The Labor Impact of Lao Export Growth

SUMMARY

February 2016
Lao PDR has seen strong economic growth during the past decade with an average growth rate of 7.8 percent per annum. Much of this has been driven by the growing external appetite for Lao PDR’s natural resources, which have not generated broad-based job creation and income growth for a significant proportion of the Lao population. Manufacturing – and especially garment manufacturing – has the potential to generate jobs for the large unskilled segment of the Lao labor force. The garment sector did indeed provide substantial job creation in the 1990s, especially for women, but more recent trends suggest a relative contraction of the manufacturing sector since 2007/08, both in terms of employment and weaker wage growth. This contraction is mirrored in Lao PDR’s manufacturing trade outcomes over the past decade, pointing to a decline in competitiveness on the international stage. While exports can be an avenue to growth and job creation, the success of policies aiming to sustainably improve employment outcomes will depend on the realities of Lao export competitiveness and global market demand.
2. Based on a series of complementary methodological approaches and datasets implicitly linking trade to jobs, this report paints a mixed picture of Lao PDR’s recent export performance and how this has translated into job creation and improved job quality across the economy. The findings of these various analytical approaches provide insight into the potential drivers of Lao PDR’s labor outcomes including the role of exports, and what the Government and firms can do to better position Lao producers in external markets so that more and better jobs are created for Lao workers in the future.

3. Whereas the economy is undergoing some structural transformation away from agriculture, workers are primarily shifting into low-skill non-tradable service activities and there is no strong concurrent rural-to-urban shift. Agricultural employment continues to dominate the Lao labor market, but agricultural production accounts for only a small share of Lao exports. The most dynamic export sectors – mineral products, base metals, and wood and pulp – are not generating sufficient labor demand to absorb the large unskilled segment of the labor force. Mining wages are higher than other sectors, controlling for other factors, but mining activities are not labor-intensive. Even the garment sector, which accounts for a tenth of exports, employs less than 2 percent of the labor force, pays very low wages, and experienced slower real wage growth than the rest of the economy (except for hotels and restaurants).

4. Manufacturing in Lao PDR is more export-oriented than average compared to other countries, with export rates similar to Vietnam. Exporting firms tend to be larger than non-exporting firms, both in Lao PDR and elsewhere. However, comparing Lao PDR’s 2012 export basket to countries at a similar level of development, Lao exports tend to be less sophisticated than those from Senegal, Cambodia, Indonesia, Bangladesh and the Philippines, based on indirect (global trade-weighted average) measures of wage, value-added, and human and physical capital. In the case of garments, which have a high labor content, Lao garment exports may in fact be less competitive due to higher wages vis-à-vis Bangladesh and Cambodia. Lao PDR’s small scale of garment production also makes it less well placed to compete for large contracts in certain markets compared to Cambodia and Bangladesh, even if Lao producers have found a competitive niche in European markets. In dynamic terms, the
labor sophistication of Lao PDR’s export basket has remained relatively flat since 2006, and made little progress in closing the competitiveness gap vis-à-vis comparator countries. This suggests relatively low-tech production methods and/or weak education outcomes. These factors in turn limit exporters’ capacity or incentives to invest in more productive technologies.

5. A key obstacle to attracting investment in high-value manufacturing is the Lao labor force’s low schooling levels. With respect to wages, the Lao labor market rewards higher education levels with higher wages, although we find evidence of declining returns to each level of education between 2007/08 and 2012/13. For those with a tertiary degree, for example, the premium relative to less than primary fell from 58 percent in 2007/08 to 39 percent in 2012/13, suggesting that there is increasing supply of skilled labor to meet current demand (this may be partly driven by civil service wage distortions). This also translates into relatively lower incentives for workers to achieve higher education levels. This trend contrasts with other dynamic economies where the diversification into higher value products and the adoption of new technologies require more and more top skills and therefore generate increasing returns to the highest levels of education.

6. It is notable that in the garment sector in particular, wage growth for those with a vocational degree was much faster than the average for all garment workers (14 percent vs. 2.6 percent annual growth). Whereas this implies increasing returns to semi-skilled workers, consistent with reported shortages of skilled labor, the slower wage growth for unskilled or entry-level garment workers may explain why employers have difficulty retaining workers (factories report high turnover rates of new entrants, most of whom lack a secondary or vocational degree). This either means that employers are actually willing to incur the repeated recruitment and training costs of their rapidly changing unskilled labor force, or that profit margins are too small to accommodate higher wages for this majority segment of the garment sector workforce.
7. Data on worker movements between jobs and into and out of different sectors suggest that the Lao labor market is relatively fluid, but workers seeking better work opportunities in other sectors typically face significant costs to transition. High labor mobility costs are the norm for countries with a large share of primary employment, and Lao PDR is no exception. Skilled workers face relatively lower mobility costs than unskilled workers, while female workers face higher transition costs compared to men. The agriculture sector has the lowest entry costs, and as such acts as the “sector of last resort”.
Policy Recommendations

8. Policies to facilitate better labor outcomes could focus on improving existing firms’ or producers’ competitiveness, helping firms to enter and/or grow, facilitating access to technology and higher value production, and enhancing the skills in the labor market to attract and induce higher-value activities.

9. Small profit margins in the low-value garments sector mean that Lao producers have little room for finding productivity gains vis-à-vis competitors such as Bangladesh and Cambodia. A more promising strategy would focus on creating more attractive niches or product lines for high income economies through e.g., upgrading labor standards and environmental standards, thus helping big brand retailers and buyers to meet their corporate social responsibility objectives.

10. High turnover and exit rates from garment factories back to farm work or migration results in productivity and production losses for the Lao economy. Policies to reshape the incentive structure of garment jobs (such as working conditions and/or career development) could entice workers to remain in relatively more productive work.

11. A large pool of skilled and competitive labor is an essential component both for attracting investment in higher-value activities, and for enabling firms to upgrade the quality of their output. This means policies to increase educational attainment, more support for basic education, curricula reform to meet market demand including soft skills and entrepreneurial skills, and aligning vocational training to private sector demand.
12. Exporting rather than selling to the domestic market is correlated with more skilled and unskilled employment, although the effect is quite small. Policies that help producers access new external markets could include joining (electronic) knowledge platforms, improving standards compliance and certification in line with international standards, reducing trading costs by improving trade logistics and trade facilitation systems, and providing enterprises with support for marketing assistance and training, for example.

13. Whereas labor regulations do not seem to be a binding constraint on hiring, there is anecdotal evidence of confusion surrounding the implementation of the new minimum wage regulation which could diminish labor demand, suggesting a need for clarification and outreach by the Ministry of Labor. In addition, other recent World Bank reports¹ identify critical business climate challenges that present larger impediments for firms trying to export, and that should be addressed.

14. Lao’s relatively low-tech export basket limits its capacity to access higher income consumers seeking higher quality goods and services. Policies should therefore focus on facilitating access to technology and higher value production through for example more favorable (but still non-distortionary) investment incentives, or more generally by easing access to formal finance through banks or SME-targeted credit institutions.

15. The high labor mobility costs in Lao PDR prevent efficient labor allocation across sectors, and could generate significant welfare losses in the event of a sudden change in the economic environment by slowing and dampening the labor market response. Policies to facilitate labor mobility could include labor market information or matching services, or cost-share training that is demand-driven and targeted to specific private sector needs.

16. Diversifying production and employment away from the primary sector toward industry and services will also reduce labor mobility costs, enabling workers to transition more easily to better jobs. In addition to policies directly

targeting lower mobility costs, there is scope for reforming distortionary public employment hiring, compensation and human resource management policies, and revisiting the role of SOEs. Reducing these distortions could curtail queuing for public sector jobs and free more educated workers to enter the private sector.

17. The limitations of Lao PDR’s manufacturing sector – both in size and quality – mean that any positive policy impacts are likely to have only modest effects on aggregate welfare and inclusive growth. Policies will need to go beyond the manufacturing sector to address the limited employment and demand spillovers of mining production, and the limited market integration and value addition in agricultural production. Policies to enhance agricultural productivity, job quality and economic opportunities in rural areas will not only foster greater equity, but will also reduce urban-rural distortions and dampen the incentives to migrate.