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POST-“NORMAL” TRADE: NTR and the Next Steps in U.S.-Lao Economic Relations

Three years have passed since Congress restored normal economic relations between the U.S. and Laos. The decision, embodied in the ratification of the U.S.-Laos Bilateral Trade Agreement in 2005 and the Presidential proclamation of Normal Trade Relations in February 2005, was the final step in restoration of normal diplomatic and economic ties with Vietnam, Cambodia and Laos—and of course the first step in development of a modern economic relationship between the United States and Laos.

To date, the data reveal a relationship that can be interpreted in two different ways, and point the way to some of the next steps.

The US-Lao economic relationship remains small—not only in the world of American trade and investment, but in Laos’ external relationships. At about \$15 million in 2006, US-Lao trade remains well below U.S. trade with most other ASEAN member; and also below trade with Nepal and Mongolia, the other two land-linked Asian states with comparable economies. The United States takes less than three percent of Laotian exports, and accounts for barely one percent of Laos’ roughly \$2 billion in foreign trade. And American investment in Laos likewise remains small, limited to a few individuals and industries, and accounting for about \$15 million in licensed projects out of a \$4.8 billion total.¹

But the still relatively small totals disguise some very positive trends. U.S.-Lao trade is growing more rapidly than American trade with most other ASEAN states, and stands in sharp contrast to falling total trade with Mongolia and Nepal. Investment totals remain low, but a number of small firms run by Laotian-Americans are exploring opportunities in a range of services industries, evidence of potential for exchange led by Laotian-American communities. Finally, the imposition of quota limits on Chinese clothing until 2009 offers clothing factories based in Vientiane, which now account for most of Laos’ exports to the US, space to grow and develop long-term relationships with their customers.

The grant of NTR has thus created a foundation for US-Laotian economic relations which is growing rapidly and has considerable promise for the future. Three years of experience also give the two governments, businesses, and NGOs interested in trade as a tool for development and poverty reduction the opportunity for an active and productive policy dialogue. This could focus on four areas:

- Full implementation of the U.S.-Laos Bilateral Trade Agreement;
- U.S. legislation to give Laotian goods tariff parity with those of other Least-Developed Countries;
- Concluding Laos’ accession to the World Trade Organization.
- Trade and investment promotion, including Laos’ export-promotion programs, building ties with large-scale American buyers of Laotian-made clothing, and developing relationships with Lao- and Hmong-American businesses.

I. OVERVIEW

Before turning to these points in more detail, a quick look at the larger environment is probably helpful.

Since approval of NTR, Laos' economy has been healthy and growing. The Asian Development Bank estimates national economic growth rates at 7.2 percent per year since 2005; IMF data show Laos' exports nearly doubling from \$370 million in 2004 to \$700 million in 2006.ⁱⁱ Laos' per capita income has accordingly risen by 50 percent since 2001, from \$322 to \$491ⁱⁱⁱ. And figures published early in 2007 by the U.S. Embassy, meanwhile, suggest a steady if small rise in foreign direct investment, from \$5 million a year around the turn of the century to \$27 million.

These figures should be taken with some care, however. The ADB suggests that most of Laos' growth in recent years has been driven by gold and copper mining, rather than development of urban industry or agriculture. This implies that much of the jump in exports and per capita income mostly reflects higher prices for wood and metals, driven by Chinese industrial demand, rather than actual increases in export volume accompanied by job creation and rising farm incomes. A reversal in world commodity markets, therefore, could easily damage Laos' growth and investment statistics; and more generally, development based principally on natural-resource investment and exports, if not balanced by sophisticated regulation and growth in other sectors, can have some negative environmental and distributional consequences.

On a policy level, Laos has been engaged in an ambitious set of complementary trade policies which can help to avert such consequences. These are designed to secure the country's economic place in Southeast Asia through membership in ASEAN and participation in the ASEAN Free Trade Area, reach larger markets through logistical agreements with neighboring Thailand and Vietnam that allow Laotian manufactures and farm products to reach ASEAN ports easily and cheaply, and join the World Trade Organization.

Normalization of trade relations with the U.S., through the Bilateral Trade Agreement signed in 1997 and ratified in 2005, should be seen in the context of this larger effort to secure for Laos a place in the global economy. Official data and anecdotal accounts now suggest that NTR is taking hold.

II. TRADE AND INVESTMENT SINCE NTR

Laos' challenge in developing American export markets is greater than was the comparable challenge for Cambodia in 1996 and Vietnam in 2001.

Laos did not receive NTR until 2005, a decade after normal trade resumed with Cambodia, and more than three years after Congress granted Vietnam annually renewed NTR status. Vietnam and Cambodia are therefore already well-established as suppliers to the United States and competitors with Laotian farms and factories; and Cambodia's early successes were facilitated by textile quotas that limited imports from China, India, Pakistan, Bangladesh and other larger Asian states but were abolished in 2006. As a non-WTO member, Laos also faces some disadvantages in dealing with possible investors and customers. And Laos' inland geography, of course, means lack of a national port, higher transport costs, and less developed road networks.

But the approval of NTR is nonetheless beginning to show some clear and positive effects.

Trade: Nearly three years after the approval of NTR, trade remains low in absolute terms, but is growing rapidly – in percentage terms, in comparison to the comparable figures for peer countries, and especially in terms of Laos' exports to the United States.

In total dollars, US-Laotian trade totaled roughly \$15 million in 2006.^{iv} This is only a modest increase from the \$10 million total in 2004. But when measured by the rate of growth, Laotian exports to the US appear quite strong: America's imports of Laotian-made manufactured goods more than doubled in 2006, from \$4.3 to \$8.7 million.

Without NTR, Laos remained free to export tropical and natural resource products – raw logs and tropical wood, metal ores, coffee – which remained largely free of tariffs even without NTR status. It was essentially unable, though, to export the light manufactured goods that other Southeast Asian countries have used as the first steps in industrial development. These goods, especially clothes, are now the bulk of Laos' exports to the U.S.

In percentage terms, Laos is now ASEAN's fastest-growing exporter to the United States, and also the fastest-growing exporter among Asia's least-developed countries. Especially striking is the contrast between rapid growth in imports from Laos on one hand, and falling imports from Mongolia and Nepal on the other. In all three cases, clothing accounts for most of the trade, meaning that all three countries are contending with intense garment-industry competition after the 2005 abolition of the U.S. textile quota system. But Laos is evidently succeeding even as Asia's other two land-linked clothing exporters struggle.

COUNTRY	2005 EXPORTS	2006 EXPORTS	CHANGE 2005/06 ^v
Laos	\$4 million	\$8.7 million	109%
Vietnam	\$6.52 billion	\$8.46 billion	30%
Cambodia	\$1.77 billion	\$2.19 billion	24%
Asian LDC's	\$4.81 billion	\$5.74 billion	19%
ASEAN	\$98.4 billion	\$111 billion	12%
<i>World</i>	<i>\$1.66 trillion</i>	<i>\$1.85 trillion</i>	<i>11%</i>
Afghanistan	\$15 million	\$13 million	-9%
Nepal	\$110 million	\$99 million	-11%
Mongolia	\$144 million	\$114 million	-21%

By contrast, U.S. exports to Laos have so far not begun a consistent rise. Instead they remain volatile, heavily affected by single purchases of capital goods. (In 2005, U.S. exports to Laos rose from \$5.5 million to \$9 million, and then fell back in 2006 to \$5.7 million. The apparent surge in 2005 came from single large orders of information technologies, plus the delivery of an airplane. The apparent drop in 2006 likewise reflects the absence of these single large orders rather than an overall decline.) This may reflect slow implementation of some of Laos' commitments under the BTA, or simply a lack of attention so far by American exporting businesses.

Investment: Laos' annual foreign investment inflows rose about six-fold, from \$4.5 million to \$28 million, between 2002 and 2005. The value of "approved" but not realized investment projects is vastly higher—\$2.7 billion in 2005—reflecting possibly heavy future foreign investment in hydro-electric power project and copper and gold mines. American investors to date have played a relatively small role in this, but an interesting one.

As of 2005, the Laotian government had approved 14 American investments—more than any western country but France and Australia, with a value of \$15 million. Some investment from other countries, though the level is hard to quantify, is designed to serve the American export market. In all, investments by U.S. firms or with U.S. markets in mind fall into three categories.

- First, accounting for most of Laos' exports to the United States, is the garment business. Vientiane has attracted about 30 garment factories, owned by Korean, Taiwanese and Thai firms, of which seven were exporting to the United States as of late 2006. These factories now employ about 27,000 people, or about a tenth of Cambodia's 300,000-strong garment workforce. Their main customer seems to be the apparel company Benetton, which prefers small orders of high-quality products.
- Second, investment by small businesses owned by Laotian-Americans. Companies from Wichita, Virginia, Minnesota and California have visited Vientiane and Luang Prabang, individually and as part of larger delegations, to discuss long-term investment opportunities. Most of these are service providers rather than import-export firms. Examples include a construction firm building dormitories at the Vientiane campus; hotel and restaurant management businesses in Luang Prabang and Vientiane; another construction firm interested in construction of homes for Laotian-American retirees interested in spending part of their retirement in Laos; warehousing operations at Savannakhet to serve truckers transiting between Vietnam, Laos and Thailand; and an investor hoping to supply mobile phone contracts.
- Third and finally, a few very large companies have shown interest in participation in natural-resource projects. The largest of these are gold mining operations and construction work associated with the Nam Theun 2 dam on the Mekong River.

III. NEXT STEPS

The data therefore show a rapidly growing relationship with larger potential for the future, especially if the two governments and other interested parties work together to promote it. The main areas for discussion might fall into four categories.

1. BTA Implementation

One is implementation of the US-Laos Bilateral Trade Agreement.

As with the US-Vietnam BTA, the BTA is a two-way agreement including obligations for both governments. Laos' commitments include some market-liberalization measures, in particular dealing with non-tariff measures, as well as reforms in investment, services policy and customs procedures. These are designed to create a more open and integrated Laotian economy, and serve as building blocks for the process of WTO implementation. These include tariff cuts, abolition of import licenses, customs and trade facilitation provisions, changes in intellectual property laws, and grants of trading rights for Laotian citizens interested in exporting goods, and importing products either as inputs for industry or for sale inside the country.

Implementation of this agreement is a complex task, especially as Laos has relatively few government officials trained in managing international trade agreements and their implementation, and coordination between ministries charged with developing policy and the National Assembly is yet to be fully developed. Implementing some sections of the BTA which might encourage labor-intensive investment (as opposed to investment limited to hydroelectric power and mining) has accordingly been slow. Examples include passage of a law granting national treatment in taxation to foreign investors, and "trading rights" provisions ensuring that both foreigners resident in Laos and Laotian citizens can import goods for sale in local markets and inputs needed for factory production.

2. Possible U.S. Tariff Preference

Second, tariff equity for Laotian goods.

Even with approval of NTR, Laos is still at a tariff disadvantage vis-à-vis many countries producing identical goods. Clothes, now Laos' main export to the U.S., are usually high-tariff products. For example, Laos' three highest-value exports in 2006—women's underwear, cotton T-shirts, and cotton pullover shirts, which together accounted for \$3.9 million of Laos' \$8.7 million in exports—receive NTR tariffs of 7.6, 16.5 and 16.5 percent.

This places Laos' factories in a difficult competitive condition. They must compete with longer-established industries in Cambodia, Vietnam, Thailand and China, and also with about sixty countries in Africa, Latin America and the Middle East which have been exempted from tariffs through the free trade agreements and preference programs. (The African Growth and Opportunity Act and the Caribbean Basin Initiative, plus free trade agreements with Mexico, Central America, Jordan and possibly soon Colombia and Peru.) That is, the same shirts and underwear, if they are made in El Salvador, Haiti, South Africa or Kenya, face no tariffs.

This disadvantage is not insurmountable, but still significant. In 2005, several members of Congress proposed creating a program, known as the "Tariff Relief Assistance for Developing Economies (TRADE) Act," which would exempt Laos and other least-developed countries not already covered by a preference program from most U.S. tariffs. Senators Dianne Feinstein (D-CA) and Gordon Smith (R-OR) re-introduced this bill in February 2007, and will likely soon be joined by several House members. The Laotian and U.S. governments, together with businesses and NGO's interested in helping promote Laos' exports, could make passage of this bill a priority in the course of 2008.

3. Export Promotion

Third, trade facilitation and export promotion. This area is well-suited for development by the Lao PDR embassy in Washington, NGOs, U.S. businesses which are already purchasing Laotian-made goods, and the U.S. Customs Service and Commerce Department. Some options would include:

- Trade facilitation in Vientiane: This can include accelerated revision of customs procedures that, consistent with the BTA, ease flows of goods in and out of Laos, and development of export promotion programs that help Laotian businesses further develop markets for farm products and manufactures in neighboring countries.
- Craft and specialty products for the U.S. market: traditional clothing and crafts, and locally grown rice, coffee, and specialty produce, are well-suited for American “fair trade” outlets which sell village products, and also for Asian markets catering to Thai-, Vietnamese-American and Laotian-American shoppers.
- Closer relations with retail-industry customers. Finally, Laos needs to cement its relationship with larger retail-industry buyers of Laotian-made clothing. The U.S.’ reimposition of quotas on Chinese clothing in 2005 has opened space for countries like Laos to export. The quotas will vanish again, this time for good, in 2009, likely placing additional pressures on exporters in neighboring countries. In the next two years, therefore, the Laotian Embassy and government have an opportunity to place these new relationships on a firm foundation to avoid disruption at the end of the decade.

4. WTO Membership

Finally, Laos has made considerable progress toward membership in the World Trade Organization, and is now entering the decisive phase of the accession process. With Vietnam joining the WTO in early 2007 and Cambodia in 2004, Laos is now the only East Asian country other than North Korea still outside the WTO, and may suffer some considerable disadvantages for this status. Without WTO membership, Laos cannot defend its trade interests through dispute settlement, and is unable to participate in negotiations that can help create new market opportunities in all the major markets – not only the United States, Japan and the European Union but Thailand, Vietnam, China, India and Burma. Concluding the talks will ensure that Laos can defend its rights and play its rightful part in setting world trade policy.

Accession is a demanding process, requiring highly technical reforms in services regulation, intellectual property rights, and other areas. Many forms of technical assistance are available, however, through NGOs, the WTO itself, and WTO member governments. US-Laos dialogue could help identify the areas of greatest need and the programs best suited to addressing them.

CONCLUSION

In summary, after approval of NTR Laos and the United States have a small but rapidly developing trade and investment relationship. Normalized trade relations has encouraged rapid growth in Laotian exports, and the beginnings of an investment relationship as well.

Both have considerable potential to broaden out beyond into much larger relationships in the years ahead, as farm products and crafts join clothing and Laos draws interest not only from major companies interested in large natural resource contracts but small firms that can create urban jobs and long-term partnerships between Laos and Laotian-American businesses. The two governments, as well as private citizens, businesses and NGOs, can choose from a number of complementary options to take this beginning and turn it into a healthy, strong and lasting relationship.

ⁱ *2007 Investment Climate Report, Lao PDR*, U.S. Embassy, Vientiane, December 2006.

ⁱⁱ *Mekong Annual Report*, Asian Development Bank, 2006, at http://www.adb.org/Documents/Reports/Annual_Report/2005/part010600.asp

ⁱⁱⁱ World Bank

^{iv} Trade data are from the U.S. International Trade Commission, at dataweb.usitc.gov

^v Ibid.