FACTORS BEHIND LOW LEVEL OF FOREIGN DIRECT INVESTMENT (FDI) TO LAO PDR

BY

MR. PALAMY PHETPASEUTH

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF MASTER OF ARTS
(ASIA PACIFIC STUDIES)
COLLEGE OF INTERDISCIPLINARY STUDIES
THAMMASAT UNIVERSITY
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ENTITLED

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ABSTRACT

This study aims to investigate the factors behind low level of Foreign Direct Investment (FDI) to Lao PDR, so as to provide a proper recommendation to Lao government and related institutions, since FDI has been playing a significant role on economic growth and it also accounts for a considerable share of Lao PDR's GDP. According to the theoretical framework of the determinants of FDI, this paper will analyze the factors that affect FDI inflow to Lao PDR by applying the methodology of qualitative approach and comparing the FDI determinants in Lao PDR with those in Vietnam. Vietnam is chosen as the comparative sample due to the fact that the inflow of FDI to Vietnam is relatively much higher than that of Lao PDR. In addition, the study also conducts the interviews with Lao government officers, economists, and foreign investors. The findings of the research reveal different significant factors in Lao PDR that have a disadvantage to those in Vietnam. (1) Infrastructure Factors: geographical location; electricity and the internet accessibility in Lao PDR have a disadvantage to those in Vietnam. (2) Economic and Market Factors: Lao PDR has disadvantage in market size; regional and international market accessibility and labor cost. (3) Political and Government Regulation Factors: government expenditure and investment incentives. (4) Social and Cultural Factors: human capital and (5) Financial Factors: interest rate and external debt. All of the variables stated above are considered to be the factors that discourage FDI inflow to Lao PDR due to they have a disadvantage to those in Vietnam which made FDI to Lao PDR remains relatively low. Finally, the paper concludes based on the findings, by providing policy recommendations on how to improve those significant factors in order to attract more FDI inflow.

Keywords: Low level of FDI, FDI inflow, Determinants of FDI inflow

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LIST OF ABBREVIATIONS

Symbols/Abbreviations	Terms
ADB	Asia Development Bank
ASEAN	Association of Southeast Asian Nations
CLMV	Cambodia, Laos, Myanmar, Vietnam
FDI	Foreign Direct Investment
FTAs	Free Trade Areas
GMS	Greater Mekong Sub-Region
GDP	Gross Domestic Product
IMF	International Monetary Fund
NSEDP	National Socio-Economic Development Plan
OECD	Organization for Economic Cooperation and Development
TPP	Trans-Pacific Partnership Agreement
WB	World Bank
WTO	World Trade Organization

CHAPTER 1
INTRODUCTION

1.1 Introduction

Over several decades, Foreign Direct Investment (FDI) has been considered as a key driver on the economic development of the countries. As a result, many countries have been actively promoting their strategic potential in order to attract FDI inflow, especially the developing countries. As in the present time, FDI has been defined in various ways with different perspectives by many institutes, national and international organizations, and scholars. According to the United Nations Conference on Trade and Development (UNCTAD, 1999), FDI is

> *"an investment involving a long-term relationship and reflecting a lasting interest and control of resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investors (FDI enterprise, affiliate enterprise or foreign enterprise)".*

In addition, the Organization of Economic Cooperation and Development (OECD, 2015) also defines FDI is an investment of foreign investors from one country (source country) to another country (host country) with at least 10 per cent ownership of foreign investor on ordinary shares in the business.

Since the 1990s, FDI has played a significant role in the world's economic integration and development (UNCTAD, 2015). It contributes a lot of benefits to the host countries by raising the capital inflows, providing an employment, transferring technology, simulating domestic enterprise sectors as well as enhancing both external and internal competition on trade and investment (Phommahaxay, 2013). However, each recipient country gains different advantages from FDI activities, some may gain a lot of benefits, but some may gain less. Thus, the investment promotion policy, as well as the law on foreign investment of the host country are the crucial factors for promoting an investment sector consequently attracting more FDI inflow in order to enhance country's economic development.

In 1975, the Lao People's Democratic Republic (Lao PDR) was proclaimed. At that time, the FDI sector had no significant role on Lao economy because the government highly concentrated in central or planned economic system and the state became the main character playing a key role on national economic development, while the private sector and FDI were not promoted. During that time, the international cooperation was unfavorable and the external economic relations relied on the socialist countries particularly the former Soviet Union. Over a decade that planned economic system was implemented, but Lao economic still suffered and stagnated. As a result, its GDP growth was very low. Therefore, Lao government decided to reform the national economy by shifting from planned economy to market-oriented economy and began implementing the open-door policy by promoting the international economic cooperation. Since then, FDI became an important driver of Lao economy and it was recognized as a significant source of capital inflows because it stimulated the economic growth and strengthened the social economic development especially after the Lao government started implementing the national economic decentralization in 1986. Two years later, the law on foreign investment promotion was officially promulgated for the first time. Since then, Lao PDR began attracting more and more FDI inflow in the following years. As a result, FDI inflows to Lao PDR has dramatically increased from $ 58.54 million in 1991 to $ 1.19 billion in 2015 (UNCTAD, 2016b), and around 78.26 per cent of the total FDI inflow to Lao PDR during 2001 - 2011 came from the three biggest foreign investors including China, Vietnam, and Thailand (Phommahaxay, 2013). Mostly, the hydropower and mining sectors were dominated by these countries which accounted for almost 70 per cent of total FDI inward during 2006 - 2011.

1.2 Statement of Problem

Despite the decline of global FDI inflow by 18 per cent, from $ 1.65 trillion in 2011 to $ 1.35 trillion in 2012, the Association of Southeast Asian Nations (ASEAN) remained a major destination of FDI inflow among the developing economies, accounted for 16 per cent of the total FDI inflow. With a slowdown of

FDI flows in ASEAN by 8 per cent, from $ 130 billion in 2014 to $ 120 billion in 2015, intra-ASEAN investment has shared the largest percentage of FDI flow in ASEAN for 17 per cent and 18.5 per cent in 2014 and 2015 respectively. It rose marginally by $ 15 million in 2010 to 22.1 million in 2015, making it remains the largest sources of FDI flows in ASEAN, According to the Asia-Pacific Trade and Investment Report (UNESCAP, 2013) and ASEAN Investment report (UNCTAD, 2016a).

Lao PDR is one of the ASEAN member countries and it was recognized as one of the fastest growing economies in Asia - Pacific region and globally, as a result of its national economic decentralization in 1986 (WB, 2017c). Notably, Lao PDR opened for FDI in 1988, but the country received FDI inflow very modest when compared to other countries in ASEAN. Specifically, the FDI inflow to CLMV[1] countries increased from $ 12.5 billion in 2014 to $ 17.5 billion in 2015. But Lao PDR obtained the smallest amount of FDI inflow among them, only $ 0.7 billion and $ 1.2 billion in 2014 and 2015 respectively. This making the FDI inflow to Lao PDR remains relatively low when compared to other ASEAN member countries as well as in the region. Therefore, this research attempts to analyze the factors behind low level of FDI to Lao PDR in order to answer the question why FDI inflow to Lao PDR remains relatively low and then to provide the appropriate recommendations to Lao government and related institutions in order to attract more FDI in the future.

[1] C: Cambodia, L: Lao PDR, M: Myanmar, V: Vietnam

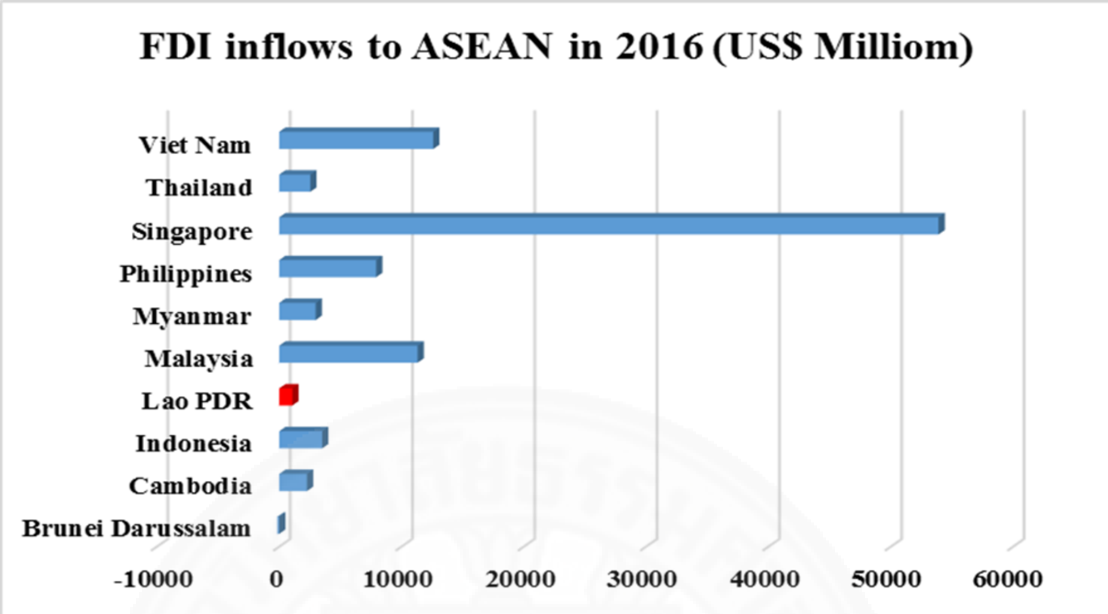

Figure 1.1 FDI inflows to ASEAN in 2016 (US$ Million)

Source: ASEAN Secretariat - ASEAN FDI Database as of 31 October 2017

1.3 Research Objectives

(1) To investigate the current situation of FDI inflow to Lao PDR.

(2) To analyze the factors behind low level of FDI inflow to Lao PDR, by comparing to Vietnamese case.

(3) To provide the appropriate recommendations to Lao government and related institutions in order to increase FDI inflow to Lao PDR.

1.4 Research Question

According to the statement of the problem, which demonstrates the situation of FDI inflow to Lao PDR. And Lao PDR obtains very modest FDI when compare to other countries in the region, especially to Vietnam. Therefore, in order to fulfil the research objectives, this study will be guided by the question: Why Vietnam is preferred to Lao PDR in terms of foreign direct investment?

1.5 Research Methodology

This study was designed in a qualitative method in order to investigate the significant factors behind low level of FDI inflow to Lao PDR. The paper mainly utilized the secondary data through an approach in documentary researches including articles, academic research papers, textbooks, journals, official reports from international organizations and other internet sources. In addition, it also conducts the data collection by an in-depth interview with Lao government officers, economists, and foreign investors.

1.6 Scope of Study

Base on the data availability, this paper will study the factors behind low level of FDI inflow to Lao PDR specifically after the national economic reform, in the period 1986 - 2015. The definition of FDI using in this paper was defined by the United Nations Conference on Trade and Development (UNCTAD, 1999). The study mainly utilizes both primary and secondary data.

1.7 Conceptual Framework

This paper will investigate the fundamental factors that affect FDI inflows to Lao PDR by utilizing the conceptual framework of the OLI or eclectic paradigm which will be described more in the next chapter.

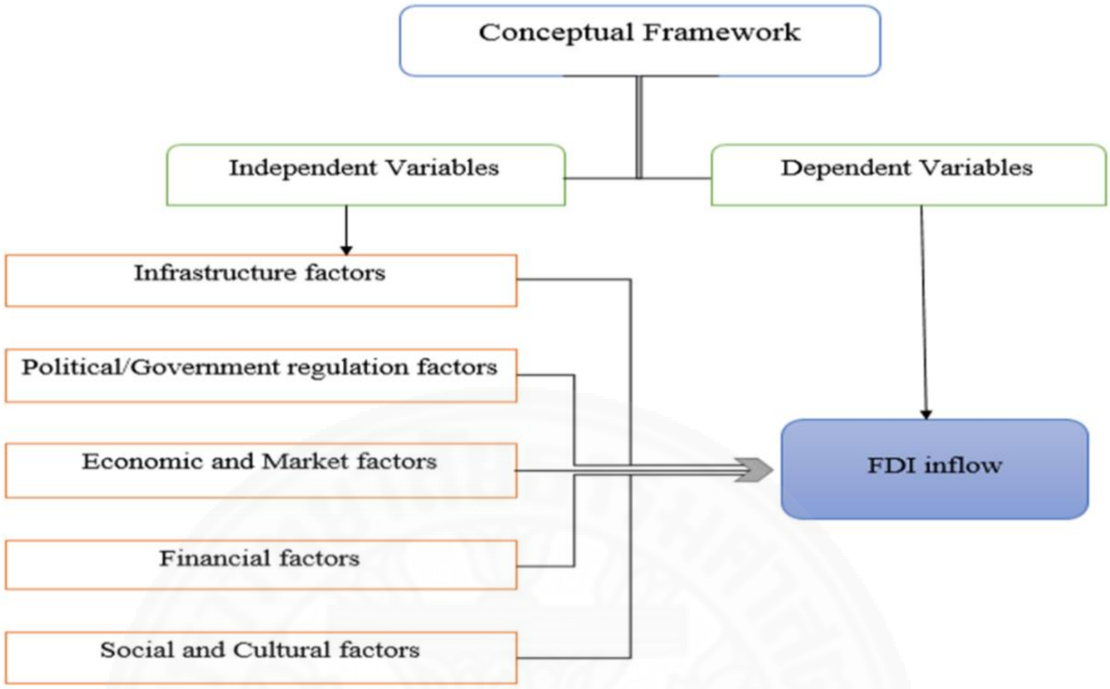

Figure 1.2 the conceptual framework

Source: Author's compilation

The conceptual framework above explains how the FDI flow to Lao PDR is affected by using independent and dependent variables as the indicators. The independent variables consist of five crucial factors that are assumed to be the factors affecting FDI inflow to Lao PDR. And for the dependent variable is the FDI inflow itself which is the outcome of the effect from five those major factors.

1.8 Research Organization

This study consists of 6 chapters. Chapter 1: Introduction which includes the statement of the problem, research objectives, research questions, research methodology, the scope of the study and conceptual framework. Chapter 2: Review of Literature including the theoretical framework, types of FDI and the review of previous researches. While the research methodology is presented in Chapter 3, which includes the comparative study, source of data and data analysis. Chapter 4:

The current situation of FDI and economic development in Lao PDR, which describes the overview of Lao Economy, the role of FDI in Laos as well as the investment promotion policy of Lao PDR and Vietnam by comparing some related parts of the FDI determinants. The results and discussion are presented in Chapter 5 and ending with the conclusion and recommendations in Chapter 6.

CHAPTER 2
REVIEW OF LITERATURE

2.1 Theoretical Framework

Since the second half of the twentieth century, many theories have been developed in order to explain the concepts, nature, and determinants of FDI including the industrial organization approach; Vernon's product life cycle model; the internalization theory and Dunning's eclectic theory (Mai, 2004). However, this study will employ the internalization theory and Dunning's eclectic theory to explain the fundamental concepts of FDI.

2.1.1 Internalization Theory

The Internalization or the transaction cost theory was developed by Casson and Buckley in 1976. This theory attempts to explain the motivation of FDI which is because of the existence of market imperfection. The market imperfection causes the decreased in transaction cost and it can also be reduced by internalizing their economic operation. In addition, the multinational corporations (MNCs) can nationalize the market imperfection's structure such as foreign exchange rate controls, tariffs, income taxes, import and other regulatory restrictions. Moreover, the transaction cost of intangible assets especially technology is also imposed by market imperfection. Therefore, MNCs go to invest in foreign countries instead of selling their own technology in order to overcome this obstacle (Safarian, 2003).

2.1.2 Dunning's Eclectic Theory

The Dunning or Eclectic paradigm theory was developed by Professor Dunning in 1977, 1988, 1993 and made the second edition in 2008. This theory attempts to combine various isolate theories such as industrial organization theory, location theory, and internalization theory to be one. The concept of this theory is to explain why the multinational enterprises (MNEs) invest in other international markets. Three different theories were described in this paradigm including Ownership, Location, and Internalization advantages or it is well known as the "OLI Paradigm"(Dunning, 1979).

2.1.2.1 Ownership Advantages.

This refers to assets that the companies obtain advantages because they are able to own some specific assets while these do not exist in their competitors. For an instant, the tangible assets including labor, capital, natural resources and others. And the intangible assets such as marketing, production skill, entrepreneurial techniques, trademark and so on (Dunning & Lundan, 2008).

There are three types of specific advantages:

a) Monopoly advantages in the form of privileged access to markets through ownership of natural limited resources, patents, trademarks;

b) Technology, knowledge broadly defined so as to contain all forms of innovation activities

c) Economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital.

(Denisia, 2010)

2.1.2.2 Location Advantages

After the first factor is completed, there must be more advantageous for firms. Each country has different location advantages including domestic market potential, natural resources, political stability and government policies which are the significant components to determine the ability of host countries. The location-specific advantages of each country can be divided into three categories:

a) The economic benefits consist of quantitative and qualitative factors of production, costs of transport, telecommunications, market size etc.

b) Political advantages: common and specific government policies that affect FDI flows

c) Social advantages: includes the distance between the home and home countries, cultural diversity, attitude towards strangers etc.

(Denisia, 2010)

2.1.2.3 Internalization Advantages

When the first two factors are fulfilled, the firm must advantage at least in some conditions outside the country of origin. It refers to the circumstance that MNEs invest in international production obtain more profit than a transaction in their own countries which reduces the transaction cost as well. It is better for their privileged or specific skill to their own companies in other countries than selling them in their own countries due to the international firms have capacity to operate domestic market under their administration in order to reduce the risk of market failure which is the cause that affects the transaction cost.

2.2 Types of FDI

According to (Dunning & Lundan, 2008), the FDI can be classified into four categories based on their investment objections and activities including resource – seeking investment, market – seeking investment, efficiency – seeking investment and strategic assets – seeking investment.

2.2.1 Resource – Seeking Investment

The resource – seeking investment is one type of FDI emerges when the foreign investor has an intention to take advantage of resource availability in other countries which is lacking or may not have in the home country including raw material and natural resources, infrastructure system, agriculture products and low cost of unskilled and skilled labor.

2.2.2 Market – Seeking Investment

This type of FDI occurs when foreign investor encounters the obstacles to export from home country or when foreign investor attempts to take advantage of a local market in other countries. This type of investment focus on market size and per capita income, market growth potential, regional and international market accessibility, consumer's behavior as well as the market structure of the target country. In addition, it also wishes to promote new markets in the neighboring counties and other regions. The government regulations and the cost of transportation in the home country could be the main reasons encouraging this type of investment.

2.2.3 Efficiency – Seeking Investment

This type of FDI aims to benefit the efficient cost or economic scale in other countries. It usually occur in the country with plenty of Semi-skilled or unskilled labors, because the wages are an important element of production cost. Moreover, it also focuses on another input cost such as communication and transport cost between home and the host countries. The purpose of this types of FDI also attempts to maintain the enterprise operation and utilize the economic integration in the neighboring countries.

2.2.4 Strategic assets – Seeking Investment

Strategic asset – seeking investment is also another type of FDI which represents the enterprise aiming to cooperate with a local partnerships or seek new assets in other countries. It usually emerge in the industrialized and middle-income countries and the country with firm-specific assets availability such as marketing, technology, innovatory, brand name and so on. In addition, it also wishes to purchase market power, reduce the risk and lower the transaction cost.

2.3 Literature Review

2.3.1 Review of Significant FDI Determinants

2.3.1.1 Geographical location

According to a study of Misovicova (2003) indicated that the landlocked developing countries spent about 50 per cent more in logistic costs than coastal countries. It means that the geographical location of the host countries is very important element for FDI inflow attractiveness. A study on FDI distribution in China also found that foreign investors concentrate more on geographical location. As a result, since 1989 the coastal provinces of China attracted more FDI than the inland provinces which accounted for over 90 per cent of total FDI (Broadman & Sun, 1997). It is similar to a study of (He, 2002) suggested that inland cities in China attract less FDI than port provinces. Another scholar (Asiedu, 2002) also suggested that the countries in Africa receive less FDI inflow due to their geographical location. Therefore, geographical location of a host country should be considered as a key component for FDI inflow attractiveness.

2.3.1.2 Electricity accessibility

Electricity is also considered as one of the significant elements in attracting FDI inflow, a shortage of electricity in a host country discourages the inflow of FDI. A result of a study on the impact of electricity crisis on FDI reveals that the inflow of FDI in Pakistan decreased especially after the occurrence of electricity crisis in 2015 (Zulfiqar, 2014).

2.3.1.3 Internet Accessibility

Internet accessibility in a host country is one of a significant elements in attracting the inward of FDI. According to a study on the effect of the internet on FDI in China found that the internet has a positive impact on the amount of FDI inflow (Han, 2010). And another study on the effect of the internet on the volume of inward FDI also indicated that the increase in 10 per cent of the number of internet users in a host country encourages the FDI inflows by more than 2 per cent (Choi, 2003). It means that the internet accessibility in a host country has plays a significant role in attracting FDI inflows as well as stimulating economic development of the country. (Mottaleb, 2007) also suggested that availability of good infrastructure in a host country especially the internet accessibility can promote FDI inflow. It means that the internet accessibility has played an important role in attracting inward FDI.

2.3.1.4 Road Network

Road network is an important transport infrastructure for country's economic development because it involves in FDI inflow attractiveness. A study of (Kaur, 2016) revealed that road network has played a significant role in attracting an inflow of FDI, because investors consider much about the facility and accessibility on transportation in order to transfer their commodities easily, effectively, and the most important thing is to reduce the logistic cost. Another study of (Wekesa, Wawire, & Kosimbei, 2016) on the effect of infrastructure development on FDI in Kenya also found that the transport infrastructure of a host country has played a crucial role in attracting FDI inflow because the better road network infrastructure can reduce the cost of doing business for investors.

2.3.1.5 Political Stability

A study of (Shahzad, Mithani, Al-Swidi, & Fadzil, 2012) revealed that unstable politic has a negative impact on FDI inflow which caused the declining in inward FDI in Pakistan since 2008. Another study on relationship between political instability and inflow of FDI indicated that the political stability in a host country is considered as a crucial factor in attracting FDI inflow, because the investors believed that unstable politic in a host country is likely to make foreign investment face with vagaries of forces beyond their control and cause the risk in their business as well (Fatehi-Sedeh & Safizadeh, 1989). Moreover, the study in Bangladesh also found that the political stability has a positive impact on FDI inflow in the long run (Jewel, 2015). This means most investors consider much in political stability in a host country before deciding to do investment since it has played a significant role in attracting FDI inflows.

2.3.1.6 Government expenditure

According to a study of (Edwards, 1990) revealed that the government expenditure has a negative impact in attracting FDI inflow to a host country. Because it is believed that large spending of the government may create the gap for government officials for misusing funds and emerging corruption. Moreover, the private business including FDI in the fundamental sectors of the country may be affected by big consumption of the government as well. Another study also found that the larger size of government expenditure creates complicated bureaucracy system which makes the possibility of higher tax rate and an unfavorable environment for an investment (Onyeiwu, 2003). However, another scholar (Samargandi, Fidrmuc, & Ghosh, 2015) argued that the large size of government expenditure could attract more FDI inflow and encourage more private investment if the government spend more on the public sectors such as infrastructure, healthcare, and education.

2.3.1.7 Tax Incentives.

Results of a study on the impact of tax incentive on FDI in China found that the tax incentives have a significant impact on FDI attractiveness because the tax incentives strongly influence the decision of investors for doing business in the host country (Tung & Cho, 2000). In addition, a study in Nigeria indicated that tax incentives have a crucial impact in attracting inward FDI (Babatunde & Adepeju, 2012). While other scholars (Morisset & Pirnia, 2000) argued that a trouble deficiencies in a host country's investment sector are caused by tax incentives. Although tax incentives are effective for FDI attractiveness, the costs may over the revenues. Moreover, it also creates a chance for illegal behavior especially corruption. Another study of (Onyeiwu & Shrestha, 2004) suggested that tax incentives would increase or decrease FDI in a host country depend on its level. If those countries have higher tax rate, it would discourage FDI inflow and vice versa. Therefore, many countries attempt lower the tax rate in order to attract more FDI.

2.3.1.8 Domestic Market Size

There are immensity of literatures on seeking for the factors that motive or influence the investors for moving their capital abroad. Due to the growing role of multinational enterprises (MNEs) in the global economy, the topic has been started to be popular among scholars since the late 1950s and various macro-micro factors have been proposed as determinants of inward FDI, such as size of recipient market, resource endowment, firm strategic and transaction-related factors (Erdal & Tatoglu, 2002). Fundamentally, the key motives for an investor to invest in a foreign market are to seek for market and resources. However, the investor’s motivations have changed toward efficiency seeking except for the case of developing countries because the traditional factors remained key determinants (Nunnenkamp, 2002).

In addition, Erdal and Tatoglu (2002) suggested two sets of variables concerning the location effect of the host country on FDI. The first set is Ricardian type endowments, including natural resources, labor, and proximity to market. The second set is a range of environmental factors which consist of economic, politics, infrastructure and other relevant factors. Moreover, (Erdal &

Tatoglu, 2002) has provided few sub-factors such as market size, economic growth, labor cost, raw material, transportation cost, so forth. Especially, market size and market growth are the main factors in attracting inward FDI, which have been found by many works. Such as the study of (Hakizimana, 2015) indicated that GDP per capita has a significantly positive relationship with FDI inflow since GDP per capita refers to the market size and economic development of a host country. Another study also revealed that the GDP per capita has played a significant role in attracting FDI inflow. As a result, FDI inflow in a host country raises by 4.82 percent when the GDP per capita increase in 1 per cent (Khamis Hareb Alshamsi, 2015). In addition, a study of (Demirhan & Masca, 2008) also stated that GDP per capita has a positive impact on FDI inflow attractiveness. It means the GDP per capital of the host country is considered as one of crucial elements in attracting the inflow of FDI.

In terms of the theoretical explanation for the casual relationship, Erdal and Tatoglu (2002) proposed that market size and growth have an effect on demand for products and services of the investors. A larger market size is conducive to an increase in demand for such products. Moreover, the market size also exhibits an important role in improving economies of scale, which make the production more efficient. In contrast, the role of market size seems to have less effect on FDI in export-oriented industry, because the main goal of the investment is to export its products abroad rather than domestic market (Azam & Lukman, 2010).

2.3.1.9 Regional and International Integration

Basically, export-import and GDP are utilized as a proxy for trade openness which influences investors' decision of doing business in the host country particular the vertical FDI. The study on trade openness of economic online found that the degree of openness contribute a lot of benefits on country's economy, including an increase in technology, skills transfer, raised labor productivity as well as economic development (Blog, 2017). Moreover, the degree of openness also determines a freedom of government to make economic policies and intervene the country to regional and international market easily. In addition, a study on factors attracting FDI inflows by employing a sample of 36 developing counties during 1990–2008 revealed that trade openness has a positive effect on inward FDI in the long run in developing counties (Liargovas & Skandalis, 2012). Nguyen (2016) suggested that FTAs contributes significant and positive effect on encouraging the increase of FDI inflows into Vietnam.

2.3.1.10 Labor Cost

Labor cost is also considered as an important element for making a decision of investor in order to invest in a host country because it affects the investment revenue, especially the resource-seeking FDI. A study of (Lim, 2001) revealed that foreign investors consider the lower labor cost as well as the availability of skilled labor before deciding to invest in a host country, where there is abundant of skilled labor trend to attract more FDI inflow. Another study indicated that there is a significant relationship between labor cost and FDI inflows in OECD countries (Bayraktar-Sağlam & Sayek Böke, 2017). However, Hilber and Voicu (2010) argued that there is no relationship between wage level and FDI inflow, the same as a study in Vietnam also reveal that there is no effect of labor cost on inward FDI (Meyer & Nguyen, 2005).

2.3.1.11 Exchange Rate Volatility

Generally, the exchange rate volatility has a significant relationship with FDI inflow in a host country. According to a study of Jaratin Lily (2014) indicated that the depreciation in the host country’s exchange rate encourages the increase in FDI inflow because it reduces the cost of capital investment. Another study revealed that the exchange rate variation in the host country has an insignificant relationship with FDI inflow (Hosein Sha rifi-Reanni, 2012). Thus, it means that the exchange rate instability in a host country is not a crucial factor in attracting FDI.

2.3.1.12 Inflation Rate

The inflation rate is one of the significant factors in promoting inward FDI. According to a study of Demirhan and Masca (2008) found that inflation has a negative impact on inward FDI because high ratio inflation rate discourages investor’s confidence on the economic stability of a host country. While the lower inflation rate tends to have more efficient in attracting FDI. Another study also revealed similar results that a high ratio of inflation rate indicates the instability of host country’s economy, particularly the monetary-fiscal policy (Giri, 2016). These results are also consistent with the study of Gholam Syedain Khan (2014), a high proportion of inflation rate has a negative impact on economic stability and discourage FDI inflow respectively. Therefore, the inflation rate of the host country is considered as an important element in attracting FDI inflow, because it diminishes uncertainty and investors’ confidence in making the decision to invest in these countries.

2.3.1.13 Interest Rate

According to a study of H. Hoang and Bui (2015) stated that foreign investors consider interest rate as a crucial element for the cost of operating business especially the vertical FDI that aim to borrow capital in the host country. The host country should make lower interest rate than those in the home country in order to attract inward FDI. Another study found that interest rate has a positive effect on the inflow of FDI (Payaslioglu & Polat, 2013). In addition, ÇEviŞ and Camurdan (2007) also revealed that there is a positive relationship between interest rate and inward FDI. While and Chingarande et al. (2012) and Faroh and Shen (2015) argued that interest rate has no effect on FDI inflow in Zimbabwe and Sierra Leone respectively.

2.3.1.14 External Debt

Generally, a high ratio of external debt deters the FDI inflow because it demonstrates the weakness of macroeconomic policy of a host country. A study of Gulzar Ahmad Khan (2013) revealed that an external indebtedness has a negative impact on FDI inflow to Malaysia over three decades. Another study also found that external debt level indicates trouble of repayment to country’s economy which discourages the investor’s decision to do business in those countries (Chopra, 2003). In addition, Onyeiwu and Shrestha (2004) stated that most investors prefer to invest in the countries with lower external indebtedness, because they tend to have high potential to distribute or provide the standard infrastructure such as water supply, internet, telecommunication, and electricity.

2.3.1.15 Social Stability (crime rate)

The situation of social stability in a host country is one of the fundamental factors that influenced FDI inflow. The study revealed that crimes contributed negative and statistically significant impact on FDI inflows because crimes activities led an unfavorable business and affect the confidence of foreign investors to do business in that country (Nadeem & Shakeel, 2017). Another scholar's Brown and Hibbert (2017) also explained that violent crime discourages the inward FDI because doing business in where there is high crime tends to raise the cost of business operation and diminish the demand for services and products in that area as well. It means crime rate has a negative effect on FDI inflow because it discourages investors' confidence.

2.3.1.16 Human Capital

Human capital has played a significant role in attracting FDI inflow in a host country. According to a study of Noorbakhsh, Paloni, and Youssef (2001) stated that human capital is one of the key factors affecting FDI inflow to a host country since the higher level of human capita indicates the availability of high quality of labor forces which tend to encourage the FDI inflow. Another study found that educational level has a significant relationship with inward FDI (Strat, 2015). In addition, Sichei and Kinyondo (2012) also suggested that a county with more educated people would have high potential to use new technology efficiently. These result also consistent with a study of Kim, Liu, Tuxhorn, Brown, and Leblang (2015) revealed that there is a strong and significant relationship between language and FDI inflow, because the high percentage of foreign languages spoken in a host country especially English would make it easier in communication and decrease the translation cost as well.

2.3.2 Review of Additional Related Works

According to a study of Kumar (2006) on infrastructure availability in 66 counties indicated that a better of infrastructure in a host country has played a significant role in FDI inflow attractiveness. The quality of infrastructure included both hard and soft infrastructure, for the hard infrastructure including internet accessibility, electricity and road networks. And the soft one such as bureaucracy, transparency and taxation administration.

A study of Vathsana (2016) on determinant of foreign direct investment inflows to Lao PDR found that there are twelve significant factors affecting FDI inflows to Lao PDR including electricity, road and internet, investment law, government stability, enterprise law, bureaucracy, low labor cost, economic stability, market growth potential, exchange rate fluctuation, and social stability.

TRINH and NGUYEN (2015) have researched on determinants of FDI inflow to Vietnam, the result indicated that GDP growth rate, trade openness, external debt, human capital, and exchange rate promote inward FDI to Vietnam, whereas government expenditure, telephone line, and inflation rate discourage the FDI inflow. It is similar to a study on the determinants of FDI in Vietnam during 1988 to 2005, it demonstrated that market size, GDP growth rate, trade openness and better infrastructure have positive effect on the inflow of FDI to Vietnam (T. T. Hoang, 2006)

Another scholar (Asiedu, 2002) study on the factors affecting FDI in developing countries, case study of Sub-Saharan Africa (SSA) countries, the study revealed a positive effect of better infrastructure and higher return on investment on inward FDI to non-SSA countries but indicated the insignificant impact on FDI to SSA. Besides, the study also found that trade openness encourages FDI inflow to both SSA and non-SSA countries.

Another study of Huyen and Hoang (2015) on the determinant factors affecting FDI inflow into Thanh Hoa province in Vietnam stated that there are some factors have a significant impact on FDI inflow including the availability of resources factors, Infrastructure factors, and financial factors. Whereas the social and cultural factors have negative effect on FDI inflow

In addition, a study of Ali and Guo (2005) found that market size and market growth potential are the major factors affecting FDI inflow into China mainly for the US investors, while the labor cost is the key factor for export-oriented investment including for Asian investors as well. it is similar to a study of Cuyvers, Soeng, Plasmans, and Van Den Bulcke (2011) indicated that GDP and exchange rate of the host country contribute significant impact on FDI inflow to Cambodia, while there is no significant relationship between geographic location and FDI inflow.

CHAPTER 3
RESEARCH METHODOLOGY

3.1 Comparative Study

This study attempts to investigate the factors behind low level of FDI to Lao PDR by comparing the determinants of FDI in Lao PDR with those in Vietnam. In this study, Vietnam is chosen as the comparative sample due to several significant reasons. Firstly, Lao PDR and Vietnam officially promulgated the law on foreign direct investment in the same period in 1987, one year after the economic decentralization in both countries was implemented. At the same time, the open door policy was also launched since the economic systems in both countries were shifted from centrally economy to market-oriented economy in 1986. It means that Lao PDR and Vietnam started attracting FDI and promoting the economic integration with other counties over the globe in the same period. Secondly, although Lao PDR and Vietnam started opening for FDI in the same period, Vietnam is very successful in attracting FDI and became one of the most attractive destinations for FDI in Asia region while Lao PDR attracted very modest FDI comparatively. Thirdly, Lao PDR and Vietnam have similarity in the political system and government administration, because both Lao PDR and Vietnam rule the countries by communist parties. This makes Lao PDR and Vietnam have a lot of similarities particularly the political and economic implementation system. Lastly, Vietnam is a neighboring country of Lao PDR with over 2,000 Km boundary share together. It means Lao PDR and Vietnam are very close in terms of geographical location which is one of the significant factors that encourage FDI inflow.

Overall, all of the reasons mentioned above indicated that Vietnam and Lao PDR have a lot of similarities that have a crucial role in attracting FDI. Therefore, Vietnam can be a very efficient comparative sample in terms of FDI attractiveness in order to examine the factors behind low level of FDI to Lao PDR which is the main objective of this study.

3.2 Source of Data

3.2.1 Primary Data

The primary data of this research will be collected by in-depth interview with the target people including Lao government officers, economists and foreign investors in order to investigate the factors that obstruct FDI inflow to Lao PDR which are supposed to be the cause making FDI to Lao PDR remains relatively low when compare to that in Vietnam. The sample of the interview's questions include:

3.2.1.1 Questions for Lao government officers.

- Why is Vietnam preferred to Lao PDR in terms of foreign direct investment?
- What is the difference of nature of FDI to Lao and Vietnam?
- What are the factors that obstruct the inflow of FDI to Lao PDR?
- What is the strong and weak point of Lao PDR for FDI attractiveness?
- What are the limitations that Lao PDR cannot provide to foreign investors but Vietnam?
- How is the difference of investment incentive in Lao PDR and Vietnam?
- What should be improved in order to attract more FDI in the future?

3.2.1.2 Questions for economists and/or foreign investors.

- Why is Vietnam preferred to Lao PDR in terms of foreign direct investment?
- What are the main reasons that make you decided to invest in Vietnam instead of in Lao PDR?
- What are the factors the influence you to invest in Vietnam and Lao PDR?

- What are the difficulties of doing investment in Lao PDR/Vietnam?
- What do you want Lao government to improve for FDI attractiveness?

3.2.2 Secondary Data

The secondary data of this study obtains from various published and unpublished sources which are related to the determinants of FDI including previous research papers, articles, academic textbooks, government's documents, online database and other internet sources. In addition, this study also collects the data from the official reports of regional and international organizations such as ASEAN, ADB, IMF, WB, OECD, and UNCTAD.

3.3 Data Analysis

This study constructed a basic analytical framework based on a qualitative approach in order to examine the factors behind low level of FDI inflow to Lao PDR by comparing the determinants of FDI inflow to Lao PDR and Vietnam which included in these five major factors: infrastructure factors, political and government regulation factors, economic and market factors, financial factors and social and cultural factors. At the end, the study will summarize the factors in Lao PDR that have a disadvantage to those in Vietnam. And these factors will be considered as the factors that discourage the inflow of FDI to Lao PDR which are supposed to be the cause that makes FDI in Lao PDR remain relatively low.

3.3.1 Conceptual Analysis

In order to make this work more comprehensive, the words "advantage and disadvantage" will be used in this study to define the result of FDI determinants comparison in Lao PDR and Vietnam.

"Advantage" means the factors in Lao PDR or Vietnam that have more potential in attracting FDI inflow comparatively.

"Disadvantage" means the factors in Lao PDR or Vietnam that have less potential in attracting FDI inflow comparatively.

However, this study will mainly focus on the factors in Lao PDR that have a disadvantage to those in Vietnam because these disadvantageous factors in Lao PDR are assumed to be the factors behind low level of FDI inflow to Lao PDR accordingly.

3.3.2 Variable Explanation

To find the factors that have an advantage or disadvantages over one another between Lao PDR and Vietnam. This study will analyze the five crucial factors which consist of different variables as follow:

3.3.2.1 Infrastructure factors

These factors consist of four variables. For the geographical location will be examined by the possibility to be accessed by investors. Electricity accessibility will be measured by the percentage of household's electricity accessibility (%).The internet accessibility will be measured by the percentage of the internet users (% of the population). And road networks will be measured by the length of road networks (km/100people).

3.3.2.2 Political and government regulation factors

These factors consist of four variables. Political stability will be examined by the situation and event of political movement. Lengthen approval procedure will be investigated by timeframe for admission consideration for general business (day). Government expenditure will be measured by total consumption expenditure (% of GDP). And the investment incentives will be examined by sectors provided for investment incentives.

3.3.2.3 Economic and market factors

These factors consist of three significant variables. Market size will be measured by GDP per capita ($) and GDP growth (%). Regional and international market accessibility will be measured by completion and trend of external economic integration and trade openness (%). And labor cost will be measured by minimum wages ($) and labor forces (people).

3.3.2.4 Financial Factors

These factors consist of four variables. Exchange rate volatility (%). Inflation rate (%). Interest rate (%). And external debt (%).

3.3.2.5 Social and cultural factors

These factors consist of two variables. Social stability will be measured by crime rate (%). And human capital will be measured by lower secondary completion rate (%) and an average of English proficiency (%).

CHAPTER 4
CURRENT SITUATION OF FOREIGN DIRECT INVESTMENT (FDI) AND ECONOMIC DEVELOPMENT IN LAO PDR

4.1 Overview of Lao Economy

Lao People's Democratic Republic (Lao PDR) or Laos is located in the Southeast Asia region. Lao PDR is the only landlocked country in this region with the total area of 236.800 square kilometers (Land: 230.800 Km^2; Water: 6000 Km^2). It is surrounded by five neighboring countries: China to the North; Cambodia to South; Vietnam to East; Thailand to the West and Myanmar to the North West with the total land boundary of 5.083 Km. In 2016, the total population of Lao PDR was approximately 6.76 million with annual growth of 1.4 per cent and 29.3 person per kilometer for the population density (WB, 2016b).

Since Lao PDR was proclaimed as Lao People's Democratic Republic (Lao PDR) at the end of 1975, Lao communist government implemented a socialist economic planned (centrally planned economy) which followed the former Soviet Union's economic model by replacing the private sector with state enterprises and cooperatives. In addition, the state had played a dominant role in national and social economic development by centralizing the investment sector, production, price, trade which created barriers to both internal and external trade. However, a decade after the socialist economic system had implemented, the Lao government realized that this economic policy declined the national economic growth rate instead of stimulating economic growth and development due to it led the national economy suffered in many difficulties and the country's development also stagnated. Therefore, the government initiated to announce the New Economy Mechanism (NEM) in 1986 in order to shift from a centrally planned economy to a market-oriented economy. At the same time, the open door policy was also implemented and began encouraging the international economic cooperation with all counties over the world.

After its decentralization and private enterprise promotion since 1986, Lao PDR is recognized as one of the fastest growing economies in the East Asia and Pacific region and the 13th fastest growing economy globally with the average of 8 per cent per year in GDP growth (WB, 2016a). Under the NEM, the open door policy had implemented toward the international markets and at the same time, the foreign investment law was also promulgated in 1988 in order to promote and attract FDI inflow which was a significant factor for enhancing the economic growth.

Lao PDR had been an observant country for World Trade Organization (WTO) for 15 years, then it was officially admitted as the WTO member on 2nd February, 2013. This was one the success of Lao PDR on the international economic integration and this would be a good opportunity for Lao PDR to trade and cooperate with other WTO member countries in both regional and international level. Moreover, Lao PDR has been continuing to cooperate with all ASEAN members because they have trade agreement together. Lao PDR and the US returned a Normal Trade Relations status in 2004 and then, the trade and investment framework between Lao PDR and the US was signed in 2016. In addition, Lao PDR has also signed various bilateral agreements with Vietnam, China, Cambodia, Burma, Thailand, North Korea, Mongolia, Malaysia, Russia, India, Belarus, Argentina, Kuwait, and Turkey (USA.gov, 2016).

However, Lao PDR still encounters with many challenges on the country development framework, with this, the Millennium Development Goals (MDGs) is one of them that Lao PDR has a commitment to achieve by 2015. Moreover, after Lao PDR became a member of the Association of Southeast Asian Nations (ASEAN), Lao PDR had to prepare the readiness for a big change on regional economic integration at the end of 2015, particularly the ASEAN Economic Community (AEC).

According to the International Monetary Fund (IFM), although Lao PDR had started to decentralize its national economy system and promoted the private enterprise in 1986. Lao PDR remains being on the list of the least developed countries (LDCs) (Indexmundi, 2017). From the year 1988-2008, the average of economic growth was more than 6 per cent and expected to be around 6.8 per cent by 2017. The GDP- real growth rate from 2000 to 2016 has been increased averagely almost 7 per cent. With this, only 4 per cent of GDP growth in 2000 and steadily increased to 8.3 per cent in 2012 before it dropped down a little to 7.5 per cent in 2016. However, the GDP-per capital (PPP) has been increasing gradually from $ 1.700 US in 2000 to $ 2.100 US in 2008 and it dramatically increase from $ 3.100 US in 2012 to $ 5.400 and $ 5.700 US in 2015 and 2016 respectively (CIA, 2017).

Table 4.1 GDP growth, GDP per capita and Inflation rate of Lao PDR from 1990- 2016

Year	1990	1995	2000	2004	2008	2012	2014	2016
GDP growth rate (%)	6.7	7	5.8	6.3	7.8	8	7.6	7
GDP per capita ($)	203	363	325	418	899	1.589	2.018	2.353
Inflation rate (%)	37.9	19.7	24.8	10.7	8.8	13.9	5.7	3

Source: The World Bank, Lao Indicator 2017

For the export and import industry, since 2000 to 2016, Lao PDR had exported over $ 20 billion (the table included the data in every other years). As in 2015, Lao PDR exported almost $ 3 billion to the top export destinations mainly Thailand, China, Vietnam, India, and Japan. This making Lao PDR became the 115th largest export economy in the world. The top of its exports are electricity ($527 million), refined copper ($509 million), rough wood ($448 million), copper ore ($402 million), sawn wood ($397 million) and others. However, Lao PDR has trade deficit almost every year, because it also needed to import a lot from the top import countries mainly from Thailand, China, Vietnam, South Korea and Japan with the top imports communities such as refined petroleum ($776 million), cars ($395 million), delivery trucks ($298 million), planes, helicopters, and/or spacecraft ($177 million), electricity ($167 million) and so on.

Table 4.2 The Export and Import partners of Lao PDR in 2015

No \ Year	2015			
	Export Partners	Million $	Import Partners	Million $
1	Thailand	1.380	Thailand	4.170
2	China	1.220	China	1.210
3	Vietnam	554	Vietnam	519
4	India	136	South Korea	170
5	Japan	96	Japan	101

Source: OEC 2015 (http://atlas.media.mit.edu/en/profile/country/lao/)

Only in 2006 and 2010, Lao PDR had trade surplus of $ 440 million and $ 450 million respectively (OEC, 2015). Because during that time, Lao government was implementing the sixth National Socio-Economic Development Plan 2006 – 2010 (6^{th}NSEDP) and in this five years plan, the government upgraded the level of international economic cooperation and strengthened the bilateral and multilateral agreements in both regional and international level. In addition, the internal facility condition was also improved in order to increase exports and attract foreign investment that concern to the technology transfer. As the result, during the fifth National Socio-Economic Development Plan 2001 – 2005 (5^{th}NSEDP) and the 6^{th} NSEDP, Lao PDR expected to increase the export by 8.6 per cent but it reached 18.1 per cent in reality. This created trade surplus in Lao PDR in 2006. However, the trade deficit occurred again in the following years because of the impact of the global economic crisis. After that Lao economy recovered and had trade surplus again in 2010.

Table 4.3 The Exports and imports' value of Lao PDR from 2000 – 2016

Year	2000	2002	2004	2006	2008	2010	2012	2015	2016
Export (bill $)	0.32	0.35	0.37	0.98	1.16	1.95	1.98	2.928	3.075
Import (bill $)	0.54	0.54	0.49	0.54	1.38	1.50	2.74	4.058	3.936
Balance of Trade (bill $)	-0.22	-0.19	-0.12	0.44	-0.22	0.45	-0.76	-1.13	-0.86

Source: CIA World Factbook 2016

Although Lao PDR is recognized as one of the fastest growing economies, Lao PDR is still classified as a Least Developed Country because Lao PDR is a lower - middle-income economy with GNI per capita of $ 1.740 (2015). Life expectancy of Lao citizen was 66.5 years (2015) and there was 23.2 per cent of the population lives below the national poverty line (ADB, 2015).

4.2 Role of foreign direct investment (FDI) in Lao PDR

Over two decades, Lao PDR officially promulgated the law on foreign direct investment, implemented the open door policy and encouraged the international economic integration in both regional and international level. Since then, FDI has been considered as a significant factor stimulating economic growth and development (Assunção, Forte, & Teixeira, 2011). Because it contributes a lot of benefits to Lao PDR such as creating job opportunity, attracting foreign capital inflows and supporting technology transfer. As a result, the value of GDP per capita of Lao PDR has been increasing dramatically from $ 203 in 1990 to $ 2,353 in 2016. Nowadays, Lao PDR is recognized as one of the fastest growing economies in the East Asia and Pacific region with the average of 7 per cent in GDP growth for over the past two decades (WB, 2016).

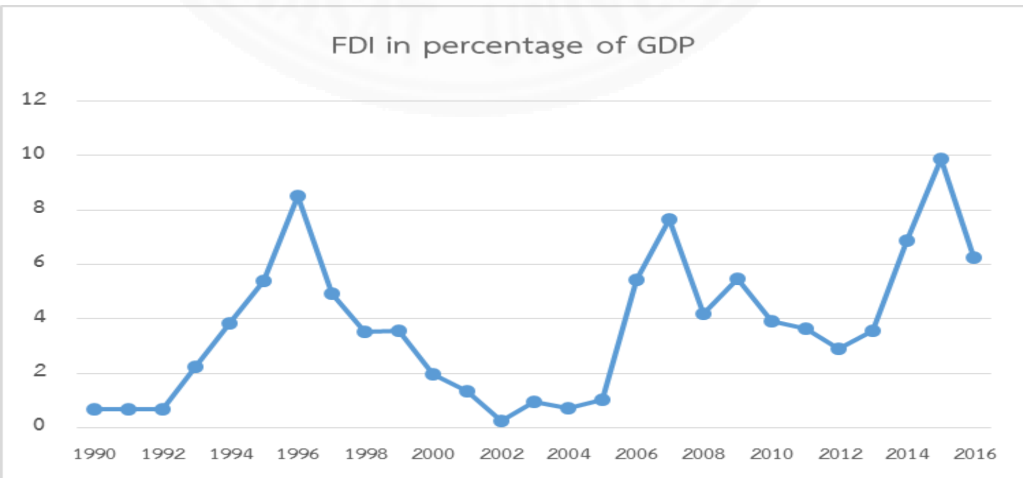

Figure 4.1 Foreign direct investment (in percentage of GDP)

Source: The World Bank Lao Indicator 2017

As in figure 4.1, it indicates that the percentage of FDI shared in GDP depends on the internal and external impact of the economic situation in each period. As it shows in the figure above, FDI shared in GDP was still modest in the first few years after the law on foreign investment promulgated. Then the FDI began accounting for a considerable share of Lao PDR's GDP in the following years. As a result, it increased from 0.7 per cent in 1992 to 8.5 per cent in 1996. And from 1996 to 2002, it decreased sharply by 0.3 per cent because of the impact of Asian financial crisis in 1997. Then it gradually increased for a few years before it extremely increased from 1 per cent in 2005 to 7.7 per cent in 2007. After that, it started to decline again because of the global financial crisis in 2008. However, it started to increase rapidly again from 2.8 per cent in 2012 to almost 10 per cent in 2015 before it dropped down a little in the following years.

Even though FDI has been playing an important role on economic growth, Lao PDR is still poor in attracting FDI when to compare to other ASEAN member countries especially Vietnam. As a result, Lao PDR attracted only 0.3 per cent of the total FDI inflows to ASEAN in 2013, while other 54.91 percent which was the highest percentage belongs to Singapore and 6.74 per cent to Vietnam. It means Lao PDR received almost the smallest amount of FDI share in ASEAN. Interestingly, Lao PDR and Vietnam started to decentralize their national economy by transforming from the centrally economy to market-oriented economy in the same period (1986) but FDI inflows to Lao PDR remains relatively low. Whereas, FDI inflow to Vietnam dramatically increased. As a result, in the first five years of economic decentralization. Lao PDR and Vietnam received almost the same amount of FDI inflow. Then, FDI inflow to Vietnam increased dramatically before declining in 2001, and it started to increase rapidly again by almost $ 12,000 million in 2015, while Lao PDR attracted only $ 1.119 million in the same year.

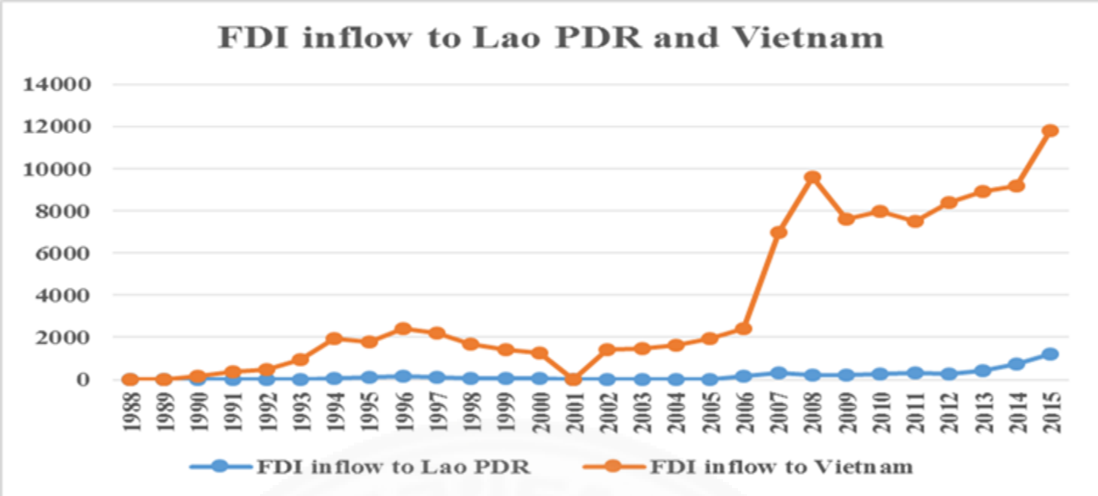

Figure 4.2 FDI inflow to Lao PDR and Vietnam ($ million)

Source: UNCTAD FDI Database 2016.

4.3 Specific Characteristic of Lao PDR as an Investment Destination

4.3.1 Landlocked Country

Lao PDR is the only landlocked country in the Southeast Asian region with the total area of 236.800 km^2, the 7th largest country in the Southeast Asian Nations (ASEAN). It is surrounded by 5 neighboring countries namely China to the north (505 Km), Cambodia to the south (435 Km), Vietnam to the east (2,069 Km), Myanmar to the north-west (236 Km), and Thailand to the west (1,835 Km). The country stretches 1,700 km from north to South, with over 500 Km width from east to west at its widest, and only 140 km at the narrowest point. About 70 per cent of Lao PDR's landscape makes up of mountain ranges, highlands, plateau, and rivers. And it is divided into three distinct regions including the northern part which is dominated by mountains that average 1,500 meters above sea level, the middle part which is the plains region comprises large and small plains along the Mekong river and the southern part which stretches between the Thai and Cambodian border.

According to its geographical location, Lao PDR has no territorial access to the seas, limited border crossing and transit dependence, which is regarded as a disadvantageous position of Lao PDR. Due to being a landlocked country cut off from the sea resources such as fishery, maritime tourism and more importantly, have no access to coastal trade with other countries in both regional and international level that makes up a large percentage of international trade (Gretchen A. Kunze, 2008). In addition, it makes an investment environment of Lao PDR less attractive, because the geographical location as a landlocked country creates a deterrent for FDI inflows especially the vertical FDI or export-oriented investment, and most of its international trade depends on neighboring transit countries. As a result, Lao PDR shipped only $ 3.2 billion worth in 2016 (Workman, 2017).

Therefore, the geographical location of Lao PDR may discourage the inward FDI particularly the export-oriented investment because doing business in Lao PDR has high cost of transportation when compared to coastal countries. Moreover, the import raw material to Lao PDR for the production activity also costs a lot because of long distance from the seaports. As the studies of (Broadman & Sun, 1997; He, 2002) found that coastal provinces attract more FDI than inland cities. However, Lao PDR may attract more FDI in the near future, because the government attempts to transform this traditional limitation by enhancing the economic integration with neighboring countries particularly with the Greater Mekong Subregion countries and promoting special economic zones. At the same time, it is also making Lao PDR as a land bridge, providing the most direct overland transport routes between its seaboard neighbors. In addition, Lao PDR is now implementing the policy for making Lao PDR from Land-locked to Land-link country by 2020 (Vaenkeo, 2015). And one of the very good examples is the China – Laos Railway Project connecting Yunnan province (southern China) to Vientiane, the capital of Lao PDR.

4.3.2 Small Market Size

Lao PDR is one of ASEAN member countries, located in the central of the Indochina peninsular with the total population of 6.7 million people (2016). After the economic decentralization was implemented by shifting from centrally planned economy to market-oriented economy in 1986, the economics of Lao PDR has been growing rapidly. As a result, the GDP growth average of Lao PDR accounted for 8 percent over the last decade. Likewise economic growth, the FDI inflow to Lao PDR also gradually increased from $ 2 million in 1988 to $ 160 million in 1996 and constantly increased to over $ 1.000 million in 2016. Interestingly, although Lao PDR is considered as one of the fastest growing economies in East Asia and the Pacific region, Lao PDR still encounters with a lot of challenges for the economic development, particularly for the FDI inflows attractiveness. Because the market size of Lao PDR is smaller than other countries. According to the GDP of Lao PDR, it had $ 2.367 billion in 1985 and gradually increased to almost $ 16 billion in 2016. It means that the domestic demand in Lao PDR was also relatively low which created the deterrent for FDI inflow especially the horizontal FDI or those investments that aim to serve the domestic market. Therefore, Lao PDR would be an attractive destination for vertical FDI or export-oriented investment. However, this type of FDI also remains facing with an obstacle for transportation or high logistic cost, because Lao PDR is a landlocked country which has no territory access to the sea and it creates difficulty to export commodities to the international markets. Thus, it can be concluded that the market size of a host country is very important in attracting FDI inflow. And in the case of Lao PDR that has small market size, it bring a negative impact on the investment destination. This consequently makes the investment environment of Lao PDR less attractive and discourage FDI inflows to Lao PDR respectively.

Table 4.4 The GDP of Lao PDR from 1985 to 2016

Year	1985	1990	1995	2000	2005	2010	2012	2014	2016
GDP($ billion)	2.367	0.866	1.764	1.731	2.736	7.128	10.290	13.270	15.900

Source: World Bank, Lao indicator 2016

4.3.3 Rich in Natural Resources

Lao PDR has a wealth of natural resources that make a lot of income for the country. There are many kinds of resources that can be found in Lao PDR. However, it can be classified into two main kinds of natural resources which has been exploiting over a half of century especially the beneath the earth's surface and on the surface natural resources. For beneath the earth's surface, which is the mineral deposits including tin, limestone, iron, coal, zinc, gypsum, copper, gold, silver, Sulphur and sapphires. The surveys indicated that the quantity and density of mineral deposits in Lao PDR are quite high even though mining is still in its infancy. During 2010, the mineral production in Lao PDR had increased such as the production of tin, copper, silver, and gold increased by 46, 26, 7.2 and 0.6 per cent respectively when compared to that in the previous years (Thomas, 2012). As a result, there are many foreign investment projects on mining that are operating in Lao PDR especially the big projects such as Sepon Mining in Savannakhet province and Phobia Mining in Xaingkhuang province. And on the surface natural resources, Lao PDR has an abundance of forests which covered a large percentage of the surface. They consist of a variety species of plants which provide valuable timbers and have a high value on economic development such as Eaglewood, Khagnoung, Khamphi, Dou, Longleng and so on. Moreover, Lao PDR also has many rivers especially the Mekong and its tributaries which enhance the potential for hydropower construction and encourage its ambitious to become a battery of Southeast Asian. As a result, there are many foreign investment projects on dam construction in Lao PDR. Nowadays, almost 20 hydropower plants are operating and over 40 are in the process of construction.

Overall, Lao PDR is considered as one of the attractive destinations for the investments that are seeking for natural resources. Therefore, the natural resources in Lao PDR have played a significant role in attracting FDI inflow especially the resource-based FDI which makes a larger revenue for country development.

4.4 Current situation of foreign direct investment (FDI) in Lao PDR and Vietnam

4.4.1 Current Situation of FDI in Lao PDR

Since the law on foreign investment was enacted in 1988, FDI inflow to Lao PDR gradually increased from $ 2 million in 1988 to $ 160 million in 1996 which was the peak of FDI inflow to Lao PDR in the 1990s. Then it declined dramatically from $ 86 million in 1997 to $ 5 million in 2002 due to the influence of ASEAN financial crisis before it began increasing again after 2003 and reached $ 187 million in 2006. After that, it dropped a little in 2009 because of the impact of the global economic crisis in 2008. However, after 2010, FDI inflow to Lao PDR started to increase gradually again and reached $ 1.119 million in 2015 (UNCTAD, 2017).

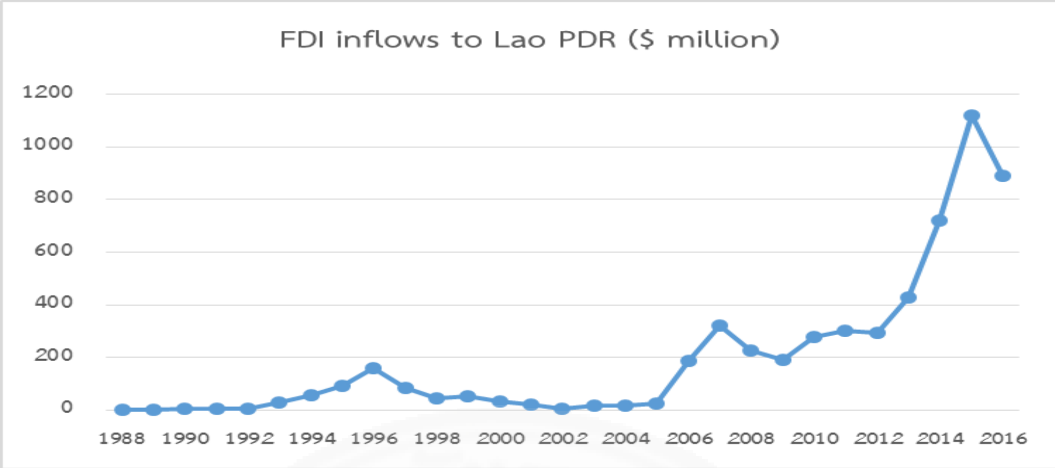

Figure 4.3 Foreign direct investment inflow to Lao PDR from 1988 to 2016

Source: UNCTAD FDI inward database 2017

Over the past two decades, the major foreign investors in Lao PDR were dominated by the neighboring countries namely China, Thailand and Vietnam. And followed by non-ASEAN countries such as South Korea, France, United States, Japan, and Australia. At the present time, 4,549 projects were approved with the total value investment of $ 27,322 million (IPD, 2017).

Table 4.5 Lao FDI distribution by country from 1990 – 2015

No	1990 - 2000		2001 - 2011		2015	
	Country	($)	Country	($)	Country	($)
1	Thailand	2,592.800	Vietnam	3,209.580	Vietnam	466,057.189
2	USA	1,054.660	China	2,970.510	Malaysia	430,320.000
3	Malaysia	722.460	Thailand	2,840.390	China	88,915.884
4	France	410.910	S. Korea	523.130	Hong Kong	18,550.000
5	Australia	201.860	France	473.480	UK	4,000.000
6	S. Korea	195.800	Norway	357.360	Thailand	2,340.000
7	China	151.190	India	355.230	Indonesia	550.000
8	Taiwan	69.990	Japan	347.230	Japan	275.000
9	Russia	29.750	Australia	321.740	NA	NA
10	Japan	23.820	Malaysia	127.630	NA	NA

Source: Ministry of Planning and Investment of Lao PDR

As in table 4.4 shows that during 1990 – 2000, Thailand was the biggest investor in Lao PDR with the total value of $ 2,592.800 because during that time, Lao PDR was in the first phase of opening for FDI, while Thailand had a very strong economy and Thai government also encouraged outward FDI as well. In addition, Thailand still remains the biggest trade partner of Lao PDR since the past several decades. Therefore, many Thai investors came to invest in Lao PDR in various sectors. The USA was ranked as the second biggest investor during that time with the total amount of $ 1,054.660, followed by Malaysia, France, and Australia with the value of $ 722.460, $ 410.910, and $ 201.860 respectively.

From 2001 to 2011, the major investors in Lao PDR were consistently dominated by neighboring counties. Vietnam became the biggest investor in Lao PDR with the total value of $ 3,209.580. Because the economy of Vietnam strongly emerged and grew rapidly after 2000. Moreover, Lao PDR and Vietnam also have a special relationship together. Therefore, many investors from Vietnam prefer to invest in Lao PDR. The second biggest investor was China with the total amount of $ 2,970.510, follow by Thailand $ 2,840.390. While South Korea and France were ranked as the fourth and fifth investors with the value of $ 523.130 and $ 473.480 respectively.

Although there was a change in investor ranking in Lao PDR in 2015, Vietnam still being the biggest investor in Lao PDR with the value of $ 466,057.189. Malaysia became the second biggest investor $ 430,320.000, followed by China, Hong Kong, and the UK. Whereas Thailand dropped to number fifth investor in Lao PDR.

Table 4.6 Lao FDI distribution by sector from 1990 – 2015

No	1990 - 2011		2011 – 2015	
	Sectors	Value ($)	Sectors	Value ($)
1	Hydropower	10,854.860	Hydropower	2,218,526,092
2	Mining	2,788.360	Mining	2,123,422,568
3	Agriculture	2,144.306	Agriculture	935,040,112
4	Other Services	1,686.640	Industry & handicraft	399,218,657
5	Telecommunication	718,910	Hotel & restaurant	146,258,474
6	Construction	532,740	Banking	140,483,275
7	Manufacturing	1,650.630	Service	137,174,978
8	Hotel & Restaurant	811,460	Construction	137,136,000
9	Banking	232,660	Trading	35,184,209
10	Trading	196,950	Public Health	42,528,900

Source: Ministry of Planning and Investment of Lao PDR

As the table 4.5 above indicates the top ten investment sectors in Lao PDR. It is interesting that the top three investment sectors are still consistent as the major investment sectors over two decades. They are electricity generation, mining, and agriculture sectors. These sectors are considered as the mega projects in Lao PDR because Lao PDR has an abundance of natural resources especially mine and many of Mekong River's tributaries. These encourage the potential of Lao PDR to build many hydropower such as Theun-Hinboun, Nam Theun 2, Nam Ngum 1, 2 and many still in the construction process such as Nam Ngiep, Xayabouly and etc. Moreover, Lao PDR also has some big projects in mining such as Sepon Mining, Phubia Mining and so on. And the following sectors are service, industry and handicraft, hotel, restaurant etc.

4.4.2 Current Situation of FDI in Vietnam

Since economic reform called Doi Moi policy was implemented in 1986. Vietnam is considered as one of the fastest economic growth in Asia Pacific region because Vietnamese government always promotes the investment sector in order to attract FDI inflow from other countries over the world. The FDI attractiveness is the priority target for the economic development. FDI is a significant factor that enhance the growth of Vietnam's economy. In addition, with a very good geographical location as a heart of Asia Pacific region making Vietnam is one of the world's most attractive destinations for FDI. As a result, FDI inflow to Vietnam has been increasing dramatically especially after 2006. These investors came from over hundred countries and territories around the world and many of them are some of the world's leading multinational corporations (Dung, 2014, p. 08). It is over $ 22 billion of FDI inflow to Vietnam in 2013 which increased of more than 35 per cent from 2012. While in 2014, FDI inflow reached $ 238 billion with more than 16,300 active projects. And the FDI inflow rose to $ 24.4 billion in 2016, with 9 per cent increased comparing to 2015 (Vinkenborg, 2017).

As it shows in the graph below, the value of investment in Vietnam increased year on year, it climbed to the peak in 1996 with the total FDI value of $ 2.395 million before it dropped down in the following years because of the Asian Financial Crisis in 1997. However, after 2000 the FDI inflows started increased steadily and rose rapidly to $ 9.579 million in 2008 before it decreased again in the following years due to global economic crisis (hamburger crisis). After that, it started to increase again and made the highest FDI inflow in 2016 with the total value of $ 12.600 million (F. UNCTAD, 2017). It absolutely indicated that FDI inflows to Vietnam over two decades making a huge progress of investment industry in Lao Vietnam and became a very essential competitors with other countries in the region.

Figure 4.4 FDI inflows to Vietnam from 1988 to 2016

Source: UNCTAD FDI inward database indicator 2017

Vietnam is recognized as one of the most successful countries on economic development especially in attracting FDI inflow. It received a very large amount of FDI with an increase average of $ 10 – 12 billion per year (state, 2014). According to Santander Trade Portal, The major investors in Vietnam are from the Asia region. The major foreign investors in Vietnam in each period is not really different from the present year. The top ten foreign investors still perform very well over the decades. In 2013, Japan was the biggest foreign investor in Vietnam with the total FDI investment of 14.93 per cent, followed by Singapore which covered 12.93 per cent. While Taiwan and South Korea were ranked as the third and fourth biggest foreign investors with the total FDI investment of 12.53 and 11.66 per cent respectively. In 2016, South Korea became the biggest foreign investor in Vietnam with total FDI of 28.8 per cent ($ 7 billion), Japan and Singapore ranked as the second and third with the total FDI of 10.6 and 9.9 per cent accordingly. Surprisingly, the new investor like China became the fourth among the top ten biggest investors in Vietnam. While the US which was the seventh investor in 2013 disappeared from the top ten biggest investors in 2016. And the rest were Taiwan, Hong Kong, Malaysia, British Virgin Islands, Thailand, and others. As the information presented in the top ten biggest foreign investors, most of them came from Asia region. The only British Virgin Islands are not in Asian countries list for the top 10 of investment in Vietnam.

Table 4.7 Top 10 foreign investors in Vietnam in 2013 and 2016

No	2013		2016		
	Countries	Total FDI (%)	Countries	FDI value ($ Billion)	Total FDI (%)
1	Japan	14.93	South Korea	7.00	28.8
2	Singapore	12.93	Japan	2.58	10.6
3	Taiwan	12.53	Singapore	2.41	9.9
4	South Korea	11.66	China	1.88	7.7
5	British Virgin Islands	6.99	Taiwan	1.86	7.6
6	Hong Kong	5.55	Hong Kong	1.64	6.7
7	US	4.82	Malaysia	914	3.7
8	Malaysia	4.67	British Virgin Islands	860	3.5
9	Thailand	2.92	Thailand	700	2.9
10	Others	18.77	Others	4.56	18.6

Source: Vietnam Trade Promotion Agency and Pan – Asian Interment

For the investment sectors in 2013 and 2014, the manufacturing and processing were the largest FDI sectors in Vietnam. It received investment capital of $ 120.964.540. Followed by real estate business and hotel & restaurant with investment capital of $ 48.432.910 and $ 10.722.250 respectively.

Table 4.8 Investment sectors in Vietnam in 2013 and 2014

No	2013		2014	
	Sectors	Capital ($)	Sectors	Capital ($)
1	Processing & Manufacturing	42,492.57	Processing & Manufacturing	120,964.54
2	Real estate business	12,359.20	Real estate business	48,432.91
3	Construction	2,786.48	Hotel & Restaurant	10,722.25
4	Accommodation service	3,611.22	Construction	9,809.91
5	Electricity, water & Air-Conditioning	1,688.30	Electricity, water & Air-Conditioning	9,530.18
6	Information & Communication	2,223.43	Information & Communication	3,988.16
7	Arts & Entrainment	1,075.49	Arts & Entrainment	3,664.48
8	Transportation	1,075.00	Transportation	3,531.26
9	Agriculture, Forestry & Fisheries	1,719.75	Agriculture, Forestry & Fisheries	3,336.08
10	Mining	2,652.71	Wholesale, retail & maintenance service	3,296.59

Source: Vietnam Trade Promotion Agency

4.5 Investment promotion policy of Lao PDR and Vietnam

4.5.1 Investment Promotion Policy of Lao PDR

Over two decades, the Lao government has attempted to promote foreign investment policy in various ways particularly the open door policy in order to stimulate economic growth and to engage with international economics partners. After the economic decentralization in 1986, the National Socio-Economic Development Plan was implemented every 5 year (5 Year NSEDP) in order to encourage Lao PDR graduating from Least Developed Countries by 2020. One of the important framework is an investment policy particularly the law on investment promotion. The Ministry of Planning and Investment (MPI) has attempted to promote the investment policy of Lao PDR to both domestic and foreign investors by improving Law on investment promotion and publishing some documents and guidebooks such as One Stop Service Guidebook (2011), Investment Guidebook (2014), Cost of Doing Business in Lao PDR (2015) and etc. Since the first law on foreign investment was promulgated, it was amended in 1994, 2004, 2009 and 2016 (Phommahaxay, 2013).

The first revision in 1994, there were two forms of investments including a joint – venture between foreign and domestic investors and fully operational on their business as foreign-owned enterprises in order to provide more freedom to foreign investors for repatriation of profits and expand more business area on FDI.

The second revision in 2004, in this amendment foreign investors can invest in Lao PDR in three different forms such as the cooperation of business by contacting, joint-venture, and 100% foreign-owned enterprises. The purpose was to make the FDI legal framework more efficient and to improve the investment that concern on the environment as well as its possible impacts.

And in 2009, it was amended again. This time the law on foreign and domestic investment were combined together. It means that the domestic investors have the same level of right as the foreign investors and practice under the same conditions. For example One Stop Service accessibility, tax exemption and so on. The aim of this amendment is to shorten the procedure of approval in order to speed up the approval business documentaries and facilitate the business registration quickly. The amendment of the law on investment promotion in each time was approved by the Lao National Assembly (Vathsana, 2016).

4.5.2 Investment Promotion Policy of Vietnam

Since the inauguration of Doi Moi was implemented in 1986, FDI became a significant factor with such a transformative process. Along with the country's official adoption of the multi-ownership economy, FDI was critical for national development. Indeed, the promulgation of the Foreign Investment Law in 1987 clearly reflected its importance to the government of Vietnam. The Law subsequently has undergone four revisions in 1990, 1992, 1996 and 2000. These revisions were implemented in order to increase the rights of foreign investors and make the investment environment more favorable as well as to narrow the policy gap between foreign and domestic investors. At the same time, the law improvements were comprehensive, ranging from registration procedures and the decentralization of investment licensing to land access, trade policy, foreign exchange control, and tax policies. These improvements were induced by such factors as the performance of the FDI sector, changes in the awareness and views towards the FDI sector, competitive pressures in attracting FDI, and international commitments. The Investment Law of 2005 went even further by establishing more level investment environment for all investors, whilst simplifying the registration procedures for foreign investment. Accordingly, the central government has delegated more functions and tasks related to FDI promotion and management to both provincial and municipal government authorities. Equal treatment was also incorporated in the unified enterprise Law in 2005, which set out the legal framework for enterprises of all ownership types. Specifically, FDI enterprises were adjusted by almost the same regulations on business registration, operations, selection of unconditional investment areas, and autonomy in business decisions. Overall, Vietnam has made significant attempts to reform FDI policies and to enhance their role. The reforms improved the efficiency and capacity of enterprises and required trade and FDI corrections to broaden the chances for such enterprises. Therefore, FDI promotion is induced not only by FDI policy but by the interactions of such policy with trade policy reforms and other domestic reforms as well.

CHAPTER 5
RESULTS AND DISCUSSION

5.1 Infrastructure Factors

5.1.1 Geographical Location

Lao PDR is located in Southeast Asia with the total area of 236.800 km^2, the 7th largest country in South East Asia Nations (ASEAN). It is the only land-locked country in this region surrounding by 5 neighboring countries namely China to the north, Cambodia to the south, Vietnam to the east, Myanmar to the north-west, and Thailand to the west. According to its geographical location mentioned, Lao PDR has no territorial access to the seas, limited border crossings and transit dependence, which is the very important route for shipment especially commodities export and import to and from other countries both regional and international markets. Therefore, it is a deterrent for Lao PDR for FDI attractiveness, and it is very hard for investors to make a decision to invest in this land lock country particularly those large investment industries that focus on export. Because most of its external trade depend on neighboring transit countries. Normally, these types of investments share a considerable amount of country's total investment value, but they cannot ship their products from Lao PDR to international markets in other countries easily. And another reason is the landscape barrier, about 70 per cent made up of mountain ranges, highlands, plateau, and rivers. These are obstacles for the investment that needs to operate in the plain or large area especially the agriculture industry. As a result, Lao PDR shipped only $ 3.2 billion worth in 2016. At the same times, those investment focusing on domestic consumers is also facing the less demand due to Lao PDR has a small domestic market with only 6.7 million people (2016). According to a result of the interview, a consultant for economy and commerce department at Lao Embassy in Bangkok. He stated that the geographical location of Lao PDR is the main factor that deters FDI inflow to Lao PDR because Lao PDR is a land-locked country which creates a barrier for its export by seaport to outside market both regional and international level. Whereas Vietnam has an appropriate location according to its geography. It is ranked as the 4th largest country in ASEAN and alongside its land in the east lay on the South China Sea coast. In addition, Vietnam is recognized as a heart of Asia Pacific region. This made Vietnam become one of the world's top destinations for FDI. As a result, Vietnam shipped $ 210.8 billion worth of goods to other countries and regions around the globe in 2016 (Workman, 2017). Moreover, Vietnam had signed trade agreements with many countries both bilateral multilateral. Some of the significant agreements are the bilateral trade agreement with the U.S and multinational trade agreements such as Trans-Pacific Partnership (TPP). It means that Vietnam has a high potential to export to other regions around the world. At the same time, Vietnam also is able to import raw materials from outside easily as well. Therefore, Lao PDR has a disadvantage to Vietnam in terms of geographical location.

It can be concluded that geographical location of Lao PDR is one of the factors discourage inward FDI to Lao PDR. Because Lao PDR is a landlocked country which has no territory access to the sea. It means doing business in Lao PDR has a higher cost in transportation since there is no any seaport. Being a landlocked country also create obstacles for export or ship the commodities to other countries or other regions, and it absolutely affects particularly the export-oriented investment that wishes to export their products to the international market. At the same time, the import raw material to Lao PDR also cost a lot because of long distance to the seaport, but the logistics cost is one of an important part of doing business. It is similar the studies of (Broadman & Sun, 1997; He, 2002) revealed that port provinces attract more FDI than inland cities. While investing in Vietnam is more comfortable to export to other countries or regions because investors can ship their products through the seaports and reduce the transport cost as well. Therefore, geographical location of a host country can be considered as a crucial element in attracting FDI inflow, since it is one of the key factors for FDI desirability. Therefore, the host country as Vietnam with maritime ports attract more FDI than a landlocked country like Lao PDR. And this is the reason why Vietnam is preferred to Lao PDR in terms of FDI inflow which causes FDI in Lao PDR remained relatively low.

However, Lao PDR may attract more FDI in the near future, because Lao government is now implementing the policy for turning Lao PDR from Land-locked to Land-link country by 2020 (Vaenkeo, 2015). One of very good examples is the China – Laos Railway Project connecting Yunnan province (southern China) to Vientiane, the capital of Lao PDR.

5.1.2 Electricity Accessibility

Lao PDR is one the richest countries in Southeast Asia in terms of hydropower resources. One of its national economic development strategies is to become "Battery of Southeast Asia" to do so, it has to exploit nearly all of its massive hydropower potential on the Mekong River and its tributaries (Sager, 2016). With its electricity ambition, Lao PDR exported an estimated two-third of hydropower to Thailand and other neighboring countries in 2016, accounted for roughly 30 per cent of country's total export. In 2017, there are 42 hydropower plants operating in Lao PDR with approximately 6,000 MW for installed capacity and the Lao government expects to have more than 90 hydropower plants with a combined installed capacity of almost 14,000 MW by 2020. However, Lao PDR is still poor in household's electricity accessibility when compared to that in Vietnam. According to the World Bank (WB), about 73.9 per cent of Vietnamese household could access to electricity in 1990 and raise to 99.2 per cent in 2014. While Lao household could access to electricity only 17.7 per cent in 1990 and increased to 78.1 per cent in 2014. As a result, the household in Vietnam is able to access to electricity almost 100 per cent in 2014, while only 78 per cent in Lao PDR (WB, 2017a).

It can be concluded that high percentage of household's electricity accessibility is one of the important factors. Because nowadays, most of the investment industries use the technology in the production process. It is different from the past that used petrol or gas. So, the electricity is needed for the operating system. As a result, the household's electricity accessibility in Lao is lower than in Vietnam which affects the decision of foreign investors because the network of electricity is not cover in many places. This would create a barrier for investors to invest in some specific areas. In addition, shortage in electricity coverage is also discouraged the investment that aims to produce electronic devices for the domestic consumer such as refrigerator, television, iron and etc. Because of the percentage of household without electricity in Lao PDR still high. Therefore, many investors decided to invest in Vietnam where there is almost 100 per cent coverage of electricity. This makes Lao PDR receive less FDI when compare to Vietnam.

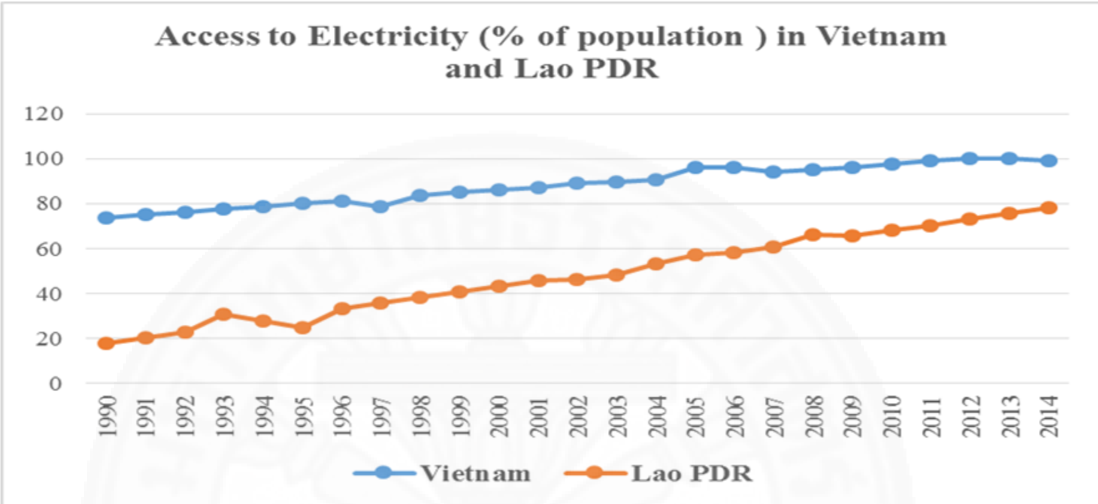

Figure 5.1 Access to Electricity (% of population) in Lao PDR and Vietnam

Source: The World Bank Data Base 2017

5.1.3 Road Length Networks

In Lao PDR and Vietnam, the increase in the length of the road network can be seen in both countries. Lao PDR has totally 0.76 Km/100 people in 2010 before increased gradually to 0.84 Km/100 people in 2015. While in Vietnam is almost unchanged in the past several years, it increases from 0.22 and 0.23 Km/100 people in 2010 and 2015 respectively. As a result, the length of road network in Lao PDR is longer than that in Vietnam.

Even though, Lao PDR has an advantage over Vietnam comparatively in terms of road length networks, the investor still prefer to invest in Vietnam. It probably because of the quality of the roads. A foreign investor may consider much on road quality than the length of the road. It is similar to a study of (Wekesa et al., 2016) revealed that road networks have played a significant role for FDI attractiveness because the better quality of road network infrastructure can reduce the cost of doing business. In addition, Lao PDR had a very small population when compared to Vietnam, this would be the reason behind the length of road in Lao PDR which make it longer than in Vietnam when measure in Kilometer per capital. And the road length network might be just one part of the factor that influences inward FDI to Lao PDR Therefore, FDI inflow to Lao PDR remains relatively low.

Table 5.1 Length of road networks in Lao PDR and Vietnam (Km/100 people)

Country/Year	2010	2011	2012	2013	2014	2015
Lao PDR	0.76	0.64	0.67	0.70	0.72	0.84
Vietnam	0.22	0.24	0.25	0.24	0.23	0.23

Sources: Asian Development Bank (ADB) 2016

5.1.4 Internet Accessibility

Actually, the Internet is a very new thing in last two decades particularly for the least developed countries. Among these, Lao PDR is still poor in the internet accessibility. In 2000, there were only 5,933 internet users in Lao PDR, accounted for 0.1 per cent of the population. While there were 204,125 users in Vietnam could access to the internet in the same year, accounted for 0.3 per cent of the population. However, the increasing of the internet users can be seen in both countries. Notably, the percentage of the internet users in Lao PDR increased dramatically after 2006, from 1.2 per cent to 7 per cent in 2010 and steadily increased in 10.7, 14.3, and 15.7 per cent in 2012, 2014 and 2016 respectively. On the other hand, the percentage of the internet users in Vietnam increased rapidly since 2002, from 1.9 per cent to 30.7 per cent in 2010 and rose dramatically to 48.3 and 52 per cent in 2014 and 2016 (stats, 2016). As the result, since 2000 to 2016, there is only 15.7 per cent of the population those who can access the internet, while in Vietnam is 52 per cent. Therefore, the percentage of the population for the internet accessibility in Lao PDR remains relatively low when compared to that in Vietnam.

The reason why internet accessibility has an influence for inward FDI to Lao PDR and Vietnam because most of the business operation need to use the internet especially in the service sector such as banking, telecommunication and so on. And some of the manufacturing sectors also need to be controlled by the online system. Therefore, the internet accessibility is considered as a crucial element in attracting FDI. In addition, a high percentage in the internet accessibility also create an opportunity for marketing advertisement and high possibility to reach many people in both domestic and international level. It is similar to the study of (Mottaleb, 2007), (Han, 2010) stated that the internet accessibility has a positive impact on FDI inflow and also help to promote inward FDI as well. Moreover, (Choi, 2003) also suggested that the increase in 10 per cent of the number of the internet users in a host country encourages the FDI inflows by more than 2 per cent. But the percentage of the internet accessibility in Lao PDR was very low when compared to that in Vietnam. The internet users in Vietnam accounted for 52 per cent in 2016, whereas Lao PDR had only 15 per cent. Thus, low percentage of the internet accessibility in Lao PDR contributed low FDI inflow as well.

Table 5.2 Number of the internet users in Lao PDR and Vietnam (% of population)

Year	Lao PDR		Vietnam	
	Internet Users	% of Population	Internet Users	% of Population
2000	5,933	0.1	204,125	0.3
2002	14,741	0.3	1,519,569	1.9
2004	20,453	0.4	6,376,811	7.6
2006	68,308	1.2	14,662,869	17.3
2008	214,613	3.6	20,712,171	23.9
2010	438,238	7.0	27,081,658	30.7
2012	695,702	10.7	35,673,508	39.5
2014	953,894	14.3	44,649,715	48.3
2016	1,087,567	15.7	49,063,762	52

Source: Internet live stats 2017 (www.internetlivestats.com)

5.2 Political and Government Regulations Factor

5.2.1 Political Stability

The political situation in a host country plays a significant role in FDI inflows attractiveness. In the case of Lao PDR and Vietnam, Vietnam is a one-party state ruled by the Communist Party of Vietnam (CPV) which provides strategic direction and decides all major policy issues. It means it has a communist government and is one of the four remaining one-party socialist states in the world today. Vietnam has the president as the head of the republic and the prime minister as the head of the government. It is supposed to be that government stability has been a constant in Vietnam. Political stability is also one of the main factors that have helped Vietnam pursue its economic development policy. Since 1990, most other regional countries, except Singapore, have experienced political crises. Meanwhile, Vietnam has achieved political stability – a factor that enables Vietnam to go ahead with its renewal process. Therefore, Vietnam is known as one of the most politically stable countries in South East Asia, because the internal conflict is very rare over several decades, although recently there have been a small number of protests on environment disaster issue in the central of Vietnam (GOV.UK, 2017). Its economic and political stability is a great advantage of the country compared to other Asian nations as well.

On the other hand, Lao PDR is also one of the world's few remaining communist states and it is still recognized as one of East Asia's the poorest countries (Mangahas, 2014). Like in Vietnam, there are no free democratic elections in Lao PDR. Only candidates that are selected by the LPRP (or pre-approved by it) are allowed to run for the five-yearly elections to the National Assembly. But, Lao former Prime Minister told the NA (National Assembly) in 2016 that Lao PDR has actively participated in protecting peace and stability, and promoting friendship and cooperation towards development in the region and the world. He also stressed the need to strictly enforce laws and regulations in order to suppress corruption, which is known to occur, as well as curb the proliferation of social ills. The same as in Vietnam, there is a rare internal conflict since Lao PDR was proclaimed, although there was a small internal strife between Lao government and minority ethnic group (Hmong rebellion) before the year 2000. However, there is no any effect on the on economic development as well the FDI inward in both countries in term of political stability.

From a Political Stability point of view, unstable in politic has a negative impact on FDI inflow which is the same as the suggestion of (Shahzad et al., 2012) and (Jewel, 2015). But it is obvious that political situation in Lao PDR and Vietnam is equally stable. Because both of them have the same political system-communist and share a lot of similarities in most administration structures. When foreign investors analyze the background of the country for their investments, political stability will be one of the top lists that can attract and impress their attitude toward these countries. So, above of all, Lao PDR and Vietnam will be at the same level of investors' choices to do investment in terms of political stability in both Lao PDR and Vietnam.

5.2.2 Lengthy Approval Procedure (Bureaucracy)

Lengthy approval procedure is also one of the significant elements for FDI attractiveness. In this paper, the timeframe for admission consideration for general business is used as an indicator for this variable. According to article 37 of the law on investment promotion of Lao PDR amended in 2016 states that

> *"Investor will receive their investment license and enterprise registration certificate within twenty –five working day from the date of the investment one-stop-service office's receipt of complete application"*

While in Vietnam or it will take for forty -six working days to get an investment license and enterprise registration certificate. It means Lao PDR has an advantage over Vietnam in terms of lengthy approval procedure for general business registration.

It is believed that a country with red tape would discourage FDI because it tends to take a long time in the registration procedure. However, Lao PDR still attracts less FDI when compare to Vietnam, it means that investor may not consider much of the timeframe of business registration since it is just small part of the whole process. Therefore, FDI inflows to Lao PDR remain relatively low.

5.2.3 Government Expenditure

As the figures in the table below show the total government expenditure of Lao PDR and Vietnam from 2005 to 2016, it indicates that the government expenditure of Lao PDR is much higher than Vietnam. In 2005, it accounted for 8.1 per cent and gradually increased by 13.97 per cent in 2016. While Vietnamese government spent 5.47 per cent in 2005 and increase a little to 6.51 per cent in 2016. As a result, Vietnam has an advantage over Lao PDR in terms of government expenditure, the proportion of government expenditure of Vietnam is lower than Lao PDR.

The reason why government expenditure affects the inflow of FDI to Lao PDR and Vietnam because it is believed that a big size of government expenditure can create a chance for misuse of funds by government officers. Moreover, a large size of government may deter the private investment in fundamental sectors of the Lao and Vietnamese economy which is including FDI as well. These findings are also consistent with a study of (Onyeiwu, 2003) revealed that a big size of government spending creates a complicated bureaucratic structure which makes an unattractive environment for an investment and tend to charge higher tax rate in the future. Thus, FDI in Lao remains relatively low because investors are concern about a large size of government expenditure of Lao PDR.

Table 5.3 Total government expenditure of Lao PDR and Vietnam (% of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Lao PDR	8.10	8.35	8.46	9.43	10.74	9.54	9.83	11.73	14.56	13.79	13.96	13.97
Vietnam	5.47	5.53	5.55	5.63	5.78	5.99	5.91	5.93	6.16	6.27	6.33	6.51

Source: World Bank Database, Lao PDR, and Vietnamese indicators

5.2.4 Investment Incentives

Lao PDR and Vietnam attempt to promote FDI in various ways. The investment incentive is one of the crucial ways in attracting FDI inflow. The investment incentives by the business sector in both countries are used as an indicator for this variable. However, Lao PDR and Vietnam have provided incentives for an investment in similar and different. According to article 9 of the law on investment promotion (amended in 2016) of Lao PDR and Vietnam provide the for these following business sectors (appendix B and C)

As a result, there is no strong evidence to prove whether investment incentive in Lao PDR or Vietnam is better, because in the similarities, there are some differences. But as in the coverage aspect, it can be seen that Vietnam has provided more incentives than Lao PDR. The important thing, Vietnam had stated clearly in their investment incentives about what investment types they require and what sectors they want to promote. While the investment incentives of Lao PDR describes in general. This would make investor no confidence to invest in Lao PDR since the incentive is not clear enough. In addition, the investment incentives in Lao PDR mainly focus on agriculture and service sectors that might not attract the business with a huge capital like in Vietnam where the investment incentives promoting the industry sector which is attractive for the big capital of inward FDI. Thus, Lao PDR is a disadvantage to Vietnam in terms of investment incentives which is making FDI in Lao PDR remain relatively low.

5.3 Economic and Market Factors

5.3.1 Market Size

In the case of Lao PDR and Vietnam, the increase in the value of GDP per capita can be seen in both countries from 1990 to 2016. After their economic reform policies were implemented in 1986, it encouraged their economy to grow dramatically. As in the graph below indicated that the GDP per capita of Lao PDR in the first decade increased gradually from $ 203.256 in 1990 to $ 377.971 in 1996. These figures are even higher than Vietnam's with $ 98.032 in 1990 and $ 337.05 in 1996. However, the GDP per capita of Lao PDR decreased in $ 345.497 in 1997 due to the impact of Asian financial crisis before it rapidly increased again after 2005. While GDP per capita in Vietnam strongly raised above Lao PDR's for almost 2 decades before taking over by Lao PDR again in 2014 with the figure of $ 2,017.56 and steadily increased in the value of $ 2,353.153 in 2016, while Vietnam's gradually increased in $ 2,185.69 in the same year (WB, 2017b). In terms of GDP growth rate, despite Lao PDR is a landlocked country with small economies, but it is considered as one of the fastest growing economies in the world. ranked as the 7th of the world's fastest-growing economies in 2017 (Pusparani, 2017). As it shows in the table below, from 2010 – 2016 the average GDP growth rate of Lao PDR is almost 7.8 per cent per year, whereas it is 6 per cent growth per year in Vietnam. It means Lao PDR has an advantage over Vietnam in the term the rate of GDP growth which one of the crucial factors for FDI attractiveness. As a result, form 1997 – 2014 the GDP per capital of Vietnam is much higher than Lao PDR. However, after 2014 the GDP per capita of Lao PDR is higher than Vietnam. Thus, Lao PDR could be an attractive destination for FDI inflows in the new era in terms of the worth of GDP per capital. Moreover, in terms of growth, the average growth rate of Lao PDR is almost 7.8 per cent per year, whereas Vietnam has 6 per cent growth per year.

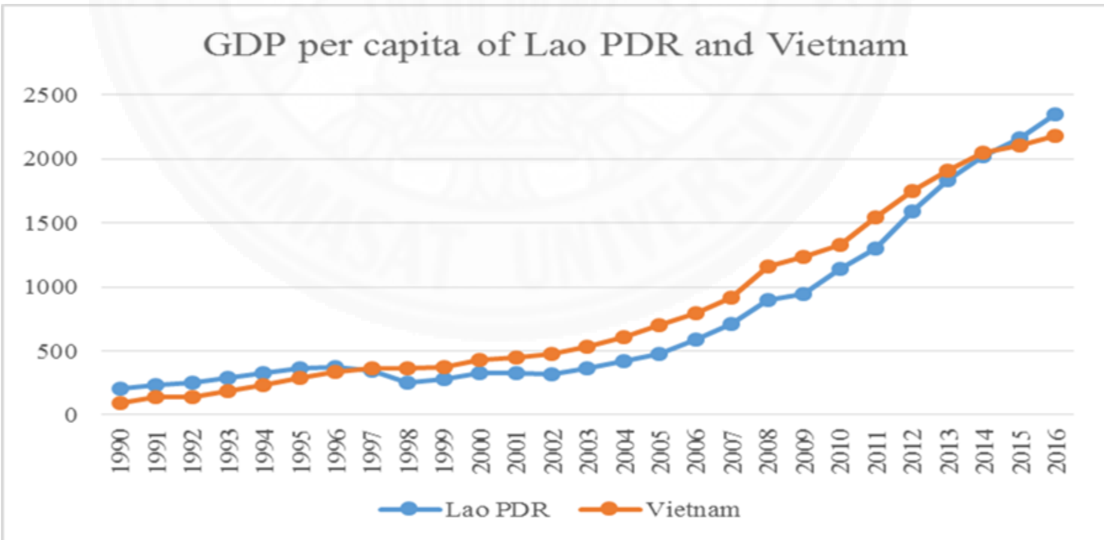

Figure 5.2 GDP per capita of Lao PDR and Vietnam

Source: The World Bank Data Base, Lao indicator 2017

As it was discussed above, both of GDP per capita and growth potential of Lao PDR is higher than Vietnam. However, in terms of the size of the economy, Lao PDR is incomparable to Vietnam. The nominal GDP of Vietnam is around 202.6 billion US in 2016, which is 10 folds more than Lao PDR's GDP (15.9 billion US). Moreover, the difference between the sizes of Lao PDR and Vietnam are associated with the different level of FDI volume. The size of Vietnam domestic market is much larger than Lao PDR's and the FDI inflow is also on the same trend. According to the theoretical explanation, market size is crucial one of the FDI determinants because investors would make less benefit from the accessing to the domestic market in the small market size. By nature, the small size market could not absorb much of the goods and services produced by the investment and the small size also negatively affects economies of scale. In case of Lao PDR, the less FDI inflow than Vietnam could be driven by this fact. The small market size with tiny population seems to be an obstructer for a foreign investor to invest in.

Table 5.4 GDP growth rate (%) of Lao PDR and Vietnam from 2010 – 2016

Country/Year	2010	2011	2012	2013	2014	2015	2016
Lao PDR	8.5	8.0	8.0	8.0	7.6	7.3	7.0
Vietnam	6.4	6.2	5.2	5.4	6.0	6.7	6.2

Source: Work Bank Data Base. Lao indicator 2017

5.3.2 Regional and International Market Integration

Regional and international integration of the host country is considered as crucial components for FDI inflow attractiveness. In order to investigate the fact, the regional and international market accessibility and trade openness are employed as indicators for this variable.

In terms of regional and international market accessibility, the economic integration is used to measure the ability to access the outside markets of Lao PDR and Vietnam which are mainly focusing on trade agreements including bilateral and multilateral agreements. Since the 1990s, FDI flows have been increasing dramatically to emerging economies because of an increase in the number of regional and international trade agreements (Thangavelu, 2011). Vietnam participated in many trade agreements in regional and international level especially after becoming a member of ASEAN in 1995. Then, Vietnam became an official member of ASEAN Free Trade Area (AFTA), followed by Asia-Pacific Economic Cooperation Forum (APEC) in 1998, World Trade Organization (WTO) in 2007. In addition, Vietnam has signed a bilateral and multilateral trade agreement with China, the Republic of Korea, Australia and New Zealand, India, Chile, and Japan. Moreover, Vietnam has completed all bilateral negotiations of the Trans-Pacific Partnership (TPP) free trade agreement but has not yet ratified the agreement. Importantly, Vietnam had signed a bilateral agreement with the U.S since 2001 which is the strongest economic super country in the world and Vietnam also has 16 FTAs with other countries around the globe in 2017. This making Vietnam became the third largest FDI inflow recipient in ASEAN after Singapore and Malaysia (Mirza, 2004). On the other hand, Lao PDR mostly signed trade agreement with ASEAN member countries and some non ASEAN such as Mongolia, Malaysia, Russia, India, Belarus, Argentina, Kuwait, and Turkey. In addition, Lao PDR had just signed a Trade and Investment Framework Agreement with the U.S last year. Notably, Lao PDR has only 10 FTAs with other economies over the world. As a result, the ability and possibility to access the world markets of Lao PDR are still restrictive and incomparable with Vietnam. Therefore, Lao PDR is a disadvantage to Vietnam in terms of global market accessibility.

In terms of trade openness, Lao PDR and Vietnam have significantly different proportion. As in the table below, the degree of openness of Vietnam is higher than Lao PDR overtimes. In 2010, Vietnam's degree of openness accounted for 152.217 per cent. Then it gradually increased year by year and reached 184.686 per cent in 2016. Whereas in Lao PDR, it accounted for 74.217 per cent only in 2010 and gradually increased to 85.481 per cent in 2014 before decreasing to 68.445 per cent in 2016 (WB, 2017b). As a result, the degree of openness ratio of Vietnam is much higher than Lao PDR, it means Vietnam actively cooperate with other economics especially in the export and import sectors.

Table 5.5 Trade of openness of Lao PDR and Vietnam from 2010 - 2015 (% of GDP)

Country/Year	2010	2011	2012	2013	2014	2015	2016
Lao PDR	74.217	80.573	83.065	84.09	85.481	74.761	68.445
Vietnam	152.217	162.941	156.554	165.094	169.535	178.767	184.686

Sources: World Bank national accounts data, and OECD National Accounts data files

As the fact mentioned above, Lao PDR have a disadvantage to Vietnam in both regional and international and trade openness which are crucial components influencing the decision of investors. Due to being a member of many regional and international trade agreements of a host country meaning the ability to access the global market which is a desirability of vertical FDI and create confidence for an export-oriented investment. Moreover, a higher proportion of trade openness of a host country also encourages more the inward FDI especially the vertical FDI, because it demonstrates trade interdependence between host and other countries. Base on the internalization theory, it creates a good opportunity for investors to invest in Vietnam which had joined numerous of trade agreements and has a high ratio of trade openness. Whereas, Lao PDR had participated some of the trade agreements and mostly with neighboring economies and ASEAN members which is sometimes focusing on the political relationship than trade purpose. Therefore, Vietnam is preferred to Lao PDR in terms of FDI inflow because of its potential to integrate with other economics. This making FDI inflow to Lao PDR remains relatively low.

5.3.3 Labor Cost

In case of Lao PDR and Vietnam, both still ranked as the low minimum wage countries. As a result, the monthly minimum wage of Lao PDR in 2014 was $ 77 per month, and after April 2015, it was increased by 44 % to $ 110 per month. However, this making Lao PDR still ranked as the second lowest wage in ASEAN after Myanmar. While the minimum wage in Vietnam is relatively higher when compared to Lao PDR. In 2015, Vietnam’s minimum wage was $ 96 – 137 per month. According to the Ministry of Labor, Invalids and Social Affairs (MOLISA), the minimum wage in Vietnam has increased by 12.4 % in 2016 (Nation, 2015). And based on its minimum wage adjustment roadmap, the minimum wage in 2020 will be around $

151 – 231 per month (Ta, 2016). To sum up, the minimum wage in Lao PDR is relatively lower than in Vietnam. In contrast, when measured with another indicator like labor force found that Lao PDR is incomparable to Vietnam in terms of labor force participation because the number of the labor force in Vietnam is significantly higher than in Lao PDR.

It is very interesting that, although the minimum wage in Lao PDR is lower than in Vietnam, FDI inflows to Lao PDR remain relatively low. It is probably because the indicator utilize to measure the labor cost in this study is just the minimum wage which might not be measurable for the whole picture of the labor cost market. It is similar to the studies of Meyer and Nguyen (2005) and Hilber and Voicu (2010) indicated that there is no relationship between labor cost and FDI inflow. One more thing, low wage means unskilled labors, while the business today prefer semi-skilled or skilled labors. Another reason behind this might be the nature of FDI to Lao PDR which is not the labor incentives sector. In addition, Lao PDR is a disadvantage to Vietnam in terms of labor force. It means that even though the labor cost in Lao PDR is cheaper than in Vietnam, Lao PDR would encounter the shortage of labor force in participation in the long run especially for the larger investment industry. It is, therefore, Vietnam is preferred to Lao PDR in terms of FDI attractiveness which cause FDI in Lao PDR remain relatively low.

Table 5.6 Minimum wage ($/month) and labor force (people) in Lao PDR and Vietnam

Year	Lao PDR		Vietnam	
	Minimum wage ($)	Labor force	Minimum wage ($)	Labor force
2010	NA	3.169.000	NA	51.687.000
2012	78.20	3.332.000	88.04	53.464.000
2013	NA	3.414.000	103.44	54.264.000
2014	77.00	3.494.000	118.85	54.995.000
2015	110.00	3.573.000	136.46	55.654.000
2016	NA	3.650.00	154.07	56.280.000

Source: American Chamber of Commerce Vietnam 2016 and UNCTAD 2017

5.4 Financial Factors

5.4.1 Exchange Rate Volatility

The volatility of exchange rate can be seen in both Lao PDR and Vietnam. But in average, the fluctuation of the exchange rate in Vietnam is stronger than that in Lao PDR. Especially in 2015, the exchange rate volatility in Vietnam was 5.13 per cent, while in Lao PDR was only 1.08 per cent. Therefore, Lao PDR has more advantage than Vietnam in terms of exchange volatility, because the fluctuation of the exchange rate in Lao PDR remained relatively low when compared to that in Vietnam.

Generally, high fluctuation of exchange rate contributes indirect effect on production cost of the business. Because high volatility of exchange rate shows instability of currency value. Thus, it discourages the confidence of investors to invest in a host country where there is unstable fluctuation of exchange rate. However, the fluctuation of the exchange rate in the short term alone may not be able to determine the FDI inflow, since it is just one indicator of financial factors affecting FDI inflow. As a result, although the exchange rate volatility in Lao PDR is more stable than in Vietnam, the FDI inflows to Lao PDR remains relatively low. It is similar to a study of (Hosein Sha rifi-Reanni, 2012) indicated that the exchange rate variation in the host country has an insignificant relationship with FDI inflow. Therefore, Lao PDR still attracts less FDI when compare to Vietnam due to investors are not confident in exchange rate volatility.

Table 5.7 Exchange Rate Volatility in Lao PDR and Vietnam from 2013 to 2016 (in %)

Country/Year	2013	2014	2015	2016
Lao PDR (LAK vs USD)	- 0.65	1.22	1.08	0.48
Vietnam (VND vs USD)	1.22	1.39	5.13	1.27

Source: General Statistics Office of Lao PDR/Vietnam and Focus Economics calculations

5.4.2 Inflation Rate

The inflation is existence in both Lao PDR and Vietnam, But Lao PDR of hyperinflation in 1999 by over 125 per cent due to the influence of Asian financial crisis since the economics of Lao PDR relied on Thailand. While Vietnam didn't get much impact, only 4 per cent. Because Vietnam's economic was not dependence much on outside country at that time. Then, the inflation rate in Lao PDR declined sharply a year later and continue decreasing to 7.8 per cent in 2001. However, the inflation rate in Vietnam was much higher than Lao PDR almost a decade from 2005 – 2014. As it shows in the graph below, the inflation rate in Vietnam increase by 23.1 per cent in 2008, because of the impact of global financial crisis and it constantly fluctuated in high level before it deceased by 4 per cent in 2014, whereas, Lao PDR got 7.6 per cent in 2008 and fluctuate in low level before declining in 4.1 per cent in 2014. As a result, the inflation rate in Lao PDR is lower than Vietnam especially after 2005. This means Lao PDR has an advantage over Vietnam in terms of inflation rate.

According to the previous studies suggested that the host country with low inflation rate tend to encourage more FDI inflow, because the level of inflation rate indicates the macroeconomic stability of the host country (Demirhan & Masca, 2008) (Gholam Syedain Khan, 2014). However, only inflation may not determine the determinants of inward FDI, since it is only an indicator of financial factors. Therefore, the inflow of FDI to Lao PDR remains low level.

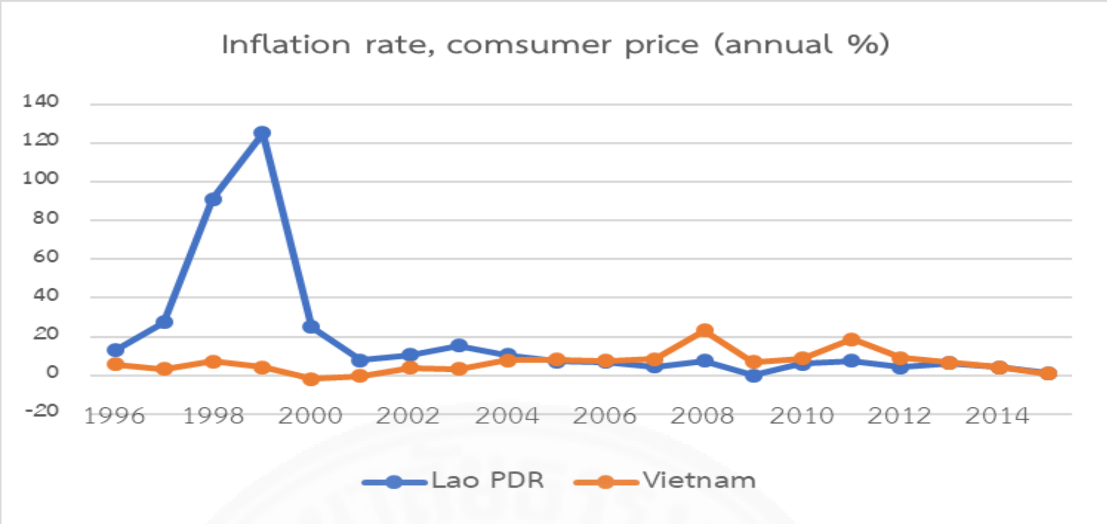

Figure 5.3 Inflation Rate in Lao PDR and Vietnam (CPI, annual variation in %)

Source: International Monetary Fund, International Financial Statistics and data files

5.4.3 Interest Rate

The interest rate in a host country is considered as an important component for encouraging FDI inflow because it could be a financial source for investors. But the table below shows a very high-interest rate in Lao PDR when compare to Vietnam. As figures in the table below, the interest rate in Lao PDR is extremely higher than Vietnam over the past decade. In 2002, it accounted for 21.65 per cent in Lao PDR and steadily fluctuated in a high level in the following years and increased dramatically by 28.54 per cent in 2009, influenced by global economic crisis before declined into 12.28 per cent in 2010. On the other hand, the interest rate in Vietnam remains relatively stable in low level. It was 4.77 per cent in 2002 and accounted for 0.94 per cent in 2010. As a result, Lao PDR is incomparable with Vietnam in terms of interest rate which is one of the elements influencing FDI inflow.

Generally, many investors prefer to borrow capital in a host country when they will operate their business and other activities there. Consequently, investors are not favorable to pay for high interest for capital borrowing, because it will affect their business transaction and production cost. These results also consistent with several previous studies found that interest rate has a significant and positive effect on FDI inflow (ÇEviŞ & Camurdan, 2007), (Payaslioglu & Polat, 2013), (H.

Hoang & Bui, 2015). Thus, the high interest rate in Lao PDR deters the inward FDI particularly vertical FDI, and it is better for investors to favor investing in Vietnam where there is the lower interest rate. This making FDI in Lao PDR remains relatively low.

Table 5.8 Real interest rate in % of Lao PDR and Vietnam from 2010 – 2016

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
Lao PDR	21.65	15.02	16.77	16.74	17.32	19.60	13.90	28.54	12.28
Vietnam	4.77	2.21	1.19	- 6.55	2.40	1.41	- 5.61	3.62	0.94

Source: World Bank Database, Lao and Vietnam indicator 2017

5.4.4 External Debt

The table below shows the external debt proportion of GDP in both Lao PDR and Vietnam. The external debt of Lao PDR is much higher than Vietnam overtimes. In 2006, the external debt of Lao PDR accounted for 70.45 per cent of GDP. Then, it gradually declined in the following years and found at 39.47 per cent in 2015. Conversely, Vietnam's external debt slowly rose from 23.52 per cent in 2006 to 26.33 per cent in 2015. However, Lao PDR is still disadvantaged to Vietnam since the external debt remains to be in the high ratio of county's GDP.

Basically, a country with high level of external debt would attract less FDI than those that have lower, because investors have no confident on the quality of their macroeconomic policy and repayment to economic circle system. This finding is also consistent with some previous researchers which indicated that high level of external debt discourages FDI inflow (Chopra, 2003), (Onyeiwu & Shrestha, 2004), (Gulzar Ahmad Khan, 2013). As a result, Lao PDR is unattractive for inward FDI since its external indebtedness accounted for a very high proportion of GDP. Thus, it diminishes the investors' confidence which makes a concern that Lao PDR would encounter the repayment burden and service of debt to its economic system. In addition, Lao PDR would have less potential to provide basic infrastructure including internet, water supply, telecommunication, electricity and so on. Therefore, Vietnam is preferred to Lao PDR, because of its lower external debt which is similar to a study of Onyeiwu and Shrestha (2004) stated that countries with low external debt are more favorable than those that have a high level of debt. This making FDI in Lao PDR remains relatively low.

Table 5.9 External Debt of Lao PDR and Vietnam from 2006 – 2015 (% of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Lao PDR	70.45	57.70	48.73	48.24	41.04	36.52	38.99	41.37	40.85	39.47
Vietnam	23.52	34.90	22.01	26.34	28.24	27.78	27.06	26.42	25.81	26.33

Source: CEIC 2017 (https://www.ceicdata.com/en/indicator/laos/external-debt)

5.5 Social and Cultural Factors

5.5.1 Social Stability (crime rate)

Basically, Lao and Vietnamese are generally very law-abiding, but the crime rate in Lao PDR is lower than Vietnam. However, violent crime is uncommon in both countries, but petty crime occurs. There is some theft in the big cities. There is also some banditry, illegal drug activity and insurgent activity in some areas in the countryside. However, foreigners are generally not victimized by violent crime but are often victims of purse snatchings while going outside. As a result, the number of thefts and assaults in Lao PDR and Vietnam has increased in recent years, and some have turned violent and petty crime, which includes pick-pocketing and snatch theft, is also a problem in Vietnam. Thus, Traveling alone in remote areas after dark is at risk especially to foreigners. Nevertheless, it is interesting that according the updated data of crime rate and safety rate in ASEAN in 2015 which is based on the perceptions of the visitors to both countries, the percentage on the level of crime in Lao PDR is quite low with 36.24 per cent if it is compared with 52.29 per cent in Vietnam. Besides, their safety rate in Lao PDR is over 63 per cent while over 47 per cent in Vietnam. In addition, crime index by country (South-Eastern Asia) 2015 also ranked Vietnam stood in the 2nd position of ASEAN member countries whereas Lao PDR is 9th. It means safety index of Lao PDR is much more than that of Vietnam.

Therefore, according to these statistics, the crime rate in Lao PDR is lower than that in Vietnam which is an important factor that can influence investors' decision since the safety is also considered as a significant element for investors. This result is consistent with a study of Nadeem and Shakeel (2017) indicated that high level of crime rate obstruct FDI inflow because will might affect their business operation as well their daily life security. This making Lao PDR may have greater potential in attracting FDI inflows. However, one crime rare variable may not be able to determine the inflow of FDI because it was employed as one of the indicators for social and cultural factors. Thus, there is no surprise if Lao PDR received low FDI inflow when compare to Vietnam.

Table 5.10 Crime rate and Safety rate in ASEAN in 2015

No	Country	Crime Rate (%)	Safety Rate (%)
1	Malaysia	69.97	30.03
2	Vietnam	52.29	47.71
3	Myanmar	49.77	50.23
4	Indonesia	47.22	52.78
5	Cambodia	44.06	55.94
6	Timor-Leste	43.75	56.25
7	Philippines	43.00	56.89
8	Thailand	11.00	62.94
9	Lao PDR	36.24	63.76
10	Brunei	30.35	69.65
11	Singapore	17.59	82.41

Source: NUMBEO (https://www.numbeo.com/crime/rankings_by_country.jsp)

5.5.2 Human Capital

The human capital of a host country is also considered as one of the crucial components in attracting FDI inflow. In this variable, the lower secondary completion rate and langue and communication are used as indicators of the study in order to compare these result between Lao PDR and Vietnam.

In terms of lower secondary completion rate, Education has always had a central role in its culture and society in Vietnam, because it is a state-run system of public and private education run by the Ministry of Education and Training. On the other hand, the education of Lao PDR is under the Ministry of Education and Sports. In both countries, children normally start primary education at the age of six. Education at this level lasts for 5 years and is compulsory for all children. However, the increase in the percentage of student graduated from lower secondary school can be seen in both countries. According to the statistic from the WB, in 2011, about 77.925 per cent of Vietnamese who graduated from lower secondary school, while around 43.063 per cent in Lao PDR, and in 2015, the proportion of the completion rate of lower secondary school in both countries has dramatically increased to nearly 100 per cent in Vietnam and over 60 per cent in Lao PDR. This consequently effects on the literacy rate of Lao PDR. According to (UNESCO, 2015), the percentage of literacy rate in Vietnam is over 90 per cent while under 70 per cent in Lao PDR. As a result, Vietnam has an advantage over Lao PDR since the completion rate of lower secondary school in Vietnam is relatively high.

In terms of langue and communication, Lao is the first language and most common language which is used as an official language in Lao PDR. In addition, some of the second languages are also spoken in Lao PDR as well including French, English, and Chinese. But at present time, French is spoken by a very small population in Lao PDR. On the other hand, English and Chinese became so popular among teenagers. Likewise in Lao PDR, Vietnam used its first language, Vietnamese as an official language and it is the language of most people. Many older Vietnamese are familiar with French or English. Interest in English has been rising among youths, with language schools opening throughout the country nowadays. In tourist centers, many Vietnamese will speak some English and in recent years, as Vietnam's contacts with Western nations have increased, English has become more popular as a second language in the country. The study of English is now compulsory in most Vietnamese schools, either alongside or in many cases. Japanese, Chinese and Korean have also grown in popularity as Vietnam's links with other East Asian nations have strengthened. However, according to the survey of EF English Proficiency Index in

2017, the percentage of the average English proficiency in Lao PDR is still very poor when compared to that in Vietnam. As a result, Lao PDR is ranked as the lowest level of average English proficiency in Asia with 37.56 per cent. Whereas Vietnam is moderate with 53.43 per cent. Therefore, from the point of view of languages and communication, Vietnam has an advantage over Lao PDR term of language and communication due to the rate of average English proficiency in Vietnam is over 50 per cent and the number of Vietnamese people learning foreign languages has also rapidly increased nowadays.

The reason why the ratio of lower secondary graduation affects the inflow if FDI to Lao PDR and Vietnam because nowadays, an educated or knowledgeable workforce is essential for business operation especially in the industries that use high technology. Consequently, these people would have the ability to handle with new technologies and work efficiently as well as more productive. Moreover, a higher level of educated people also demonstrates the availability of knowledgeable people and skilled labors. These findings are also consistent with several previous studies (Sichei & Kinyondo, 2012), (H. Hoang & Bui, 2015). Likewise, the lower secondary completion rate, Language, and communication also influence the inward FDI to Lao DR and Vietnam, since both countries speak their own official languages, this would create a difficulty for communication between investors local people. It is similar the study of (Kim et al., 2015) indicate that langue a significant relationship with FDI inflow, due to a higher proportion of foreign languages spoken in a host country particularly English can shorten the time for communication and also reduce the cost of foreign langue translation as well. Therefore, it can be concluded that there is no surprise for Vietnam with the relatively high level of FDI inflow because Vietnam has an advantage over Lao PDR in terms of human capital which is measured by employing the lower secondary completion rate and langue and communication. This making FDI in Lao PDR remains relatively low.

Table 5.11 Lower secondary completion rate, total of Lao PDR and Vietnam (% of relevant age group)

Country/Year	2011	2012	2013	2014	2015
Lao PDR	43.063	45.643	48.872	53.923	60.681
Vietnam	77.925	78.433	77.446	93.771	99.551

Source: The World Bank Data Base 2017

CHAPTER 6
CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

It has been acknowledged that FDI contributes a lot of benefits to the recipient countries through providing capital inflows, foreign exchange reserves, high technologies as well as narrowing the gap between domestic savings and investment (Azam & Lukman, 2010). This study attempted to investigate the factors behind low level of foreign direct investment to Lao PDR by analyzing the five crucial factors including infrastructure factors, political and government regulation factors, economic and market factors, financial factors and social and cultural factors. Each factor consists of different significant variables that are supposed to be the factors affecting the FDI inflow to Lao PDR and Vietnam. After these significant factors were analyzed base on the secondary data and interview, the findings of the study revealed different significant factors in Lao PDR that have disadvantages to those in Vietnam.

The infrastructure factors: Lao PDR has a disadvantage to Vietnam in terms of geographical location; electricity accessibility and the internet accessibility. The disadvantageous infrastructures of Lao PDR have a negative impact on FDI inflow due to it deters the accessibility of investors to the basic need of their business operation particularly the logistic cost. Therefore, it consequently discourages FDI inflow to Lao PDR.

The economic and market factors: Lao PDR has disadvantage to Vietnam in terms of market size, regional and international market accessibility and labor cost. As these variables are considered to be disadvantageous factors in Lao PDR when compare to those in Vietnam, they ultimately create a deterrent for FDI inflow to Lao PDR. The small size of market and labor cost discourage horizontal FDI while regional and international market accessibility obstructs vertical FDI to Lao PDR.

The political and government regulation factors: Lao PDR has a disadvantage to Vietnam in terms of government expenditure and investment incentives. These disadvantageous factors discourage the opportunity for investors to operate their business in Lao PDR since a large size of government spending occurred. Moreover, less and unclear investment incentives in Laos PDR also make investment environment less attractive.

The financial factors: Lao PDR has a disadvantage to Vietnam in terms of interest rate and external debt. For the interest rate, it has a negative impact on investors who wish to get loan in Lao PDR because of high-interest rate. At the same time, high level of external debt also makes macroeconomy of Lao PDR less favorable for investors.

The social and cultural factors: Lao PDR has a disadvantage to Vietnam in terms of human capital. Since the low level of lower secondary completion rate and langue and communication which used as a proxy for human capital in Lao PDR led to unskilled labor. This directly affects the FDI to Lao PDR particularly the business with new technologies.

Overall, all of the findings of the study mentioned above are considered as the factors that discourage FDI inflow to Lao PDR and make FDI in Lao PDR remains relatively low. Therefore, Vietnam is preferred to Lao PDR in terms FDI inflow.

6.2 Recommendations

According to the study, many factors behind low level of FDI to Lao PDR have been revealed. Some factors affect the FDI inflows to Lao PDR directly while some affect indirectly. In order to encourage more FDI inflows to Lao PDR, this paper will have some recommendations to improve the factors which are considered as the determinants of FDI particularly those that have disadvantage comparatively.

Firstly, since the infrastructure is considered as a significant factor in attracting FDI inflows and improving the capability of domestic industries, but the results of the study indicated some factors in Lao PDR that have disadvantages to those in Vietnam especially the geographical location, electricity, and the internet accessibility which deter investors on basic need accessibility. Thus, there is a need for infrastructure improvement. In terms of geographical location, there should have projects on road networks construction in order to make Lao PDR to be a land-linked country and be able to access neighboring countries that have seaports particularly Vietnam and Thailand. This will create an opportunity for Lao PDR to export more to the global markets as well as to attract vertical FDI or export-oriented investment. In addition, Lao PDR should promote the economic integration with other neighboring countries such as CLMV, GMS counties, and implement policy on special economic zones in order to encourage more investors. In terms of electricity and the internet accessibility, there is a need for electricity and the internet networks distribution expansion widely especially to the rural area in order to increase penetration ratio.

Secondly, as economic and market factors have played a key role in FDI attractiveness, but Lao PDR has disadvantage to Vietnam in market size, regional and international market accessibility. Thus, Lao PDR should enhance the economic integration with other countries in both regional and international level in order to increase international trade and strengthen the size of the domestic market which is an important factor in attracting FDI inflow.

Lastly, social and cultural factors are also perceived as am important determinants of FDI inflow. As in this study, the lower secondary completion rate and langue and communication were used as a proxy for human capital. However, the human capital of Lao PDR is found to have a disadvantage to that in Vietnam. Therefore, there is a need for qualified teachers and school expansion to the remote areas, because many districts don’t have schools which is an important place for students to learn and strengthen their knowledge in order to become skilled labors. At the same, a teacher occupation should promote by providing a good social welfare for them. In addition, foreign languages particularly English should also be promoted by applying to the education systems both private and state sectors and other languages that are used the majority of people such as Chinese, Japanese, Korean, Vietnamese also should be promoted. This would create an opportunity for Lao PDR to have more skilled labors in the future which are desired by foreign investors.

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APPENDICES

APPENDIX A

FDI per GDP, FDI growth and FDI inflow of Lao PDR and Vietnam

Year	Lao PDR			Vietnam		
	FDI in GDP (%)	FDI growth (%)	FDI Inflow ($ million)	FDI in GDP (%)	FDI growth (%)	FDI Inflow ($ million)
1988	0.33	100.00	2.00	0.03	- 47.01	7.68
1989	0.86	50.00	4.00	0.06	4322.60	4.07
1990	0.69	15.00	6.00	2.78	108.44	180
1991	0.67	13.04	6.9	3.90	26.32	375.190
1992	0.69	283.33	7.8	4.80	95.45	473.946
1993	2.25	97.99	29.9	7.03	109.92	926.304
1994	3.84	60.64	59.2	11.94	- 8.44	1,944.516
1995	5.39	68.03	95.1	8.59	34.52	1,780.4
1996	8.53	- 45.99	159.8	9.71	- 7.31	2,395
1997	4.94	- 47.51	86.3	8.27	- 24.73	2,220
1998	3.54	13.93	45.3	6.14	- 15.50	1,671
1999	3.55	- 34.33	51.7	4.92	- 8.07	1,412
2000	1.96	- 29.47	33.9	4.16	0.15	1,298
2001	1.35	- 81.38	23.9	3.98	7.69	1,300
2002	0.25	337.72	4.5	3.99	3.57	1,400
2003	0.96	- 13.17	19.5	3.67	11.03	1,450
2004	0.71	63.86	17.00	3.54	21.37	1,610
2005	1.01	575.72	27.72	3.39	22.82	1,954
2006	5.42	72.72	187.31	3.62	179.17	2,400
2007	7.66	- 29.60	323.52	8.65	42.97	6,700
2008	4.18	39.86	227.77	9.66	- 20.66	9,579
2009	5.46	- 12.49	318.59	7.17	5.26	7,600
2010	3.91	7.87	278.81	6.90	- 7.13	8,000
2011	3.64	- 2.12	300.74	5.48	12.62	7,430
2012	2.89	44.94	294.37	5.37	6.36	8,368
2013	3.57	114.04	426.67	5.20	3.37	8,900
2014	6.88	55.62	913.25	4.94	28.26	9,200
2015	9.88	- 29.82	1,421.167	6.11	6.78	11,800

APPENDIX B
Investment Incentives by Sectors in Lao PDR

1. High and modern technology application, scientific research, research and development, use of innovative, environmental-friendly [technology] application, and efficient use of natural resource and energy.

2. Clean, toxic-free agriculture, planting seed production, animal breeding, industrial plantation, forestry development, protection of environment and bio-diversity, activities promoting rural development and poverty reduction.

3. Environmental-friendly agricultural processing industry, national, traditional and unique handicraft processing industry.

4. Environmental-friendly and sustainable natural, cultural and historical tourism development industry.

5. Education, sports, human resource development and labor skill development, vocational training institutions or centers, production of educational and sports equipment.

6. Construction of modern hospitals, pharmaceutical and medical equipment factory, production of and treatment by traditional medicine.

7. Investment, service provision and development of public infrastructure for urban traffic congestion reduction and residence facilities, infrastructure development for agricultural and industrial production, transportation services of goods, transit services and international linkage.

8. Policy banks and micro-finance institutions, focusing on poverty reduction for people and communities who have less access to a bank.

9. Modern commercial centers promoting domestic products and world-renowned brands, exhibition centers, fairs for domestic industrial, handicraft and agricultural products.

APPENDIX C

Investment Incentives by Sectors in Vietnam

1. High-tech activities, high-tech ancillary products; research and development;
2. Production of new materials, new energy, clean energy, renewable energy; productions of products with at least 30% value added; energy-saving products;
3. Production of key electronic, mechanical products, agricultural machinery, cars, car parts; shipbuilding;
4. Production of ancillary products serving textile and garment industry, leather and footwear industry;
5. Production of IT products, software products, digital contents;
6. Cultivation, processing of agriculture products, forestry products, aquaculture products; a forestation and forest protection; salt production; fishing and ancillary fishing services; production of plant varieties, animal breads, and biotechnology products;
7. Collection, treatment, recycling of waste;
8. Investment in development, operation, management of infrastructural works; development of public passenger transportation in urban areas;
9. Preschool education, compulsory education, vocational education;
10. Medical examination and treatment; production of medicines, medicine ingredients, essential medicines, medicines for prevention and treatment of sexually transmitted diseases, vaccines, biological, herbal medicines, orient medicines; scientific research into preparation technology and/or biotechnology serving creation of new medicines;
11. Investment in sport facilities for the disabled or professional athletes; protection and development of cultural heritage;
12. Investment in geriatric centers, mental health centers, treatment for agent orange patients; care centers for the elderly, the disabled, orphans, street children; and
13. People's credit funds, microfinance institutions.

BIOGRAPHY

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