

An Evaluation of Support to Lao PDR's Special Economic Zones (SEZs)

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ABBREVIATIONS

ADB	Asian Development Bank
CSP	Country Strategy and Program
DTIS	Diagnostic Trade Integration Strategy
EPZ	Export Processing Zones
FDI	Foreign Direct Investment
FTZ	Free Trade Zones
FZ	Free Zones
GMS	Greater Mekong Subregion
GoL	Government of the Lao PDR
IE	Industrial parks or Industrial Estates
IEAT	Industrial Estate Authority of Thailand
IT	Information technology
JICA	Japan International Cooperation Agency
JV	Joint Venture
M&E	Monitoring and Evaluation
MOIC	Ministry of Industry and Commerce
MoU	Memorandum of Understanding
MPI	Ministry of Planning and Investment
NCSEZ	National Committee for Special Economic Zone
NEM	New Economic Mechanism
NSEDP	National Social and Economic Development Plan
OSS	One Single Service
PMO	Prime Minister's Office
PPP	Public Private Partnership
R&D	Research & Development
SEZ	Special Economic Zone
SEZA	Savan-Seno SEZ Authority
S-NSEDP	Secretariat of National Social and Economic Development Plan
SSEZ	Savan-Seno Special Economic Zone
SWOT	Strengths, Weaknesses, Opportunities and Threats
TPPD	Trade and Product Promotion Department

EXECUTIVE SUMMARY

A.1 Background

Introduction. The technical assistance project on *Building Lao PDR's Capacity to Develop Special Economic Zones* (TA 7188) was approved in November 2007 and implemented between mid-2009 and mid-2011 with the aim of encouraging and strengthening local capacities and the country's overall SEZ regulatory environment. It initially envisaged the building of the Lao PDR's capacity to develop SEZs by focusing on the Savan-Seno Special Economic Zone (SSEZ) along the Savannakhet portion of the GMS East-West Economic Corridor (EWEC). It intended to promote the Savan-Seno SEZ Authority (SEZA) as a future national SEZ organization and help prepare a national SEZ decree. The end result of these efforts was that in October 2010 the national SEZ degree (No. 443/PM) was approved, and in December 2010 a National Committee for Special Economic Zone (NCSEZ) was established in the Prime Minister's Office (PMO). The establishment of a national regulatory and institutional framework for SEZs led to an expansion of the TA's scope from that of capacity building at the provincial level to that of supporting the country-wide NCSEZ and line ministries involved in regulating SEZs throughout the Lao PDR.

Objectives. The objective of this report is twofold: First, for TA 7188, (a) it evaluates the outcomes and outputs of TA 7188; (b) it assesses the relevance of those results to the objectives of sustainable economic growth and job creation; and (c) it identifies any shortcomings that still need to be addressed. Secondly, for the Seventh National Social and Economic Development Plan's (7thNSEDP) goal of achieving an inclusive, private sector led growth, it assesses the effectiveness and relevance of the Government's SEZ policies, especially that of the Prime Minister's 'Decree on Special Economic Zone and Specific Economic Zone in the Lao PDR'.

Coverage. Four types of activities have been carried out to achieve these objectives. The first consisted of a review of recent literature on SEZs, a summary of which is contained in Chapter 2 of this report. The second involved an assessment of TA 7188's capacity building activities in terms of their outputs, outcomes and possible impact on growth and employment (Chapter 3). The third one consisted of an assessment of TA 7188's institutional and regulatory framework, the effectiveness and relevance of the Prime Minister's decree and, more generally, the Government's strategic framework in promoting SEZs as a means of driving private-sector-led growth (Chapter 4). The final one involves an analysis of the remaining challenges, risks and sustainability needs of the SEZ program (Chapter 5).

A.2 SEZ Global Experiences and Lessons for the Lao PDR

Rational for SEZs in Lao PDR. There are four reasons motivating the Lao PDR's program to promote SEZs throughout the country. First, SEZs support the GoL's wider economic reform strategy to develop and diversify the economy, especially through a private sector driven expansion of value adding activities. Second, they promote investment from foreign and domestic sources, along with know-how and technology transfers, by fast-tracking the approval process and offering various incentives, infrastructural facilities, and reliable supplies of labor and utilities services such as telecommunications, water, sewerage and power. Third, SEZs serve as test areas of possible role models for the rest of the country. Finally, they help to generate employment in specific geographic areas, along with skills development for the local population that aims to transition their inputs to higher value added systems.

Adaptability and evolution of the SEZ program. For the Lao PDR, a successful SEZ strategy will require the adoption of a flexible approach to leveraging the country's current comparative advantages in a way that allows its current SEZ program to evolve over time.

Since investors' attraction to SEZs must necessarily be based on the location's comparative advantages, initial activities will need to focus on basic manufacturing activities that require relatively unskilled labor. As training and social infrastructure improve workforce standards, service-based industries and high value-added manufacturing activity will be increasingly attracted into the area. That process will, however, require an active and fully integrated strategy and action plan within the country's overall development program, the involvement of all the public and private stakeholders in the promotion and facilitation of particular zones, and appropriate institutional capacity that supports the transformation of those zones to high-value activities in a manner that is socially and environmentally sustainable.

Building a Strategy and Action Plan. The National Committee for Special Economic Zone (S-NCSEZ) has recently established a strategy (in Lao only), which promotes three types of SEZs associated with (a) border zones focusing on services and tourism; (b) zones located in remote area to strengthen links to urban and commercial centers; and (c) agricultural and mineral processing areas. Having determined the results that are to be achieved, the S-NCSEZ will next need to establish the mechanism or action plan for implementing that strategy. One possible area of high-value specialization is to evolve border zones into logistics hubs, along with light manufacturing and agro-industrial processing centers. The country is strategically positioned to serve as a logistics hub servicing intermodal systems that support not only trade of the Lao PDR, but also that of Thailand, China, Vietnam and those countries' major shipping ports to overseas markets. Through the efforts of the ADB and other Lao PDR development partners, considerable work is underway provide the institutional capacity, infrastructural facilities and legal and regulatory environment for facilitating trade. What is needed now is a clear action plan on how to transform the border zones into intermodal transport and logistics hubs that can provide high value added for the economy.

A.3 Assessment of TA 7188's Capacity Building and Promotional Activities

Capacity building assessment. Notwithstanding progress made under TA 7188 for strengthening the capacity of staff in S-NCSEZ, there remains considerable room for improvement to bring the work of the Secretariat up to international standards. To achieve those standards, further assistance will be needed for training in English and Thai-based programs covering SEZ management, single stop services, SEZ selection and assessment procedures, environmental and green area management, information technology, negotiating skills, accounting and auditing, and monitoring and evaluation (M&E) techniques and procedures.

Assessment of Promotional Activities. The NCSEZ website needs to be transformed into a dynamic site that has detailed and up-to-date information of interest to potential investors. Among the key areas to be bolstered are the site's investor-oriented focus, promotional media about in the country and its potential for investors, and an emphasis on and investment perspective that promotes the country's increasingly transparent and market oriented system. Moreover, further outreach activities need to be implemented in the near future to attract investment in what is likely to be an increasingly competitive environment under the present global economic situation. To that end, the S-NCSEZ should incorporate into its website and other media campaigns the powerful influence of regionalization under the GMS and ASEAN and more broadly globalizing tendencies into its SEZ strategic adaptations.

Supply chain business opportunities. The Lao National Committee for Special and Specific Economic Zone would benefit from a better understanding of the types of business that could be attracted to SEZs, clustering methods that add value and promote competitiveness in SEZ, and strategic approaches to linking SME to large enterprises to network activities and attract investment in SEZs. TA 7188 provided some basic information about mechanisms for identifying supply chains business opportunities that could be targeted by the NCSEZ,

specifically through its workshop on ‘Production Chain Analysis’. Building on that knowledge dissemination, the next technical assistance should deepen the NCSEZ’s understanding about supply chain systems and how to transform them into value chains.

Economic impact assessment. Performance outcomes and impact. The S-NCSEZ is currently identifying benchmarks with which to measure performance outcomes and impacts of SEZs. Since the indicators have to be established at district or provincial level where the zones are located, it is important to determine early on in the program what type of information is available that best reflects SEZ outcomes and impacts. The irregular frequency of estimates for Provincial Gross Domestic Product (PGDP) prevents that data from being used to evaluate SEZ provincial and district-level impacts. An alternative approach is to use the Lao Expenditure and Consumption Survey (LECS), which is published every five years. The next LECS for 2012/13 will provide data on socio-economic indicators that could be used to analyze local and provincial changes associated with the SSEZ in Savannakhet. Other sources are currently limited to perceptions surveys that are undertaken by NGOs and development partners from time to time.

Social impact assessment. There are a number of social problems generally associated with SEZs. They include problems of land concessions, health effects and occupational injuries, and the impact on traditional production and livelihood methods. In the case of the SSEZ in Savannakhet, those problems have been aggravated by investments in the entertainment and hospitality industries, especially activities associated with the Savan Vegas Casino and Hotel. They have given rise to public health issues, especially those related to increasing rates of HIV/AIDS infections in the area. Gambling has also brought with it a sharp rise in criminal activities, family conflicts, income losses and greater indebtedness of the local population, according to focus group discussions in the surrounding villages. These issues will need to be addressed if the SSEZ is to have a positive impact on livelihoods in Savannakhet. The S-NCSEZ is planning to issue a decree on casinos, which eventually would be made into a law to regulate casinos. However, enforcement is likely to remain a problem, as is country’s ability to remedy the negative consequences of these casinos on the population in surrounding districts.

Environmental impact assessment. Environmental protection in Savannakhet is not being rigorously enforced. As industrial investments increase in SSEZ, the impact of processing facilities on local water supplies and their quality will require careful management if the SSEZ is to have a positive demonstration effect on SEZ development in other parts of the country. For new SEZs, there are current regulations that require applicants to submit environmental impact assessments (EIAs) to the S-NCSEZ. For this process to work, however, the S-NCSEZ will need assistance in developing an effective methodology for EIA to (a) establish the baseline environmental setting in the radius area of the proposed zone; (b) assess the potential impacts of the proposed project components on different environmental components; (c) develop adequate and feasible mitigation measures, for example, through revising project design and layout, working practices, adopting cleaner development mechanism or to mitigate where appropriate to keep residual impacts within acceptable limits; and (d) develop monitoring and other measures as necessary to ensure successful implementation.

A.4 Assessment of TA 7188’s Institutional and Regulatory Framework

Assessment of SEZ legal and regulatory framework. The SEZ decree could be strengthened by establishing detailed guidelines in four areas: SEZs, One Single Service (OSS), Public Private Partnership (PPP) activities, and safeguards for the environment and the displaced population. First, SEZ guidelines should cover development plans, including land uses (e.g., green belt, transport and communications, public utilities), types of processing and non-processing activities permitted, possible priorities for SMEs, provisions of physical

infrastructure (e.g., water supply, sewage, power supply), and role of the GoL. Secondly, OSS guidelines should cover specific services provided to investors within SEZ beyond the general establishment of a one stop service currently provided by the SEZ decree. Thirdly, PPP guidelines should specify the roles and participation of the GoL and the private sector in SEZs. Fourthly, environmental guidelines should cover the environmental impact of the SEZ in the area, while green guidelines should indicate how to optimize energy efficiency, water consumption, waste management, plantation, and use of other renewable or non-renewable resources. Finally, resettlement and compensation provisions need to be detailed, beyond a simple general provision that now exists in the SEZ decree.

SEZ management and institutional framework assessment. The location of the SEZ authority in the PMO has the advantage of proximity to high level decision-makers. The S-NCSEZ believes that its location in the PMO ensures its ability to work across ministries, and that it can operate under the ‘breakthrough approach’ adopted at the 9th Party Congress in 2011 to developing the Lao PDR economy. Over the longer term, the Secretariat’s current location in the GoL structure could be better mainstreamed into other investment promotion mechanisms. Since SEZs are mechanisms for investment promotion, it rightly falls under the purview of the Ministry of Planning and Investment (MPI), and specifically within its Department of Investment Promotion. Where there is some overlap with mandate of the Ministry of Industry and Commerce (MOIC) to manage production of the country’s tradable products, inter-ministerial coordination could occur in the manner that the GoL is currently encouraging. Indeed, one of the main functions of MPI is to coordinate the GoL’s line ministries in socio-economic development strategies their implementation in all sectors and at all levels of Government. Eventually, consideration could be given to whether the SEZ authority should be mainstreamed under MPI’s investment promotion activities.

SEZ one stop services assessment. Under TA 7188 the consultants established OSS guidelines that could be applied to the development of one stop services in the S-NCSEZ. Once operational, these types of services will facilitate investment in specific zones around the country. Caution should, nonetheless, be exercised in duplicating MPI’s one-stop services for investments, including those that are directed at SEZs. Over the longer term, the interpretation of the Investment Law would appear to indicate that MPI should exercise control over national investment, including those for SEZ investors, who could then be subject to further processing by the one-stop service of a particular SEZ, such as that of the Savan-Seno SEZ Authority.

Assessment of effectiveness and relevance of GoL’s SEZ strategic framework. The SEZ Roadmap is effective in describing specific activities that would help to develop SEZs in the country, the SEZ institutional framework, and a results-oriented framework for the SEZ development plan. As a next step, the S-NCSEZ should design and implement an action program and supporting action matrix that supports its strategy-based vision, goals, guiding principles and core implementation strategy leading up to outcomes and associated with impact indicators. The resulting strategy and action plan would ensure that the GoL’s SEZ program is well-integrated into the 7thNSEDP in supporting the GoL’s overall development plan.

Improving the SEZ program’s relevance and effectiveness. To improve the SEZ program’s effectiveness and relevance in forming part of the GoL’s overall development plan, consideration should be given to expanding its coverage and content to include the following components: (a) mechanisms for overcoming challenges for private sector development in non-natural resource sectors, and SEZ development complementarities with the 7thNSEDP’s strategy and action plan for key targeted areas in regional and local development, development of enterprises, employment and poverty alleviation, and industrialization and modernization; (b) SEZ vision and strategic goals that parallels those of the 7thNSEDP; (c) an action plan whose outputs generate the outcomes necessary to achieve the SEZ strategic

goals; and (d) specific actionable areas for the SEZ's implementation modality and promotion channels.

A.5 The Way Forward

The effectiveness of the GoL's national development plan and its strategy to utilize industry cluster groups that build on SEZ modalities will largely depend on whether a number of existing obstacles are removed. As a minimum, the following interventions are suggested to eliminate the most important obstacles to the SEZ program:

- (a) For the national SEZ strategy and action plan, (a) integrate Lao PDR's SEZ strategy and action plan, along with the roadmap, into the 7th NSEDP, building on its 'breakthrough approach' for focusing efforts to realize the GoL's goals; (b) assess the possibility of eventually mainstreaming the NCSEZ into other national, regional and local investment promotion mechanisms by integrating it and the C-NCSEZ into MPI once the 'breakthrough' approach has been completed; (c) avoid duplication of OSS activities related to SEZs in MPI's OSS center, and limit other agency activities to operations with specific SEZs like that of SEZA; (d) continue capacity building of S-NCSEZ staff to bring them up to internationally acceptable standards and ensure the competitiveness of the Lao PDR's SEZs with those of neighboring countries; (e) redesign the S-NCSEZ website to better target potential investors and ensure that the site is in line with today's web page design standards; and (f) broaden participation of SEZ-related officials in study tours.
- (b) Expand the SEZ decree and strengthen its implementation to cover (a) SEZ guidelines on development plans for land uses, types of processing and non-processing activities permitted based on a negative list approach, priorities for SME involvement, provisions of physical infrastructure, and the GoL's role; (b) OSS guidelines on specific services provided to investors within SEZ beyond the general establishment of a one stop service currently provided by the SEZ decree; (c) PPP guidelines on the roles and participation of the GoL and the private sector in SEZs; (d) environmental guidelines for the SEZ in the area, and green guidelines on optimization of energy efficiency, water consumption, waste management, plantation, and use of other renewable or non-renewable resources; (e) resettlement and detailed compensation provisions of displaced population.
- (c) For the Savan-Seno Special Economic Zone, support activities that (a) improve the knowledge base of the local population; (b) expand the number of trained workers and qualified professional; (c) address social problems such as alcohol consumption, trafficking of people, and HIV/AIDS associated with investments in the entertainment and hospitality industries; (d) address conflicts over land associated with investments in the agriculture and forest sector, especially land concessions; (e) address the growing health effects and occupational injuries from SSEZ-related activities; (f) address changes being exerted on traditional production and livelihoods of local people by SSEZ-related industrialization and modernization.

A.6 Where ADB Should be Involved

TA 7188 enabled the Lao PDR to make significant progress towards a proactive investment environment in SEZs. It contributed towards spearheading initiatives in demonstration areas that can now serve as catalysts for country-wide economic policy reforms conducive to investments and trade. For the ADB, three guiding principles are recommended for the SEZ program's next phase:

- (1) First, a key priority should be ground-based operations of existing and new zones, with an increased focus on implementation of reforms and follow-through of activities at a

level that directly stimulate private sector development and skills improvements of the local workforce.

- (2) Secondly, even with fairly large ADB assistance, outcomes and impacts are likely to be higher with a scope and agenda that is narrower than that of TA 7188 since it will allow a deeper focus on key strategic initiatives aimed at producing well-defined results in terms of the implementation of regulatory measures and the promotion of investment at localized levels.
- (3) Finally, SEZs present tremendous opportunities for accelerating investment in value-added activities that could support local workforce training and social infrastructure both for improving livelihoods and for transitioning SEZs to higher value activities that help diversify and grow the economy in non-resource based products and services. Skills development and training of the local workforce would help to shift the type of investment inflows from those that rely on unskilled labor and natural resource intensive activities to those that utilize skilled and capital intensive ones, as well as concentrating production on higher value-added service sector activities in such areas as information and communication technology (ICT), business support services, knowledge-based activities, and research and development (R&D).

These guidelines suggest that the ADB's next SEZ program phase should focus on the following three activity grouping:

- *Localized Zone Support* – Target SEZ assistance to those having large, demonstrable impact for others to follow. Key interventions would include interventions to (a) promote public-private partnerships (PPPs) to address capital constraints and to contribute to the public sector catalytic role for a private sector driven investment growth; (b) integrate the ADB's support to SMEPDO's Business Development Services (BDS) into efforts in SEZs to develop SME business support services for larger companies operating in the zones; (c) address district-level social problems created by zone-related activities, conflicts over land concessions, health effects and occupational injuries, and changes being exerted on traditional production and livelihoods of local people by modernization; (d) establish environmental guidelines for zones and enforce compliance with environmental impact assessments that are in line with international standards; and (e) create localized benchmarks for measuring outcomes and impacts from SEZs.
- *Transform SEZs to High Value Adding Zones* – Establish the conditions that will allow zones catering to stand-alone investments to shift to integrated activities of 'next generation' zones that cater to high value-added or knowledge-intensive activities with increased specialization of facilities in a cluster environment having a range of networked support services. Key interventions would include (a) S-NCSEZ training on value-chains and their clustering in zones; (b) skills upgrading in specialized zone activities through formal training and apprenticeship programs; (c) design strategy for making timely adjustments to relevant policies and regulations based on business needs and market conditions, as well as on development stages of zones in the country.
- *Policy and Regulatory Framework* – Coordinate and harmonize SEZ-related public policy and the regulatory environment in order to establish a conducive and unified investment climate for localized zones, including the strengthening of institutional capacity. Key interventions would include (a) building on Lao PDR's new SEZ strategy, develop a detailed timeline for SEZ action plan supporting the 7thNSEDP; (b) continue capacity building of S-NCSEZ staff to bring them up to internationally acceptable standards and ensure the competitiveness of the Lao PDR's SEZs with those of neighboring countries; (c) upgrade media campaigns to target potential zone investors.

1. INTRODUCTION

1.1. Background

1.1.1. The Government of the Lao PDR introduced the New Economic Mechanism (NEM) in 1986 in order to transform the country from a centrally planned economy to a market economy. The reform program has resulted in a remarkable economic performance since the 1990s, with real GDP growth averaging 6.5 percent a year. The Government's Sixth National Social and Economic Development Plan (6thNSEDP) for 2006-2010 acknowledged the private sector's contribution as a driving force for growth and employment, and introduced a number of measures to stimulate involvement of small and medium size enterprises (SMEs). The Seventh NSEDP (7thNSEDP) for 2011-2015 gives even more emphasis to the development and expansion of the private sector as the driving force for the economy.

1.1.2. One of the channels put forward by the NSEDPs for facilitating private sector-led growth is through special economic zones (SEZs). It recognizes the positive benefits from capital investment that infrastructural and legislative provisions of SEZs have had in other Asian countries and developing countries elsewhere. In essence, SEZs provide delimited geographic locations that allow governments to jump-start private sector development by introducing conducive regulatory, financial and infrastructural conditions that are otherwise difficult to implement at the national level.

1.1.3. In Savannakhet province, the Savan-Seno Special Economic Zone (SSEZ) has been designed as a model SEZ for the country. Established by the GoL in 2002, SSEZ has three sites. Site A, with 305 hectares near the Second Friendship Bridge, focuses on service sector activities like hotels, restaurants, shopping centers and leisure activities for what has become known as Savan City (Paradise City). Site B, with 20 hectares, is for logistic activities and is being promoted by a joint venture between Japan Logistic System (Japan), Global Logistic (Lao PDR), KP (the Lao PDR), and the AA Paper Company (Thailand). Site C, with 10 hectares, is allocated to an industrial estate known as Savan Seno Industrial Park. Until recently, it remained largely undeveloped because the absence of basic infrastructure and services dissuaded investors from locating their factories, warehouses and other facilities in the area. In February 2008 the GoL and the Malaysian-based Pacifica Streams Development Co. Ltd signed an agreement establishing a joint venture under the name of Savan Pacifica Development Co. Ltd to accelerate the industrial park's development. The injection of new capital has spurred development of basic infrastructure services. There are currently 5 companies operating in the industrial park, with another 16 companies planning to build factories in 2012.

1.1.4. To advance SEZs in the country, the Government of the Lao PDR (GoL) signed a Memorandum of Understanding (MoU) in April 2008 with the ADB and UNIDO for the implementation of a technical assistance (TA) project to develop SSEZ. Since it is located near the junction between the National Road No. 13 and National Road No. 9, which is part of the East-West Economic Corridor (EWEC), it provides important synergies with the ADB's Strategy and Action Plan for the Greater Mekong Subregional, specifically in terms of its efforts to promote trade, investment and business enterprises along one of the major GMS corridors.

1.1.5. The technical assistance project (TA 7188) on *Building Lao PDR's Capacity to Develop Special Economic Zones* was approved in November 2007 and implemented between 2009 and 2011 with the aim of encouraging and strengthening local capacities and the country's overall SEZ regulatory environment. More specifically, the TA sought to (a) improve the management environment for the SEZ by conducting capacity development trainings for staff in the SEZ authority (SEZA); (b) strengthen legal framework and regulatory guidelines for the country's SEZ development; and (c) assist SEZA to promote SEZs in a manner that attracts domestic and foreign investors by establishing an information center and other promotional mechanisms. These interventions were in line with the ADB's Country Strategy and Program (CSP) for 2007-2011 and UNIDO's Integrated Programme Phase II for 2004-2008. And, because of its cross-border trade and investment dimension, the TA bolstered the GMS program's efforts to encourage subregional economic cooperation in a way that enhances economic relations among the countries.

1.2. Objectives and Report Coverage

1.2.1. The objective of this report is twofold: First, for TA 7188, (a) it evaluates the outcomes and outputs of TA 7188; (b) it assesses the relevance of those results to the objectives of sustainable

economic growth and job creation; and (c) it identifies any shortcomings that still need to be addressed. Secondly, for the 7thNSEDP's goal of achieving an inclusive, private sector led growth, it assesses the effectiveness and relevance of the Government's SEZ policies, especially that of the Prime Minister's decree number 443/PM (26 October 2010) on 'Decree on Special Economic Zone and Specific Economic Zone in the Lao PDR'.

1.2.2. Four types of activities have been carried out to achieve these objectives. The first consisted of a review of recent literature on SEZs, a summary of which is contained in Chapter 2. The second involved an assessment of TA 7188's capacity building activities in terms of their outputs, outcomes and possible impact on growth and employment (Chapter 3). The third one consisted of an assessment of TA 7188's institutional and regulatory framework, the effectiveness and relevance of the Prime Minister's decree and, more generally, the Government's strategic framework in promoting SEZs as a means of driving private-sector-led growth (Chapter 4). The last involves an analysis of the remaining challenges, risks and sustainability needs of the SEZ program (Chapter 5).

2. SPECIAL ECONOMIC ZONES – GLOBAL EXPERIENCES

2.1. Overview

2.1.1. A Special Economic Zone (SEZ) is a geographical area that possesses special and differentiated economic regulations from those that apply at the national level. It has four key features: first, its geographic delimitation is often physically secured; second, it has a single management or administration; thirdly, it offers benefits such as regular utility supplies and tax and other incentives; and, finally, it has a separate customs area providing duty-free benefits and streamlined procedures. The concept covers Free Trade Zones (FTZ), Export Processing Zones (EPZ), Free Zones (FZ), (IE), and others.¹ Incentives are often based on duty-free trade and the absence of exchange controls, the facilitation of licenses and other regulatory requirements, reduced corporate and value-added tax obligations, and the elimination of local fees. Although some SEZs are either entirely public or private entities, they are more often developed under Public-Private Partnership (PPP) arrangements whereby the public sector provides some level of support, such as provision of infrastructure, equity investment, soft loans or bond issues, while the private sector contributes towards capital investments, employment, and local and provincial economic growth.

2.2. Economic Performance and Impacts

2.2.1. *Motivation for SEZs.* The reasons why host countries establish SEZs are (a) to attract foreign and domestic investment, along with the transfer of know-how and technology; (b) to generate employment in the area and develop skills for the local population; (c) to transition into wider economic reforms; and (d) to support cross-border trade and investment, especially along corridors. For multinationals, the attraction arises from sourcing natural resource inputs and utilizing low-cost labor. Reliance on low-labor costs is, however, proving to be unsustainable because of their economic and social implications. Host countries recognize that there are important benefits to be had from training and social infrastructure both for improving livelihoods and for transitioning SEZs to higher value added activities. Skills development and training of the local workforce help to shift the type of FDI inflows from those that rely on unskilled labor and natural resource intensive activities to those that utilize skilled and capital intensive ones. As a result, there is less reliance on traditional SEZs that depend on proximity to primary inputs and cheap, unskilled labor, and greater focus on SEZs that concentrate on higher value-added and service sector activities in areas such as information and communication technology (ICT), business services, knowledge-based activities, and research and development (R&D).

2.2.2. *Proliferation.* Countries throughout Latin America and East Asia have aggressively promoted SEZs since the 1970s as a way of shifting away from import-substitution policies to export-led growth policies as a means of integrating their economies into global markets. As a consequence, their

¹ Foreign Investment Advisory Service (FIAS), "*Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*". Washington, DC, World Bank, 2008.

numbers have risen from 176 to 3,500 in the course of the last 20 years.² While many countries have set up special economic zones, China has been the most successful in using them to attract foreign capital, and SEZs have been credited as one of the key engines of China's remarkable development.³ Equally important, SEZs have helped China to transition the economic system by using them as test areas of possible role models for the rest of the country. They have also played important roles in bringing new technologies to China and in adopting modern management practices throughout the country.⁴

2.2.3. *Mixed record.* Despite their success in China and proliferation elsewhere, SEZs have had a mixed record of success, and they remain controversial on both economic and social grounds. From an economic perspective, their past expansion coincided with the rapid rise in trade and investment globalization that began in the 1970s and continued into the 1990s and 2000s, driven by the fragmentation of manufacturing into geographically dispersed global production networks. With the recent moderation in FDI growth, their record has been less distinguished. In the case of China, for example, recent data show that real wages of workers operating within SEZs have not significantly improve relative to those outside the areas.⁵ Without sustainable sources of competition, SEZs have been found to fail, for instance, in the experiences of African countries, where political support for the projects were unsuccessful in driving investors to areas lacking (a) competitive advantages, (b) transparent legal and regulatory systems, and (d) adequate promotional and regulatory capacity on the part of SEZ authorities.⁶

2.2.4. *Social impacts.* Negative social consequences can begin when households are relocated to make way for SEZs. Arable land can be further reduced by so-called 'zone fever' that results from real estate speculation in the area. Land fragmentation follows as a greater number of households compete for smaller areas of arable land. Often there is a lack of adequate compensation to displaced households, which can exacerbate poverty levels and indebtedness. Erosion of cultures and traditional values within households can occur because of the rising number of women employed in SEZs. Gender inequality and exploitation of female workers often arises because companies regard women as better suited for the repetitive activities in the textile and electronic-based manufacturing industries that tend to dominate SEZs.⁷ Also, workers often receive below-minimum wage rates to ensure that SEZ labor costs remain competitive. In some countries, labor migration to support SEZs undermines social protection of workers. In other cases, child labor proliferates, illnesses, injury and death rates climb, human trafficking expands to supply the rising sex trade, and crime rates increase.

2.2.5. *Environmental impact.* SEZs are frequently associated with problems of pollution that cause degradation of the environment and exacerbate health problems of the local population. Lower environmental standards are often applied within SEZs to attract investment or simply because of inadequate government capacity to effectively monitor and enforce standards. Environmental degradation and oversight are especially pervasive in SEZs because rapid growth and insufficient infrastructure regularly generate large increases in waste and environmental damage.

2.2.6. *Race to the bottom.* Rising competition among countries to attract FDI can lead governments to offer greater incentives to multinational companies than they could obtain in neighboring countries. This phenomenon creates a 'race to the bottom' as different countries compete with each other to offer greater incentives to multinationals. Downward spiraling labor costs and upward spiraling trade preferences and fiscal incentives are not sustainable and can instigate further distortions. In reality, the success of SEZs has been less due to those incentives than to their ability to provide serviceable

² J.P.S. Boyenge, "ILO Database on Export Processing Zones, Revised." Working Paper, ILO, Geneva, 2007. Available: www.ilo.org/public/libdoc/ilo/2007/107B09_80_engl.pdf.

³ D.Z. Zeng, "Building engines for growth and competitiveness in China: experience with special economic zones and industrial clusters". Washington, DC, World Bank, March 2010.

⁴ D.Z. Zeng, "How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development?". Policy Research Working Paper No. 5583. Washington, DC, World Bank, March 2011.

⁵ A. Ebenstein, "Winners and Losers of Multinational Firm Entry into Developing Countries: Evidence from the Special Economic Zones of the People's Republic of China". ADB Economics Working Paper Series No. 276. Manila, Asian Development Bank, October 2011.

⁶ T. Farole, "Special Economic Zones: What Have We Learned?". Washington, DC: World Bank, 2011. Available: <http://siteresources.worldbank.org/INTPREMNET/Resources/EP64.pdf>.

⁷ V.B. Rawat, M.B. Bhushan and S. Surepally, "The Impact of Special Economic Zones in India". Institute of Development Studies, University of Sussex, April 2011.

industrial land infrastructure and relatively reliable supplies of power.⁸ Long term, sustainable success has also been associated with an integration of SEZs within the country's strategic development plan, improvements in local and regional social and environmental conditions, and the provision of capacity building and training to the workforce as a means of attracting high value added service and manufacturing activities into the region.

2.3. Lessons Learned for the Lao PDR

2.3.1. *Matching SEZs to their contexts.* Special economic zones in the current global and regional environment can play an important part in the Lao PDR's overall economic development plan and the role of the private sector in driving economic growth. Their success, however, will depend on the relevance of the specific context in which SEZs are introduced, along with the effectiveness of the program's design, implementation, and management. At the level of individual SEZs, a flexible regime allows a range of commercial as well as manufacturing activities that can evolve into higher value-added activities such as training and capacity building generates a more skilled workforce in the area. At the national level, flexible legal, regulatory and institutional schemes ensure that adequate supervision can evolve over time as institutional capacities improve and the SEZ program matures.

2.3.2. *Mainstreaming the SEZ program.* It is unlikely that investment will be attracted to the models that originally characterized SEZs in Latin America and other East Asian countries. They were based on unsustainably low labor costs, preferential trading arrangements, and fiscal incentives. Instead a successful strategy will require the adoption of a flexible approach to leveraging the Lao PDR's current comparative advantages in a way that allows the SEZ program to evolve over time. Since investors' attraction to SEZs must necessarily be based on the location's comparative advantages, initial activities will need to focus on basic manufacturing activities that require relatively unskilled labor. As training and social infrastructure improve workforce standards, service-based industries and high value-added manufacturing activity will be increasingly attracted into the area. That process will, however, require an active and fully integrated master plan and appropriate institutional capacity that supports the transformation of the area to high-value activities in a manner that is socially and environmentally sustainable.

2.3.3. *Strategy and Action Plan.* The National Committee for Special Economic Zone (S-NCSEZ) has recently established a strategy (in Lao only), which promotes three types of SEZs associated with (a) border zones focusing on services and tourism; (b) zones located in remote area to strengthen links to urban and commercial centers; and (c) agricultural and mineral processing areas. Having determined the results that are to be achieved, the S-NCSEZ will next need to establish the mechanism or action plan for implementing that strategy. One possible area of high-value specialization is to evolve border zones into logistics hubs, along with light manufacturing and agro-industrial processing centers. The country is strategically positioned to serve as a logistics hub servicing intermodal systems that support not only trade of the Lao PDR, but also that of Thailand, China, Vietnam and those countries' major shipping ports to overseas markets. Through the efforts of the ADB and other Lao PDR development partners, considerable work is underway provide the institutional capacity, infrastructural facilities and legal and regulatory environment for facilitating trade. What is needed now is a clear action plan on how to transform the border zones into intermodal transport and logistics hubs that can provide high value added for the economy.

3. BUILDING LAO PDR'S CAPACITY TO DEVELOP SEZs

3.1. Overview of the TA

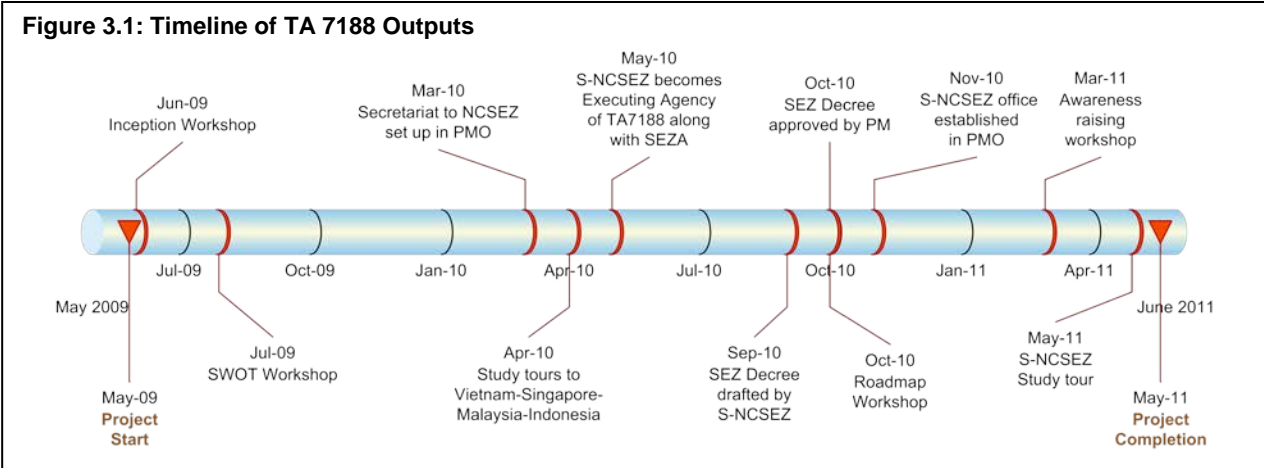
3.1.1. *Overview. Introduction.* The technical assistance project on *Building Lao PDR's Capacity to Develop Special Economic Zones* (TA 7188) was approved in November 2007 and implemented between mid-2009 and mid-2011 with the aim of encouraging and strengthening local capacities and

⁸ T. Farole, "Special Economic Zones in Africa: Comparing Performance and Learning from Global Experiences". Washington, DC: World Bank, 2011. Available: <http://issuu.com/world.bank.publications/docs/9780821386385>.

the country’s overall SEZ regulatory environment. It initially envisaged the building of the Lao PDR’s capacity to develop SEZs by focusing on the Savan-Seno Special Economic Zone (SSEZ) along the Savannakhet portion of the GMS East-West Economic Corridor (EWEC). It intended to promote the Savan-Seno SEZ Authority (SEZA) as a future national SEZ organization and help prepare a national SEZ decree. The end result of these efforts was that in October 2010 the national SEZ decree (No. 443/PM) was approved, and in December 2010 a National Committee for Special Economic Zone (NCSEZ) was established in the Prime Minister’s Office (PMO). The establishment of a national regulatory and institutional framework for SEZs led to an expansion of the TA’s scope from that of capacity building at the provincial level to that of supporting the country-wide NCSEZ and line ministries involved in regulating SEZs throughout the Lao PDR. At present, there are 5 officially endorsed SEZs, another 5 that are under negotiation, and 11 that are under consideration.⁹

3.1.2. **Outcomes.** Implementation of the TA began in June 2009 with the objective of achieving four major *outcomes*: (a) an improved SEZ management and institutional capacity; (b) the establishment of an investment promotion network and the conduct of other promotional activities; (c) the identification of supply-chain business opportunities to be targeted; and (d) an improved policy, legal and regulatory framework for SEZ.¹⁰ This chapter examines the first three outcomes, and the next chapter analyzes achievements for the SEZ legal and regulatory framework.

3.1.3. **Outputs.** The *outputs* required under the TA were as follows: (i) a detailed analysis of strengths, weaknesses, opportunities and threats (SWOT) of existing SEZ-related policies, legal and institutional arrangements for achieving robust and sustainable socioeconomic development; (ii) a review and analyze of the policy, legal and institutional arrangements on SEZs; (iii) the formulation of a results-oriented national SEZ roadmap for a medium-term SEZ strategy and action plan for the Lao PDR; (iv) the preparation of an SEZ law consonant with exiting investment-related laws; (v) the preparation of a set of SEZ operational manuals outlining the step-by-step process and procedures for managing, negotiating and promoting SEZs; (vi) the preparation of a training manual for government officials and potential investors; (vii) the establishment of an SEZ resource center; (viii) on-the-job training of government officials on how to manage, negotiate and promote SEZs; (ix) a study tour to the PRC, Malaysia, Vietnam and Thailand on SEZ management, negotiation and promotion; and (x) the implementation of training modules and workshops on SEZ management, negotiation and promotion.



3.2. Evaluation of Outputs and Outcomes

3.2.1. **Outputs.** Figure 3.1 presents the timeline of the TA’s outputs. They consisted of (a) the submission of the SWOT analysis report to the ADB and a dissemination workshop in June-July 2009; (b) establishment of the NCSEZ and its Secretariat (S-NCSEZ) in March-May 2010; (c)

⁹ The officially endorsed SEZs are the Savan-Seno SEZ, the Borten Dankham SEZ, the Golden Triangle SEZ, the Phoukhyo Specific Economic Zone, and the Vita Park (Vientiane Industrial and Trade Area).
¹⁰ ADB, “ Lao People’s Democratic Republic: Building Lao PDR’s Capacity to Develop Special Economic Zones”. Manila, Asian Development Bank. Technical Assistance Report, Project number: 42032-01, Capacity Development Technical Assistance (CDTA), November 2008. These four outcomes are also specified in the Project Information Document for TA 7188 on the ADB online database. See <http://pid.adb.org/pid/TaView.htm?projNo=42032&seqNo=01&typeCd=2>.

completion of the NCSEZ draft strategy; (d) completion of the draft NCSEZ decree and its approval by the Prime Minister in September-October 2010; (e) study tours and training in April 2010 and March-May 2011; (f) publication of a training manual for NCSEZ's administration; (g) establishment of NCSEZ website; (h) installation of information technology (IT) equipment; and (i) completion of One Single Service (OSS) guidelines. A Public Private Partnership (PPP) report was also prepared to address limited financial resources on the parts of the GoL and private sector, and recommending the establishment of a Joint Venture (JV) Company between the GoL and the private sector to develop SEZs.

3.2.2. *Outcome for SEZ capacity building*

Background. Capacity building consisted of study tours to ASEAN SEZs and training modules for officials. In March-April 2010 a study tour was conducted by eight Lao officials to nine SEZs in Vietnam, Singapore, Indonesia and Malaysia, and in May 2011, another study tour took place in Thailand to several SEZs with 31 S-NCSEZ staff members. There were five SEZ-related training modules provided to SEZ-related officials during the TA's implementation period. Training included an English language module and another one on information technology. For promotional activities, the S-NCSEZ website www.sncsez.gov.la was launched in May 2011.

Capacity building assessment. Notwithstanding progress made under TA 7188 for strengthening the capacity of S-NCSEZ staff, there remains considerable room for improvement to bring the Secretariat up to international standards. To achieve those standards, there is a need for continued training in English and Thai-based programs covering SEZ management, single stop services, SEZ selection and assessment procedures, environmental and green area management, information technology, negotiating skills, accounting and auditing, and monitoring and evaluation (M&E) techniques and procedures. The final TA report also recommends study tours for a wider range of SEZ-related officials, and possible on-the-job training lasting 2-3 weeks for officials should be conducted at the Industrial Estate Authority of Thailand (IEAT).¹¹

3.2.3. *Outcome for SEZ promotional activities*

Background. The major TA's major milestone for promoting SEZ was the creation of the www.sncsez.gov.la website for the S-NCSEZ. The inputs for this area of the TA consisted of website training in basic web development; and network server and file administration related to network and file server systems, wireless routers and the internet. Other promotional activities included a road show to coordination with the ASEAN-Japan Center, which promotes ASEAN trade, investment and tourism; and a March 2011 workshop organized by S-NCSEZ for attracting investors and developers.

Assessment of promotional activities. At present, the NCSEZ website remains static and with limited interest to potential investors. Some of the major issues are lack of investor-oriented focus of the material presented in the web site, a low-tech promotional video in Lao about Lao tourism, the central planning committee, and a perspective that lacks emphasis on a transparent, market oriented system. The web site itself has broken links or erroneous links (e.g., 'Promoting Investment > Technical Guidelines' that take the user to the Home Page; other links take the user to the wrong page (e.g., 'SEZ > Newly Proposed Zones' takes the user to the same page as 'Promoting Investment > Investor', which lacks any useful information). Given the state of today's sophisticated web page designs and their low design costs, it would be advisable to redesign the site to better target potential investors. More generally, further outreach activities will need to be implemented in the near future to attract investment in what is likely to be an increasingly competitive environment under the present global economic situation. In addition to the GoL's need to provide favorable investment terms relative to those of neighboring countries, the final TA report recommends that a road show take place in 2012 to promote investments Lao SEZs to investors from Thailand, Singapore and possibly Japan. There are also numerous opportunities in trade shows that are regularly held in the Lao PDR and neighboring countries.

3.2.4. *Outcome for Supply Chain Business Opportunities.* The TA made little progress in identified supply chains business opportunities to be targeted. A capacity building workshop was held in March 2010 on 'Production Chain Analysis'. No other activities in this area appear to have been undertaken. The Lao National Committee for Special and Specific Economic Zone would benefit from a

¹¹ Asian Development Bank, "ADB TA No: LAO-7188. 'Building Lao PDR's Capacity to Develop Special Economic Zones'. Final Report". June 2011.

better understanding of the types of business that could be attracted to SEZs, clustering methods that add value and promote competitiveness in SEZ, and strategic approaches to linking SME to large enterprises to network activities and attract investment in SEZs. TA 7188 provided some basic information about mechanisms for identifying supply chains business opportunities that could be targeted by the NCSEZ, specifically through its workshop on 'Production Chain Analysis'. Building on that knowledge dissemination, the next technical assistance should deepen the NCSEZ's understanding about supply chain systems and how to transform them into value chains.

3.3. Impact Assessment

3.3.1. *National Development Context.* TA 7188 was implemented during an important period of structural transition in the Lao PDR. Starting in 2007 mining and hydroelectric power generation became the driving forces of the economy. As a result, the importance of copper and electricity exports grew from a mere 2-4 percent of total export earnings in 2000-2005 to over 60 percent by 2010. The resulting dependence on a narrow production base has made the country highly susceptible to foreign exchange earnings volatility. International copper prices in particular have had large month-to-month variations, ranging as much as from -30 to 26 percent in the last decade. Under Lao PDR's current export structure, earnings volatility of primary commodities now affects almost two-thirds of total exports, while 17 percent of the total are electricity exports and therefore more subject to more earnings stability.¹² Under these circumstances, the challenge is to find ways to sustain the country's high rates of economic growth in the coming years. Since a large proportion of its foreign exchange earnings now originate from finite mineral and electrical energy reserves, the only way to achieve sustainable export growth is through export diversification into dynamic non-resource based activities. Development of new product exports is particularly important in view of the fact that proven copper reserves are expected to last 10 to 15 years, implying that mineral earnings could begin to decline rapidly after 2020.

3.3.2. The GoL has designated SEZs as one of the key instruments for mobilizing substantial foreign and domestic investment in non-resource-based sectors. To this end, TA 7188 was designed to build the capacity of the country to attract foreign direct investment, spur employment, promote development of new technologies, enhance entrepreneurial capabilities, and ultimately provide a model for other SEZs to help diversify the country's economic production base. The impact of these interventions are likely to take 5 to 10 years to fully impact on the Lao PDR's growth and employment in the non-resource sectors.

3.3.3. *Provincial Economic Development Context.* The 7th NSEDP establishes SEZs as a mechanism for ensuring a balance between national, provincial and local development, and thereby reducing existing inequalities between regions. It views SEZs as one of the key mechanisms for local and provincial development to (a) generate economic growth; (b) promotion of exports of goods and services; (c) encourage investment from domestic and foreign sources; (d) create employment opportunities; and (e) develop infrastructure facilities. Provincial Gross Domestic Product (PGDP) is published from time to time, but without any regularity in Savannakhet and other provinces. The Lao Expenditure and Consumption Survey (LECS) is published every 5 years, the most recent of which covers 2007/08.¹³ It contains data on socio-economic indicators at the provincial and district-levels, and will eventually be useful in assessing local and provincial changes that could be associated with the SSEZ when the 2012/13 LECS is prepared. For the time being, impact analysis are likely to be limited to perceptions surveys that are undertaken by NGOs and development partners from time to time. For the Savan Industrial and Commercial Park, a recent ADB report suggests that number of jobs created will be upwards of 5,000 by 2015.¹⁴ Once the 21 factories that have committed to building in Savan Park are fully operational, it is expected that they will employ more than 15,000

¹² Montague Lord, "The Lao PDR Diagnostic Trade Integration Study (DTIS): Resource Exports – Impacts and Linkages". Draft report for the forthcoming Lao DTIS Update. Vientiane, Ministry of Industry and Commerce, Government of the Lao PDR. November 2011.

¹³ For a comparative analysis of Savannakhet socio-economic conditions between 2003/04 and 2007/08, see Montague Lord, "Impact of the EWEC on Development in Border Provinces: Case Study of Savannakhet Province in Lao PDR". Manila, Asian Development Bank, October 2010.

¹⁴ ADB, "Shifting Trade Into High Gear". Manila, 16 December 2011. Available: <http://beta.adb.org/features/shifting-trade-high-gear>.

workers. Spillover effects in the construction, transport and retail sectors are also having large employment and income generating effects.

3.3.4. Provincial Social Development Context. There are a number of social problems associated with most SEZs. They include problems of land concessions, health effects and occupational injuries, and the impact on traditional production and livelihood methods. Industrialization and modernization generates new opportunities for local people, which in turn leads to changes in traditional patterns of production and livelihoods. In the case of Savannakhet, the problems associated with SSEZ have been aggravated by investments in the entertainment and hospitality industries. More people are being attracted into Savannakhet province and specifically into the casino, hotels, guest houses, bars, and other entertainment facilities. Savan Vegas Casino and Hotel is an investment project of Sanum Company, with shares held by the GoL and two Lao investors. The main casino and hotel are located in Nong Deng Village, within the SSEZ. There is also a branch casino near the Mekong River in Savannakhet town. The hotel and casino facilities have, in turn, given rise to public health issues, especially those related to the rate of HIV/AIDS infections in the area.¹⁵ Increased gambling has also brought with it an increasing trend in criminal activities, family conflicts, and separation of families, according to focus group discussions in villages around the casino and hotel facilities.¹⁶ These issues will need to be addressed in the immediate future if the SSEZ is to have a positive impact on Savannakhet province and be a representative model to be emulated in other areas of the country. The S-NCSEZ is planning to issue a decree on casinos, which eventually would be made into a law to regulate casinos. However, enforcement is likely to remain a problem, as is country's ability to remedy the negative consequences of these casinos on the population in surrounding districts.

3.3.5. Provincial Environmental Context. Environmental protection in Savannakhet is not being rigorously enforced, according to a recent UNDP study.¹⁷ The casino and associated hotel does not utilize a waste water treatment system. Untreated water flows immediately along an open wastewater channel located in front of the casino in Nong Deng village where people live and travel. One of the focus groups of the UNDP study complained of the wastewater smells and the physical and mental health effects on people in the area. As industrial investments increase in SSEZ, the impact of processing facilities on local water supplies and their quality will require careful management if the SSEZ is to have a positive demonstration effect on SEZ development in other parts of the country. For new SEZs, applicants are required to submit environmental impact assessments (EIAs) to the S-NCSEZ.¹⁸ For this process to work, the S-NCSEZ will need assistance in developing an effective methodology for EIA to (a) establish the baseline environmental setting in the radius area of the proposed zone; (b) assess the potential impacts of the proposed project components on different environmental components; (c) develop adequate and feasible mitigation measures, for example, through revising project design and layout, working practices, adopting cleaner development mechanism or to mitigate where appropriate to keep residual impacts within acceptable limits; and (d) develop monitoring and other measures as necessary to ensure successful implementation.

¹⁵ For a survey and ranking of social problems, see Nobuko Fujita and Eriko Takahashi, "The Socio-Economic Impacts of the Second Mekong International Bridge", in Nobuko Fujita, *Beyond Logframe; Using Systems Concepts in Evaluations*. Tokyo, International Development Research Institute, 2010.

¹⁶ For details, see UNDP, "Report on Economic, Social and Environmental Costs and Benefits of Investments in Savannakhet Province". Prepared by International Union for Conservation of Nature (IUCN) Lao PDR, and the National Economic Research Institute (NERI), Ministry of Planning and Investment of Lao PDR Vientiane, Poverty-Environment Initiative (PEI) Lao PDR, January 2011.

¹⁷ For details, see UNDP, "Report on Economic, Social and Environmental Costs and Benefits of Investments in Savannakhet Province". Prepared by International Union for Conservation of Nature (IUCN) Lao PDR, and the National Economic Research Institute (NERI), Ministry of Planning and Investment of Lao PDR Vientiane, Poverty-Environment Initiative (PEI) Lao PDR, January 2011.

¹⁸ Secretariat, Lao National Committee for Special Economic Zone, "Special Economic Zone (SEZ) Development and Management In Lao PDR". Lao PDR, Prime Minister's Office, undated.

4. LAO PDR'S STRATEGIC FRAMEWORK FOR SEZs

4.1. Legal and Regulatory Framework for SEZs

4.1.1. **Background.** In July 2009 the National Assembly approved the Law on Investment Promotion. Chapter 5 on Special Economic Zones and Specific Economic Zones covers the establishment guidelines and procedures, the establishment committee's duties, implementation arrangements under the SEZ decree, investment incentives, and the operational and investment guidelines. Subsequent regulations and decrees stipulated implementation modalities of the organization and administration of SEZs. TA 7188 helped to draft the *Decree on Special Economic Zone and Specific Economic Zone in the Lao PDR* (hereafter SPZ decree), which was approved by the Prime Minister in October 2010. It defined the principles, regulations, organization, activities, policies on SEZs, and it identified the management functions of the NCSEZ and S-NCSEZ. The TA also helped to define details about NCSEZ and S-NCSEZ activities in the *Decree on the Organization and Activities of the National Committee for Special Economic Zone* (hereafter SPZ organizational decree), which was approved in December 2010.

4.1.2. **Assessment.** The SEZ decree provides a wide range of implementation activities and channels, but it has a number of shortcomings. It lacks guidelines for SEZs, OSS and PPP. It also lacks safeguards for the environment and the displaced population. SEZ guidelines should cover development plans, including land uses (e.g., green belt, transport and communications, public utilities), types of processing and non-processing activities permitted, possible priorities for SMEs, provisions of physical infrastructure (e.g., water supply, sewage, power supply), and role of the GoL. OSS guidelines should cover specific services provided to investors within SEZ beyond the general establishment of a one stop service currently provided by the SEZ decree. PPP guidelines should specify the roles and participation of the GoL and the private sector in SEZs. Environmental guidelines should cover the environmental impact of the SEZ in the area, while green guidelines should indicate how to optimize energy efficiency, water consumption, waste management, plantation, and use of other renewable or non-renewable resources. Finally, resettlement and compensation provisions need to be detailed, beyond the general provision of compensation of people that are affected by the project that now exists in the SEZ decree.

4.2. SEZ Management and Institutional Framework

4.2.1. **Background.** The TA 7188's original outcome for the regulatory environment aimed to establish the Savan-Seno SEZ Authority as the national SEZ organization. However, when the TA started in June 2009, a national SEZ decree was being prepared with the support of the Japan International Cooperation Agency (JICA). The draft decree proposed that the MOIC be the lead agency to promote SEZs in the Lao PDR, and that a national SEZ Secretariat be created within that ministry. The TA consultants believed MOIC to be an inappropriate choice for the location of the national SEZ authority based on their belief that MOIC focused on the industrial sector and that it excluded other sectors or industries such as 'food-processing, tourism, border trade and other services'.¹⁹ The consultants considered the Ministry of Planning and Investment (MPI) as a possible agency for the national SEZ authority, but in the end it was decided to locate it in the PMO. In September 2009 the NCSEZ was established in the Office of the Prime Minister (chaired by the Deputy Prime Minister and having MPI and MOIC representation), and in March 2010 the Secretariat of NCSEZ was within the PMO.

4.2.2. **Assessment.** The Ministry of Planning and Investment is responsible for promoting, implementing and regulating investments, including overall investment approvals. In contrast, MOIC is charged with all policy and regulatory aspects related to trade, including management and promotion of the production of tradable products. While MOIC's Industry Department handles registration and standards for industrial products, the Trade and Product Promotion Department (TPPD) promotes production and trade of all types of tradable products in the Lao PDR.²⁰ The location of the SEZ authority in the PMO has the advantage of proximity to high level decision-

¹⁹ Asian Development Bank, "ADB TA No: LAO-7188. 'Building Lao PDR's Capacity to Develop Special Economic Zones'. Final Report". June 2011.

²⁰ For example, under the 2006 Diagnostic Trade Integration Study (DTIS) Action Plan and the more recent DTIS Update, TPPD/MOIC has promoted agribusiness, garments, wood processing, and textile handicrafts.

makers. The S-NCSEZ believes that its location in the PMO ensures its ability to work across ministries, and that it can operate under the ‘breakthrough approach’ adopted at the 9th Party Congress in 2011 to developing the Lao PDR economy. However, it prevents the GoL’s management of SEZs from being mainstreamed into other investment promotion mechanisms. Since SEZs are mechanisms for investment promotion, it rightly falls under MPI’s purview, and specifically within its Department of Investment Promotion. Where there is some overlap with MOIC’s mandate to manage production of the country’s tradable products, inter-ministerial coordination could occur in the manner that the GoL is currently encouraging. Indeed, one of the main functions of MPI is to coordinate the GoL’s line ministries in socio-economic development strategies their implementation in all sectors and at all levels of Government. Eventually, consideration could be given to whether the SEZ authority should be mainstreamed under MPI’s investment promotion activities once the ‘breakthrough approach’ has been achieved.

4.3. SEZ One Stop Services

4.3.1. **Background.** Chapter 6 of the Law on Investment Promotion on One-Stop-Service For Investment covers the principles, implementation mechanism, and their location. It establishes three types of One-Stop Services for investors: (1) the One-Stop Service Center in MPI “for investment in concession business and the development of activities in Special Economic Zones and Specific Economic Zones”; (2) the One-Stop Service in MOIC for registration of business enterprises in compliance with the Enterprise Law; and (3) the “special economic zones and specific economic zones for the investment in these zones”.²¹ The Savan-Seno SEZ Authority currently provides limited one-stop services to potential investors in the form of investment licenses.²²

4.3.2. **Assessment.** According to the draft final report on TA 7188, the consultants established OSS guidelines that could be applied to the development of OSS in the S-NCSEZ.²³ However, caution should be exercised in duplicating MPI’s one-stop services for investments, including those directed at SEZs. The interpretation of the Investment Law would appear to indicate that MPI should exercise control over national investment, including those for SEZ investors, who could then be subject to further processing by the one-stop service of a particular SEZ, such as that of the Savan-Seno SEZ Authority.²⁴

4.4. Effectiveness and Relevance of GoL’s SEZ Strategic Framework

4.4.1. **Overview.** In September 2010, the TA 7188 consultants prepared SEZ Strategic Roadmap on how the Lao PDR could utilize SEZs ‘to sustain and optimize economic growth’ over the medium to long term.²⁵ The SEZ Roadmap was intended to form part of a National SEZ Development Plan for 2010-2030. It proposed three phases for the achievement of that objective: *Phase 1: Mobilizing Phase* (2010-2015) focuses on the implementation of the national SEZ institutional structure, capacity building, establishment of SSEZ as a model SEZ for the country, and the selection and implementation of new SEZs. *Phase 2: Growth Period* (2016-2020) accelerates the national SEZ program, building on the lessons from the program’s first phase. Finally, *Phase 3: Maturity Period* (2011-2030) transitions from an incentives-based system to a service-based one, shifting SEZ activities from processing to high-tech and service based industries. While the SEZ Roadmap lacks

²¹ See Chapter 6, Article 44 of the 2009 Investment Law (Government of the Lao PDR, “Law on Investment Promotion”. Vientiane, National Assembly, 8 July 2009).

²² It has not yet coordinated with the tax and customs authorities to provide tax and customs services that would allow clearance for imports and exports in the SEZ.

²³ Asian Development Bank, “ADB TA No: LAO-7188. ‘Building Lao PDR’s Capacity to Develop Special Economic Zones’. Final Report”. June 2011.

²⁴ Chapter 3, Article 21 of the Investment Law states that, “Investors wishing to invest in the concession business shall submit the application to the one-stop-service of the Planning and Investment authority for consideration and then the application will be proposed to the Government or provincial authorities for further consideration”. Chapter 5, Article 43, then states that, “Besides developers, other investors wishing to invest in the Special Economic Zone and Specific Economic Zone shall submit application through the one-stop-service office of the management committee of that Special Economic Zone and Specific Economic Zone for consideration in accordance with regulations”. See Government of the Lao PDR, “Law on Investment Promotion”. Vientiane, National Assembly, 8 July 2009.

²⁵ Asian Development Bank, “ADB TA No: LAO-7188. ‘Building Lao PDR’s Capacity to Develop Special Economic Zones’. Strategic Road Map (Draft)”. October 2011.

output indicators, it does contain a number of broad impact indicators, such as improving the country's 'doing business' ranking, improving the Millennium Development Goals (MDGs), and raising per capita income.

4.4.2. **Effectiveness and Relevance.** The SEZ Roadmap is effective in describing specific activities that would help to develop SEZs in the country, the SEZ institutional framework, and a results oriented framework for the SEZ development plan. It nonetheless lacks a vision, goals, guiding principles and core implementation strategy leading up to outcomes and associated with impact indicators. The absence of a well-integrated structure with that of the 7thNSEDP undermines its relevance to the GoL's development plan. To improve its effectiveness and relevance in forming part of the GoL's overall development plan, consideration should be given to expanding its coverage and content to include the following components: (a) mechanisms for overcoming challenges for private sector development in non-natural resource sectors, and SEZ development complementarities with the 7thNSEDP's strategy and action plan for key targeted areas in regional and local development, development of enterprises, employment and poverty alleviation, and industrialization and modernization; (b) SEZ vision and strategic goals that parallels those of the 7thNSEDP; (c) an action plan whose outputs generate the outcomes necessary to achieve the SEZ strategic goals; and (d) specific actionable areas for the SEZ's implementation modality, promotion channels, and integration mechanisms with the Lao PDR's overall trade and investment strategy under the GoL's NSEDP and Diagnostic Trade Integration Strategy (DTIS) update.

5. FUTURE CHALLENGES, RISKS AND SUSTAINABILITY

5.1. Challenges

5.1.1. **National Development Context.** TA 7188 was implemented during an important period of structural transition in the Lao PDR. Starting in 2007 mining and hydroelectric power generation became the driving forces of the economy. As a result, the importance of copper and electricity exports grew from a mere 2-4 percent of total export earnings in 2000-2005 to over 60 percent by 2010. The resulting dependence on a narrow production base has made the country highly susceptible to foreign exchange earnings volatility. International copper prices in particular have had large month-to-month variations, ranging as much as from -30 to 26 percent in the last decade. Under Lao PDR's current export structure, earnings volatility of primary commodities now affects almost two-thirds of total exports, while 17 percent of the total are electricity exports and therefore more subject to more earnings stability.²⁶ Under these circumstances, the challenge is to find ways to sustain the country's high rates of economic growth in the coming years, while minimizing year-to-year growth variations. Since a large proportion of foreign exchange earnings now originate from finite mineral and electrical energy reserves, the only way to achieve sustainable growth is through export diversification into dynamic non-resource based activities. Development of new product exports is particularly important in view of the fact that proven copper reserves are expected to last 15 to 20 years, implying that mineral earnings could begin to decline rapidly after 2020.

5.1.2. **Context of SEZs in GoL's Growth and Diversification Strategy.** To counter the country's growing dependence on a narrow range of natural resource based industries, the GoL has intensified its efforts to promote non-resource based industries and to encourage the private sector, especially SMEs, to diversify into new and emerging non-resource based activities. To this end, the 7th NSEDP has proposed a strategy for achieving sustainable growth that relies not just on the country's hydroelectric power and mineral extraction industry, but also on private sector-government collaboration to promote investment in the non-resource sector. One of the key implementation mechanisms is the formation of industry cluster groups, wherein businesses working together could design and implement strategic initiatives covering a range of interventions that help to boost the country's export competitiveness. They included improving market linkages, product innovation and branding, development of value chains and improved supply chain management, and support for the development of SEZs.

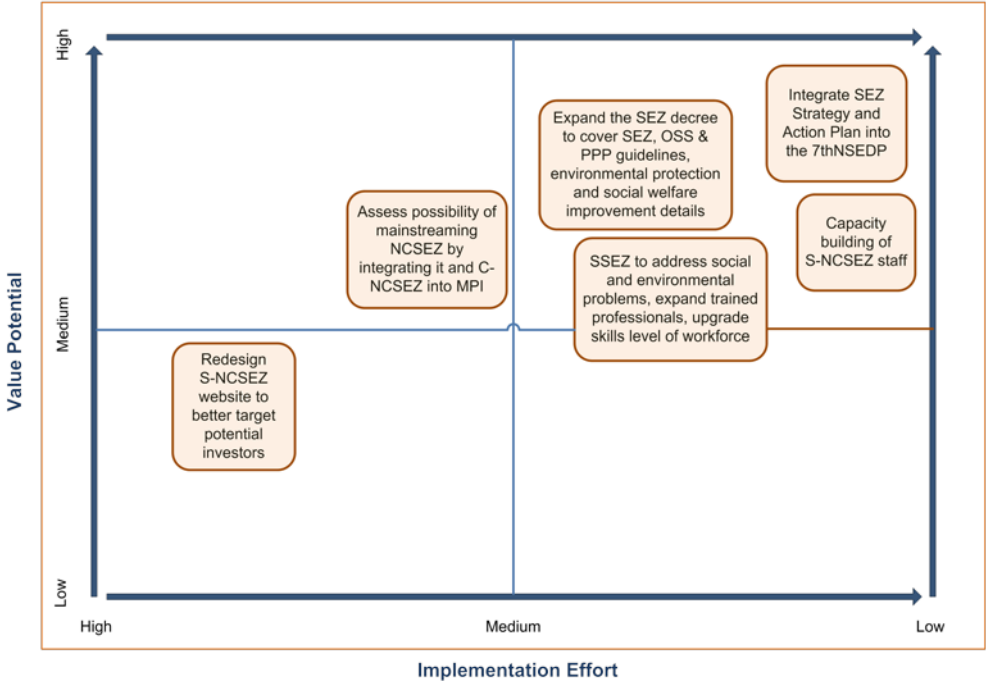
²⁶ Montague Lord, "The Lao PDR Diagnostic Trade Integration Study (DTIS): Resource Exports – Impacts and Linkages". Draft report for the forthcoming Lao DTIS Update. Vientiane, Ministry of Industry and Commerce, Government of the Lao PDR. November 2011.

5.1.3. **Overcoming remaining shortcomings.** The effectiveness of the GoL’s national development plan and its strategy to utilize industry cluster groups that build on SEZ modalities will largely depend on whether a number of shortcomings can be overcome. The previous two chapters have described the most important obstacles that are preventing the GoL from successfully implementing its SEZ strategy and action plan. To overcome those obstacles, the interventions that follow are recommended (see Figure 4.1 for implementation difficulty versus value adding potential to the SEZ program):

1. National SEZ Strategy and Action Plan

- Integrate Lao PDR's SEZ Strategy and Action Plan, along with the Roadmap, into the 7thNSED, building on ‘breakthrough approach’ to focus efforts on realization of NSED's goals.

Figure 4.1: Implementation Difficulty Relative to Value Adding Potential to SEZ Program



- Assess the possibility of mainstreaming the NCSEZ into other national, regional and local investment promotion mechanisms by integrating it and the C-NCSEZ into MPI.
 - Avoid duplication of OSS activities related to SEZs in MPI's OSS center, and limit other agency activities to operations with specific SEZs like that of SEZA.
 - Continue capacity building of S-NCSEZ staff to bring them up to internationally acceptable standards and ensure the competitiveness of the Lao PDR's SEZs with those of neighboring countries.
 - Redesign the S-NCSEZ website to better target potential investors and ensure that the site is in line with today’s sophisticated web page designs.
 - Broaden participation of SEZ-related officials in study tours, including those planned for Thailand, Singapore and possibly Japan.
2. Expand the SEZ decree to cover:
- SEZ guidelines on development plans for land uses, types of processing and non-processing activities permitted, possible priorities for SMEs, provisions of physical infrastructure, and role of the GoL
 - OSS guidelines on specific services provided to investors within SEZ beyond the general establishment of a one stop service currently provided by the SEZ decree.
 - PPP guidelines on the roles and participation of the GoL and the private sector in SEZs.

- Environmental guidelines for the SEZ in the area, and green guidelines on optimization of energy efficiency, water consumption, waste management, plantation, and use of other renewable or non-renewable resources.
 - Resettlement and detailed compensation provisions of the population displaced by the SEZs.
3. Savan-Seno Special Economic Zone (SSEZ)
- Lower transportation costs for goods and business travel.
 - Increase number of airline flights in Savannakhet airport.
 - Improve knowledge base of provincial population.
 - Expand number of trained and qualified professional.
 - Address social problems such as alcohol consumption, trafficking of people, and the commercial sex trade caused by investment in the service sectors.
 - Address conflicts over land associated with investments in the agriculture and forest sector, especially concerning land concessions.
 - Address growing health effects and occupational injuries from SSEZ-related activities.
 - Address changes being exerted on traditional production and livelihoods of local people by SSEZ-related industrialization and modernization.

5.2. The Way Forward

5.2.1. The effectiveness of the GoL's national development plan and its strategy to utilize industry cluster groups that build on SEZ modalities will largely depend on whether a number of existing obstacles are removed. As a minimum, the following interventions are suggested to eliminate the most important obstacles to the SEZ program:

- (a) For the national SEZ strategy and action plan, (a) integrate Lao PDR's SEZ strategy and action plan, along with the roadmap, into the 7th NSEDP, building on its 'breakthrough approach' for focusing efforts to realize the GoL's goals; (b) assess the possibility of eventually mainstreaming the NCSEZ into other national, regional and local investment promotion mechanisms by integrating it and the C-NCSEZ into MPI once the 'breakthrough' approach has been completed; (c) avoid duplication of OSS activities related to SEZs in MPI's OSS center, and limit other agency activities to operations with specific SEZs like that of SEZA; (d) continue capacity building of S-NCSEZ staff to bring them up to internationally acceptable standards and ensure the competitiveness of the Lao PDR's SEZs with those of neighboring countries; (e) redesign the S-NCSEZ website to better target potential investors and ensure that the site is in line with today's web page design standards; and (f) broaden participation of SEZ-related officials in study tours.
- (b) Expand the SEZ decree and strengthen its implementation to cover (a) SEZ guidelines on development plans for land uses, types of processing and non-processing activities permitted based on a negative list approach, priorities for SME involvement, provisions of physical infrastructure, and the GoL's role; (b) OSS guidelines on specific services provided to investors within SEZ beyond the general establishment of a one stop service currently provided by the SEZ decree; (c) PPP guidelines on the roles and participation of the GoL and the private sector in SEZs; (d) environmental guidelines for the SEZ in the area, and green guidelines on optimization of energy efficiency, water consumption, waste management, plantation, and use of other renewable or non-renewable resources; (e) resettlement and detailed compensation provisions of displaced population.
- (c) For the Savan-Seno Special Economic Zone, support activities that (a) improve the knowledge base of the local population; (b) expand the number of trained workers and qualified professional; (c) address social problems such as alcohol consumption, trafficking of people, and HIV/AIDS associated with investments in the entertainment and hospitality industries; (d) address conflicts over land associated with investments in

the agriculture and forest sector, especially land concessions; (e) address the growing health effects and occupational injuries from SSEZ-related activities; (f) address changes being exerted on traditional production and livelihoods of local people by SSEZ-related industrialization and modernization.

5.3. Where ADB Should be Involved

5.3.1. TA 7188 enabled the Lao PDR to make significant progress towards a proactive investment environment in SEZs. It contributed towards spearheading initiatives in demonstration areas that can now serve as catalysts for country-wide economic policy reforms conducive to investments and trade. For the ADB, three guiding principles are recommended for the SEZ program's next phase:

- (1) First, a key priority should be ground-based operations of existing and new zones, with an increased focus on implementation of reforms and follow-through of activities at a level that directly stimulate private sector development and skills improvements of the local workforce.
- (2) Secondly, even with fairly large ADB assistance, outcomes and impacts are likely to be higher with a scope and agenda that is narrower than that of TA 7188 since it will allow a deeper focus on key strategic initiatives aimed at producing well-defined results in terms of the implementation of regulatory measures and the promotion of investment at localized levels.
- (3) Finally, SEZs present tremendous opportunities for accelerating investment in value-added activities that could support local workforce training and social infrastructure both for improving livelihoods and for transitioning SEZs to higher value activities that help diversify and grow the economy in non-resource based products and services. Skills development and training of the local workforce would help to shift the type of investment inflows from those that rely on unskilled labor and natural resource intensive activities to those that utilize skilled and capital intensive ones, as well as concentrating production on higher value-added service sector activities in such areas as information and communication technology (ICT), business support services, knowledge-based activities, and research and development (R&D).

5.3.2. These guidelines suggest that the ADB's next SEZ program phase should focus on the following three activity grouping:

- *Localized Zone Support* – Target SEZ assistance to those having large, demonstrable impact for others to follow. Key interventions would include interventions to (a) promote public-private partnerships (PPPs) to address capital constraints and to contribute to the public sector catalytic role for a private sector driven investment growth; (b) integrate the ADB's support to SMEPDO's Business Development Services (BDS) into efforts in SEZs to develop SME business support services for larger companies operating in the zones; (c) address district-level social problems created by zone-related activities, conflicts over land concessions, health effects and occupational injuries, and changes being exerted on traditional production and livelihoods of local people by modernization; (d) establish environmental guidelines for zones and enforce compliance with environmental impact assessments that are in line with international standards; and (e) create localized benchmarks for measuring outcomes and impacts from SEZs.
- *Transform SEZs to High Value Adding Zones* – Establish the conditions that will allow zones catering to stand-alone investments to shift to integrated activities of 'next generation' zones that cater to high value-added or knowledge-intensive activities with increased specialization of facilities in a cluster environment having a range of networked support services. Key interventions would include (a) S-NCSEZ training on value-chains and their clustering in zones; (b) skills upgrading in specialized zone activities through formal training and apprenticeship programs; (c) design strategy for making timely adjustments to relevant policies and regulations based on business needs and market conditions, as well as on development stages of zones in the country.

- *Policy and Regulatory Framework* – Coordinate and harmonize SEZ-related public policy and the regulatory environment in order to establish a conducive and unified investment climate for localized zones, including the strengthening of institutional capacity. Key interventions would include (a) building on Lao PDR's new SEZ strategy, develop a detailed timeline for SEZ action plan supporting the 7thNSEDP; (b) continue capacity building of S-NCSEZ staff to bring them up to internationally acceptable standards and ensure the competitiveness of the Lao PDR's SEZs with those of neighboring countries; (c) upgrade media campaigns to target potential zone investors.

5.4. Risks

5.4.1. There are several critical risks involved in SEZ policies and regulations needed to achieve the GoL's stated objectives of inclusive, private sector led growth. These risk factors and their associated risk-mitigation strategy are as follows:

- *Political risk (risk level: low)* - While the overall economic development plan and the proposed SEZ strategy will potentially increase economic growth for the country, it will require transparency, accountability, and dedication on the part of government institutions. Yet the 2011 Investment Climate Report for the Lao PDR finds that transparency in permits, licenses and taxes for investment and business operation remain the key growth constraints for the country.
- *Risk to achieving goals (risk level: low)* – Possible weak GoL commitment to SEZs could undermine progress in trade and investment interventions. Moreover, the global economic crisis could weakened trade and cross-border investments, and possibly raised protectionist barriers and severely limiting foreign capital movements into less investment attractive provinces like Savannakhet.
- *Capacity risk (risk level: medium)* – Limited Capacity of SEZ administration and One Stop Service (OSS) to properly manage and promote investments either at the provincial level such as the SSEZ or the national level through the NCSEZ.
- *Coordination risk (risk level: high)* – Inter-agency coordination and collaboration continues to be a challenge in general, and for investment and trade-related activities in particular. These difficulties have continued to substantially increase the coordination risks for SEZ-related activities. Lack of coordination has prevented SEZs from being mainstreamed into the day-to-day operations of both MPI and MOIC.
- *Risk of ignoring cross-cutting issues on the environment damage and social problems (risk level: high)* - Environment and social are two important cross-cutting issues that arise from SEZs. The most significant environmental impacts of investments in Savannakhet province are negative effects on forests, watersheds and biodiversity. For social issues, in addition to the usual problems of land concessions, health effects and occupational injuries, and the impact on traditional production and livelihood methods, the problems in SSEZ have been aggravated by investment in the service sector.

5.5. Sustainability

5.5.1. Sustainability is an important feature of the GoL's economic development plan under the 7thNSEDP. If SEZs are to contribute to that goal, they will need to ensure that there is sufficient commitment in GoL support, financing, capacity building, and private sector involvement.

- *Political will and commitment:* The GoL has shown a strong willingness and commitment to promoting a private sector driven expansion of investment in non-resource sectors. The SEZ's contribution to that process has been highlighted in the 7thNSEDP and the DTIS update. To ensure its continued participation in the process, it will be important to address the negative issues associated with SEZs and overcome the key remaining shortcomings in the current national SEZ regulatory environment and the implementation of the GoL's SEZ strategy and action plan.
- *Long-term capacity building:* TA 7188 has aimed to build the long-term capacity of the Lao PDR's trade-related institutions. This process assumes that the transfer of knowledge and skills taking place from international experts to national experts and the institutional capacities will be gradually strengthened and built through the knowledge-sharing process.

- *Institutional sustainability*: Mainstreaming SEZs into the GoL's investment and trade strategies are essential to their success. In order to accomplish this objective, consideration will need to be given to the location of the NCSEZ within the governance structure of the GoL. Since MPI is the lead agency for investment promotion activities, it could be advantageous to incorporate the national SEZ authority with other activities of MPI's Department of Investment Promotion.
- *Financial sustainability*: Financial sustainability refers to the ability of some, if not all, SEZ interventions to generate sufficient funding to continue operations and expand activities in other areas of the country. The current SEZ concept framework recognizes that neither the GoL nor the private sector has sufficient resources to embark on the type of infrastructural investments that will propel SEZs to sufficiently high activities needed in the non-resource sectors. For that reason, GoL-private sector collaboration has become the primary mechanism for driving SEZs activities in the country.
- *Environmental and social sustainability*: For the Lao PDR, the social and environmental impact of SEZs is the two key cross-cutting issues in the design and implementation of the national SEZ strategy and action plan, along with the associated SEZ roadmap. In Savannakhet, these issues have become all the more important because of its model role and demonstration effects for other areas of the country. As such, the action plan and roadmap needs to incorporate the specific social and environmental issues that are affecting the SEZ's potential demonstration role by the GoL to ensure that all the activities produce positive results for the environment and the people in the province.