

Facilitating landlocked and least developed country SMEs participation in trade

by the

Hon. Mr. Ousavanh Thiengthepvongsa

President of the Young Entrepreneurs Association of Lao PDR

Email: ousavanh@sokcorporation.com

Ladies and Gentlemen, may I begin by saying how very grateful I am to have the opportunity to attend and participate in this Regional Policy Forum. In my capacity as President of the Lao Young Entrepreneurs Association (LYEA) I will be talking to you this morning on the subject of “Facilitating landlocked and least developed country SMEs participation in trade”.

Introduction

Landlocked developing countries (LLDCs) are widely dispersed around the globe: 15 are located in Africa, 12 in Asia, 2 in South America and 2 in Europe.

Despite their location on four different continents, all 31 LLDCs share common problems of geographical remoteness and dependence on trade and transport systems in neighbouring and coastal countries. The location of LLDCs in the interior of continents requires their export and import goods to travel long distances to and from the closest maritime ports, increases transactions costs and reducing competitiveness in world markets.

Not surprisingly, most landlocked developing countries are very poor. Most of them are far from reaching the Millennium Development Goals (MDGs) related to primary education, infant mortality, access to safe water and the primary goal of poverty eradication. In fact, several landlocked developing countries are even moving further away from reaching these objectives.

Promoting SME development in LLDCs means finding ways to make domestic enterprises more competitive so that they can develop and grow in a globalizing world. The facilitation of small and medium enterprises (SMEs) has been recognized as an important task also for Governments as the future national economy development will depend

on them as a source of income (including foreign exchange and tax revenues) and of jobs.

Lao PDR

Laos is a landlocked, Buddhist country in South East Asia, covering an area of 236,800 km², 2% of which is water. In 2007 its estimated population was 5,800,000 with a low population density of only 24/km²). 75% of people live in rural areas. The economy is dominated by agriculture, which employs over 70% of the 2,900,000 labour force, while manufacturing employs only about 11%. The mostly small business dominated manufacturing sector produces 56% of industrial output, however while approximately 22,000 small businesses account for 98% of manufacturing activities and over 50% of commercial activities, these firms employ on average less than five people¹.

One challenge that faces Laos is the establishing and strengthening of backward and forward linkages between large FDI projects and local SMEs. Growth and development can be more broadly based and sustained when local enterprises are linked into the growth of FDI in any given country. The importance of FDI and the importance of developing the SME sector can be considered separately but the linkage between the two needs to be improved so the wider population can access the benefits of FDI. Enhancing FDI/SME linkages will be discussed in more detail shortly.

Mineral reserves, such as gold, copper, bauxite and tin, will play an important role in the country's economic future. Thanks to its enormous water reserves, Laos is also regarded as the "battery of southeast Asia".

"Landlocked" to "Landlinked"

Being landlocked, certainly influences economic, infrastructure and political decisions. However, it cannot be blamed for all economic, social and political development problems a country faces. It is not an excuse for inertia and slow-moving reforms. There are examples of "landlocked" countries that have found their very own way out of their geographical "handicap". Although being landlocked is a challenge, it is not destiny.

For landlocked countries it is all the more important to get basic macroeconomic and trade policies right, to cut red tape in freight

¹ Mallon, R., 2006 "Review of Context – Economic and Institutional Analysis, Mekong Private Sector Facility".

operations and to speed up customs clearance procedures. Governments have to accept that they need to eventually become, and act as, real “trade-enablers” in order to facilitate the flow of goods. It is also very important to raise awareness and increase information dissemination both among landlocked and transit countries and among the private operators.

As landlocked countries are often also transit countries for their neighbours, the issue of carefully balancing environmental concerns with traffic and transport requirements is a high priority for them as well. On the other hand, being a transit country also opens new potential opportunities for landlocked countries. The development of a modern up-to-date service infrastructure for transiting cars, trucks, trains, airplanes or ships adds value to the transit process, creates jobs and creates a whole new logistics sector with distribution centres, warehouses, technical and even processing facilities.

The successful participation of LLDCs in international trade largely depends on their capacity to build up efficient trade and transport infrastructure and services that will reduce transaction costs. This is due to the process of globalization being closely linked to technological changes in transportation, as well as to business practices and operational patterns. In particular, the exponential growth of containerization and the widespread use of multimodal transport requires an appropriate legal and regulatory framework to complement the enabling environment for business and investment. The practical problem facing many countries is the highly disjointed and ineffective coordination of the elements that make up a trade-supporting infrastructure. Overall, there is a need to develop modern policies, administrative arrangements and management practices that bridge institutional and organizational disparities and inconsistencies.

Developed countries can support SMEs in LLDCs participation in trade through reductions in tariffs and other barriers to trade. Transport and trade facilitation issues play an essential role in the development process of all countries, particularly that of LLDCs. The costs of transport and of those related to compliance with trade control procedures have become more significant barriers to market entry than tariffs. Access to multimodal transport and logistics services is crucial for the competitiveness of SMEs in the global economy, many developing countries however, notably LLDCs and small island, have only limited access to these services. There is need for further research on multimodal transport and for guidelines on best practices for transport and trade facilitation.

Finally, being landlocked in Europe is not the same as being a landlocked country in Asia. The landlocked status is very closely linked with a complex set of challenges and problems and therefore cannot be tackled as an isolated problem. Governments in landlocked and coastal countries, as well as the international community and donor agencies, should attach increased importance to the mix of challenges and attempt to deal with these challenges in their many aspects. There are certainly priority actions to be taken and there are very particular region-wide measures to consider. But generic solutions can also be applied to all landlocked countries. Work would be particularly useful with regard to trade and customs facilitation measures, cross-border infrastructure development or coordination and implementation of regional or sub-regional approaches. The international community should also be open to monitoring the implementation of agreements that guarantee better transit conditions and access to the sea.

Role of SME's in Economic Development and their Situation in Lao PDR

A strong and vibrant SME sector contributes to economic development in LLDCs in a number of ways. In general, SMEs tend to employ more labour-intensive technologies than larger enterprises. They generate a large share of any developing country's productive employment. Many SMEs are located outside of urban areas and employ a large proportion of women hence the benefits of employment and business means a more equitable distribution of incomes (in rural areas and for women). This locational aspect also implies that SME development leads to lower regional disparities (reducing urban drift for example). SMEs in developing countries form a large part of the private sector, which forms the basis for private sector-lead growth.

The GoL has emphasized the importance of private sector development in the economy to facilitate SME development as well as attract FDI to promote sustainable development of the natural resource base. The Government recognizes SMEs' high potential to create jobs and reduce poverty, and FDI's high potential to mobilize investment, improve human resource skills development, and access technology and export markets (Lao PDR National Growth and Poverty Eradication Strategy (NGPES), 2004).

Since the mid-1980s, the government of Laos (GoL) has been implementing substantial institutional and legal reforms to give more freedom to private business development, including SMEs, and to facilitate the transition from a central planned economy to a market economy. The GoL has made promoting private sector activity a priority of economic policy. It is seen to be important to maintain a regular

dialogue between government and business in order to identify what the obstacles are to business development. The 6th National Socio-economic Development Plan 2006 – 2010 has set ambitious economic growth and development targets.

The implementation of the 6th National Socio-economic Development Plan is designed to create a more favourable enabling environment for the promotion of the private sector and the attraction of FDI by primarily improving the legal system and maintaining socio-economic stability. Attracting FDI is a sound development strategy for a country such as Laos, with its wealth of natural resources offering it a range of new opportunities.

Facilitating landlocked and least developed country SMEs participation in trade by enhancing FDI/SME Linkages

Foreign Direct Investment (FDI) accelerates economic growth and income beyond available domestic resources. However more can be done to increase its development impact. Linking FDI and the domestic economy through strengthening business linkages between FDI and SMEs is one of the most effective ways of upgrading domestic enterprises, facilitating the transfer of technology, knowledge and skills, improving business and management practices, and facilitating access to finance and markets. Strong linkages can promote production efficiency, productivity growth, technological and managerial capabilities and market diversification in local SMEs but it can also attract further FDI.

The competitiveness and economic growth of developing countries will to a large degree depend on the ability of their industrial system to access international sources of knowledge, and to absorb and use this knowledge in order to employ its resources more efficiently²

Accounting for the complexity of current patterns of global value chain integration, governments and the private sector are realizing that specific institutions and selective industrial policies need to be developed and implemented to cope with the requirements of global integration. Since global value chains governed by Transnational Corporations account for a significant part of world production, being unable to participate in these chains can effectively exclude SMEs in developing countries and in particular LLDCs, from a large share of economic opportunities.

² Lall, S., 2002. "Linking FDI and Technology Development for Capacity Building and Strategic Competitiveness", in: UNCTAD, Transnational Corporations, vol. 11, no. 3, pp. 39 -88.

The Lao PDR is currently developing its marketing and technology base. This process takes time so the soundest strategy to underpin economic growth at this stage is attracting FDI into the country. This strategy needs to be part of an overall growth strategy such as Laos's 6th National Socio-economic Development Plan. Closing the marketing and technology gaps to a point where exporting complete or value-added products would be the ultimate goal. This will require building linkages between FDI companies and domestic SMEs so the benefits of FDI can be more easily absorbed or captured within the Lao economy and a solid foundation is laid for sustained economic growth.

Policies to promote business linkages can be considered an essential part of industrial policies. The type of policy depends on the overall economic and political objectives and the general level of economic development of the country. A government that wishes to support the development of specific industries with large learning spillovers might use a more targeted policy than a government that primarily focuses on general economic improvement. Four major policy areas can be distinguished that are especially relevant for building linkages between FDI and SMEs³.

On the FDI side:

1. Improving the investment climate.
2. Attracting FDI strategically.

On the SME side:

3. Strengthening the local absorptive capacity.
4. Developing domestic SME suppliers.

The promotion of business linkages is likely to be successful only if a systematic policy approach is adopted where all factors influencing the linkages are targeted.

In practice it is not so easy to exploit the potential benefits from foreign investment for the SME sector⁴. There are many reasons why this may occur. The limited availability of educated employees with management and entrepreneurial skills, the quality of the basic (e.g. roads, electricity) and advanced infrastructure (universities, diversified financial sector, specialized research and training institutions etc.), and the underlying incentive system of all the institutions involved, are important factors for

³ UNCTAD, 2006, Promoting TNC-SME Linkages to Enhance The Productive Capacity Of Developing Countries' Firms: A Policy Perspective.

⁴ See 3.

the development of the SME sector. Improving the “absorptive capacities” (i.e. their ability to “absorb” or take in new ideas, concepts and technology) of SME cannot be adequately addressed by a SME policy alone. A mix of policies is required that integrates technology policies, FDI policies and educational policies that target SME sector development.

International experiences that shape the absorptive capacities of countries and their SME sectors include educational policy and incentive systems. Educational policy is a centerpiece of all strategies to increase absorptive capacities⁵. Investment in management capabilities is as important as investment in technological skills. Incentive schemes are important. High levels of investment in developing absorptive capacities are not sufficient. What is even more important is the interaction of different institutions and policies. For example, FDI companies need to have appropriate incentives for local sourcing. In this context, the existence of market-oriented intermediaries such as Business Development Services, acting as intermediary support structures, is essential for supporting local SMEs access opportunities.

The constraints of SMEs in Lao PDR

The Enterprise Survey 2007 (ES2007) is the second survey in a series, subsequent surveys are to be carried out in 2009 and 2011, to track the changes in enterprise performance and their business environment in Lao PDR.

How have enterprises of various sizes, industries, and locations *performed*? What are their most important *constraints*? And finally, what *conclusions* can be drawn for policy or support action by central and provincial Governments as well as private business organisations to effectively promote business development and enhance the competitiveness of enterprises, including SMEs, in Lao PDR on regional as well as global markets.

These are the key questions that the ES2007 report tries to answer.

You can see from the bar chart representing ‘Perceived Business-External Constraints’ that the following points are of particular interest:

‘Fees & regulations’ are perceived to be the most significant external constraint – over 40% of all enterprises reported fees and regulations to be either a “very big problem”, “big problem” or a “problem”. This was followed closely by competition (37%) and physical infrastructure (21%)

⁵ See 3.

More specifically, “Too high taxes and duties” was cited as the main reason for enterprises’ concern over fees and regulations (over 73%). This was followed by “fuel prices”, “electricity prices” and “other fees and unofficial payments”.

The data on external business constraints show that:

- High transaction costs, official (and unofficial) taxes and fees are seen as serious problems for business development, despite the fact that taxes in Lao PDR are, compared to other countries in the region, relatively low.
- Lao PDR is becoming more and more intertwined in international markets with rising energy and fuel prices, improved road linkages and trade barriers and restrictions on imports being dismantled.
- Increasing competition is slowly becoming more important but the knowledge on changes in trade regulations, customs duties etc. and the implications for own products are still inadequate.
- Instead of acting defensively enterprises must look at opportunities for accessing neighbouring markets.

Competition is a major challenge for Lao enterprises. SMEs usually perceived their “unit cost/price” as the main reason for their competition problems. Their generally low level of competitiveness and inadequate innovation is especially troublesome in the context of the ASEAN Free Trade Agreement (AFTA) and the upcoming accession of Lao PDR to World Trade Organisation (WTO). In order to overcome these constraints, significant efforts of both public and private sectors are needed. In particular, the SME Promotion & Development Office (SMEPDO) and the Lao National Chamber of Commerce & Industry (LNCCI) are tasked as key organisations to address these challenges.

Enhancing competitiveness of Lao enterprises also requires addressing the large overestimation of financial factors (relative to other needs and constraints) for successful enterprise development. The banking sector has to develop – quickly – the ability to function as a capital resource for SME sector. Of particular concern are the interest rates which are in international comparison prohibitively high and limit the competitiveness of business sector (interest 20-25%).

- More than 46% of enterprises reported that they had received a loan in 2006 yet 67% of these enterprises still indicated “lack of capital” as their most significant internal constraint.

- This finding indicates that the types of loans offered (short-term rather than long-term) might not be in the form or size of financing that enterprises are seeking.

Besides the need to pursue the public-private dialogue and cooperation business associations should become a more active player in this field. Services offered by Business Membership Organisations (BMO) must better meet the interests of its members. As the majority of BMO members are SMEs, the most critical challenges are to strengthen their competitiveness on the national, regional and international markets.

The lack of competitiveness is related to the low levels of knowledge about the business environment, including related laws and terms and conditions. AFTA provides a clear example. An overwhelming majority (79%) of enterprises were not aware of AFTA. A strikingly high

percentage of the firms who were aware of AFTA felt that it would have no effect on their businesses – nearly double the number of enterprises that either felt that AFTA would be positive or negative on their businesses. Similarly, enterprises did not appear to realize improved export opportunities for themselves due to the integration within ASEAN. Increased efforts must be made to raise awareness and to educate enterprises regarding the effects that AFTA could have on their business and livelihoods. Three potential intervention points include:

1. BMOs: The most commonly-cited reason for enterprises to join BMOs is to learn about rules and regulations (e.g LNCCI, LYEA or other networks of businesses).
2. Radio stations: A significant majority of businesses (43%), which knew about AFTA stated that they obtained their information about AFTA from the local media.
3. PPDs: Public-Private Sector Dialogues provide a mechanism for the existing business community to identify and prioritize issues that affect business development and investment. Also provincial public-private dialogues (PPPD) allow for transparent communication channels among and between the private and the public sectors. They encourage both parties to openly raise and jointly solve issues of concern.

The perception of business owners/managers was that enterprise performance had improved since the first survey in 2005 although the survey revealed that there are also numerous challenges for Lao businesses:

- The lagging performance of SMEs compared to large enterprises
- As well as inadequate innovation (improvement of the quality, increase in the level of output and productivity in order to lower unit costs of their products or services) compared to regional and international market dynamics and
- for the Government, the reduction of 'transaction costs and risks' posed by too cumbersome administrative procedures and discriminatory practices in applying existing laws, rules and regulations.

The future of landlocked and least developed country SMEs participation in trade

The problems of SME's participation in trade in landlocked countries can be overcome in the long run, with the right mix of many, often rather country or region-specific, programmes and policies. One such programme that has benefited the Lao PDR is the Greater Mekong Subregion (GMS), launched in 1992, which has focused on transport and trade facilitation initiatives in its endeavor to enhance connectivity and improve competitiveness across international borders.

The improvement of the GMS roads has resulted in significant savings in vehicle operating costs and reduced travel time. Border-crossing times in Cambodia, Lao PDR and Viet Nam have also been reduced and will be further reduced pending the full implementation of the Cross-Border Trade Agreement.

The GMS Cross-Border Transport Agreement (GMS Agreement) is a multilateral instrument for the facilitation of cross-border transport of goods and people. Formulated under the auspices of the Asia Development Bank (ADB) technical assistance, the GMS Agreement provides a practical approach, in the short to medium term, to streamline regulations and reduce nonphysical barriers in the GMS. It incorporates the principles of bilateral or multilateral action, and flexibility in recognition of differences in procedures in each of the GMS countries.

The GMS Agreement includes references to existing international conventions that have demonstrated their usefulness in a broad range of countries. It also takes into account, and is consistent with, similar initiatives being undertaken by ASEAN.

The GMS Agreement is a compact and comprehensive multilateral instrument, which covers in 1 document all the relevant aspects of cross-border transport facilitation. These include

- single-stop/single-window customs inspection

- cross-border movement of persons (i.e., visas for persons engaged in transport operations)
- transit traffic regimes, including exemptions from physical customs inspection, bond deposit, escort, and phytosanitary and veterinary inspection
- requirements that road vehicles will have to meet to be eligible for cross-border traffic
- exchange of commercial traffic rights
- infrastructure, including road and bridge design standards, road signs and signals

The GMS Agreement will apply to selected and mutually agreed upon routes and points of entry and exit in the signatory countries (see Map 1).

The combined impact of the GMS Agreement for the transport and trade facilitation sectors is visible at various levels. At the project level, the agreement has resulted in increased domestic economic activity, including SMEs, with new industries and special economic zones developing along the road. At the corridor level, passenger fares have decreased reflecting lower costs. At the national level, the impact on small-sized economies such as Lao PDR and Cambodia, has been higher, since a larger proportion of their trade uses the border points on the Southern Corridor and the East–West Corridor. The impact on larger economies such as Viet Nam is relatively less, since it has several other trade points including seaports.

Key Lessons learnt so far include:

- For the benefits of the GMS projects to spread to the subregional level, trade facilitation should be expedited.
- Subregional projects have enabled cooperation among the countries by improving the efficiency of transport and creating a favorable climate for dialogue and exchange of information.
- The creation of national transport facilitation committees in each GMS country is a positive step but needs to be accompanied with a more inclusive functioning with their counterparts in other sectors.
- Support for policy reforms is needed to enable private sector participation.

In summary the GMS transport and trade facilitation programme has created a demonstration effect in that it is being replicated in other subregions in Asia.

Conclusion

Trade facilitation is often identified with highly technical and expensive procedures, but there are some very simple, basic measures which are neither very costly nor complicated to implement, and which can make a huge impact on the way trade and transport function for SMEs in LLDCs. Such simple measures include adequate opening hours at border stations, joint customs posts with neighbouring countries, or the publishing of applicable rules, laws, procedures or security measures and SME support, promotion and development. Traders and investors look for predictability, accountability and reliability. If such basic enabling conditions are not given, trade flows are simply diverted.

Trade facilitation measures require realistic timeframes that have to include long-term implications, acquire the support of all stakeholders, public and private, and take into consideration the financial viability of projects.

The SMEs in LLDCs are often handicapped with disproportionately high trade transaction costs and therefore would consequently benefit most from the introduction of trade facilitation measures. The removal of the barriers and the related costs can therefore entail quite significant advantages. Previously published studies⁶ estimate potential benefits resulting from trade facilitation measures can range from between 2 to 3 percent of the total trade value. They can be arguably more important than tariff reductions as trade development instruments.

Likewise, a study published by UNECE in 2003 found that long-term effects on growth could only be achieved when an open and liberal trade policy is combined with trade and transport facilitation measures. This means that there is a compelling need for an open liberal trading environment with functioning institutions and good trading conditions, which trade facilitation measures can help to create.

However, trade facilitation on its own, is not enough to tackle the complex situation faced by SMEs in LLDCs competing in a globalizing economy. An integrated, holistic approach to their problems is therefore recommended to achieve any kind of tangible result. An integrated strategy should therefore encompass reforms in the areas of:

- trade facilitation with a realistic, comprehensive and targeted agenda;
- transport and transit facilitation including the physical infrastructure, economic implications and capacity building;

⁶ UNECE, 2002.

- the enabling environment with institutional reforms and institution building, legal and regulatory reforms as well as their implementation and enforcement, as the quality of institutions and the lack of a conducive growth-promoting and investment climate have a decisive impact on the economic situation of a country. Fraud, corruption and informal trade are direct symptoms of institutional malfunctioning and as such are to be blamed for many costs incurred throughout the documentation and transit chain.
- the regional approach with a coherent regional cooperation framework to negotiate solutions and linkages between all related issues. In addition, given the close dependency between landlocked and coastal countries, particular attention should also be given to the positive impact of regional cooperation on good neighbourly relations.
- and finally improved Banking Services

In the area of trade facilitation, international and regional organizations have elaborated many tools, instruments and recommendations on which any integrated development plan should draw. Furthermore, such an integrated framework needs to take into consideration regional aspects. The regional commissions are well positioned to assist in the regional development work and should be called upon to provide a forum for discussion and advice. Many of the tools have been developed over the years to tackle some of the practical problems faced by landlocked developing countries especially in the area of SME trade and transport facilitation. They range from the harmonization of documents, the use of the same location codes or technically more advanced initiatives such as the use of electronic codes and documents.

An integrated trade facilitation framework that includes all these different aspects and adapts them to each country's or region's particular situation can have the potential to reduce the economic distance that separates SMEs in LLDCs from their markets. However, strong political will is required to back it and has to be integrated into a wider policy and development framework of governments and international organisations.

I thank you for your cooperation.