SCHOOL OF ECONOMICS AND MANAGEMENT

The New China Syndrome?

A case study of the increasing South-South FDI from China to Lao PDR

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Abstract

The view of FDI and its impacts has shifted throughout history. In conjunction with globalization and liberalization, new opportunities have emerged which have allowed FDI, in its current state to flourish across the globe. South-South FDI has emerged as a cross-border investment of developing and transitional economies to create lasting links with economies of similar structures. The purpose of this study is to explore the South-South FDI relationship between Laos and China since Laos' economic liberalization in 1986. Chinese South-South FDI in Laos has seen a vast increase in the past decades, which has spurred the export of Laos and its economic development. As Laos aims to continue to fuel its economic development through FDI, utilizing it as a catalyst to support its export-led growth, this study also aims to examine the trends of trade and patterns from the same point of take-off. This study was conducted using a mixed-methods approach to provide a holistic and panoramic view of the relationship. The findings of the studies were analyzed using the conceptual frameworks of New Structural Economics and the role of FDI. Through the analytical discussion, the study suggests that a more skeptical or dirigist approach towards FDI is essential by the host government to achieve structural change and continues prosper development. Due to its nature, lack of diversification and ineffective enforcement is vital to thoroughly weigh the for and against argumentations of the current situation to adjust policy accordingly. To secure the economic base for the Laos economy, it is suggested to further diversify the FDI in Laos, to continuously improve industries across sectors to allow for the utilization of the country's natural endowment for its economic development in the long run.

Keywords: *Laos, Lao PDR, China, People's Republic of China, foreign direct investments, trade impact, trade patterns, South-South foreign direct investments*

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List of abbreviations

ACFTA ASEAN-China Free Trade Agreement

ADB Asian Development Bank

AFTA ASEAN Free Trade Agreement

ASEAN Association of Southeast Asian Nations

CPC Communist Party of China

FDI Foreign Direct Investment(s)

GDP Gross Domestic Product

HCI Human Capital Index

IMF International Monetary Fund

Lao PDR Lao People's Democratic Republic

LRPD Lao People's Revolutionary Party

LDC Less Developed Country

NEM New Economic Mechanism

NSE New Structural Economics

NGPES National Growth and Poverty Eradication Strategy

OECD Organisation for Economic Co-operation and Development

PRC People's Republic of China

RCA Revealed Comparative Advantage

SEZ Special Economic Zone

UNCTAD United Nations Conference on Trade and Development

WITS World Integrated Trade Solution

WTO World Trade Organization

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1. Introduction

South-South foreign direct investment (FDI) has increased both in its occurrence and in its importance across the globe (Lipsey & Sjöholm, 2011, pp. 1, 30). In 2017, half of the top ten investors of FDI in the less developed countries (LDCs) came from emerging economies in Asia (UNCTAD, 2019a, p. 69). The People's Republic of China[1] (PRC) functions as a major powerhouse within FDI, almost doubling its FDI stock between 2013 and 2017 (UNCTAD, 2019a, p. 69). In the past decades, China has turned to developing countries to fuel their growing demand for raw materials (Lu & Schöwenger, 2017, p. 63; Frost, 2004), shown by the 45% of their annual FDI outflows going to three LDCs in Southeast Asia; Lao People's Democratic Republic (Laos) (6,7 billion US$), the Union of Myanmar (5,5 billion US$), and the Kingdom of Cambodia (5,4 billion US$) (UNCTAD, 2019b, p. 69). One country which has now become a major recipient of Chinese FDI is Laos (ASEAN, 2019, p. 12).

The small, poor, landlocked country in Southeast Asia mainland saw liberalized reform in the 1980s and has since then transcended from the tight grip of communist rule. In recent decades, Laos has turned to FDI as one of the main sources for their development (Kyophilavong et al., 2017a). Laos's primary commodity sector is of major interest for Chinese investors, and where 70% of the Chinese FDI is winding up. Alongside the influx of Chinese FDI, Laos has also seen a larger Chinese presence within its imports and exports, primarily as an export destination of primary commodities. The effects of FDI are disputed at large and in the case of South-South FDI the research is still very limited. Thus, the path of FDI and export-led growth which Laos is on could have unpredictable consequences.

[1] Hereinafter referred to as China.

Image 1. Map of Laos.

Source: © Google Maps 2020

1.1 Relevance

Since the 1970s, there has been a global shift in the attitudes toward FDI, both from the perspective of firms and countries (Dunning, 1994, p. 1). More countries have opened up towards the global economy to upgrade the resources and capabilities on a domestic level (Dunning, 1994, p. 1). The attitude towards the cost and benefits of FDI has also seen a change, primarily from the perspective of the investor. Globalization and liberalization, driven by digitalization and improved trade institutions, resulted in an ease of transborder communication, thus reduced transportation costs which, in turn, opened the opportunity for new exploitation of the global markets by investors. After years of critical views on FDI, in the early 1990s governments across the world began to welcome FDI as they saw a need for global and regional integration (Dunning, 1994, pp. 2-3).

In more recent decades, there has been another notable change in the patterns of foreign direct investments (United Nations, 2006). The change has shown that more transnational corporations in developing and transitional economies are now serving as an investor in other developing economies, a phenomenon which is called South-South FDI (United Nations, 2006; Lipsey & Sjöholm, 2011). Despite the financial crisis of 2008, which largely affected FDI outflows from developed countries, South-South FDI saw little change in outflow (UNCTAD, 2009, p. 1; UNCTAD, 2019a; 2019b). This recent surge of South-South FDI is expected to increase additionally in importance and occurrence, thus, there is a need to further explore the phenomenon as a route to finance the development and growth of economies.

1.2 Case

Since the implementation of more liberalized economic policies in 1986, Laos has seen a large increase in the influx of FDI (Kyophilavong et al., 2017a; 2017b; Bourdet, 2000, p. 1). More recently, the inflowing FDI is now led by developing or transitioning nations in the region. China is by far the largest contributor of South-South FDI into the country at a staggering 79% in 2018 (Statista, 2018). Simultaneously, Laos has also seen substantial growth in its economy in the past two decades, averaging a gross domestic product (GDP) growth rate of 7,7% (Kyophilavong et al., 2017a, p. 218). Part of the government's plan to alleviate poverty in the country and ascend from a low-income status country is through the promotion of FDI and export-led growth. This plan is largely funded through South-South FDI from Chinese investments to transfer technology and mitigating capital shortages (Kyophilavong et al., 2017a ; The Ministry of Foreign Affairs- Lao PDR, 2004, p. 13). The country proposes to fuel its continued growth through FDI within natural resources aimed for export, thus, through export-led growth. Hence, the recent trends of trade are also of interest, especially the changed importance of Chinese trade.

1.3 Aim and research questions

Despite the increase, there is still a gap in the literature on South-South FDI, its characteristics, and its impacts. This research aims to fill the research gap by exploring the characteristics of the South-South FDI relationship between Laos and China. Additionally, the study aims to examine how trends in trade have changed since the influx of South-South FDI following the liberalizing policies implemented in the 1980s. This will be addressed through two research questions;

RQ1: What are the main characteristics of the South-South FDI between Laos and China from the time of economic liberalization in 1986 to 2019?

The first part will aim to not only identify the main characteristics of the relationship but also identify in what ways the relationship of South-South FDI has impacted the economic development in Laos as it is identified as an indirect driver of development. Inherently, this will include the discussion of how South-South FDI may differ from North-South FDI. As Laos aims to fuel their future economic growth through the influx of FDI, to upgrade and develop their industries, increasing the export value which will contribute to the export-led growth, the research will also examine the trends of trade. The section regarding trade will be looking at export, import, composition of trade and destination of exports to answer the following question;

RQ2: How has the Chinese FDI into Laos impacted the country's trade pattern?

1.4 Limitations

Due to limited primary sources on both FDI flows between developing countries and trade statistics, this study will be conducted using primarily secondary sources in addition to the primary sources available. Thus, due to the nature of these sources, there will be limitations with regards to the recorded information. There might be agendas to disrupt or not record statistics and data for both parties. Border trade is a common occurrence in Laos, thus, there exists a substantial amount of informal trade, especially along the Lao-China border in the North (Andersson et al, 2009, p. 14). The informal trade evidently is not included in official trade statistics and thus, it is, therefore, important to take into account that there could be a deviation of the results from the actual situation in Laos.

Here it is also important to note the political situation in the countries. Despite its official name, Lao People Democratic Republic, Laos has since 1975 been governed as a one-party communist state (Nationalencyklopedin, 2020; Creak & Barney, 2018). The only political party permitted by law is the Lao People's Revolutionary Party (LRPP)

(Nationalencyklopedin, 2020). Due to the state of ruling and government, the civil liberties and political rights of its citizens are limited, scoring 12 and 2 respectively according to Freedom House ratings, with an overall rating of 14 (2020). The overall score of 14 is low and gives Laos the status of 'Not Free' according to Freedom House (2020). This may indicate that information is perhaps not fully available to the public, not published transparently and that citizens' cannot actively influence policy.

Additionally, like many other countries in the region, Laos presents a high degree of corruption, scoring 29 out of 100 according to Transparency International (2015; 2019). The degree of corruption adds to the importance of caution when approaching the data, as well as the problematization of accessible information. It has been recognized in many publications used in this research, that a well-rounded analysis of the economic development and situation of Laos is difficult due to the lack of reliable and accessible data (World Bank, 1994; Kyophilavong et al., 2017b, p. 266; OECD 2017, p. 119). This was further showcased in the report published by the International Monetary Fund (IMF) in 2017 where they utilized mirror statistics to assess the quality of the trade statistics reported by Laos. The study showed that although trade is vital for the country, making up between 40 and 60% of the GDP, a lot of the statistics are unreported (Bannister et al., 2017, p. 4). Between 2014 and 2015, export was estimated to be unreported by 8 to 50 %, imports by 30 to 70%, and trade deficit by 20 to 280% (Bannister et al., 2017, p. 4). This grave underreporting is presumed to be concentrated in trade with Laos' major trading partners Thailand, China, Vietnam (Bannister et al., 2017, p. 4).

Like Laos, China is governed by a one-party communist state, the Communist Party of China (CPC) (Chow, 2004). Although shifting from centralized planning, China also scores poorly in civil liberties and political rights, 11 and -1 respectively (Freedom House, 2020). Due to a lack of transparency at a central government level, there is lacking published data for trade and investment occurring in and originating from the country (Davies, 2013, p. 9). This is a limitation for this study as it could disrupt data or limit the data available for analysis.

Nonetheless, in the case of Laos, and the vital role which South-South FDI plays in the country's economic development, illustrates the importance of this research despite the limitations it faces. The available data will be utilized despite the possible shortcomings, as this is a case study that aims to attain an overall understanding of the changes in FDI and trends in relation to the accord between China and Laos. This is where the choice of mixed-methods plays an important part. The choice of methods, which is further elaborated on in section 5, allows for qualitative and quantitative methods, thus, expanding the range of information used in the analysis. However, the utilization and choice of data will be made with caution and cross-referencing as well as the notion of the limitations in mind.

1.5 Outline of the thesis

This thesis is outlined in the following order; first I will begin by introducing the background, to provide the reader with the context of Laos' economic liberalization and the regional integration of the country since 1986. Then, I will go on to the literature review, where the topics of the traditional role of FDI and South-South FDI trends will be discussed. This is to position my study within the academic context and discussion of South-South FDI, all while using the previous literature as facilitators for this study. After the literature review, the conceptual framework will be introduced. This will be followed by the methods sections, where I explain the chosen methodology and reasonings for this choice. Subsequently, I will then move into the analytical discussion where the findings of the study will be discussed through the lenses of the conceptual frameworks of *new structural economics* and *the role of FDI*. Lastly, the thesis will close with the concluding remarks which will summarize the findings of the study.

2. Background

The following section will provide a background of the economic liberalization of Laos' economy which commenced in the late 1980s and the regional economic integration which followed. Later on, this section will also explore the increased presence and relationship with Laos' northern neighbor China.

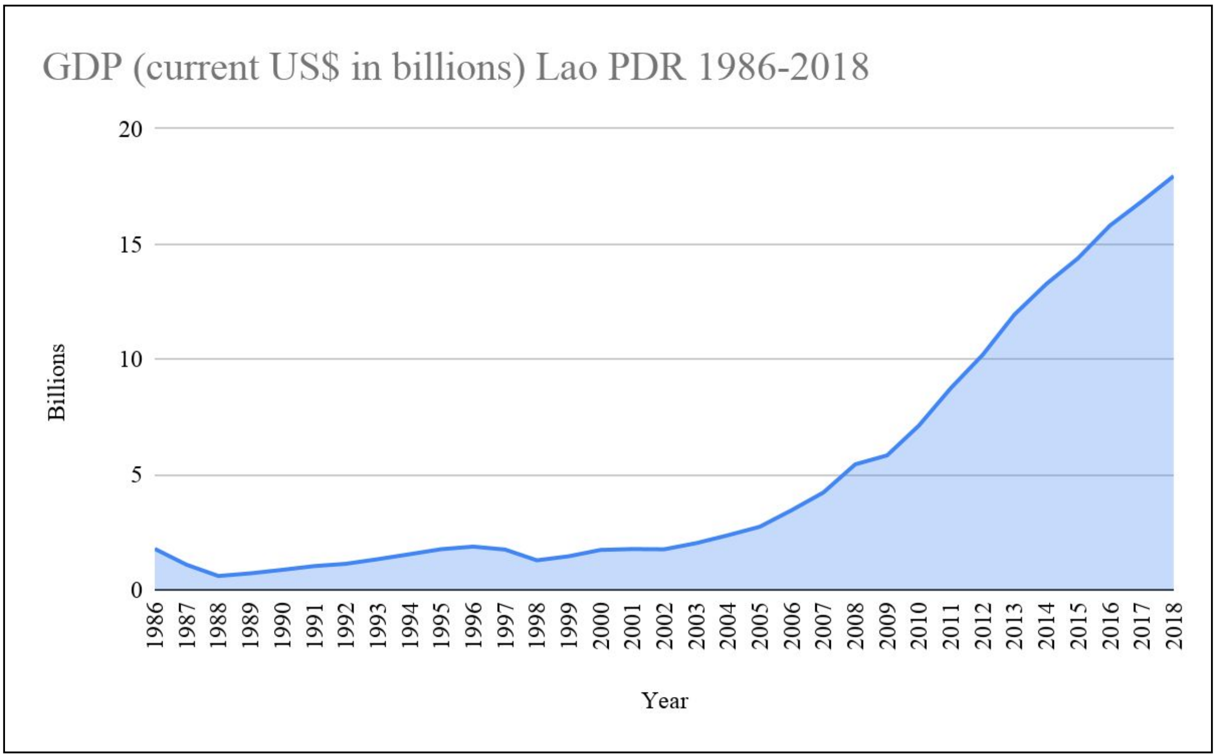
2.1 Laos and its economic liberalization

Laos is a small, historically impoverished nation, landlocked in between China, Vietnam, Thailand, Cambodia, and Myanmar (Burma) (Lu & Schöwenger, 2017, p. 61). The country did not open its doors to international trade and investments until the late 1980s, with trade taking off in the early 1990s (Kyophilavong et al., 2017a, p. 217). Formerly characterized by a high degree of economic centralization, little reliance on market mechanisms, and strict control of economic activities, Laos embarked on a series of reforms (Saignasith, 1997, p. 23-24; Bourdet 2000, p. 2). The economic liberalization commenced with the introduction of the New Economic Mechanism (NEM) in 1986 which main purpose was to open the country to foreign investment and global trade (Bourdet, 2000, pp. 3-4). Between the years 1986 to 1989, new economic policies were introduced which loosened the procurement prices of agriculture and retail while state-owned enterprises were granted autonomy in decisions of production and investments (Fane, 2006). Although the liberalization of trade was only partial, it served as a major step towards a more market-oriented economy. During the initial years of the reform, the country saw a decline in revenue from taxation, an increase in government spending, and inflation over 50% (Fane, 2006, p. 213; World Bank 1994, p. 2). In the 1990s, inflation was brought down to a single-digit along with improved economic performance. This largely contributed to economic stability in the country and increased confidence in the economy. However, the initial success of the reforms remained vulnerable (World Bank, 1994, p. 2).

Due to weak infrastructure and limited resources, one of the key goals for the Lao government, the LRPP, was to create an inviting environment for investment, and thereby, increase employment opportunities (World Bank, 1994, p. 20). However, due to the severely fragmented market of the Lao economy, the country faced major challenges. The population is located sparsely, and the geographical nature of the country, mountainous with poor road infrastructure resulted in a frail market integration (Andersson et al., 2009, pp. 1-2). To mitigate the challenging environment, part of the government reform included the introduction of Special Economic Zones (SEZs) which would aid the improvement of infrastructure within and surrounding these areas (Kyophilavong et al., 2017b, p. 264).

Since the introduction of NEM and the reforms that subsequently followed, Laos has seen considerable poverty alleviation and sustained rapid economic growth while entering the 2000s. After the turn of the millennium, Laos saw a decline in poverty from 33,5% to 23,2% (World Bank, 2020a) and steady GDP growth of 7,7% (Kyophilavong et al., 2017a, p. 218). Both of these achievements have been attributed to the liberalized policies and large influx of FDI which the country has attracted. The rapid growth of GDP is visualized in Figure 1. below which illustrates the GDP growth of Laos (current US$) in billions from 1986 to the latest available data in 2018. One can see that after the implementation of NEM, the GDP slowly started to increase but at a considerably slower pace. At the end of the 1990s, there was a slight noticeable dip in GDP, this can be attributed to the Asian Economic Crisis in 1997. Unlike many of its neighboring countries in the region, Laos managed to maintain a relatively robust growth throughout the crisis (Okonjo-Iweala et al., 1999).

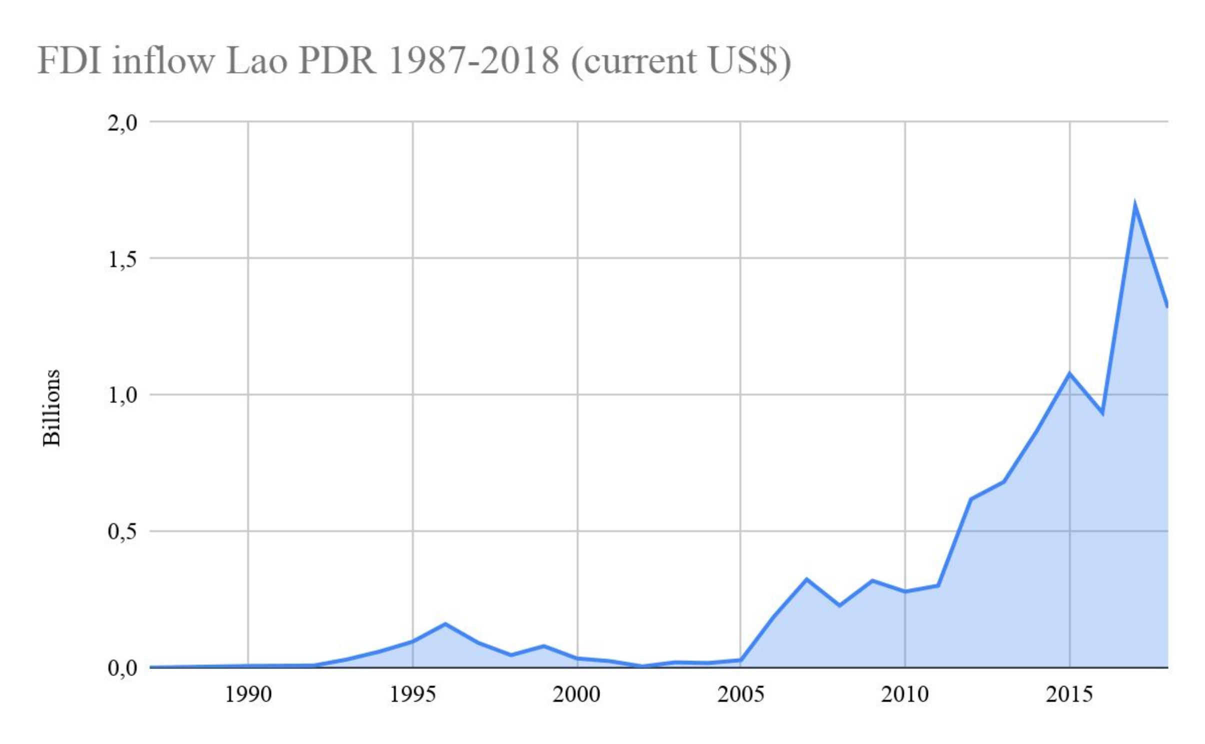
Figure 1. GDP (current US$ in billions) Lao PDR 1986-208



Source: World Bank, 2019a

Due to the fact that Laos is a landlocked country with its developmental challenges, prominent poverty rates, weak property governance, yet unspoiled natural resources, it can be argued as an exemplary target for investments (Lu & Schönweger, 2017, p. 61). Part of the reforms, which occurred after the introduction of NEM, was the supplementary new legislation regarding the FDI in Laos. This new FDI law came into place in 1988 and was revised on three separate occasions since (1994; 2004; and 2009) (Kyophilavong et al,. 2017b, p.264). This new piece of legislation was meant to consolidate regulations so foreign and domestic investors were able to participate equally, ameliorate opening procedures for new establishments, enlarge the incentives for certain investments, allow foreign investors to invest in the real estate sector and provide foreigner access to domestic financial resources. Due to the liberalized economic reforms and the implementation of the new FDI law, Laos saw an influx of FDI from 1989, both in terms of capital and the number of FDI projects (Kyophilavong et al,. 2017b, p.264). This can be seen in Figure 2. showing the inflow of FDI into Laos from 1987 to 2017. The consequences of the Asian Economic Crisis are also visible in the decline of FDI inflow in 1997 where it declined by 91% (Okonjo-Iweala et al., 1999). Arguably, due to the weak macroeconomic management, and the government's prolonged consensus-building, Laos' authorities presented difficulty in reacting to the consequences for investments of the crisis (Okonjo-Iweala et al., 1999).

Figure 2. FDI inflow Lao PDR 1987-2018 (current US$)



Source: World Bank, 2019b

Nonetheless, as visualized in Figure 2. the FDI influx in the country took off significantly again in 2005 and has seen considerable growth since.

2.2 Regional economic integration

Another step in their path for broader participation in the global and regional markets, Laos joined the Association of Southeast Asian Nations (ASEAN) in 1997. The joining of ASEAN introduced Laos to the agreement of reduced tariffs and non-tariffs barriers which came into fruition in 1992 (Bourdet, 2000, p. 5). The ASEAN countries, including Laos, have signed several Free Trade Agreements[2], including the ASEAN Free Trade Area (AFTA) which mitigates and facilitates trade between the member countries. The numerous bilateral and multilateral agreements help businesses to operate within the region, gaining access to

[2] ASEAN-Australia-New Zealand FTA, ASEAN-India FTA, ASEAN-Korea FTA, ASEAN-Japan FTA and ASEAN-China FTA(Dezan Shira & Associates, 2017).

markets for the purpose of exporting products at a lower competitive price (Dezan Shira & Associates, 2017).

2.3 China's involvement

Seven years after Laos became a part of ASEAN, the association and China signed the Agreement on Trade Goods of the Framework Agreement on Comprehensive Economic Cooperation between the member nations of ASEAN and China. This marked a leap for the realization of the ASEAN-China Free Trade Agreement (ACFTA) which commenced in 2010 by China and 2015 by the member states of ASEAN (Cordenillo, 2005). The agreement was set out to further boost the trading and investment between China and the ASEAN countries, which already in the early 2000s had seen a sizable increase from 2,1% in 1994 to 7% in 2003 making China the fourth largest trading partner with the region (Cordenillo, 2005). The agreement set out to remove non-tariff trade barriers which lowered the costs of trade transactions and boosted the resource flow to sectors of more efficient use (Cordenillo, 2005). Thus, since the commencement of the agreement in 2015, Laos has gradually removed trade duties for Chinese trade. Trade liberalization agreements and other liberalizing reforms have, as mentioned, contributed to the robust growth of the Laos economy and enabled the expansion of trade (Kyophilavong et al., 2017a, p. 217; 2017b, p. 260).

The role of China as an important trading partner for the ASEAN countries began in the mid-1990s (Devadason, 2010, p. 653). However, since ACFTA China's presence in the region and more specifically Laos, has gradually increased. In 2017, imports from China to Laos amounted to US$1,34 billion, likewise, China is one of the major export destinations for the country as well (OCE, 2017). In 2015, China was the number one contributor of FDI, in terms value invested, at US$ 5484 million with Thailand and Vietnam following behind at US$ 4491 million and US$ 3574 million (Kyophilavong et al., 2017b, p. 220). Additionally, in 2017, China became the main export destination of Laos at US$ 1,18 billion, accumulating 58% of the country's total exports, with the biggest export sectors being within natural resources (OCE, 2017).

Table 1. Imports and Origin of Imports to Lao PDR in 2017.

% of import	*Type of import*	*Origin of import*
7%	Broadcasting equipment	China (93%)
4,4,%	Hydraulic turbines	China (63%)
2,7%	Electric control boards	China (87%)
2,7%	Stone processing machines	China (60%)
2,7%	Electric motor parts	China (60%)

Source: OCE 2017.

Table 2. Export and Destination from Lao PDR in 2017.

% of export	*Type of export*	*Destination of export*
27%	Copper ore	China (85%)
9,5%	Rubber	China (99,6%)
7,6%	Gold	India (100%)
3,9%	Refined Copper	China (100%)

Source: OEC, 2017

Both Table 1. and Table 2. showcase the important role which China has evolved in terms of trade for Laos.

3. Literature Review

In this section, themes of previous studies regarding FDI and South-South FDI will be presented. This will help facilitate a context for the study as well as provide additional background information for the topics discussed.

3.1 The traditional role of FDI and how it has changed

FDI, acts as a category of cross-border investment, which occurs when an investor of the home country's economy amasses assets and establishes a lasting interest as well as influence over an enterprise resident of a host country (OECD, 2018; Blackhurst & Otten, 1996). FDI presents a key element in international economic integration, as it aims to create long-lasting links between economies. FDI also creates important channels through which technology can be transferred between economies while facilitating the promotion of international trade through access to foreign markets which therefore can serve as a vital instrument from economic growth (OECD, 2020).

The role of FDI has been largely contested throughout history. It has been argued to benefit economic development and been viewed as unfavorable as it could jeopardize the host country's capabilities and deplete resources (te Velde, 2006, p. 7). In the 1960s and 1970s, the view on FDI was rather critical. It was viewed as an unhelpful and poor strategy for development as it brought inappropriate or unsuitable technology to the developing countries (te Velde, 2006, p. 4). As mentioned earlier, the view of FDI was in the 1990s, re-visited by both parties, countries, and investors, as changes such as globalization and liberalization created new opportunities and patterns of FDI. By then the attitudes and approaches to FDI had changed. FDI began to be viewed as beneficial, and many countries attempted to provide a welcoming economic climate for investment (te Velde, 2006, p. 4; Dunning, 1994, p. 3).

From a host country's perspective, the new view of FDI meant a chance to globalize their economic activity, costs and benefits of FDI became more appreciated and another possibility to approach the 'take-off' stage in development (Dunning, 1994, p. 3). However, it also became clear that the effects of FDI, whether positive or negative, largely depended on the general economic and specific FDI policies of the host country (te Velde, 2006, p. 20). One of the perhaps noticeable changes from the country's perspective would be the adaptation of more liberal economic policies to enter the global context (Dunning, 1994, p. 11). As addressed by the traditional role of FDI, it is important that despite countries' governments taking on more liberal policies, lessening their immediate intervention, they should not forgo their role. Their role is still vital in "...their responsibility as enablers and steerers of wealth-creating activities, or as facilitators of the private enterprise system." (Dunning, 1994, p. 11).

On the other hand, the investor's view on FDI changed through the perspective of global competitiveness and pressure to produce inputs from the cheapest possible sources. Incentives to create alliances with foreign firms and the increasing ease of cross-border transitions through reduced transportation costs also contributed to the changes in the view of FDI (Dunning, 1994, p. 3). The types of policies, both general economic policies or policies specific to FDI, in areas regarding human capital, trade, investment, and innovation are now emphasized with regard to the link between FDI and development (te Velde, 2006, p. 4). The most common way in which it contributes is through the mitigation of either capital (financial) or knowledge (technology). Firms were able to through cheaper costs, in other countries, utilize the knowledge which they had already attained, all while exploring new markets and tapping into resources which the host country perhaps did not have the opportunity to utilize (Dunning, 1994, p. 3)

3.2 South-South FDI trends

With the reevaluation of FDI in the 1990s, it comes as a little surprise that this type of investment has evolved into the inclusion of agreements between developing or transitioning countries as well. This is, however, where the literature is limited. Lipsey and Sjöholm (2011) discuss the role of South-South FDI in the developing economies of Asia throughout their report for the Asian Development Bank (ADB), however, as they highlight, there is a large need for additional research as the importance of South-South FDI increases for developing countries. Discussing factors that favor South-South FDI, in the case of developing countries, they bring up the larger extent of poor institutions in developing countries, which can be favorable for FDI (Lipsey & Sjöholm, 2011, p. 1). Institutional challenges in developing countries may present as major obstacles for firms from developed countries. Other common obstacles for FDI in developing countries, such as poorly developed contracting, lack of well-functioning market mechanisms, and property rights may serve as an advantage for South-South FDI (Lipsey & Sjöholm, 2011, p. 1). In the case of South-South FDI, these conditions might be similar to the firm's home economy or something which they have experienced before, creating more manageable situations and providing firms with experience to overcome possible obstacles with greater ease. The networks and practices of businesses will thus, be easily adapted to the, sometimes called backwardness of developing countries (Lipsey & Sjöholm, 2011, pp. 1-2).

Research within FDI, and South-South FDI more specifically, point out that the conditions of the host-country matter for its ability to absorb spillover from the FDI itself (Lipsey & Sjöholm, 2011, p. 27; Sirr et al., 2017, p. 381). The technological gap between host and home countries, the educational level of the host country as well as their financial development matter for the absorption capacity of the spillover effects in the host country (Nicet-Chenaf & Rougier, 2008, p. 2). Thus, with the presence of lower technological gaps between the host country and the firms investing have shown to increase the absorption capacity (Sirr et al., 2017, p. 380).

FDI provides firms and countries the opportunity to seek resources of different varieties beyond their own borders. The role of FDI has changed throughout history due to changes in the attitudes and along with globalization. With the latest changes, the room for South-South FDI has emerged. Along with the emergence of South-South FDI follows the opportunities to better utilize the contexts of the host countries, and allow for larger opportunities for the firms to evolve. Host countries which might not be viewed as optimal for North-South FDI due to various factors, turn these challenges into opportunities through the operations of South-South FDI.

4. Conceptual framework

The research questions aim to identify the overall characteristics of the South-South FDI relationship between Laos and China and examine how the relationship has impacted the country's trade- going from a general approach to a more specific one. To do so, the lenses of two conceptual frameworks will be utilized. These are *New Structural Economics* and *the role of FDI*.

4.1 *New Structural Economics*

The first part of the conceptual framework utilized is the *New Structural Economics* (NSE). This third-wave developmental theory mainly identifies three aspects of a country's economic development; (1) endowment structure, (2) the advantage of backwardness, and (3) the active role of the government. These three aspects are highlighted as vital factors to develop the structure of a country (i.e structural change) (Lin, 2012, pp. 4-5).

The NSE theory is relatively new in comparison to other theories within economics. It has emerged through the work of a number of scholars such as Rodrik, Hausman, Velasco, Aghion, Spence, Harrison, Monga and Lin to name a few (Lin, 2012, p. 4). It aims to build on the success stories of nations, but also to learn from the failures of countries which have stagnated in their development (Lin, 2012, p. 4). A fundamental step in sustained economic growth is structural change (Kuznet, 1966 in Lin 2012, p. 3). Economic development is thus, not viewed as an easy fix, but a prolonged dynamic process, evolving from one level to another (Lin, 2012, pp. 14-15). Building on the emphasis on structural changes, this new third-wave of development thinking encompasses three main aspects; endowment structure, backwardness and an active role of government (Lin, 2012, pp. 4-6). The three aspects can be further explained as the following;

(1) The endowment structure of a country can establish the nature of its economic development. In this case, endowments include physical and human capital, thus, the land is excluded due to the unchangeable aspect of it. The industrial structure of the economy is thusly, based on its factor endowment (Htike, 2019, p. 11). To develop, a country should position themselves according to their comparative advantage, invest in industries to utilize

their endowments. This will result in capital accumulation which can be invested in new modern industries, thus, enables them to adjust their comparative advantage accordingly. This evolves alongside the development, which then the improved endowment will further develop the economy eventually resulting in structural changes (UNU-Wider, 2014; Lin, 2012 pp. 5-6).

(2) Developing countries and their so-called backwardness allow the country to adopt and follow paths of already developed countries, in other words to catch up. Here, developing countries can utilize their backwardness to their advantage by adapting and/or borrowing technologies that have matured in more developed countries (Lin, 2012, p. 6). Developing the appropriate level of technology in accordance with the country's endowments is imperative so that infrastructure can be accommodated at the current degree (Htike, 2019; Lin, 2012, p. 6). The utilization of matured, yet appropriate technology can thus, allow a country to more effectively achieve structural changes as the mismatch of technologies does not occur to the same degree.

(3) The government of the developing country must play a facilitating role in the development process. What this means, within the realm of NSE, is that they should promote industrial upgrading, attract FDI and, facilitate infrastructure improvement to achieve continuous structural change (Htike, 2019, p. 12). More specifically, this includes the identification of tradable goods and services that have dynamically grown in a country of similar endowment structure with a per capita income of approximately 100% higher than their own (de Velde, 2017, p. 181). If private domestic firms are already existing in these industries, the government should aim to identify constraints within the industries and attempt to alleviate them. If there are no domestic firms present in these industries, governments should work to promote FDI within these industries, alternatively establish programs for firm-incubation (de Velde, 2017, p. 181). In addition to the industries identified, the government should attentively monitor any self-discovery by private enterprises while supporting scaling up of successful innovation within them. If the country possesses poor infrastructure and unfavorable business environments, industrial parks or SEZs can be used to surmount obstacles of firm entry and FDI inflows (de Velde, 2017, p. 182). Furthermore, the

government should be inclined to reimburse industry-specific firms with temporary tax incentives, co-financing investments or, access to foreign exchange (de Velde, 2017, p.182).

An essential part of the government role, which must be stressed, is the continuous active role of facilitating structural change through appropriate policies to develop infrastructure, attract investments and furnish a good business environment, for foreign and domestic firms.

As developing countries, according to the NSE view, have the advantage of backwardness, it provides them with a variety of industries with various degrees of capital intensity. The factor endowment structure must first be upgraded, which involves an increase in capital stock at a more rapid pace than the labor force. After ascending the industrial ladder, the scale of production will gradually be increased. As industries expand, the need for larger markets, which generates a demand to simultaneously develop transportation, financial arrangements and additional soft infrastructure (Lin, 2012, p. 26). The market is the core mechanism for the allocation of resources while the government should actively coordinate investment for the upgrading of infrastructure and industry as well as diversification all while compensating for externalities that may emerge (Lin, 2012, p. 5).

For the scope of this thesis, the conceptual framework will primarily focus on the role of government. The aspects of backwardness and factor endowment will be discussed as well but on a smaller scale, as the governments play a major role in the presence of FDI in the country. The NSE framework will thus be used to help identify the role of the Lao state in the Lao-China FDI relationship as well as examining how trends in Laos' trade has changed since the economic liberalization and the influx of Chinese FDI.

4.2 The role of FDI

To help identify some main characteristics of the FDI relationship between Laos and China, the conceptual framework of *the role of FDI* will be utilized. As described above, FDI is a category of cross-border investment between countries and firms on an international level. The intention of these investments is to establish lasting interests and involvement in another economy (OECD, 2018). Historically, FDI has presented host and home countries with a step into integration into the global market, all while creating lasting links between the economies.

Thus, it strengthens the economic development of the two partner economies. FDI creates important channels through which technology can be transferred between economies, international trade is promoted through access to foreign markets which therefore can be a vital instrument for economic growth (OECD, 2020).

The FDI relationship can be a way in which countries mitigate for endowment shortages. The host country could have a lack of capital, while abundant in natural resources and labor. Thus, this is when FDI can help the host country utilize the endowments they possess, through investment by a firm of another economy. On the other side, the investing country might have the technology and capital, however, due to limited or lack of endowments in their home economy, choose to look across borders for new opportunities (Lu & Schönwegwer, 2019, p. 63).

4.2.1 The three perspectives

There are different views on FDI in the literature. These views can be divided into three approaches[3]; mainstream approach, skeptical approach and a dirgist approach (Jenkins, 2009, p. 45; Moran et al., 2005, p. 2).

The mainstream approach views FDI more attractively by definition, this approach is heavily linked to the view of trade by the 'World Consensus', viewing FDI as unequivocally good. According to this view, the more FDI a country can attract the better, under the notion that investors do not pollute the land or abuse workers (Moran et al., 2005, p. 2).

The skeptical approach questions the benefits of FDI, and the dubious existence of an evident relationship between FDI and development in comparison to other development strategies, "[o]ne dollar of FDI is worth no more (and no less) than a dollar of any other kind of investment" (Rodrik, 1999, p. 37). This approach shines light on the uncertainty of its impacts and non-assured spillover and is based on the academic skepticism through the experience of many developing nations (Moran et al., 2005, p. 2).

[3] Moran et al. (2005), discuss these three themes in terms of non-extractive FDI, however, for the scope of this study they will be utilized for FDI as a whole.

Lastly, the third approach, dirigist, emphasizes the important role of the host government and their responsibility in directing the FDI (Jenkins, 2008, p. 45). Based on the conventional wisdom of some developing countries' experience which indicates that a country's development goals can be achieved through FDI, however only through imposing conditions on foreign investors. Conditions such as forced intentional technological transfers and promotion of domestic input would assure backward linkages to the local host economy (Moran et al., 2005, p. 2; Jenkins, 2008, p. 45).

5. Methods and data

5.1 Methods

The chosen research questions, along with the limitations presented for this specific case, have guided the choice of methods for this thesis. The research will utilize a mixed-methods case study approach. Through the choice of a case-study, the research will be able to go more in-depth into the still rather scarcely researched phenomenon of South-South FDI (Bryman, 2001, p. 12). By utilizing mixed-methods, thus incorporating qualitative and quantitative methods, the research will be able to present a more panoramic picture of the situation, while maximizing the findings (Punch, 2005, pp. 234-256). Due to the fact that qualitative and quantitative methods will be utilized, the research is able to draw from the strengths of each approach, while mitigating for shortages (Shorten & Smith, 2017). There are various limitations, see section 1.4 above, in connection to the research, thus, the mixed-method approach is arguably most appropriate.

5.2 Data

As mentioned in the limitations section, the availability of data regarding the intra regional FDI and trade in South and Southeast Asia, specifically for Laos presents a limitation. Due to scarce statistics and data published by the governments themselves, the use of such sources will be limited. The main database sources utilized will be the World Bank Data, World Trade Organization (WTO) and United Nations Conference on Trade and Development (UNCTAD). Additionally, partner organizations to the above mentioned will be used. These are UN Comtrade, World Integrated Trade Solution (WITS), Organization for Economic Co-operation, and Development (OECD). It is recognized that these datasets are largely reported by the governments to the World Bank or WTO, however, these are available to the public through these organizations and are not easily accessible to the public through domestic sources.

Additionally, already published research by the ADB, ASEAN, the World Bank and, the IMF will be used for qualitative aspects as well as published research articles by scholars.

Furthermore, some of these published papers have conducted econometric research, the result of which will be utilized as well.

6. Analytical discussion

The following section will discuss the findings and analyze them through the lenses of chosen conceptual frameworks, *the role of FDI* and *new structural economics (NSE),* to answer the two research questions above.

6.1 New, different, and better suited?

With the emerging presence of FDI in developing economies originating from other developing or transitioning economies, it is of relevance and importance to examine some of their key characteristics. Since the first published work on the effects of FDI inflow on the host country was conducted in the late 1950s, the topic has routinely been revisited as the years have passed (Dunning, 1994). Thus, it comes to no surprise that the emerging South-South FDI phenomenon should be included in similar works.

Reasons for the topic being revisited in the past has been due to changes in the approaches towards the costs and benefits of FDI by countries and firms (Dunning, 1994, p. 2). With changes to the rules of the game; further globalization, liberalization, advances in innovation and technology, it comes to little surprise that the scope of FDI has expanded even further, now permitting space for the emerging and developing economies into the game.

Table 3. The Changing World of Foreign Direct Investment

Country's perspective	*Firm's perspective*
Revival of market system.	Increased need to exploit global markets.
Globalization of economic activity.	Competitive pressures to procure inputs (e.g. raw materials) from the cheapest possible source.
Enhanced mobility of wealth-creating assets	Regional integration of promoting more efficiency-seeking investments.
Increased number of countries approaching the 'take off' stage of development.	Growing ease of trans-border communications and cut to transportation costs.
Changing criteria by which governments evaluate FDI.	Opening of new territories for FDI.

Better appreciation by the government of costs and benefits of FDI.	Need to tap into foreign sources of technology and organizational capacities and exploit economies of agglomeration.
	New incentives to conclude alliances with foreign firms.
	Need to better balance the advantages of globalization with those of localization.

Source: adapted from Dunning, 1994, p. 3

Table 3, showcases selected changes which were brought up by Dunning in his work 'Re-evaluating the benefits of foreign direct investment'(1994). Although the work focuses mainly on the expansion of FDI from North-North FDI to North-South FDI, many of the notions are relevant to the South-South FDI phenomenon as well. As more countries, such as China, have accumulated capital through their rapid economic growth, they have sought efficiency-seeking investment to further fuel their development. Thus, many firms experience competitive pressure to solicit raw material to feed production from the cheapest source available. Due to the expansion of globalization and liberalization, regional integration of economies, and low cost of transportation, they are able to expand beyond the borders of their home country. From the perspective of countries like Laos, the governments have transcended into a market-oriented economy, with greater faith in the cost and benefits of FDI which allows them to enhance their mobility of wealth-generating assets (i.e natural resources).

6.1.2 South-South FDI: the case of the Lao-China relationship

Some additions and alterations are arguably required to explain the South-South FDI phenomenon and thus the relationship between Laos and China. Firstly, the notion of approaching the 'take off' stage can be displayed in both the perspective of the host country and the home country of the firm. China, the home country of these firms, is arguably within the proximity of "take-off" as they have seen great economic growth, yet still face developmental challenges. To continue to fuel the growth, and reach "take-off" resource-seeking done through FDI to make up for the lack of domestic resources. The other side of the coin, the host country, Laos is further away from "take-off" however has made leaps in the past decades. The country possesses an abundant supply of natural resources, labor or other endowments, however, a lack of capital to efficiently utilize these which where the desire to attract FDI comes in: to mitigate for lack of capital and technology, in order to expand trade (Ministry of Foreign Affairs- Lao PDR, 2004). With FDI commonly comes the transfer of technological innovation (Sirr & Gallagher, 2017, pp. 380-381). The technological innovation which might be invested in through South-South FDI is likely to be less complex, as it originates from transitioning or developing economies, and thus, more in line with the capabilities of the Southern recipient (Sirr & Gallagher, 2017, p. 381). Despite not being a fully developed country,[4] China provides Laos with matured technologies which Laos does not possess, something which traditionally occurs in North-South FDI as well. Historically, globalization and liberalization have contributed to the re-evaluated view of FDI.

In the case of Laos and China, with the ruling LRPD in Laos and CPC in China, the similarities of the political situation are arguably an advantage in the case of FDI. Both forms of governance have historical ties to communism, however currently not completely bound to the ideology (Bai & Lui, 2020, p. 2; Bourdet, 2000, p. 9). The historic political similarities may provide advantage for Chinese firms to situate and operate within the Lao economy as views on the current paradigm of open markets might be similar. As both countries implemented strategies towards market economies, China in 1978 (Goodman, 1981, p. 520) and Laos in 1986, it has created a rather unique context. The market and political landscape arguably create a favorable condition for China in this South-South FDI relationship as they have experienced a similar transition.

Decreased transportation and cross-border costs have enabled FDI to increase its presence (Dunning, 1994, p. 3). In the case of South-South FDI, lowered transportation costs have provided ample opportunity to invest in countries with close proximity, at a lower cost, thus the geographical component of FDI should not be overlooked. Laos and China are, as mentioned, linked together by Laos' northern border. Many of the SEZ in Laos are located in the northern regions, which arguably is no coincidence (International Organization for Migration, 2018). Moreover, the supply of natural resources in Northern Laos thus presented

[4] This classification of China as a developing country is according to the United Nations' country classification in the World Economic Situation and Prospects 2019 report (United Nations, 2019, p. 170).

as an optimal supply of resources for investment for China, within close proximity to the home country (Lu & Schöweger, 2018).

In recent years, the close proximity between China and Laos has been further utilized through the FDI project of the Belt and Road Initiative to maximize the ease of transportation. This initiative, China's largest FDI project, will not only link 65 countries across various continents but will transform Laos from landlocked to land-linked (Current Affairs Correspondent East Asia, 2020; Phommouny, 2019). Thus, the geographic proximity between countries and the economic linkages which are generated or bolstered between countries through South-South FDI can in the long run be of importance for global trade.

The Lao government has expressed a need to increase their share of skilled and knowledgeable workers, in other words to increase human capital to adapt new technologies (Ministry of Foreign Affairs- Lao PDR, 2004, p. 70). However, in the case of the Lao-China FDI relationship, this has not necessarily consistently been achieved as China commonly imports Chinese workers for projects. In 2018, there were 20,099 workers within the SEZs in Laos, nonetheless, less than 50% of these workers were Lao. Many projects, such as the large Belt and Road Initiative, require a large share of workers, and promises have been made to source many of them from the domestic market (Phommouny, 2019). To increase the benefits of the FDI in Laos, a more skeptical or even dirigist approach can be taken by the government, to ensure knowledge transfer. This forced knowledge transfer can be achieved, and most beneficial through policies which require the majority of workers to be sourced from the domestic market (Moran et al., 2005, p. 2).

6.1.2 Similarities of backwardness and differences

Arguably, China and Laos present similar contexts in various ways. Neither China nor Laos are considered developed countries. The aspect of backwardness of a developing country can present as an obstacle in traditional North-South FDI, however, in the case of Lao- and China, it can present as an opportunity. In alignment with the aspect of backwardness within the scope of NSE, the Lao government has also identified FDI as a way to import technology from other, more matured countries, i.e China. Here, the traditional role of FDI differs from Laos' South-South relationship with China. Even though China has seen accomplished economic growth at a remarkable rate, the country's economic development has exceeded its structural development (World Bank, 2020b). Hence, China is still faced with developmental challenges, which can be argued to be similar to Laos' challenges. It can then be suggested that the similar conditions and market mechanisms of the two countries allow for greater ease for Chinese firms to navigate and operate in the Lao market. Considering the political ruling and close geographic proximity, it comes as little surprise that the relationship of trade and FDI has flourished.

6.2 The role of the Lao government

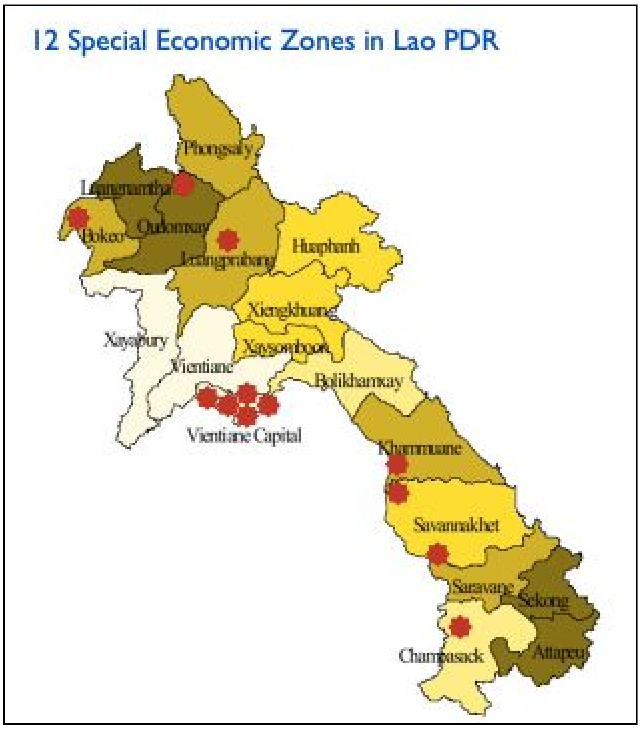
Looking back, after the introduction of the NEM in 1986 by the government, and with the additional FDI introduced in 1988, the Lao economy has seen an increase of foreign investors. However, the first years after the implementation of the reforms, the country remained centralized and non-transparent and little changed within the economy (Andersson et al., 2009, p. 2). This can be seen above in Figure 1. The figure illustrates the considerable growth of GDP in Laos since NEM, however, it also shows that GDP growth did not take off until a few years after the Asian Crisis. More comprehensive steps were taken towards the end of the 1990s and early 2000s. The FDI law which was implemented in 1988, and revised in 1994, 2004 and 2009 illustrates the government's initial choice to promote FDI and their desire to attract it.

6.2.1 The Special Economic Zones (SEZs)

As discussed above, Laos was still, largely characterized by obstacles for lucrative businesses and a lack of inviting business environments in the years following NEM. A step towards making Laos a more attractive destination for investment was the introduction of SEZs. The SEZs were primarily established to develop areas along the borders to Myanmar (Burma), China, Vietnam, Cambodia and, Thailand (Gunawardana & Sisombat, 2008, p. 34). Investments in SEZs require the approval of the government, however the sector or area of investment is not harshly regulated with the exception of the areas banned by the Lao government. These areas include dangerous chemicals, drugs and trading of arms (Dezan Shira & Associates, 2015). Arguably, this shows the keen interest and active role in attracting investments by the Lao government, however, it also displays the lack or limited regulation in which area and sector the investments are occurring in. This can be argued to indicate a mainstream approach to FDI as few restrictions show the lack of policies of which the government controls. It is worth noting that the lack of regulation could initially have been done intentionally to attract as much FDI as possible, in an attempt to steer the economy further towards a market-oriented one, however, this could also present challenges when this has been achieved.

As of 2018, there were 12 functioning SEZs in Laos with 388 companies operating within them. The location of these SEZs can be seen in Image 3. below. The Lao government wishes to expand the SEZs, to further develop infrastructure in surrounding areas and facilities in order to accommodate the investors (International Organization for Migration, 2018).

Image 2. The Special Economic Zones (SEZs) in Lao PDR 2018.



Source: International Organization for Migration, 2018

Through the initiative of SEZs, FDI began to flow into the formerly closed country. Despite the rather loose regulations within SEZs, the government added policies which would encourage foreign firms to develop infrastructure in more peripheral areas (Gunawardana & Sisombat, 2008, p. 34). Although the NSE perspective points out that the government's introduction of SEZs is a feasible option for countries with poor infrastructure and business environments to attract investment, it does not specify the regulatory role of the government. Rather, NSE states that the government shall remain active in their role as facilitators of market activity. However, in the case of Laos, the government seems to have aimed to utilize the SEZs for development opportunities of the infrastructures in rural border areas. This can be argued to be in order to provide an optimal location for the investments, thus, the ability to lower the transportation costs due to proximity. Hence, targeting Chinese investments in the SEZs along the Chinese border, Thai investments along the Thai border and, so on.

As mentioned above, the lack of regulations in the SEZs for investors could present challenges for Laos in the long run. The lack of investments arguably, along with the view of the mainstream approach, prevents the Lao government from ensuring diversification of industry but also the spread of the benefits of these investments. Thus, the investments of the regulation aspect of SEZs can be argued to need a more skeptical approach to ‘reap the fruit of the labor’.

6.2.2 FDI for development

The revisions of the FDI law and introduction of SEZs loosened the restrictions and regulations for investors, in an attempt to aid both foreign and domestic firms to equal participation in the market. In the Lao Government’s National Growth and Poverty Eradication Strategy (NGPES), FDI is on numerous occasions highlighted as a major potential source for not only increased investments but also a potential stimulator of trade. FDI is also further specified as a means to indirectly increase the growth of government revenue, and thus, a strategy for sustained economic growth, poverty eradication and, as a catalyst for export (Ministry of Foreign Affairs- Lao PDR, 2004, p. 5, 13, 50). Even though there was an expressed desire for FDI to upgrade infrastructure in rural areas, partly through investments in SEZ, additional emphasis was put on transferring modern technology to the country, which has been of great focus in later years (Gunawarda & Sisombat, 2008, p. 32). Arguably, the government has been successful in attracting FDI as seen in Figure 2. as the influx of FDI has increased substantially over the past decades.

One major sought out benefit of FDI, which is considered by most governments, including Laos, when attracting FDI is the technological transfer and knowledge spillover which may occur (Smeets, 2008; Dunning, 1994). This notion is largely assumed in the traditional view of FDI, which in the skeptical approach, it is questioned. The dirigist approach identifies the need for specific policies and requirements to be imposed in order to guarantee the spillover effect of knowledge and technology.

The knowledge spillover is however not guaranteed. In the case of Laos, many FDI projects, including Chinese, tend to to favor skilled workers from their home countries and primarily hire low-skilled workers during the limited construction time (OECD, 2017, p. 61). For Laos, this presents an additional challenge within the development process. The country has a large knowledge gap within human capital due to poor quality of education, thus, a shortage of skilled -labor (Asian Development Bank, 2011). In relation, China presents with a higher Human Capital Index (HCI) (World Bank, 2018), which arguably contributes to the desire to utilize Chinese workers abroad. Chinese projects and businesses abroad are known to favor Chinese workers over domestic ones, despite the promise to do otherwise (Stuart-Fox, 2009, p. 141). When FDI brings with it foreign workers, this limits the intended knowledge transfer which is contributing to the development of the country (Smeets, 2008, p. 109). However, some knowledge may still be transferred although it would then be unintentional and, thus, less effective (Jenkins 2018, p. 46; Smeets, 2008, p. 109). In some instances of FDI, when the FDI acquired is resource-seeking, the construction is technology, and capital intensive, in those instances the spillover overall tends to be limited and linkages to local business (OECD, 2017, p. 62). This reinforces the need for the Lao government to introduce a more skeptical approach, if not dirigiste, to maximize the possible benefits of the Chinese FDI. In order to fully reap the benefits of the spillover and linkages which may occur, the government needs to implement policies which enhance the impacts of development and facilitate the spillover (OECD, 2017, p. 62).

In the case of resource-seeking development into hydropower and mining which are most common in Laos, it has been suggested that without the implementation of efficient policy protecting the social and environmental surrounding, while utilizing the possible spillover, the FDI can have potentially harmful consequences (OECD, 2017, p. 63), in alignment with the aforementioned need for a dirigist approach. Thus, while the Lao government through their acquisition of FDI, presents a more mainstream approach to the matter, a more skeptical, or even dirigist approach needs to be applied to assure the knowledge transfer and bettering the long-term effects, to enhance the development impact throughout the country and the population.

The origin of the FDI, which Laos has managed to attract, is interesting, as the inflow of FDI is predominantly dominated by Laos' neighboring countries, with China at the top. Table 4 below shows the top ten investors of FDI by countries in Laos between 1989 and 2015. The dominating investor is China at 5484 US$ million, followed by Thailand and Vietnam at 4491 US$ million and 3574 US$ million respectively, with far larger investments than the other seven countries.

Table 4. Top Ten FDI in Laos by Country (1989-2015)

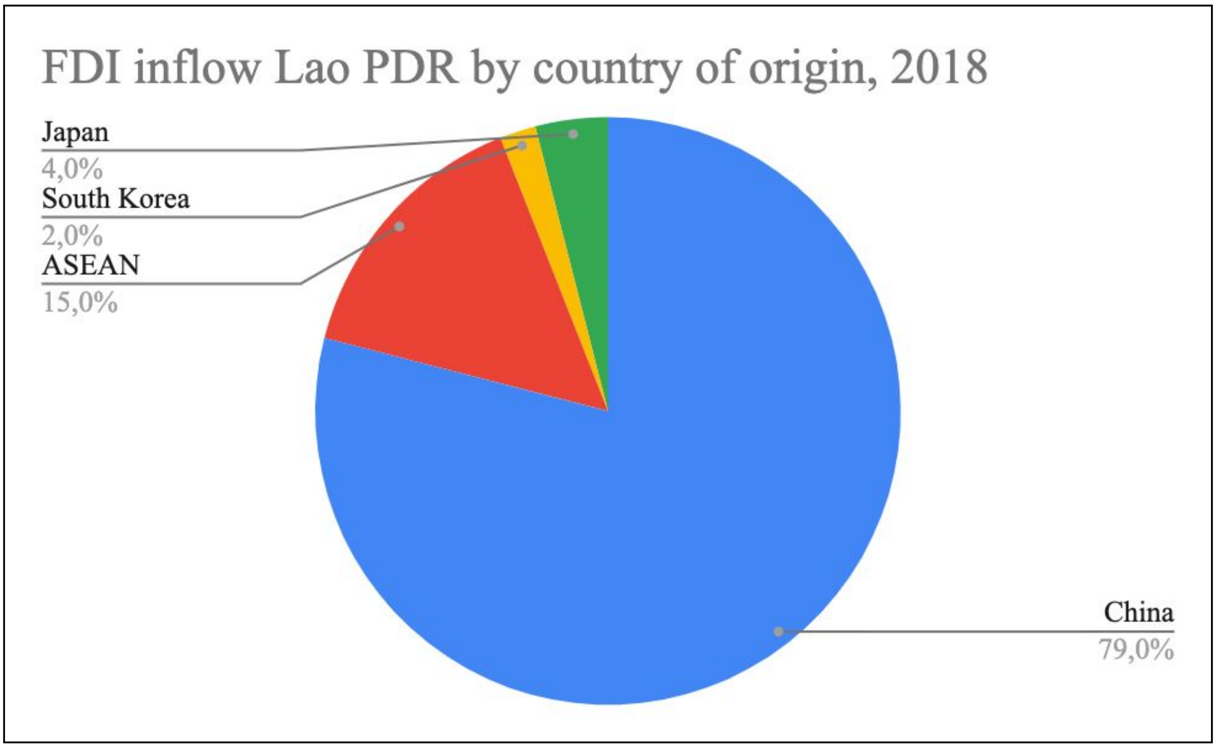
Country	*Value of Investment (US$ million)*
China	5484
Thailand	4491
Vietnam	3574
Malaysia	813
South Korea	751
France	491
Netherlands	435
Japan	438
Norway	436
Britain	202

Source: Kyophilavong et al., 2017b, p. 265

One possible reasoning for this is the context of which investors will have to function in. As mentioned, one characteristic and advantage of South-South FDI is the common experience of context. Firms from neighboring countries thus have the advantage of familiarity with either the Lao context for business or from a similar context in their home countries. For example, the top two contributors of FDI, China and Thailand present similarities and familiarity. China has a similar history of communist rule, with a transition to a more market-oriented economy in the past 50 years. Thailand, possesses a similarity in culture and language with Laos, and have historically had continuously recorded trade with the country.

Since the introduction of liberalizing reforms, China has contributed with more FDI than any of the other countries (see Table.4). As seen in Figure 3. below, in 2018, China was the largest contributor of FDI in Laos in 2018, at a staggering 79%. The ASEAN countries collectively are following behind at 15%, and Japan and South Korea at 4% and 2% respectively. Thus, in terms of FDI, China presents a far larger presence than the other investors currently and on overall since 1989.

Figure 3. FDI inflow to Lao PDR by country of origin 2018



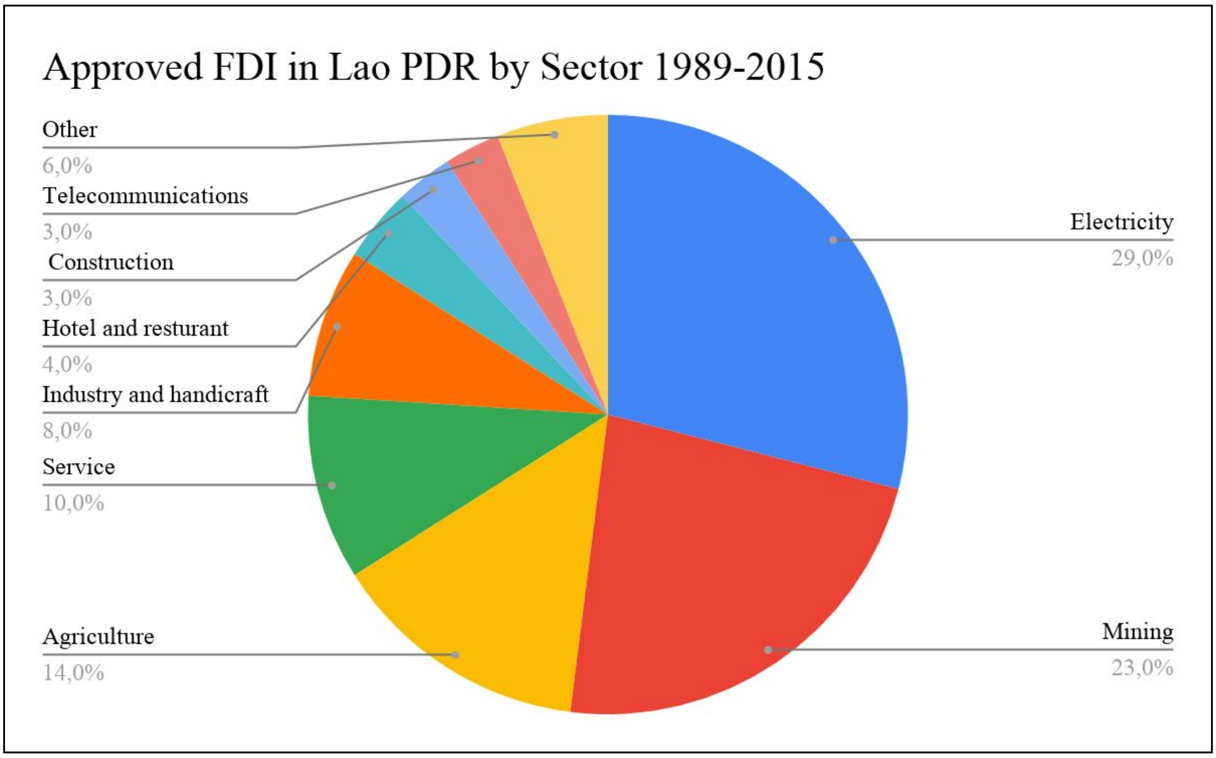
Source Statista, 2018

6.2.3 FDI and the sectors

Since 1986, the Lao government has aimed to bolster the export-sector, due to its need for development and the country's reliance on the sector, something which has been maintained through FDI areas of comparative advantage. Promoting and facilitating areas for investment of foreign and domestic investors through the identification of fruitful sectors has been successful. As Laos possesses an abundance of natural resources, attractive to the country themselves and other investors, this has been identified as a sector with the potential to fuel the country's growth (Rastogi, 2018; Ngangnouvong, 2019). The influx of FDI within sectors of exports is indicated to increase Laos' competitiveness as an exporter, thus, culminating in economic growth. Additionally, the Lao government points out the fact that the expected increased inflow of FDI will bring with it spillover effects such as management expertise and technological transfers and thus, the incentives for FDI is presented as high priority (Ministry of Foreign Affairs- Lao PDR, 2004, p. 5). The NSE perspective includes the promotion of FDI in industries where no domestic firms exist. Although there is no official information regarding the possible existence of domestic investors in hydropower and mining, the vast majority currently hail from China, followed by Vietnam, Thailand and, Malaysia (Asian Development Bank, 2019, p. 7). Thus, it can be said that attracting FDI in industries with a small domestic participation has been accomplished. However, the desire to attract FDI to achieve their developmental objectives requires the need for revision and imposing of requirements on these investors, through a dirigist approach.

In alignment with the more traditional role and mainstream approach of FDI, the Lao government has welcomed prospective FDI with open arms. The desire to attract FDI can be argued to be greater than the desire to actively monitor its effects. One of the main objectives in NSPES is to continue to steer the economy to a market-oriented one (Ministry of Foreign Affairs- Lao PDR, 2004, p. 1). Consequently to the country's increasingly liberal approach to investment and trade, it becomes clear of the FDI-driven path to enhance the economic growth of Laos. In NSPES, the government state some, rather vague, initiatives to develop "all economic sectors" (Ministry of Foreign Affairs- Lao PDR, 2004, p. 3). With the lack of investment restriction in SEZs as well as the data displayed in Figure 4. below, the government's role in steering development across all sectors can be questioned.

Figure 4. Approved FDI in Lao PDR by sector 1989-2015.



Source: OECD, 2017, p. 57

Figure 4. shows that since the time of economic liberalization and introduction of the less restrictive FDI law, the two sectors accounting for more than half of the approved FDI of the past decades are mining and electricity. Thus, it can be argued that the claimed objective to seek development through FDI and the initiative to develop all sectors, has not necessarily been followed through or achieved. Although this can be questioned from the perspective of NSE, it also shows the adjustment is focused based on their comparative advantage.

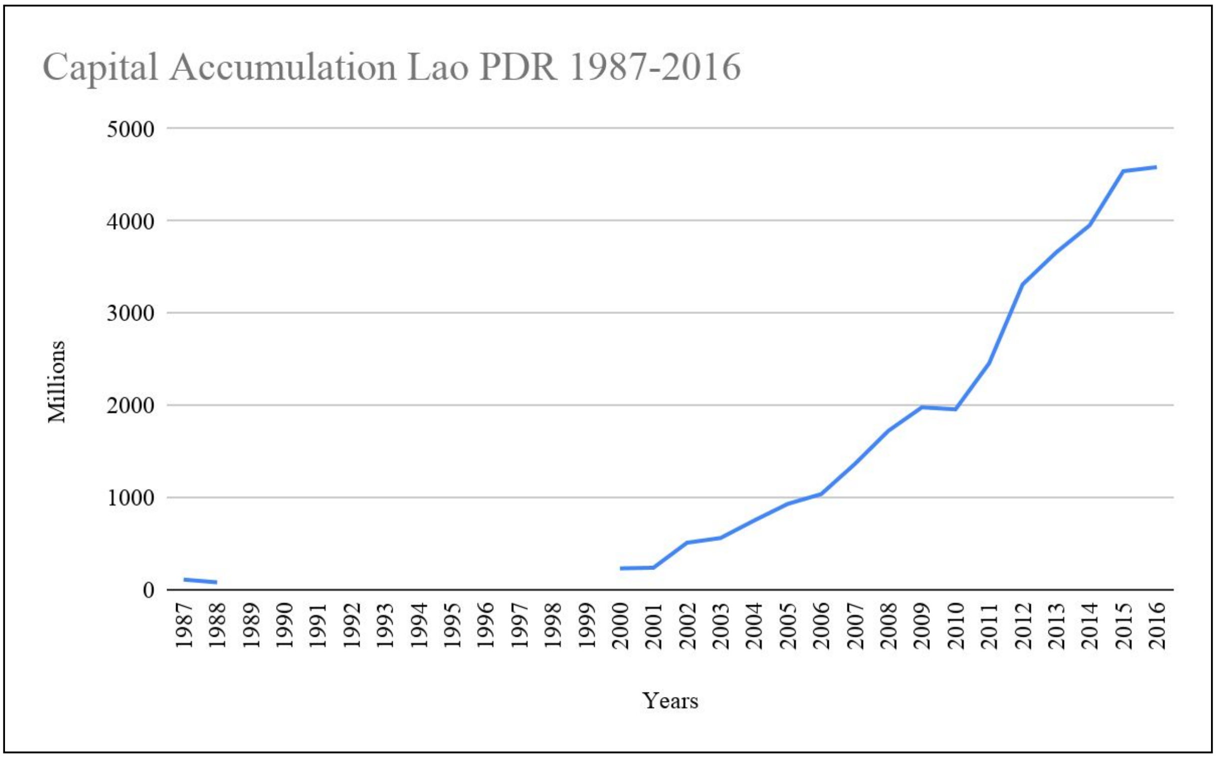
The two main FDI attracting sectors are dominated by Chinese investors. Approximately 90% of Chinese FDI is within the natural resource sectors, thus they have major influence and control within the sectors. The lack of diversity within what sectors are invested into, and the majority investor overall, and within these sectors being China can be considered questionable. Firstly, the lack of diversification of investments in terms of sector raises concerns of the sustainability of the long-term economic growth which is desired. It also raises the concerns of the possibility of natural resource curse or Dutch Disease in the future, as the country could become overly-dependent on the natural resource sector (Nolintha &

Yee, 2015, pp. 30, 50). Secondly, although few researchers reflect upon this, the large share of Chinese FDI overall and specifically within these sectors also raises concerns. As Laos has fixated on FDI as a source of growth and development, it can be suggested that a majority investor, hold leverage in terms of technology and capital and can impede the flow of these if demands are not met. With the large presence in the natural resource sector, the export of which is also expected to contribute to the growth and prosperity of Laos, the reliance of one primary investor could potentially impede development under certain circumstances.

6.2.4 Previous untapped potential?

Geographically, Laos holds great potential for the advancement of natural resources such as hydropower and mining (Andersson et al., 2009, p. 8; Lu & Schöwenger, 2000, p. 61). The natural resource abundant country is characterized by weak land governance along with the protracted poverty and is faced with developmental challenges. The primary sectors identified for attracting FDI is hydropower and mining, utilizing the natural resources (i.e factor endowments), to support the growth and capital accumulation in following the objectives of the Lao government (Ministry of Foreign Affairs- Lao PDR, 2004, pp. 4-5, 13). Thus, the opportunity for FDI within natural resources would serve as an incentive for increased investment, in conjunction with a contingency for capital accumulation for the government as well as weak regulations.

Figure 5. Capital Accumulation of Lao PDR 1987-2016



Source: The World Bank, 2019c

Arguably, the government has been able to increase its capital accumulation drastically as seen in Figure 5 above. There is a gap in the data from 1989-1999, however, if one takes the GDP growth (Figure 1.) and the Asian Economic Crisis into consideration, it can be predicted that the capital accumulation was rather stagnant in those years. Also note that data accessible for capital accumulation is only available until 2016. One can see that capital accumulation began to take off after the turn of the century, and even more so in 2010. This can arguably be connected to Laos' entrance into ASEAN and the Free Trade Agreements within the association as well as the commencement of the ACFTA in 2010 which further integrated the ASEAN countries with China. Thus, the integration into the regional market, through bilateral and multilateral agreements as well as the loosening of FDI restriction did not only promote trade and investment but simplified it, resulting in increased capital accumulation.

Discoveries of minerals and technologies within hydropower have made the natural resources of Laos very attractive to other countries. In an economy with poor governmental revenue, faced with various developmental challenges and high poverty rates, the natural resources have proved to provide incentive for further investment. The FDI in the natural resource sector has proven profitable in terms of the development and growth which the country has experienced so far (Kyophilavong, 2017a et al.; 2017b). Although the country is still largely characterized by poverty and challenges there have been improvements. With an average annual growth rate of 6,7% over the past two decades, along with decreased poverty rates by almost 10% between 2000 and 2010, the FDI led growth has proven successful. As seen in Table 4. a large share of this FDI since 1989 has originated from China, thus the Chinese FDI has contributed to the development which has taken place (Kyophilavong et al., 2017b, p. 272). It is apparent that to meet the demands of the growing economy and sustain the economic growth long-term, further reforms to improve the human capital and diversification is needed. The immense focus on natural resources to sustain the demand of exports is also alarming in terms of environmental, social and economic sustainability (Uitto, 2011, p. 480). Thus, the effective enforcement of more distributive growth, to encourage social progress, equity and environmental conservation, is needed for Laos to be able to benefit from its natural endowment in the long run (Uitto, 2011, pp. 480, 487-488).

6.2.5 Not all rainbows and sunshine

As mentioned, Laos has a rather fragmented market. The country's geographic demography, mountainous, sparsely populated, also presents challenges for the country. Although Laos has seen growth on a national level as a result of the various implementations and inflow of FDI, the distribution of the benefits of the fruits of labor (i.e growth and development) is not even (Andersson et al., 2009). Due to the need for land for further investments the government has resettled multiple ethnic minorities from their native mountain villages to clusters in the lowlands (Schoenweger & Üllenberg, 2009, p. 8). The infrastructure development which has been a result of some FDI projects, have mainly been concentrated around areas of SEZ, thus does not benefit large shares of the population that is sparsely located throughout the country. NSE fails to develop on the aspect of distributive development. However, NSE does bring up the aspects of developing the countries' comparative advantage as industries develop to further expand the economy as the infrastructure improvements occur. Nonetheless, due to the lack of diversification and clustered infrastructural development, it could be argued that distribution of the fruits of the labor is limited. As mentioned in the limitation section of the thesis, corruption pervades the country. Some of the country's elites have been strong advocates of the increasing FDI as they also conceivably benefit politically or financially from this influx (Lu & Schöwenger, 2019, p. 63). In addition, the growth which Laos has seen in recent years, is also resulting in larger inequalities across the country (Nolintha, 2015).

Throughout the development process of countries and the accumulation of capital it is, according to NSE, necessary to increase human capital as well, narrowing the gap between the two (Lin, 2012, p. 302). Although the country has achieved considerable capital accumulation (see Figure 5) in the past decades, the aspect of human capital development still presents as a key challenge. The education and training in Laos is not effectively keeping up with the economic growth of the country's economy. Thus, there is a need for the government to effectively increase their human capital in order to sustain the economic growth (Laos Australian Institute, 2014). In comparison to other economies of similar characteristics, Laos' workforce education and skills present poorly. Hence, in the current situation, the workforce is ill-equipped to further contribute as the economy transforms into a modern one (Laos Australian Institute, 2014). The Lao government has, through investments in education and health care aimed to boost the labor productivity of the country, thus, advancing its competitiveness in the global market (Asian Development Bank, 2010, pp. 30, 39). Since the implementation of reform to strengthen the educational and healthcare in Laos, HCI has gone from 0,41 to 0,45 between 2012 and 2017 (World Bank, 2018). Even though the HCI has improved, Laos' HCI is still low, it also remains considerably less than countries in the region with similar income (World Bank, 2018). Thus, serious reform in quality of education and healthcare are needed from the government to enhance the human capital in the country for future economic growth.

6.2.6 Lack of diversification

Laos has, throughout the years since liberalizing its economy, expressed a desire to expand FDI into various sectors, as well as the desire to further explore new comparative advantages for the country. Diversification of production in a country is common to decrease risk and stabilize income (Madura & Whyte, 1990, p. 74). In Laos, the natural resource sector has become the most vibrant one, with instrumental investments from Chinese investors, contributing to the recent expansion of exports and can arguably been seen as the largest driver of export-led growth (Nolintha & Yee, 2015, p. 50). The abundance of untapped natural resources, provided a catalyst for investments in Laos. Chinese investors were no exception. The Chinese domestic supply of raw materials was depleting at the speed of economic growth, thus, Laos, with close geographical proximity presented opportunity (Lu & Schöwenger, 2016, p. 63).

The FDI which surged into the Lao market, majority of which was Chinese, was destined for the natural resource sector, as seen in Table 4, and Figure 4. Even though the surge of FDI into the resource sector has contributed to the growth of GDP, poverty alleviation and capital accumulation, it is also subject to scepticism. As there are few regulations for investors, the government has little decision in what sectors are being invested into. The mining sector took off in the early 2000s, increasing its share of GDP from 0,2% in 2002, to 10% in 2006-2010 (Nolintha & Yee, 2015, p. 50). The natural resource sector accounted for 52% of approved FDI 2005-2015, peaking at 93,5% in 2006 and 2013 due to the approval of large scale hydropower plants (Nolintha & Yee, 2015, p. 50). As FDI is presented as one of the foundational sources of economic growth, and thus, capital accumulation and poverty alleviation, the vast focus of FDI in natural resources could raise concerns for sustained economic growth for the country due to its lack of diversification. As of 2016, 40 hydroelectric plants have been completed, and an additional 50 is scheduled to be completed by 2020. Out of the hydropower plants under construction and the ones that are completed, Chinese investors play a major role in approximately 50%, with a share in the project varying from 60-90% (Radio Free Asia, 2019).

6.3 Chinese participation in the Lao economy

As discussed above, China plays an important role in the Lao economy in terms of FDI. The following section will discuss the patterns of trade with China since the economic liberalization in relation to the influx of Chinese FDI.

6.3.1 Laos and its neighbors

Historically, Laos has had a more dynamic trade relationship with Thailand. Despite the political affiliation with China and Vietnam, Thailand has served as a more important trade partner. This can be argued to be due to the more dense population along the Mekong River and its tributaries along the Western border along with similarities in culture and language (Andersson et al., 2009, p. 6). However, in conjunction with China's vast economic growth and the increased scarcity of raw material, Chinese trade and investments in Laos began to take off (Schoenweger & Üllenberg, 2009, p. 26). Notably, the main interest of Chinese FDI and trade has been within the natural resource sector. (Schoenweger & Üllenberg, 2009, p. 26).

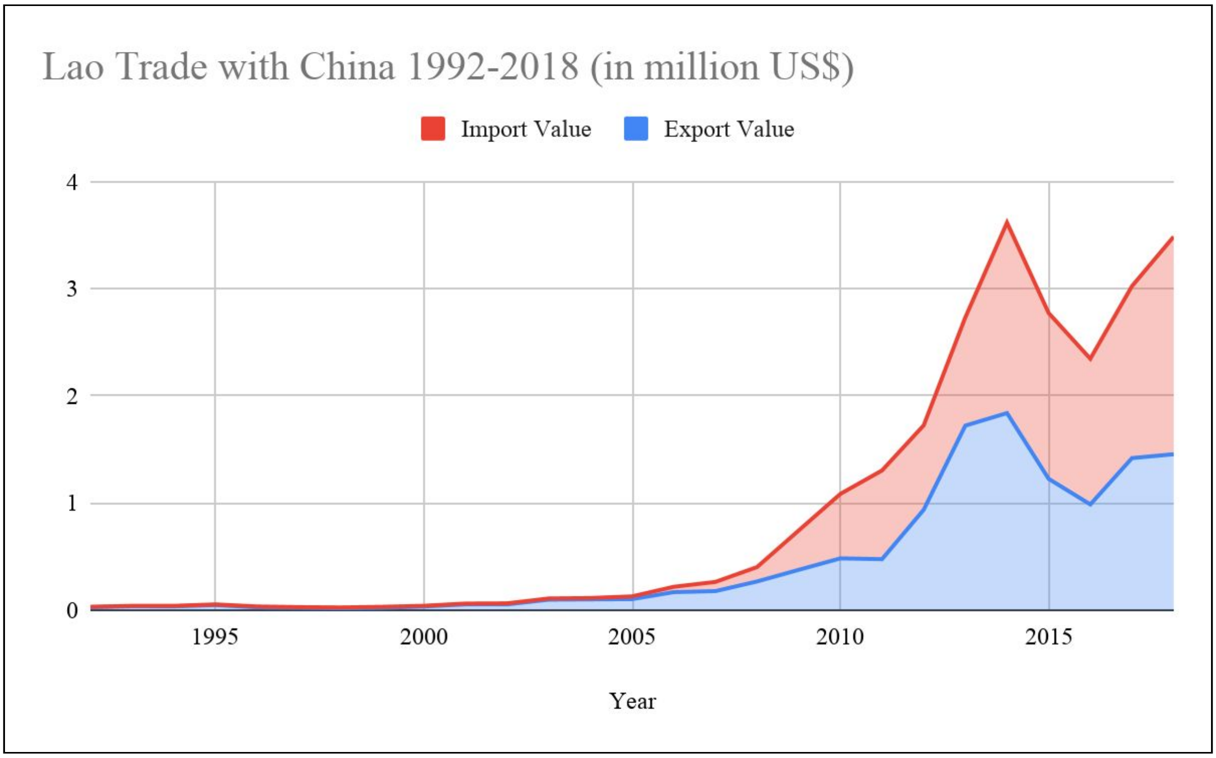
The close proximity between Laos and China would suggest great opportunities along with challenges in terms of trade. As one of the advantages of FDI is contended to be the similar context of the two countries, which in turn can make operating in a foreign economy run more smoothly, it is important to consider in discussions of South-South relationships. Within the notion of similar context, the previous experience of such context should also be taken into account.

Some of the major challenges are the regional disadvantages due to poor infrastructure (Andersson et al., 2009, p. 1). The Northern regions of Laos, which are in closer proximity to China, are in a position of more favorable trade conditions with the country. The Southern regions, au contraire, are presented with more costly transportation costs, thus the Chinese presence differs greatly throughout the country (Andersson et al., 2009, p. 2). This can arguably be attributed to the poor infrastructure in the country. The variance between regions presents a competition between Chinese, Vietnamese and Thai goods depending on regions. In the South, there is a larger presence of Vietnamese and Thai goods. As mentioned, the Northern regions have a more beneficial geographical location to China in terms of trade, thus, there is a larger share of Chinese goods in the Lao market in the northern regions (Andersson et al., 2009, pp. 2-3). Despite the regional differences, China still serves as a major contributor to the Lao economy through both exports and imports, a trend which is increasing (Andersson et al., 2009, p. 3).

6.3.2 Chinese trade- and uneven deal?

Since Laos joined ASEAN in 1997, and since the commencement of ACFTA, China's role in the Lao economy has gradually grown. Today, China is one of Laos' most important trading partners.

Figure 6. Lao Trade with China 1992-2018

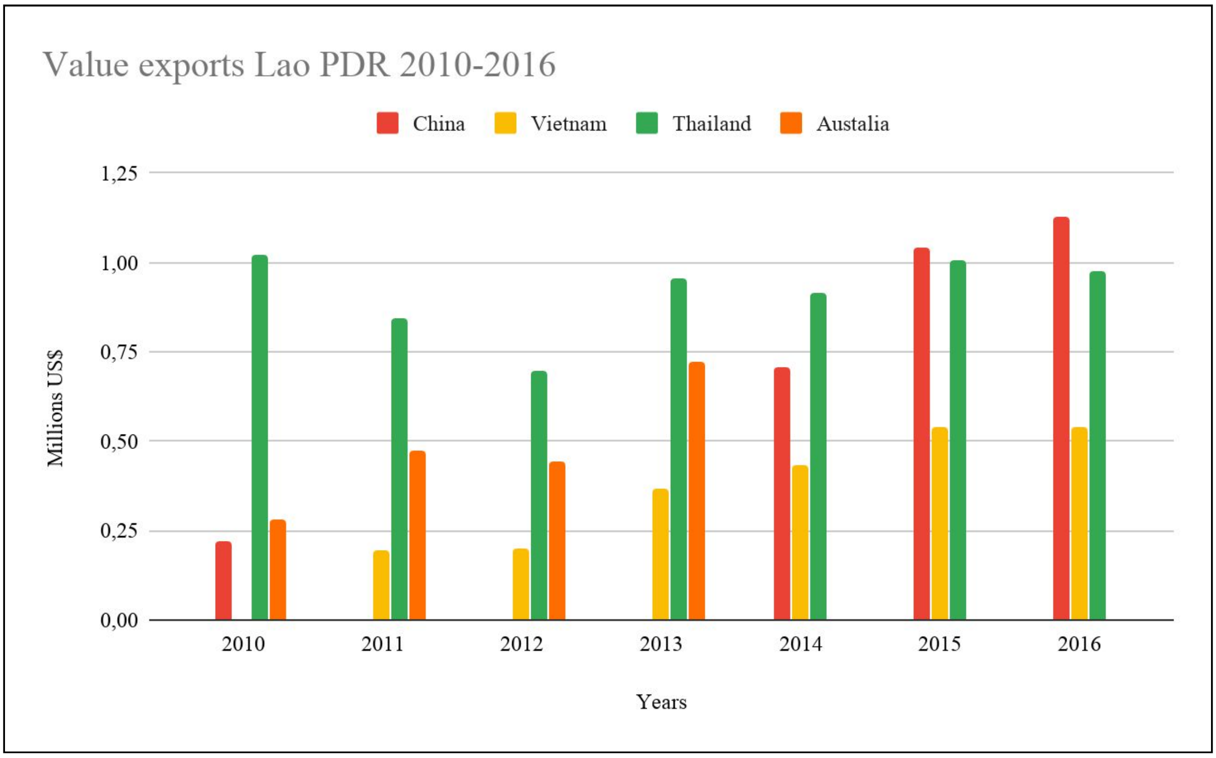


Source: United Nations, 2020

The trend of larger Chinese participation in the Lao economy is visualized in the figure above, showing the value of imports and export to and from China from 1992-2018. One can see that China now serves as one of the primary import origins and export destinations for the Lao market. The top three imports to Laos in 2017 were, in terms of percentage; broadcasting equipment, hydraulic turbines and electronic control boards. Broadcasting equipment accounted for 7%, hydraulic turbines 4,4% and electric control boards for 2,7% of imports. The main origin of all these imports was China, with 93%, 63% and 66% accordingly, although Thailand still plays a larger role as an overall importer (OCE, 2017). The composition of these imports from China, being all manufactured goods is interesting if one examines the breakdown of the exports leaving Laos. In 2017, the top three exports from Laos were copper ore, rubber and rough wood, all raw materials. Copper ore accounted for

27% of exports, with 85% being exported to China. Rubber accounted for 9,5% of exports, with 99,6% being exported to China. Lastly, rough wood accounted for 6,7% of exports, of which 100% was exported to China (OCE, 2017). Thus, basic commodities leave Laos for China, and the manufactured goods are imported from China to Laos. To make this trade composition beneficial in the long run, Laos needs to further invest in industries of manufactured goods, something which might not be in the interest of China in the long run.

Figure 7. Value of exports Lao PDR 2010-2016

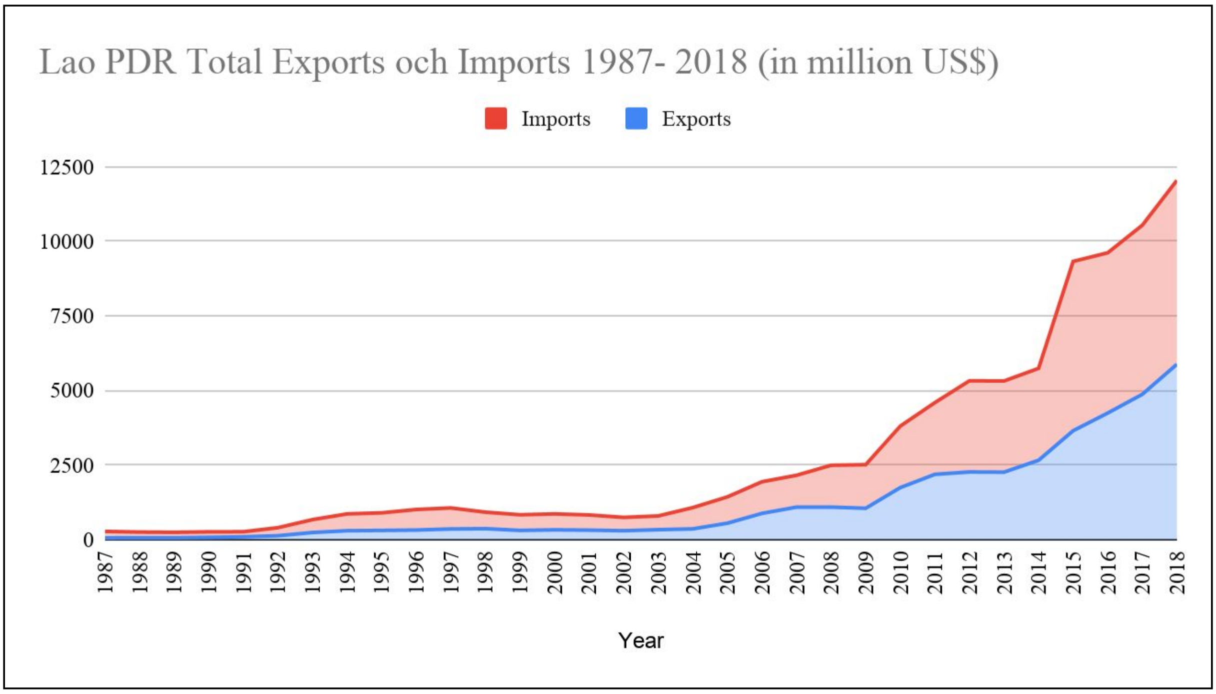


Source: World Integrated Trade Solution, 2020

The exports of the top three export commodities are either exclusively or predominantly being exported to China. As seen in Figure 7. above, the value of Lao exports going to China has increased drastically in the past decade. Mineral mining, being the second largest area of FDI, accounts for 45% of Laos' export, and 98% of the exported minerals are exported to China. Mining and other natural resource extraction has been prioritized by the government for investment and trade to fuel the economic growth of the country (Ngangnouvong, 2019). Thus, the interest shown by China, and their role and the main export destination of these resources, is important for the Lao economy as they provide an important source of capital for the country in terms of trade and FDI.

Laos' traditional exports products have experienced stable and high revealed comparative advantage (RCA) over a period of time. The exports products which have continued strong in trade for the past two decades are wood, clothing and textiles, coffee and tea and vegetables (Lord, 2011, pp. 19-20). Out of these, textiles and clothing accounted for nearly 80% of Laos' export earnings between 1994 and 2004. However, they saw an abrupt decline in 2010, when the emerging export products electricity and copper began to experience rising RCA (Lord, 2011, pp. 20-22). Here it is important to keep in mind the limitations which were discussed above. As there are large discrepancies in the reported trade statistics, the composition of the trade could differ in reality. The NSE perspective emphasizes the importance of identifying a comparative advantage. The amount of FDI approved into mining and hydropower activities can be argued to be a conscious choice of the government on that basis. The Lao government has expressed its need and desire to further research possible comparative advantages to fuel their economic growth (Ministry of Foreign Affairs- Lao PDR, 2004). This points towards engagement from the government in diversification and seeking new opportunities, however, as mentioned, not much evidence of this has been seen.

Figure 8. Lao PDR Total Exports and Imports 1987-2018 (in million US$)



Source: World Trade Organization, n.d

There is a noticeable trade deficit between Laos and China as seen in Figure 6 above. This is translated into the overall trade deficit as well which is visualized in Figure 8. above. However, as discussed in the limitation section, the IMF estimates that the trade deficit could be between 20-280% higher than recorded by the government. Although a trade deficit is not inherently bad, in the case of Laos it could become problematic for the long term growth. Trade deficit could lead to a shortage of foreign trade, disruption in the balance of payment and possibly lead to the outsourcing of jobs (Amadeo, 2020). The reliance of trade with China, and the trade deficit within that relationship, could possibly lead to some challenges in the future. As the trade with China is largely within primary commodities it could lead to a stagnation in their development without the structural changes of infrastructure as well as improvements in human capital. Additionally, the heavy reliance on natural resources as their main export could arguably present challenges in terms of sustained long-term growth, with the risk of exhausting Laos' natural resources.

7. Concluding remarks

Throughout the analytical discussion of the research findings, the empirical findings have answered the two posed research questions; *What are the main characteristics of the South-South FDI between Laos and China from the time of economic liberalization in 1986 to 2019?* and *How has the Chinese in Laos impacted the country's trade patterns?* This was done through the lenses of conceptual frameworks regarding the role of FDI and the new structural economics.

Since the introduction of economic liberalization policies in 1986, Laos has actively sought out to attract FDI. China has become the largest origin of the FDI which operates in Laos today. The surge of Chinese South-South FDI in Laos is predominantly focused within the natural resource sector, thus, can be characterized as resource-seeking from the Chinese perspective. From the Lao perspective, the South-South FDI from China can be characterized as efficiency-seeking as it aims to more efficiently utilize the resources present in the country through the help of Chinese technology and capital. 70% of Chinese FDI in Laos goes to the natural resource sector. In the NGPES, the government claims to research other areas of prospective investments, to diversify and expand their industries, however little affirmative action has been visible towards this. The Lao government has expressed their desire to upgrade and develop infrastructure in the country through FDI. Arguably, the Chinese FDI has assisted in this. However, due to the uneven distribution and diversification of FDI, clusters of SEZs and lack of restriction, the benefits of the FDI are not widespread. The clustering of FDI and the lack of regulations as well as diversification of sectors, all of which is controlled by the government suggest that the Lao government holds a mainstream view of FDI.

While actively promoting and acknowledging the benefits of FDI, especially South-South FDI with China, the government does not actively adjust policy making to avoid the pitfalls of FDI. There is no doubt that the Lao government has been successful in promoting FDI in its traditional sense, something which NSE values. However, the desire to attract FDI can be argued to overshadow the government's lack of role in other areas. Therefore, the lack of diversification, clustering and adjustments in policy may thus question the future sustainability of the long-term growth. Enforcing policies which guarantee or force knowledge transfer from FDI to the domestic workforce would help ease the knowledge gap in the country, increasing its human capital. Diversification of sectors, would allow for a more evenly distributed growth, throughout the sectors. This clearly suggests a need for a more dirigist approach towards FDI. In order to maximize the fruits of the labor, and reap the benefits of FDI, the Lao government must actively seek to expand the outcomes of FDI throughout the country and its citizens for equal development fruitful to all.

With the liberalizing reforms of 1986, and the additional policy changes since, the Lao government has taken several steps to further integrate to the global and regional market as well as to steer the country towards a more market-oriented one. Major steps such as the introduction of the FDI law, joining ASEAN, and ACFTA, ultimately allowed Lao-Chinese trade to flourish. FDI laws allowed for easier investment, attracting Chinese investors in masses. Since the commencement of the ACFTA, Chinese trade has expanded rapidly, primarily in terms of Lao exports. In the past decade, China has become the primary importer of Lao exports. The increased presence of Chinese trade, can arguably be linked to the increased presence of Chinese FDI through regional integration. Although China does not present as the main origin of Lao import, they are the main destination of Lao export. The composition of Lao exports have changed from the traditional exports of vegetables and clothing to hydropower and minerals. The composition and breakdown of exports and imports between Laos and China may present challenges for Laos in the future. If the industries continue to be focused on natural resources, the sustainable long term economic growth of Laos may see a shaky future. As natural resources do not come in endless supply, diversification of industries for export is needed to secure the future export-led growth which the government desires.

As presented throughout the analytical discussion and concluded above, it is desirable that the Lao government thoroughly examines the patterns of FDI and trade. Weighing the for and against arguments for the benefits and distributive growth to maximize the outcome, and prosperity for all.

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