacles for Chinese enterprises to invest in Lao. To begin with, backward construction of infrastructure, unitary industry structure, backward lifestyle and so on. Secondly, the legal system is unsound. Chinese enterprises may not get legal guarantee when they invest in Lao. Finally, low labor quality and great cultural differences are factors that may impede Chinese enterprises’ investment in Lao.

In the long term, the opportunity for Chinese enterprises to invest directly in Laos is greater than that of risk. Lao has advantages of fast economic growth, great potential of market and high return of investment. Chinese enterprises have to consider how to solve related barriers and problems and build advantages of themselves.

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