Southeast Asia Investment Policy Perspectives

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The OECD's work on investment policies in Southeast Asia has been growing through country-level Investment Policy Reviews in partnership with the ASEAN Secretariat supported by the AANZTA Economic Cooperation Support Program and through regional dialogue. This report presents and elaborates on findings from the Reviews and is intended to stimulate further dialogue both within the region and with peers in other regions about investment policy reforms. It has benefited from comments received during regional consultations held in March 2014 at the OECD Southeast Asia Regional Forum in Bali.

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More information about our work on international investment in Southeast Asia is available online at www.oecd.org/daf/inv/investment-policy/seasia.htm.

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INTRODUCTION

The prospects for international investment in Southeast Asia have not been this positive in almost two decades, on the back of relatively strong economic growth. At a time when many other regions are still recovering fully from the global financial crisis, the ten members of the Association of Southeast Asian Nations (ASEAN)[1] are expected to see growth on average of 5.4% over the next five years. It will be particularly strong in the countries in the Mekong region and in the Philippines and Indonesia. Not all countries will benefit equally, but growth is estimated to be more widely shared among ASEAN members than it was in the eight years leading up to the global financial crisis (OECD, 2013a).

Partly in response to these growth prospects and the rising middle class in one of the world's most dynamic markets, direct investment in ASEAN – both from outside and within the region – is likely to be at record levels for many countries over the next few years. Foreign direct investment (FDI) in Southeast Asia exceeded that in China in 2013 and was the only region to see rising inflows of FDI in 2012. Record ASEAN inflows are occurring at a time when global FDI flows are still 25% off their pre-crisis peak. This performance has given renewed confidence to ASEAN member states to pursue their ambitious goal of achieving an ASEAN Economic Community by 2015. Simultaneously, ASEAN members are building on the ASEAN-wide free trade agreements currently ratified (Australia-New Zealand, China, India and Japan) to negotiate a Regional Comprehensive Economic Partnership.

This regional and international agenda is contributing to reforms at a national level, and, as a result, ASEAN members are becoming more open to international investment over time. For Cambodia, Lao PDR and Viet Nam, another driver of reform has been WTO membership,[2] while for Myanmar it has been the economic and political reforms since 2011. Beyond this positive reform agenda, ASEAN member states (AMS) have also largely resisted the temptation to resort to widespread protectionist measures during both the Asian financial crisis in 1997 and the more recent global one.

In spite of this favourable context, the region still faces two inter-related challenges. Firstly, a genuine economic community will require greater openness to investment than is currently found in many AMS. For enterprises to consider ASEAN as a single market, they will need to be able to invest freely from one corner of the region to the other. Secondly, ASEAN will need to continue to strive to narrow the development gap between the highest achievers and the rest of ASEAN.

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[1] ASEAN includes Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam.

[2] Cambodia (2004), Lao PDR (2013) and Viet Nam (2007) all joined the WTO within the past decade.

These challenges are well understood within the region. One of the contributions of this first *Southeast Asia Investment Policy Perspectives* is to look at these issues from the perspective of the investment climate and to suggest ways in which they can be addressed so as to bring about a greater convergence of both policies and outcomes within the region. As in many other areas, there are strong divergences in the quality of investment climates among AMS.

This report benchmarks the treatment of foreign investors across Southeast Asia, both in terms of openness and with regard to the levels of investor protection offered by host governments. This exercise reveals that policy convergence has been slow within ASEAN in this area. Indeed, in spite of certain similarities in some areas, such as regarding the treatment of export-oriented investors, there is almost as much variation within ASEAN as there is worldwide in terms of policy approaches to international investment.

This divergence is mirrored in the strong variation in performance across Southeast Asia in attracting international investment. The report argues that this correlation between relative openness and FDI performance is not a coincidence: policies matter for investment. ASEAN member states wishing to improve their performance in attracting global and regional investment will need to reconsider their restrictions on foreign investment. These reforms would increase the integration of each AMS not only with the regional market but also with the global one.

Likewise, there are still substantial discrepancies in countries' legal frameworks for the protection of investment, and ASEAN countries still have a long way to go to achieve a consistent and transparent legal landscape under the single umbrella of the ASEAN structure. Yet, the report shows that reform efforts that have been undertaken, to varying degrees, by AMS gradually pave the way for legal regionalism in Southeast Asia. In this regard, the "ASEAN way" is a model of a successful ASEAN-driven approach to the unification of domestic investment legal regimes in a regional entity.

This report also considers how ASEAN member states can improve their promotion of international investment, not just in volume terms but also by maximising the development impact of that investment through spill-overs and linkages with local enterprises. Here too there has been a wide divergence in performance within ASEAN, with some countries such as Singapore and Malaysia among the best in promoting such linkages while some others lag significantly behind. Promoting investment within regional value chains provides important avenues for ASEAN firms to upgrade.

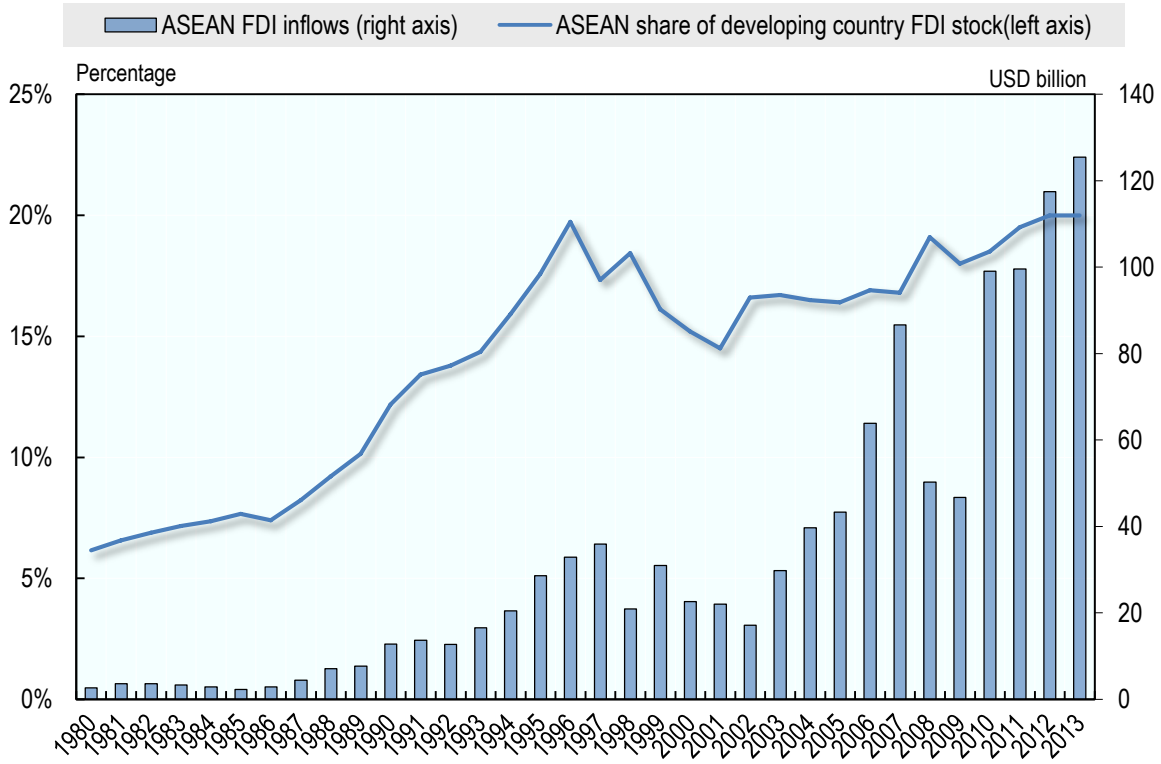
The final chapter considers infrastructure. Policy reforms can create a propitious environment for integration, but infrastructure will be needed to allow both goods and workers to move freely within economies and across borders. Infrastructure bottlenecks such as power outages and deficient transport systems are a constraint on the ability of some AMS to benefit from investment climate improvements in other areas. Improved infrastructure connectivity can help to enlarge regional demand, allowing the region to benefit from greater overall FDI inflows: the whole is more than the sum of its parts. Greater connectivity will also facilitate economic diversification and upgrading and can be particularly important for small and medium-sized enterprises. Meeting future infrastructure needs will require greater private sector participation. To make this happen, AMS are increasing efforts to build appropriate regulatory and institutional environments for public-private partnerships. They are also striving to "green" their infrastructure.

Chapter 1

FOREIGN DIRECT INVESTMENT TRENDS IN ASEAN FROM AN OECD INVESTOR PERSPECTIVE

Southeast Asia has long been a magnet for foreign direct investment. Some countries in the region were among the first-movers in shifting to export-led development based in part on the attraction of multinational enterprises (MNEs). The take-off in FDI in ASEAN occurred in the second half of the 1980s when currency realignments in East Asia were pushing enterprises in Japan and Chinese Taipei to shift some production offshore. This coincided with a sharp recession in parts of ASEAN which caused some member states to rethink their earlier restrictive policies towards foreign investors, leading to a more propitious environment for export-oriented production. A decade of rapid and uninterrupted growth in FDI in the region followed, as the ASEAN share of developing country inflows grew from 7% in the mid-1980s to 20% by 1996 (Figure 1).

Figure 1. ASEAN FDI inflows and share of total FDI stock in developing countries[1], 1980-2012



Source: based on UNCTAD data.
Notes: [1]Excluding affiliates in the Caribbean.

This trend was halted abruptly by the Asian financial crisis starting in 1997. Some ASEAN members such as Indonesia saw net outflows of investment as MNEs divested or drew down their assets. Since 2006, however, the ASEAN share has recovered once again and now exceeds its peak before the Asian financial crisis – at a time when virtually all countries now compete actively for international investment. This recovery in ASEAN's

share of the stock of FDI in emerging and developing economies demonstrates the attractiveness of Southeast Asia for multinational activities – not only as a location of production for exports but increasingly as a market in itself, as will be shown below.

FDI inflows into ASEAN are now at historical highs in nominal terms, and Southeast Asia was the only region to experience positive growth in inflows in 2012. Estimates for Japanese FDI in ASEAN in 2013 suggest that Japanese investments in ASEAN more than doubled to USD 23 billion. Data for cross-border mergers and acquisitions (M&As) can provide an early indication of expected trends in FDI flows. Estimates of M&As suggest that cross-border M&As with ASEAN firms as targets grew from USD 19 billion in 2012 to USD 43 billion in 2013, the highest level recorded over the past decade (OECD elaboration on Dealogic). Furthermore, five ASEAN economies (Indonesia, Thailand, Viet Nam, Malaysia, Philippines) were included in an UNCTAD (2013) survey of MNEs concerning the top 20 destinations worldwide for FDI in 2013-2015.

This evidence suggests that the short term prospects for further growth in FDI in ASEAN are good. In the longer term, Southeast Asia offers a large and increasingly integrated market with growth prospects of 5.4% between now and 2018 (OECD, 2013a). It also offers relative political stability and new markets for many investors following the political and economic reforms in Myanmar since 2011 and the subsequent relaxation of economic sanctions. This broad, regional view masks important disparities within ASEAN in terms of investment climate conditions which will need to be addressed and which are discussed throughout this report, but these issues should not mask the overall favourable conditions in which ASEAN member states as a whole operate in terms of their ability to attract international investment.

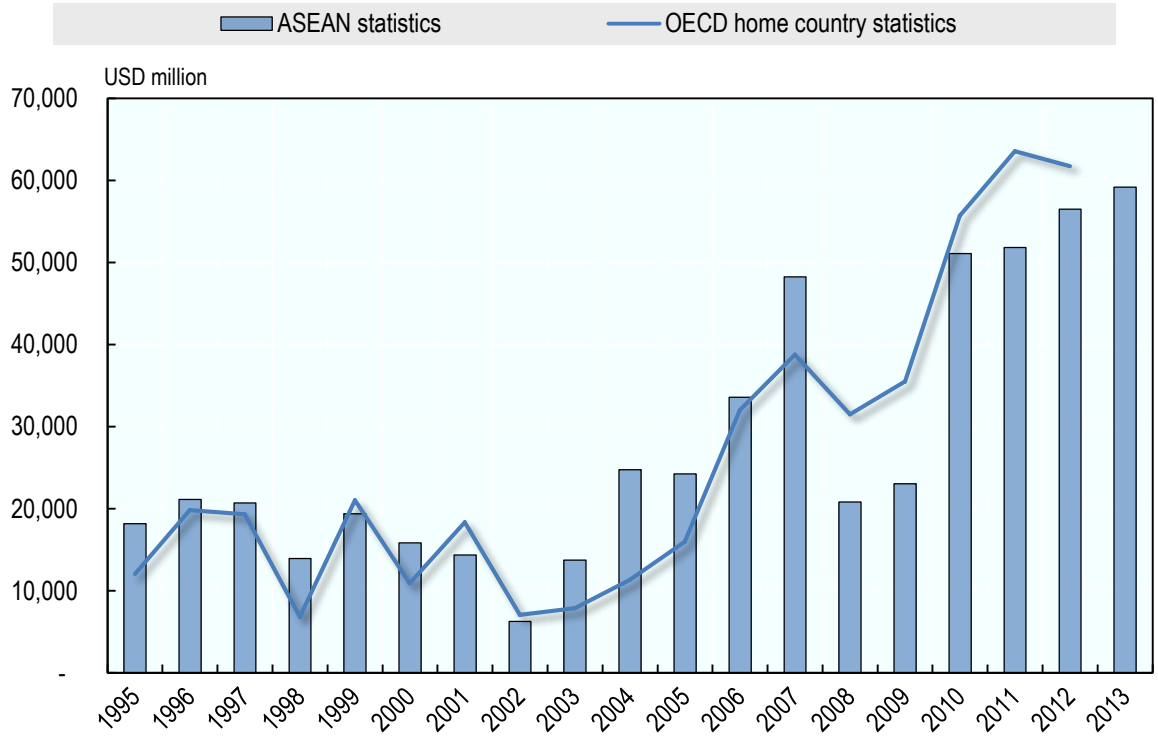
FDI in ASEAN from the perspective of OECD home countries

One way to look at trends in FDI in Southeast Asia is from the perspective of investor or home countries. To what extent do home and host country statistics tell the same story? This section focusses on trends in investment by OECD-based enterprises in ASEAN. These OECD MNEs have been active in the region for decades and represent on average two thirds of ASEAN inflows in most years since 2004. Southeast Asia is unique among regions in having almost equal shares of OECD investment from Europe, North America and the Asia/Pacific region (Australia, New Zealand, Japan and Korea). Some OECD home countries also provide information on the activities of their ASEAN affiliates which allows us better to understand why OECD MNEs are investing in individual ASEAN members and how this has changed over time.

Figure 2 compares FDI in ASEAN from OECD countries since 1990, as measured by ASEAN members as hosts to FDI, with the same information seen from the perspective of OECD members as home countries. It is common to find a discrepancy between home and host country statistics, even for countries that apply a common methodology. In spite of this, ASEAN members' statistics on FDI inflows from OECD countries appear to track quite well with ASEAN statistics on inflows from these countries over time. But recent investment as reported by home countries has exceeded that recorded in ASEAN member state statistics. Between 2008 and 2012 alone, OECD investors reported investing USD 45 billion more in ASEAN members than was reported in host country statistics – a significant discrepancy. This discrepancy can arise for many different reasons, and it should not be automatically assumed that home country statistics are more reliable than those of host

countries, but it does suggest that FDI flows to ASEAN might be higher than is commonly assumed.[3]

Figure 2. FDI flows to ASEAN from OECD countries based on home and host country statistics



Source: ASEAN Secretariat; OECD; MOFCOM, China.

The greatest discrepancy between OECD outflows and ASEAN member state inflows appears to be the Philippines. A comparison of inflow data provided by the Bangko Sentral Ng Pilipinas and that of OECD outward investors between 1999 and 2012-2013 suggests that OECD outflows exceeded Philippine inflows by 60% and that the geographical distribution of inflows into the Philippines bears little resemblance to the origin of outflows as reported by OECD members.

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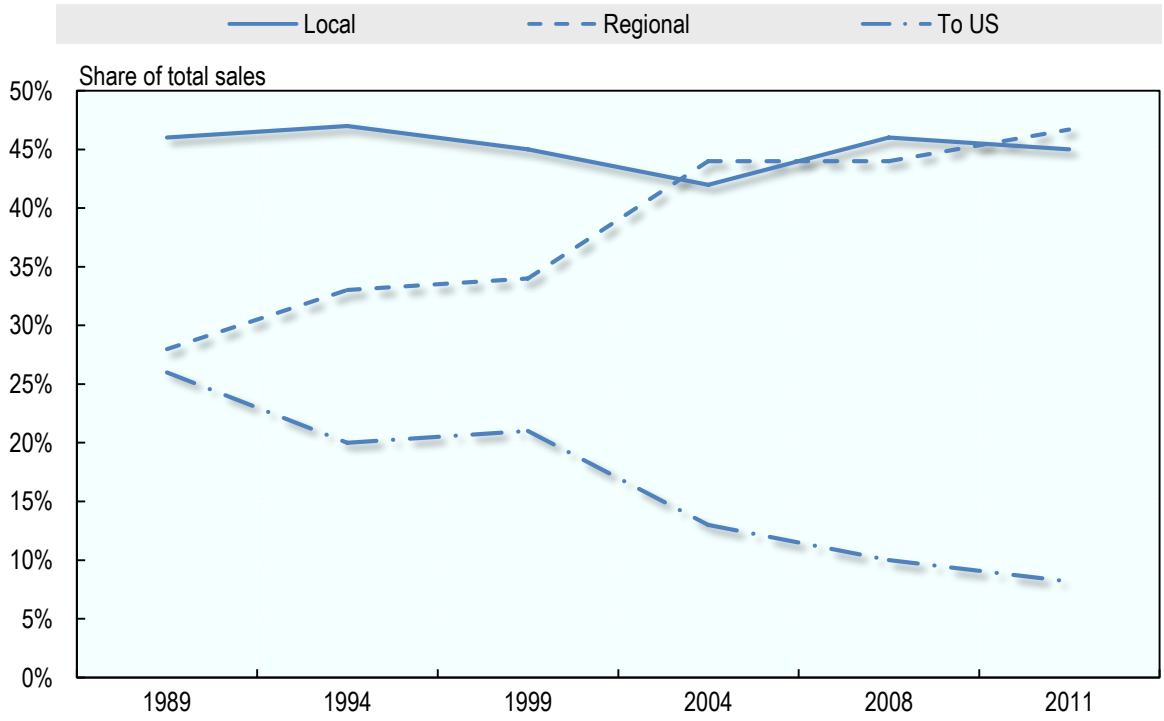
3 One explanation for part of the discrepancy may be that some FDI recorded as intra-ASEAN FDI is actually by non-ASEAN investors with a base in ASEAN, such as in Singapore. The host country would report this as Singapore investment. The ASEAN figures also exclude reinvested earnings and non-equity capital in the Philippines and intra-company debt for Singapore since these are not broken down by country of origin of the investor. Including this information for the Philippines would add up to USD 8 billion to inflows from all sources since 1999.

Why are OECD MNEs investing in ASEAN? Evidence from US and Japanese investors.

Although Southeast Asian countries are considered to be among the earliest and most successful examples of export platforms within global MNE value chains, their appeal has always been partly based both on national markets and on the regional market itself. Over time, national markets remain important, but the fastest growing segment of sales is to the region itself, reflecting the growing degree of integration within ASEAN.

Figure 3 shows sales patterns of US affiliates in ASEAN over more than two decades. Local sales (to the national market) represent almost one half of sales, a share which has changed very little over time. What has evolved is the distribution of exports. In 1989, exports were evenly divided between the home US market and the rest of the world. By 2011, only 8% of sales were back to the US market; the rest were to other countries, principally within the region itself.

Figure 3. Destination of sales of goods and services of US majority-owned affiliates in ASEAN



Source: Bureau of Economic Analysis, US Department of Commerce.

Affiliates of Japanese MNEs in ASEAN show a similar sales pattern, with almost one half of sales going to the local market. Of affiliate exports, a higher share is sent back to the home market than was the case for US MNEs, as can be expected given the closer proximity of Southeast Asia to the Japanese market. But twice as many exports are sent to third markets, with over one third of affiliate exports going to other ASEAN members. The export propensity of affiliates varies by country, and is particularly high in Cambodia, the Philippines, Viet Nam and Lao PDR. The local market is most important for Japanese investors in Thailand and Indonesia. With only 5% of Japanese affiliate exports on average

across ASEAN members flowing to the European and US markets, For both US and Japanese investors, ASEAN-based affiliates supply predominantly the regional (including local) market and to a much lesser extent the home market but not the global one.

What determines the location of investment by OECD MNEs in Southeast Asia?

International investment in ASEAN is expanding, and the regional market is taking on a greater importance for these investors. A rising tide will lift all boats, but there are nevertheless wide discrepancies across ASEAN in member states' performance in attracting FDI. This section will look at where OECD investors locate within ASEAN and at how these preferences relate to the characteristics of each ASEAN economy. Subsequent chapters will look at the policy variables which can also help to explain these preferences.

From the perspective of OECD-based investors, ASEAN can be divided into the following four groups:

1. **Singapore** is often the first choice as a location by a wide margin. For most OECD members, more than one half of the total stock of investment is in Singapore.

2. The second group comprises **Thailand**, **Malaysia** and **Indonesia**. Different OECD countries have different preferences in terms of ranking, but the three countries are almost always the most important after Singapore.

3. The third group is the **Philippines** and **Viet Nam**, both populous countries but with less appeal to OECD investors than the more developed ASEAN members. Affiliates in these two economies tend to be more export-oriented. The Philippines has attracted substantial US investment in call centres serving the US market. Viet Nam is the first choice of Korean investors, suggesting that their investment strategy in the region is strongly export-oriented. Viet Nam is the fourth destination worldwide for Korean investors, with 8 000 projects worth almost USD 10 billion.

4. The fourth group comprises **Cambodia**, **Lao PDR** and **Myanmar** which together generally receive under 10% of total OECD investment in the region. Given their wealth of mineral and water resources and a pool of relatively cheap labour, much of the investment in these markets is likely to be export-oriented in the medium term, although Myanmar offers long-term potential as a market in itself.

The distribution of FDI stocks by OECD investors in ASEAN matches very closely that of overall FDI inward stocks from an ASEAN perspective (Table 1). The only difference is that the Philippines appear to be slightly more important for OECD investors than overall, and Indonesia slightly less. For Brunei Darussalam, Cambodia and Lao PDR, some OECD investments are not reported separately for confidentiality reasons and hence the OECD total does not reflect the total stock of OECD investment in those countries.

If Singapore is excluded, the ranking of ASEAN member states in terms of OECD FDI stocks is identical to that of their GDP. The largest markets tend to receive more investment. Partly this reflects the continued importance of local host country sales for many OECD investors – almost one half of sales for US and Japanese MNEs. But larger markets may also provide benefits for export-oriented investors, particularly for those where economies of scale are important and where the presence of first- and second-tier

suppliers provides an additional incentive. For this reason, investors sometimes choose the largest national sales market within a region in any given product line as a base for exports, such as pick-up trucks produced by Japanese investors in Thailand or motorcycles in Viet Nam.

Table 1. Stocks of FDI in ASEAN, OECD and ASEAN totals

	FDI stocks, USD m.		Shares (%)	
	OECD FDI in ASEAN	ASEAN total inward FDI	OECD	ASEAN
Brunei Darussalam	433	13 302	0.1	1.0
Cambodia	5 266	8 413	0.9	0.6
Indonesia	73 392	205 656	12.4	15.6
Lao PDR	363	2 483	0.1	0.2
Malaysia	57 685	132 400	9.8	10.0
Myanmar	3 258	11 910	0.6	0.9
Philippines	29 362	31 027	5.0	2.4
Singapore	311 234	682 396	52.7	51.7
Thailand	70 583	159 125	11.9	12.1
Viet Nam	31 183	72 530	5.3	5.5
	591 045	**1 319 242**		

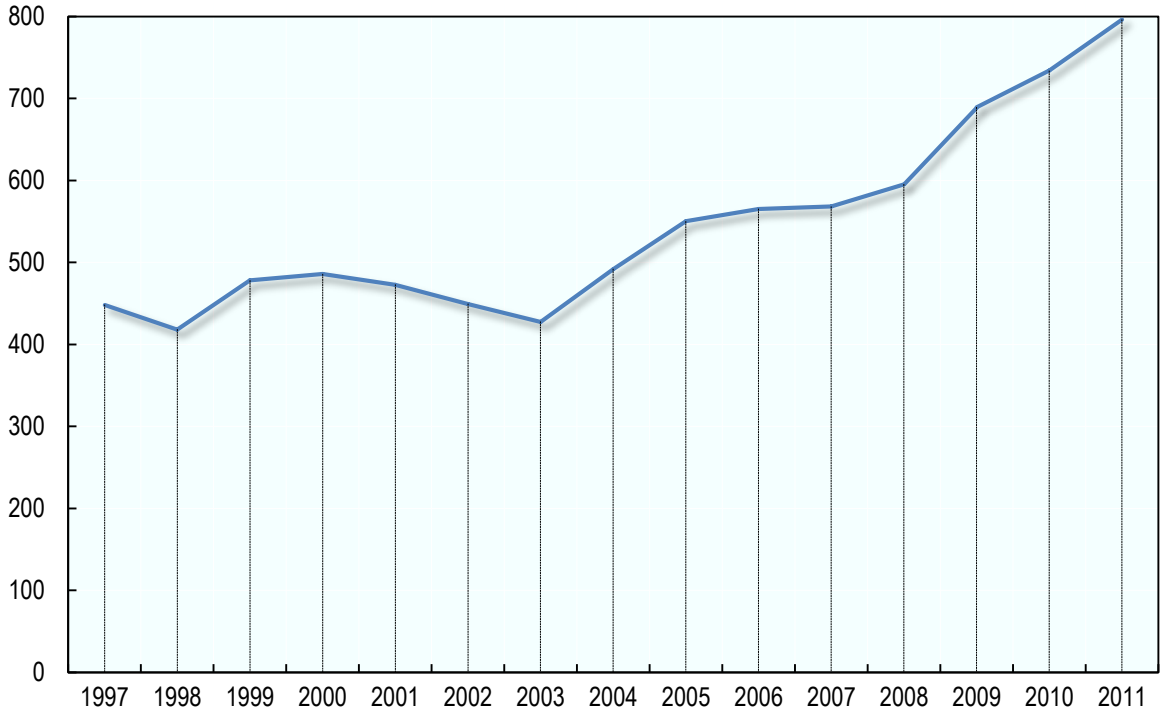
Source: OECD and UNCTAD

Another way of looking at location choices by OECD investors is to consider employment figures. Very few home countries provide such information and often with a substantial lag. For US investors in the largest ASEAN economies, total employment in majority-owned affiliates showed little movement from 1997 until 2003, in the aftermath of the Asian financial crisis (Figure 4). Since then, total employment has almost doubled. Employment is over 100 000 in each country and is more evenly balanced within ASEAN than FDI stocks. Employment has grown rapidly in four of the five countries, with the exception of Indonesia, and particularly in the Philippines which now has the most jobs in US majority-owned affiliates of any ASEAN member, in spite of such a low share of the overall FDI stock. The reason for this is likely to be the rapid growth in call centres in the Philippines which have attracted US investors taking advantage of the widespread knowledge of English. These centres involve little capital investment but generate high employment.

Out of total affiliate US-owned affiliate employment of 776 000 in these countries, one half is in the manufacturing sector, particularly in computers and electronic products, but there is substantial employment generated in a broad range of services as well (Table 2). For Japanese investors, the largest share of employment in manufacturing is likely to be in the transport equipment sector.

Figure 4. Employment in majority-owned affiliates of US MNEs in selected ASEAN countries[1]

(thousands)



Source: Bureau of Economic Analysis, US Department of Commerce.
Note: [1]Indonesia, Malaysia, Philippines, Singapore and Thailand.

Table 2. Employment in US majority-owned affiliates in ASEAN, by country and by industry

(thousands)

	Total	Mining	Mfg.	Wholesale trade	Retail trade	Information	Finance and insurance	Professional, scientific, and technical services	Other industries
Indonesia	102	25	56	3	0	0	4	0	14
Malaysia	156	2	110	6	1	2	5	6	25
Philippines	184	0	63	4	na	19	na	20	71
Singapore	168	3	63	23	0	6	19	10	44
Thailand	166	3	104	7	4	1	6	5	36
ASEAN5	**776**	**33**	**395**	**44**	**>5**	**28**	**>34**	**41**	**190**

Source: Bureau of Economic Analysis, US Department of Commerce

This chapter has looked principally at OECD FDI in ASEAN, with some discussion of how the distribution of such investment across countries reflects in part the market characteristics of the different economies in the region. The next chapter looks at the same issue from the perspective of the policy environment for investors. It will be seen that the combination of economic and policy variables can capture much of the variation across ASEAN member states in terms of FDI stocks.

Chapter 2

OPENNESS TO FOREIGN INVESTMENT IN SOUTHEAST ASIA

Southeast Asian countries were early movers in welcoming FDI as part of a strategy of export-led development. This strategy paid off handsomely in terms of FDI inflows, as shown in Chapter 1. Exports also soared as a result, with MNE-related exports from Malaysia in the electronics sector rising from only 5% of GDP in 1980 to 45% by 1995. Many countries in the region earned a well-deserved reputation for a welcoming investment climate for international investors. Nor was this shift to export promotion a one-off event: ASEAN members have continued to improve their regulatory framework for investment over time.

The drivers of these reforms have been varied and differ across ASEAN member states (AMS), as all countries faced national, regional and global challenges and opportunities. Policy reforms implemented at the national level after the Asian crisis have made many ASEAN states much more resilient against shocks as evidenced by the relatively good performance of parts of Southeast Asia during the recent global economic crisis. In those countries most affected in terms of FDI inflows by the global crisis, Singapore and Malaysia, the recovery has been as swift as the initial decline.

The Asian financial crisis in 1997 was a watershed in many ways, but governments were reforming even before the crisis and have continued since then. Another driver of reform has been the fear of losing investment to other countries, notably China. This has also been one of the factors behind the ASEAN Economic Community and the AEC Blueprint which was signed by ASEAN leaders on 20 November 2007 which called for a free and open investment regime as a key to enhancing ASEAN's competitiveness in attracting FDI as well as intra-ASEAN investment. This led to the ASEAN Comprehensive Investment Agreement signed by ASEAN member states in 2009.

In Cambodia, Lao PDR, Myanmar and Viet Nam (CLMV countries), reforms often started as a broader process of opening, such as *Doi Moi* in Viet Nam or the political and economic reforms in Myanmar since 2011. This reform process has often been supported through both ASEAN and later WTO membership. While Myanmar was an early member of the GATT and a founding member of the WTO in 1995, Cambodia (2004), Lao PDR (2013) and Viet Nam (2007) all joined the WTO within the past decade.

Beyond this positive reform agenda within the region, it should be noted that ASEAN members have generally refrained from protectionist, beggar-thy-neighbour policies, both during the Asian financial crisis and more recently during the global financial crisis which began in 2007-2008. All of these elements have contributed to the rise in the ASEAN share of developing country FDI inflows over the past decade, as seen in Chapter 1.

These drivers have all contributed greatly to improvements in the investment climate across ASEAN, as attested by the recovery in the ASEAN share of developing country FDI shown in Chapter 1. OECD *Investment Policy Reviews* of Indonesia (OECD, 2010), Malaysia (OECD, 2013b) and Myanmar (OECD, 2014a) have all documented the reforms that have been undertaken to improve the investment climate in these countries.

Notwithstanding this overall climate of reform, some ASEAN member states lag behind not only their regional peers but also other emerging economies elsewhere in terms of investment policy reform. As in other policy areas and in terms of economic performance, there is almost as much variation within ASEAN as there is among countries worldwide. This is as true for the rankings based on *Doing Business* indicators as it is for scores under the OECD *FDI Regulatory Restrictiveness Index* (discussed below). Chapter 1 suggested that ASEAN will continue to benefit from a "regional effect" in terms of its ability to attract FDI, with individual AMS leveraging the favourable reputation and growth prospects of the region as a whole. But Chapter 1 also pointed to wide discrepancies in FDI performance within ASEAN. In this chapter, it is argued that the varied pace of reform across the region can explain a significant amount of this variation.

Restrictions on foreign direct investment in Southeast Asia

Restrictions of foreign investment can take many forms and can apply to all sectors or vary by sector. The most common restrictions on foreign involvement worldwide are generally limits on foreign equity ownership. A few countries restrict foreign equity ownership across the board, while others such as Viet Nam and Lao PDR have horizontal equity restrictions only for listed companies. Most governments apply this measure, or joint venture requirements, only to certain sectors to protect local enterprises from the full onslaught of foreign competition or to encourage technology transfer while also allowing the local enterprise to share in the economic rents in the sector. Almost all governments have at least one sectoral restriction of this nature, and ASEAN members are no exception.

A second type of restriction concerns screening or approval of foreign investment, with admission usually based on a mix of criteria, such as national security, competition, net benefit or economic needs test, or, in the case of some sectors such as finance, for prudential reasons. Screening is considered to be discriminatory when it concerns only foreign investors. The motive for screening also matters. Many countries have some sort of ex ante or ex post screening mechanism based on national security considerations or for prudential reasons. Economic needs or net benefits tests are usually considered to restrict foreign investment, even if very few potential investors are actually rejected. Screening was once common across all countries and regions. In the 1970s, three out of four OECD members screened incoming investment, compared to only one out of six today. Many other countries have also removed their screening mechanism or narrowed its scope. Within ASEAN, only Myanmar screens all foreign investment coming in under the Foreign Investment Law.

Another horizontal restriction concerns land ownership. Almost all AMS have some form of restriction on foreign ownership of land. This type of restriction is much less common in OECD countries and elsewhere, and where it exists investors are usually allowed to own the land which they require for business purposes. The restriction in this case is more aimed at foreign ownership of residential property. In Southeast Asia, investors are usually provided with long leases in lieu of ownership, but even here, the length of the lease differs across the region. Other types of potential restrictions include reciprocity requirements, restrictions on profit and capital repatriation or on branching and on access to local finance.

Table 3. General restrictions on FDI in eight ASEAN member states

	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Thailand	Viet Nam
Horizontal screening	No	No	No	No	Yes, by the MIC	No	Only for activities in List 2 or 3 of the Negative List for FDI>49%.	No
Horizontal equity restrictions			Foreign ownership cannot exceed **20%** for listed companies.			No		Foreign ownership cannot exceed **49%** for listed companies.
Land	Foreign investors (**FDI>49%**) may not own land but long leases are possible.	Foreigners may not own land but may receive long-term leases (99 years) for business purposes.	Foreign investors with registered capital ≥ USD 500,000 may purchase land use rights for business purposes. Otherwise 30 years leases renewable up to 75 years are possible for business purposes.		Foreign investors are prohibited from purchasing land.	The Constitution restricts ownership of land to Filipinos and to Filipino companies (**FDI<40%**). The acquisition of agricultural land is subject to a size limit.	The Land Code (1954) prohibits purchase and ownership of land by foreign persons or foreign-owned enterprises based in Thailand (**FDI>49**).	All land belongs to the state but land use rights are available to all investors and can be used as collateral.
Other immovable property	Since 2010, foreigners have been allowed to own apartments and condominiums (above 1st floor).			Foreign investors not allowed to acquire property below a specified value RM 500 000.		Ownership of condominium units (residential or commercial) is restricted to Filipinos and to Filipino companies (FDI<40%)		
Banking	None	FDI ≤ 99%. All controlling shareholders with foreign citizenship or legal entities domiciled overseas must meet the following requirements: A commitment to support Indonesian economic development; and other prudential requirements.	None	FDI<30% of the aggregate equity for conventional commercial banks but 100% allowed for subsidiaries of foreign banks.	No foreign banks allowed, only representative offices.	Foreign ownership of banking institutions is limited to 60% of the voting capital stock. At all times, the control of 70% of the resources or assets of the entire banking system must be held by domestic banks which are at least majority-owned by Filipinos. Branches are allowed.	2008 FIBA allows FDI up to 25% which may be raised to 49% on a case-by-case basis. The Minister of Finance, with a recommendation from the Bank of Thailand, may authorise ownership above 49% if deemed necessary to support the stability of the overall financial system during a financial crisis.	FDI limited to a combined share of 30% for listed companies in financial sector, Individual investors are limited to 15% though this may be increased to 20% through a strategic alliance with a local partner and approval from the PM's office. A foreign bank is allowed to apply to establish a 100% foreign-owned affiliate.

	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Thailand	Viet Nam
Retail	No restriction on FDI for retail > 2000m^2 (GATS).	FDI only in large-scale retail and must involve local SME partner – although not necessarily through equity stake.	Retail businesses are reserved for Lao citizens only. Foreign investors are allowed to participate in wholesale businesses through joint ventures with Lao investors.	No FDI in supermarkets with less than 2000m^2. All applications involving foreign investment, including expansion of existing outlets, require approval from the Committee on Distributive Trade.	FDI permitted in supermarkets, department stores and shopping centres above a certain minimum size. No FDI in small-sized retailing. Under JV form, local citizen's share ≥ 40%.	FDI=100% for retail trade enterprises: (a) with paid-up capital >USD 2.5 million provided investment for establishing a store is not less than USD830K or (b) specializing in high end or luxury products, provided that the paid-up capital per store ≥ USD250K	The retail sale of goods of all kinds with a total minimum capital < 100 m. baht is on List 3: businesses in which Thai nationals are not yet ready to compete with foreigners. **FDI<49%** unless approved.	FDI in retail subject to a strict economic needs test (except first outlet) -- except an FIE may open a second outlet if <500m2 and located in designated areas for trading activities without a needs test.
Mobile telecoms	None	**FDI≤65%**.	The Government reserves the right to participate in the shareholding of telecommunication companies. A joint venture with the Government may be required.	**FDI ≤ 70%** for network facilities and service providers.	Joint ventures allowed (**FDI ≤ 80%**).	The Constitution restricts ownership of telecommunication companies to Filipinos and to Filipino companies (**FDI<40%**).	**FDI ≤ 49%** in basic telecommunications and higher levels for providers of value-added services that do not own their own telecoms network.	**FDI ≤ 49%-70%** depending on the activity.
Transport	None	Goods transport by road and domestic air transport, **FDI≤49%**. In international shipping, FDI≤95% but not allowed in inter-island shipping unless insufficient local capacity.	The Government reserves the right to participate in the shareholding of air and sea transport companies, as well as in infrastructure construction companies. A joint venture with the Government may be required.	**FDI≤70%** in Malaysian shipping companies.	Only joint ventures in marine passenger and freight transport and in local and international aviation services.	The Constitution restricts ownership of any transport company to Filipinos and to Filipino companies (**FDI<40%**).	Air, surface, maritime: **FDI≤49%** but may be allowed up to 75% with approval.	Rail, maritime, air (**FDI≤49%**); Road (**FDI≤51%**).

Table 3 lists the main general restrictions across all ASEAN members except Brunei Darussalam and Singapore. In some areas such as land ownership and general screening, there are many similarities across ASEAN. Where ASEAN member states differ is in the length of their negative lists which list all sectors where foreigner face restrictions, usually related to foreign equity limits. The following section gauges the level of restrictiveness in each ASEAN member and benchmarks that level against regional and international peers.

ASEAN member states' ranking under the OECD *FDI Regulatory Restrictiveness Index*

A country's investment climate cannot be captured in a single indicator, whether on the costs of doing business or a measure of statutory restrictions on FDI. Many different policies and practices impinge on investment decisions, and the way – and whether – policies are implemented is arguably as important as the policies themselves. Quantitative indicators have nevertheless proven highly effective in drawing attention to the burdens of business regulation, identifying priorities for reform and communicating success and progress.

Box 1. Calculating the OECD FDI Regulatory Restrictiveness Index

The OECD *FDI Regulatory Restrictiveness Index* covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

1. the level of foreign equity ownership permitted,
2. the screening and approval procedures applied to inward foreign direct investment;
3. restrictions on key foreign personnel; and
4. other restrictions such as on land ownership, corporate organisation (*e.g*. branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI, typically listed in countries' lists of reservations under FTAs or, for OECD countries, under the list of exceptions to national treatment. The *FDI Index* does not assess actual enforcement. The discriminatory nature of measures, *i.e*. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored.

For the latest scores, see *www.oecd.org/investment/index*

The OECD *FDI Regulatory Restrictiveness Index* (*FDI Index*) seeks to gauge the restrictiveness of a country's FDI rules (Box 1). The *FDI Index* is currently available for almost 60 countries, including provisional scores for nine ASEAN members. The *FDI Index* does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the *FDI Index*, used in combination with other indicators measuring various

aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining variations among countries in attracting FDI.

Figure 5 shows *FDI Index* scores for over 60 economies, including preliminary scores for many ASEAN members. ASEAN members tend, on average, to be among the most restrictive in terms of treatment of foreign investors. While this might seem to be at odds with the image of Southeast Asia as being investor friendly, it should be remembered that many of these restrictions affect service sectors and those producers wishing to sell in the domestic market. Preferential treatment for export-oriented investors is not factored into the *FDI Index* score.

One salient feature of Figure 5 is the variation within ASEAN in terms of restrictiveness, with both some of the most restrictive (Philippines and Myanmar) and two of the most open (Singapore and Cambodia). The same variation can be seen in the *Doing Business* rankings (Table 4), with Singapore and Malaysia among the best performers and Myanmar as one of the worst.

Table 4. Doing Business rankings in ASEAN[4]
(based on sample of 189 countries as of 2015)

	2014	2015
Singapore	1	1
Malaysia	20	18
Thailand	28	26
Brunei Darussalam	98	101
Viet Nam	72	78
Indonesia	117	114
Cambodia	134	135
Philippines	86	95
Lao PDR	155	148
Myanmar	178	177

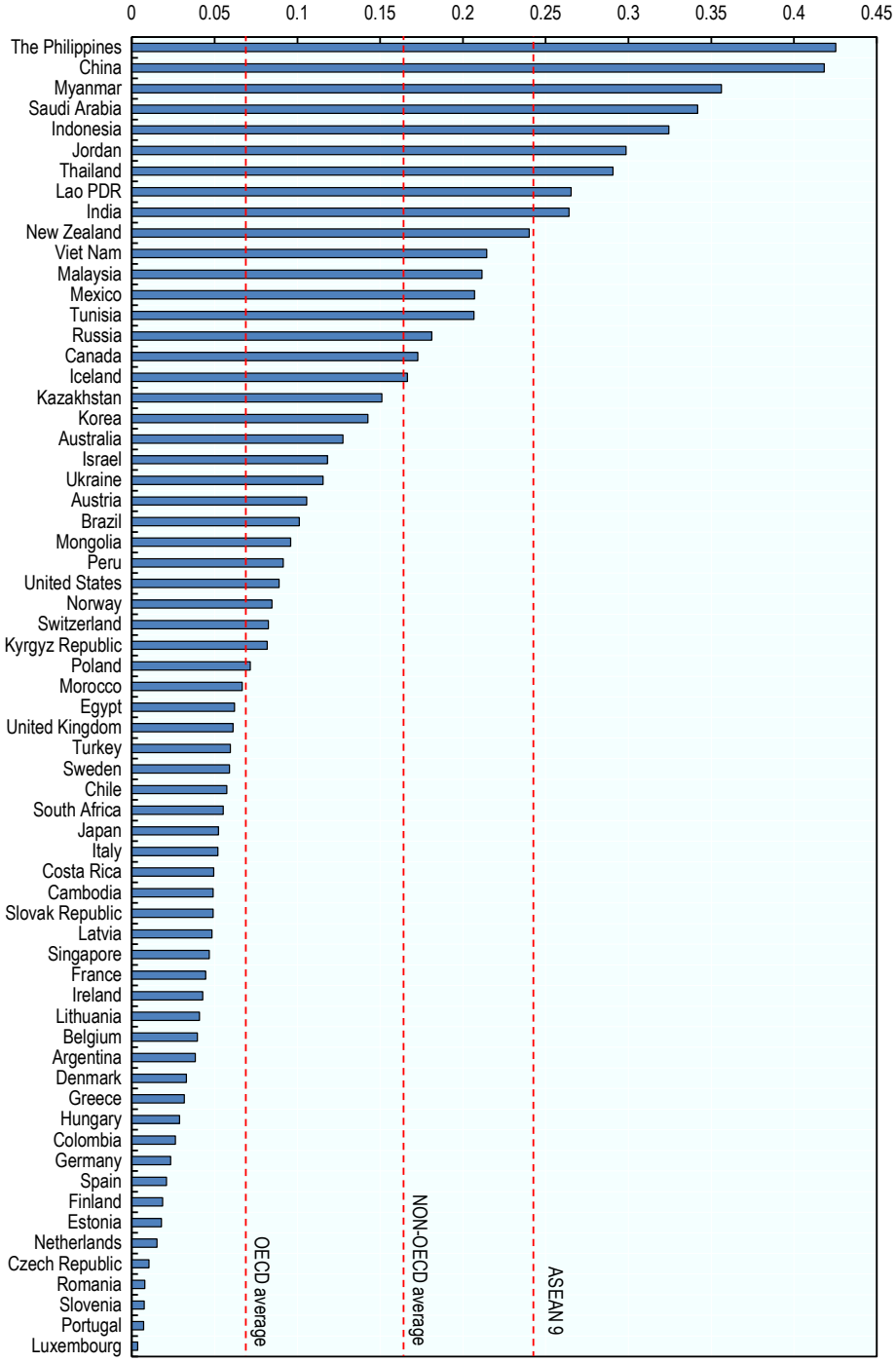
Source: Doing Business, World Bank Group

By sector, ASEAN members are generally more restrictive than OECD countries, as one would expect given their high average scores under the *FDI Index* (Figure 6). The most restrictive sectors for OECD countries (media, real estate, fisheries, transport) are also among the most restrictive for ASEAN members, but there are sectors where ASEAN members have significant restrictions and OECD countries very few (financial services, mining and quarrying, construction, distribution, hotels and restaurants).

[4] Doing Business scores reflect the new World Bank methodology.

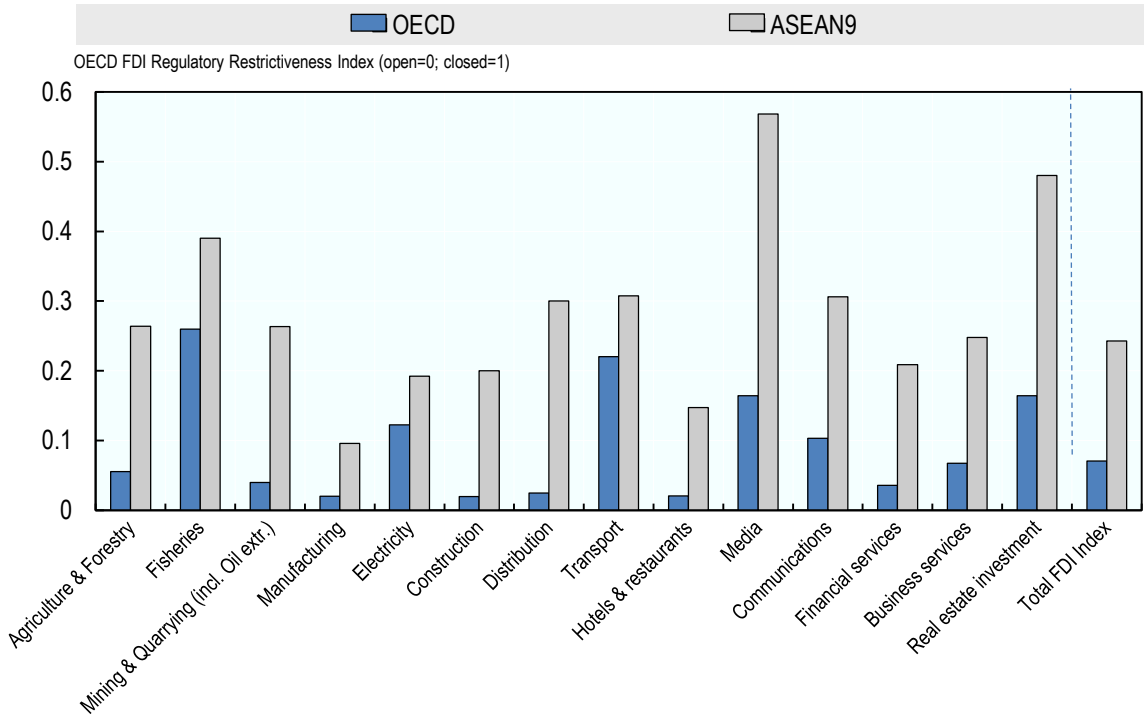
Figure 5. OECD FDI Regulatory Restrictiveness Index

(Open = 0; Closed = 1)



Source: OECD. *Note*: A score is not yet available for Brunei. Preliminary scores for all other ASEAN members except Indonesia, Malaysia and Myanmar.

Figure 6. Sectoral FDI restrictions in ASEAN and OECD members



Source: OECD. Notes: ASEAN9 scores are preliminary.

Restrictions matter for foreign direct investment

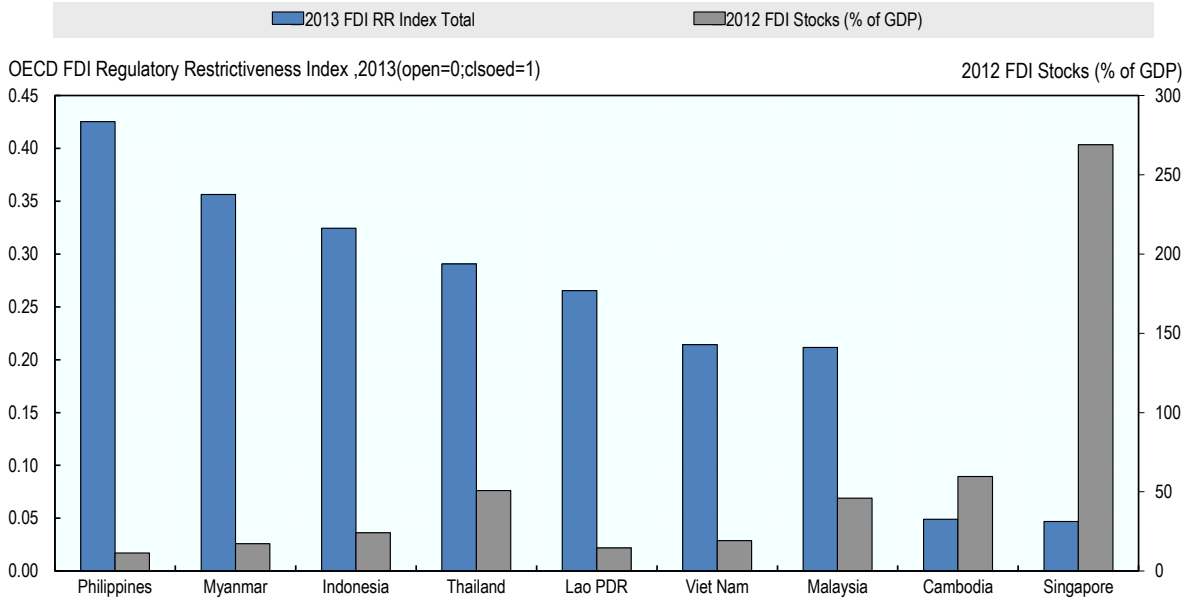
Governments impose restrictions or otherwise discriminate against investors to address various policy goals. Almost all governments liberalise their rules over time, often on a unilateral basis. The foregoing discussion of restrictions is not intended to name and shame any particular country for its statutory restrictions on foreign investors but rather to benchmark that restrictiveness against peers and, in what follows, to make the link between restrictions and the amount of foreign investment that an economy receives. It is tautological to say that when foreign investment is prohibited, an economy will receive no foreign investment, but the evidence presented below suggests that even partial restrictions can sometimes have a strong impact on investment. One way to see this is to compare *FDI Index* scores across ASEAN with the recorded FDI stock as a share of GDP (Figure 3).

The relationship between FDI restrictions and FDI stocks normalised for market size is highly negatively correlated (-0.68), as seen in Figure 7. The two most restrictive countries (Philippines and Myanmar) have the lowest stock of FDI to GDP, even if one adjusts for the possibility of under-reporting of FDI in the Philippines. Similarly, the two most open economies for foreign investment in the region (Singapore and Cambodia) have the highest stocks of FDI relative to GDP.

FDI restrictions are consistently an important policy barrier for OECD investments in ASEAN countries. Robust cross-section estimation of the effect of restrictions on bilateral FDI stocks using a simple gravity model indicates that a 1% improvement in FDI restrictions as captured by the *FDI Index* is associated with an increase of 1.1% to 1.4% in OECD bilateral FDI stocks in ASEAN (Mistura, 2015 forthcoming). The results are

consistent with other empirical-based literature that also finds a significant relationship between restrictions and the level of FDI.

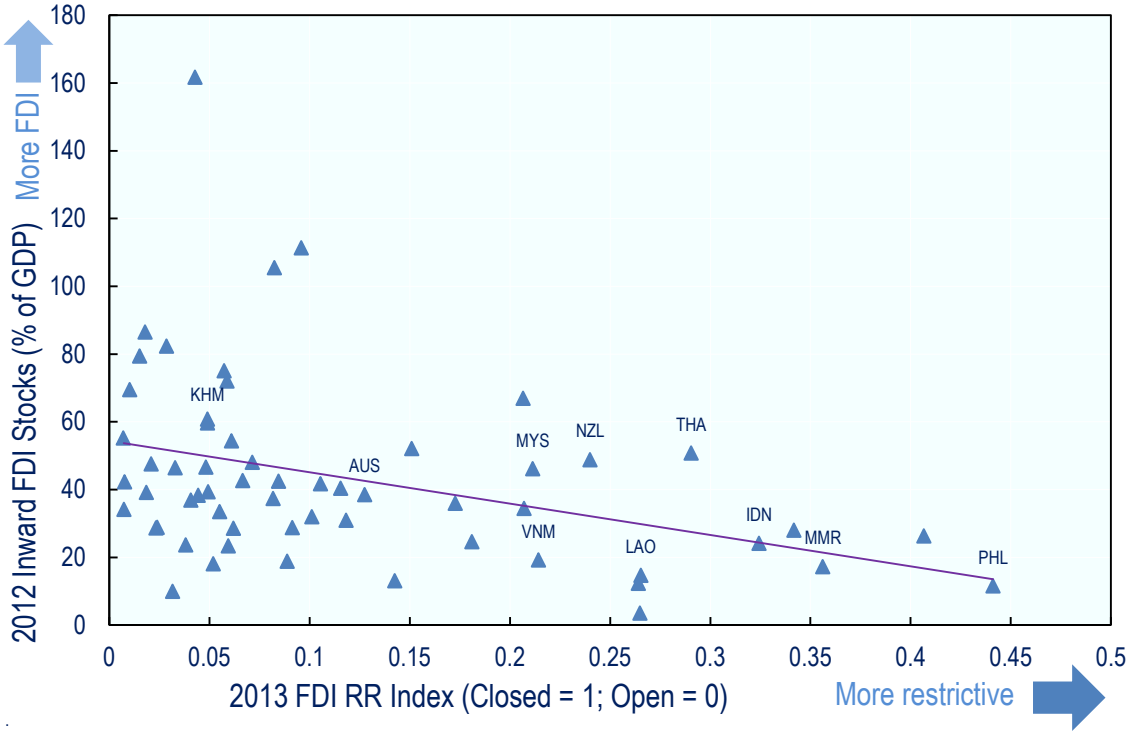
Figure 7. FDI Index scores vs FDI stocks as a share of GDP in ASEAN9 members



Source: OECD. Notes: ASEAN9 scores are preliminary.

Figure 8 shows the relationship between the *FDI Index* and a country's stock of FDI relative to its GDP for all 60 countries covered by the *FDI Index*, including eight ASEAN members for which preliminary scores exist. Figure 4 shows quite clearly that countries with more statutory restrictions tend to have less investment relative to the size of their economies. The downward sloping line reflects this relationship for all countries in the sample. Some AMS such as Malaysia and Thailand, as well as Australia and New Zealand, attract more inward investment than this simple relationship would suggest which serves as a useful reminder that a good investment climate includes many different elements. Many of the countries above the line in Figure 4 almost perform will under the *Doing Business* indicators. The good performance of Cambodia in Figure 4 does not lend itself to a ready interpretation but it is possible that the liberal FDI policies in Cambodia, together with competitive labour costs, compensate to a large extent for the small size of the market, poor infrastructure and difficulties in doing business as estimated by the World Bank in terms of attracting foreign investment.

Figure 8. Fewer restrictions mean more FDI
(FDI Index scores vs FDI stocks as a share of GDP)



Source: OECD FDI Regulatory Restrictiveness Index and IMF

Restrictions on FDI and host country competitiveness

Southeast Asia as a region continues to act as a magnet for international direct investment and increasingly for intra-regional investment. Chapter 1 suggested that its prospects for attracting FDI over the next five years are likely to be good, in spite of a continuing cyclical downturn in global flows. It offers a large and dynamic region with a growing middle class and a generally welcoming attitude towards inward investment when it is seen to contribute to exports or some other strategic objective.

In spite of this overall favourable climate, some AMS retain numerous sectoral restrictions, making them among the most restrictive in terms of statutory restrictions of all 60 countries covered by the OECD *FDI Regulatory Restrictiveness Index*. It has been argued in this chapter that these restrictions can explain a significant part of the strong variation in performance across ASEAN in attracting foreign investment. One possible explanation for this observed relationship may well be that restrictions in one sector might have implications for investment in other sectors and thus might impede investors across the board.

This could happen, for example, if restrictions on FDI in service sectors affect the overall competitiveness of other sectors and hence discourage investment in those sectors, including by foreign investors. An efficient and competitive services sector, particularly backbone services, will raise the performance of firms throughout the economy, including in the manufacturing sector. Several studies examine the effect of service liberalisation through FDI policy liberalisation on the export competitiveness and productivity of manufacturing firms by treating service sector inputs to manufacturing sectors as factors of production alongside labour, capital and other inputs. Services liberalisation is expected to

facilitate the exit of low productivity firms from the market and the entry of new competitors, as well as stimulating competition among services providers. Manufacturing industries relying on these services as inputs would thereby benefit from the improved quality and lower cost of service inputs which would increase the marginal productivity of other inputs. A recent study by Duggan et al. (2013) employs the *FDI Index* to assess the effects of restrictions on FDI in services on the manufacturing productivity of Indonesian firms from 1997 to 2009. The study finds that services sector FDI liberalisation, notably related to equity limits and screening and prior approval requirements, accounted for 8% of the observed increase in Indonesian manufacturers' total factor productivity over the period.

Another way to look at how FDI restrictions affect competitiveness is from the perspective of global value chains (GVCs) and trade in value added (TiVA) based on a new OECD-WTO dataset.

FDI and global trade participation in ASEAN

Over the past two decades, the nature of global trade has changed significantly as the production of goods and services scatter across international borders, giving rise to GVCs. As firms fragment their operations across the world, products and services contain inputs sourced from many countries. Intermediate inputs are produced in one country and then exported to other countries for further production or for final assembly. Today, more than 70% of world service imports are intermediate services, and more than 50% of world manufactured imports are intermediate goods (Miroudot and De Backer, 2012). Changes in the business and regulatory environment, new technologies, shifts in firm strategies, and the systematic liberalisation of trade and investment have all contributed to this phenomenon (OECD 2013c). The extent to which economies integrate and specialise in the world economy depends on a number of structural factors, one of which is foreign direct investment. Overcoming the obstacles for further integration into GVCs can pay big dividends. Developing economies with the fastest growing GVC participation have had GDP per capita growth rates 2% above the average (OECD, WTO and World Bank, 2013).

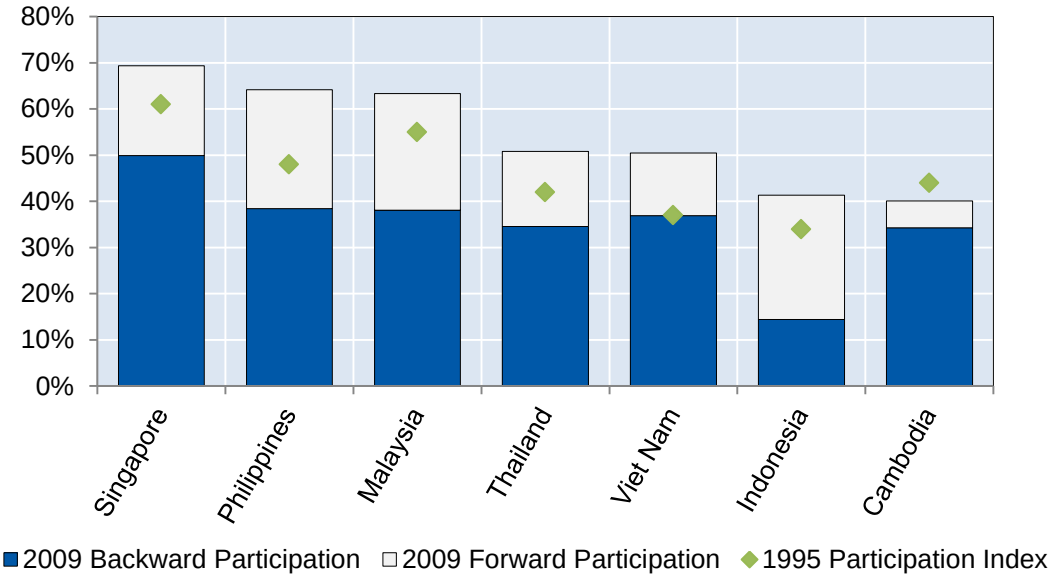
Regional supply chains in Asia emerged in the 1980s as Japanese firms deployed significant foreign direct investment in the region. Following the 1985 Plaza Accord, Japanese manufacturers relocated in East and Southeast Asia to establish lower cost production bases (OECD 1999). This began a trend of multinationals from other developed economies seeking labour and product cost reductions to invest and establish subsidiaries in the region to improve their competitiveness (Banga 2013). This international fragmentation of supply chains has allowed countries, and particularly developing ones, to internalise some of the benefits of such fragmented production networks, including by facilitating the entry of small local firms into global markets as suppliers to established networks without requiring the costs of building the value chain themselves (Cattaneo et al, 2013).

The surge in manufacturing investment led to a shift in productive capacity within the host countries in the region. Among ASEAN member states, Singapore, Malaysia and Thailand were early adopters of export strategies based on foreign investment, resulting in a rapid expansion of their manufacturing base. Indonesia and the Philippines followed suite, with the latter developing a more open policy to foreign investment in the 1990s. Through export-oriented FDI, these five countries were able to shift towards a manufacturing-based economy in which economic growth was driven by rapidly expanding exports (OECD 1999).

The participation of ASEAN economies in global value chains can be characterised in two ways: as users of foreign inputs and as suppliers of intermediate goods and services in other economies' exports (Koopman et al., 2009). The GVC Participation Index (Figure 9) indicates the share of foreign inputs in economies' exports (backward participation) and the share of domestically produced inputs used in third economies' exports (forward participation). Overall, it represents the extent of countries' presence in GVCs.

Based on the information available for seven ASEAN member states, the GVC participation rate has increased between 1995 and 2009 for all countries except Cambodia. Small open economies such as Singapore, which had the highest participation rate in 2009, source more inputs from abroad and produce more inputs used in GVCs than large economies such as Indonesia where a larger share of the value chain is domestic. The high share of Indonesia's forward participation reflects the significant contribution of domestically produced natural resources-based inputs (e.g. mining) used in third economies' exports. In contrast, the greater backward participation of the Philippines, Malaysia, Thailand, Viet Nam and Cambodia reflects the share of foreign inputs in their exports. Table 5 presents the top three largest export sectors for ASEAN countries, distinguishing those sectors which have high domestic versus foreign value added content.[5] For example, majority of the exports from the Philippines, Malaysia, Singapore and Thailand are in the electronics sector which requires considerable sourcing of foreign inputs.

Figure 9. ASEAN-7 GVC Participation Index, % of total exports (1995, 2009)



[5] Sectors of economic activity are defined according to the International Standard Industrial Classification of All Economic Activities (ISIC), Rev.3. Manufactures covers Divisions 15-37; services includes Construction (Division 45); Wholesale and retail trade, hotels and restaurants (50-55); Transport and storage, post and telecommunication (60-64); Financial intermediation (65-67); Business services (70-74) and Other services (75-99).

Source: Miroudot, S. and K. De Backer (2013), "Mapping Global Value Chains", OECD Science, Technology and Industry Working Paper, OECD Publishing. Note: The indicator is expressed as the share of foreign inputs (backward participation) and domestically produced inputs used in third countries' exports (forward participation) in a country's gross exports as proposed by Koopman et al. (2010).

While in most ASEAN economies, backward participation remains the main driver of their integration into GVCs, the growth in their overall participation since 1995 has been mainly led by greater forward participation into production networks, notably regional networks.

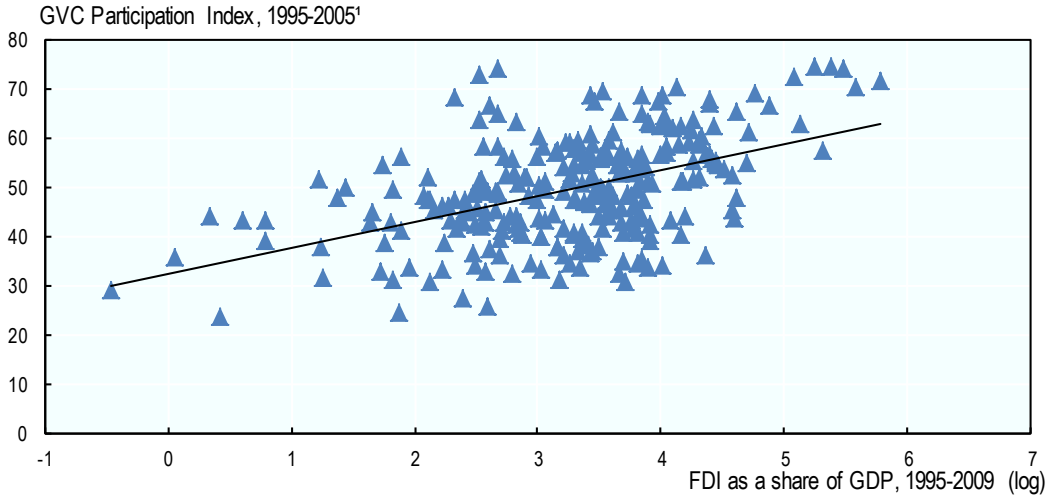
Table 5. ASEAN-7, Top 3 sectors with highest gross exports, 2009

Cambodia	Agriculture, hunting, forestry and fishing	Textiles, textile products, leather and footwear	Wholesale and retail trade; Hotels and restaurants
Indonesia	Food products, beverages and tobacco	Chemicals and non-metallic mineral products	Mining and quarrying
Malaysia	Electrical and optical equipment	Chemicals and non-metallic mineral products	Mining and quarrying
Philippines	Electrical and optical equipment	Transport and storage, post and telecommunication	Wholesale and retail trade; Hotels and restaurants
Singapore	Electrical and optical equipment	Chemicals and non-metallic mineral products	Transport and storage, post and telecommunication
Thailand	Electrical and optical equipment	Chemicals and non-metallic mineral products	Food products, beverages and tobacco
Viet Nam	Agriculture, hunting, forestry and fishing	Textiles, textile products, leather and footwear	Mining and quarrying
Legend:	*High domestic value added*	*High foreign value added*	

Source: OECD-WTO, Trade in Value Added (TiVA) Database, May 2013.

As the offshoring experience of the Japanese manufacturing sector suggests, multinational enterprises are the natural central unit behind GVCs and therefore their investment decisions have been a major driver behind the emergence of GVCs. UNCTAD (2013) estimates MNEs to account for about 80% of global trade in goods and services, of which about 42% is intra-firm trade. FDI is therefore an important avenue for countries to link to GVCs and increase their participation (Figure 10).

Figure 10. FDI and GVC Participation, 1995-2005

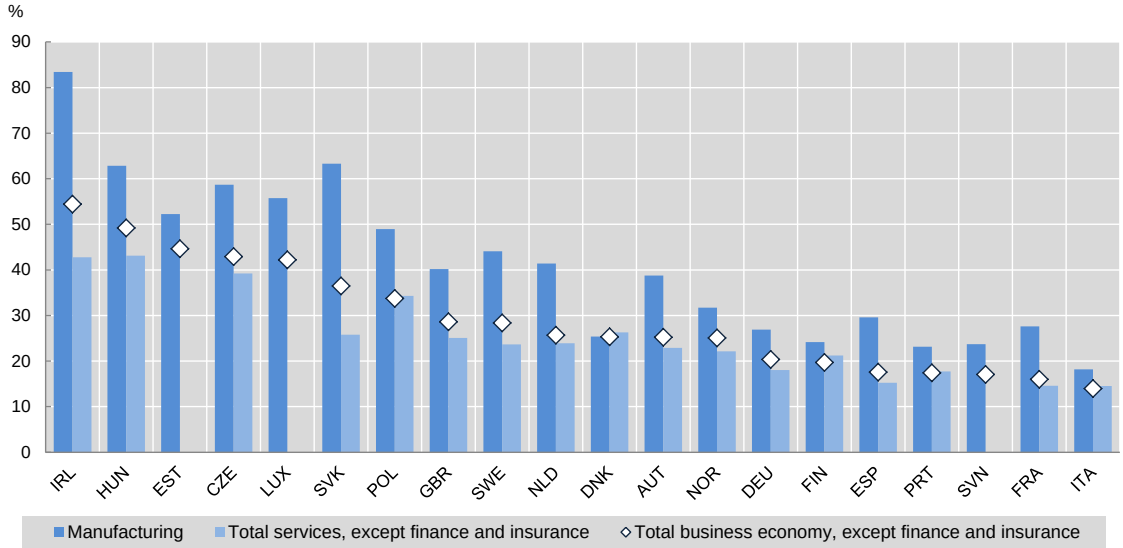


Source: OECD-WTO, Trade in Value Added (TiVA) Database, May 2013.

The extent to which countries can provide the necessary conditions for global production networks to operate efficiently is therefore a key determinant of their success in linking to GVCs. Multinational firms locational decisions have become more influenced by their need and ability to ensure predictable and reliable supply-chains, capable of delivering effectively on each stage of the chain (Taglioni and Winkler, 2014). The costs of delays, for instance, can be substantial for certain product categories (a tariff equivalent of 1% or more) (Hummels, 2007).

In terms of overall competitiveness, foreign affiliates contribute to a host country in several ways. They can provide access to new markets and new technologies for domestic suppliers and buyers, generate knowledge spillovers for domestic firms and typically invest a higher share of revenues in R&D. Evidence from OECD countries shows that foreign controlled firms are few but account for a very large share of trade. Figure 11 illustrates the share of national value added under control of foreign affiliates for manufacturing and services. The share in value added of multinational enterprises is high partly due to the fact that they are typically engaged in capital- and scale-intensive industries. While in absolute terms, value added by foreign affiliates is larger in services than in manufacturing in several OECD countries, owing to the importance of services in national economies but also to the growing internalisation of services (OECD 2013c).

Figure 11. Share of national value added under control of foreign affiliates, 2010
OECD countries, Foreign affiliates share of national value added by sector

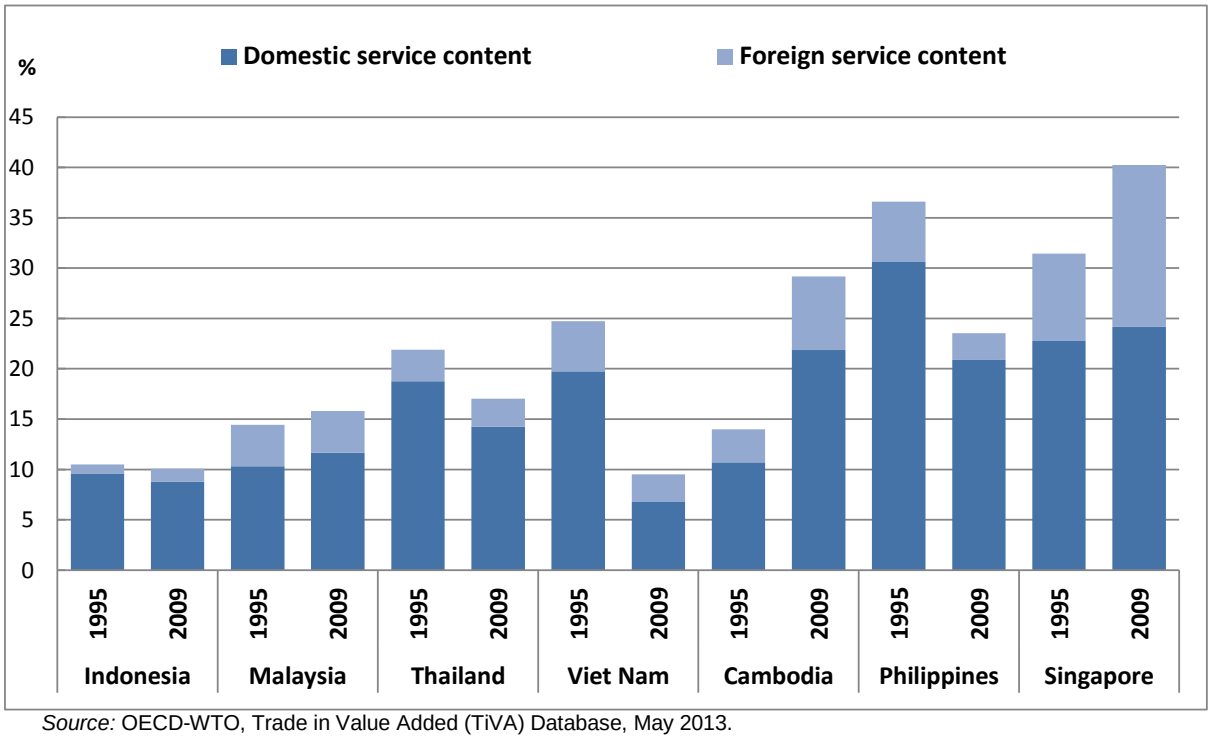


Source: OECD, Activity of Multinational Enterprises Database, Eurostat, Inward FATS Database, June 2013.

The scope and nature of manufacturing has changed in that it now relies more on inputs from the services sectors. Manufacturing firms that fragment and specialise hire service providers who can perform at a lower cost or higher quality. It is critical to better reflect the services contribution in global value chains as they become more intrinsically connected with manufacturing. For ASEAN member states, estimates from the OECD-WTO Trade in Value Added (TiVA) database reveal the amount of services content in total exports.[6] In 2009, the total services content (domestic and foreign) in exports varied between 10% and 40% across ASEAN economies with high services content from Singapore, Cambodia and Philippines (Figure 12). Between 1995 and 2009, it increased significantly for Cambodia and Singapore (primarily due to foreign services content) but decreased for Viet Nam, the Philippines and Thailand. The sectors of wholesale and retail trade, hotels and restaurants, and transport storage, and telecommunications account for the bulk of services in manufacturing exports (Figure 13).

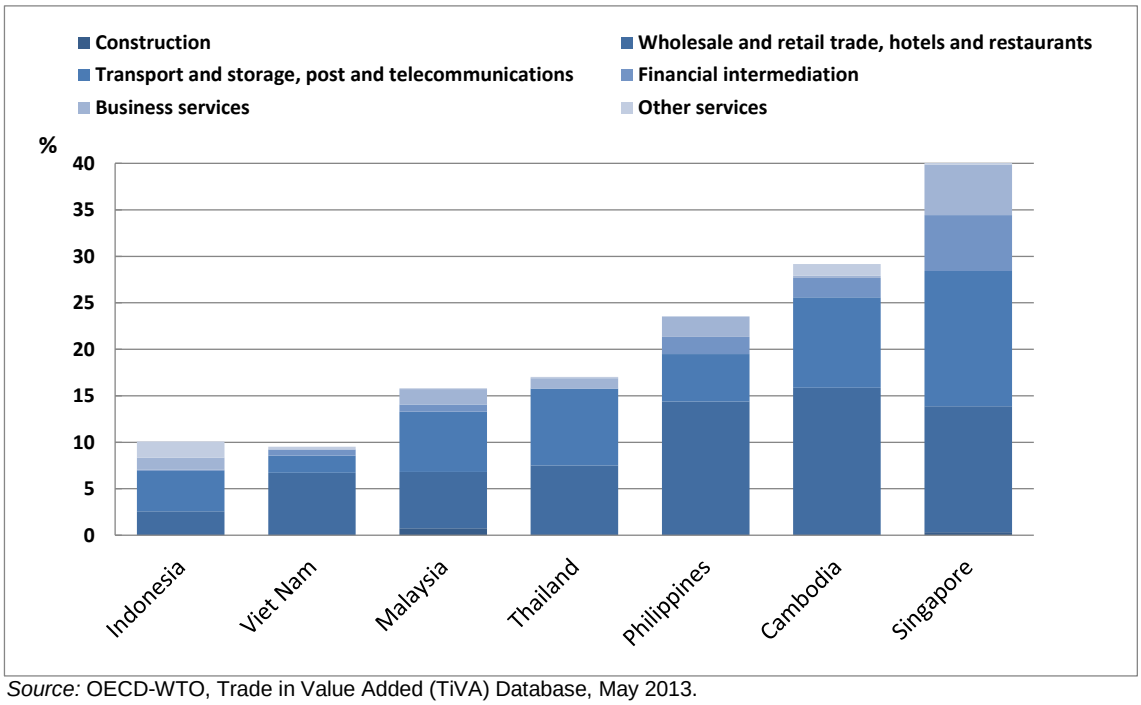
6 Sectors of economic activity are defined according to ISIC Rev.3. Manufactures covers Divisions 15-37; services includes Construction (Division 45); Wholesale and retail trade, hotels and restaurants (50-55); Transport and storage, post and telecommunication (60-64); Financial intermediation (65-67); Business services (70-74) and Other services (75-99).

Figure 12. ASEAN-7 Services content of exports, domestic and foreign, 1995 and 2009
As a percentage of total exports



Source: OECD-WTO, Trade in Value Added (TiVA) Database, May 2013.

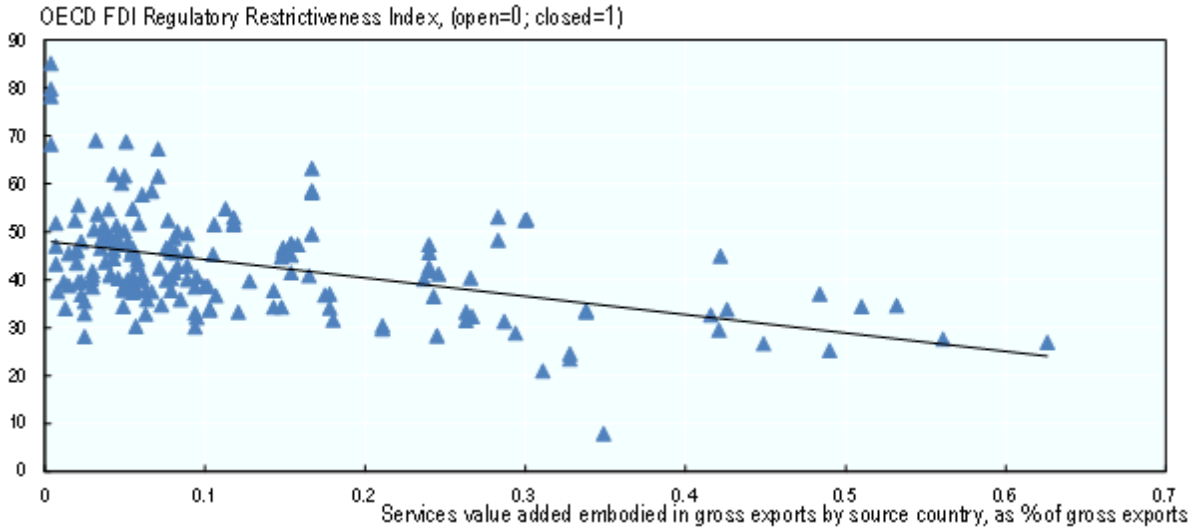
Figure 13. ASEAN-7 Services content of exports by type of service, 2009
As a percentage of total exports



Source: OECD-WTO, Trade in Value Added (TiVA) Database, May 2013.

The services sector is a significant channel for value added generation. Worldwide, while the share of services in gross exports is relatively limited (20%), services-sector activities contribute with almost half (46%) of the value added inputs to exports (OECD, 2013c). At the same time, FDI activity has been particularly intense in the service sector in the last decade, bringing service sector FDI stocks to reach more than 60% of total stocks (UNCTAD, 2013). Better services can help countries move up the value chain and diversify their export portfolio. The most diversified exporter economies are also those with greater levels of services value added embodied in the final demand. Global value chains rely heavily on the quality of network industries and complementary business services as they influence connectivity costs and quality, as well as the more knowledge-based inputs supporting firms operations. Better services reduce transactions costs, facilitate competition and expand market opportunities, allowing firms to more easily expand their portfolio of products and services into emerging opportunities.

Figure 14. Restrictions to FDI and services value added, 1995-2009



Source: OECD-WTO TiVA database and the OECD FDI Regulatory Restrictiveness Index database. Notes: The OECD FDI Regulatory Restrictiveness Index covers only statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment climate (e.g. the implementation of regulations and state monopolies among other) are not considered.

Yet, as seen in the previous section, worldwide many service sectors remain partly off limits to foreign investors, holding back potential economy-wide productivity gains which could help restore confidence and jumpstart the recovery. While barriers to FDI have generally declined across countries and overtime, restrictions to FDI in key service sectors are still common in a number of countries, particularly in ASEAN, possibly affecting countries' capacity to integrate into GVCs and capture greater value added trough more productive service sectors (Figure 14). Overall productivity of manufacturing firms is substantially affected by FDI restrictions and stringent product market regulations constraining competition and contestability in service sectors, and consequently raising service input costs, such as in financing and logistics, for other economic sectors. In catching-up countries, lower productivity firms could achieve large productivity gains if they could benefit from the expertise of foreign owners, if regulations did not impede the necessary restructuring (Kalemli-Ozcan et al., 2014). In more restrictive environments with stringent product market regulations, foreign investors perceive restructuring of weak firms as too costly and will tend to direct investment into high productivity firms by international standards, diminishing the scope for countries to upgrade the efficiency of weaker firms.

Chapter 3

THE ASEAN WAY: PROGRESSIVELY HARMONISING LEGAL PROTECTION OF INVESTMENT

There is a slow but steady evolution, among ASEAN member states (AMS), towards more convergence of national legislation for the protection of investment. Despite large differences in development among countries, there is evidence that AMS policy approaches are converging towards an increasingly sound and consistent legal landscape for the protection of investment. In this regard, the "ASEAN way" is a model of a successful top-down approach to the unification of domestic investment legal regimes in a regional entity.

Southeast Asian countries have very diverse levels of openness, economic development as well as political backgrounds, from market-based to socialist economic models. Substantial discrepancies still exist in the level of sophistication of legal language and in the substance of protection provisions encountered in national legislation. AMS' investment regulations still have a long way to go in achieving a single and consistent legal framework for protecting investments under the ASEAN umbrella. Yet, reform efforts undertaken, to varying degrees, by individual member countries are gradually paving the way for legal regionalism in Southeast Asia. Individual countries have been progressively bringing their domestic legislation in line with common protection standards, on the basis of the ASEAN Comprehensive Investment Agreement (ACIA). Implementing ACIA will require incorporating it into domestic legislation in each AMS.

In Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines and Viet Nam, domestic legislation has evolved to enshrine more legal guarantees for investment, but further adjustments are still required to facilitate achieving a common legal landscape for investment within ASEAN.[7] Some AMS, particularly the CLMV countries (Cambodia, Lao PDR, Myanmar, Viet Nam), need to further fine-tune their investment legislation in order to fully comply with standards contained in ACIA. The comparative table at the end of the chapter summarises the main substantive differences in the treatment of investment as provided in each of the nine countries. It also shows policy areas where a fair level of legal consistency has been achieved across the region.

This chapter does not address bilateral investment agreements signed by individual AMS with third countries, which constitute another layer of the legal protection regime for investments in those AMS. The broader framework for protecting investment in each country is composed of bilateral investment treaties (BITs) as well as Free Trade Agreements (FTAs) with investment chapters. These treaties, concluded on a bilateral basis between partner countries, do not illustrate the current evolution towards further regulatory convergence of national legislation in ASEAN. Yet, investment agreements are binding international commitments under which signatory states commit to provide a certain degree of legal protection to covered foreign investors. In the regulatory harmonisation process

[7] The investment legal regimes of Brunei and Singapore are not examined here.

that each AMS undertakes at its own pace, countries must also work towards more consistent overall legal regimes. They will ultimately need to fill gaps between protection guarantees given to domestic and to foreign investors that are not justified by their investment strategies. This cannot only be achieved through unifying investment laws, but also by bringing more consistency between treaty provisions and domestic law provisions. The harmonisation process is a two-way street and the future generation of investment agreements will also need to be better aligned with AMS' national investment laws and policies.

The ASEAN Comprehensive Investment Agreement: towards legal regionalisation

The general investment framework of ASEAN countries is provided in ACIA, in force since 2012. The agreement is the result of a merger of two previous agreements, namely, the ASEAN Investment Guarantee Agreement and the Framework Agreement on ASEAN Investment Area, which respectively provided for investment protection guarantees and progressive investment liberalisation, into a single comprehensive investment agreement. Before ACIA, these two aspects were considered separately. ACIA simplifies and clarifies the ASEAN investment regime in that it provides for a clear interaction of liberalisation and protection provisions. It applies to the manufacturing, agriculture, fishery, forestry, mining and quarrying sectors, as well as to services incidental to manufacturing. It does not apply to other services sectors. ACIA supersedes the two precursor agreements and is binding upon AMS.

Among other objectives, ACIA aims to create a free and open investment regime through progressive liberalisation of intra-ASEAN investment and through the improvement of transparency and predictability of investment laws. Investment protection is one of the four pillars of ACIA, along with liberalisation, promotion and facilitation, and also features among the guiding principles endorsed by ASEAN governments. This legal protection dimension of the regional construction is a building block of the collective effort towards the eventual creation of a single ASEAN Economic Community (Aldaba, 2013).

Beyond enshrining a commitment to progressive liberalisation of investment regimes, ACIA provides for enhanced protection to investors. While it reaffirms the core principles of the earlier ASEAN agreements, it also further improves the content of other treatment provisions and fine-tunes the investor-state dispute settlement provision. With more detailed provisions, it grants more predictability to the treatment of investment. For example, it provides a definition of covered investment and explicitly covers portfolio investment (ASEAN, 2013a).

Through ACIA, ASEAN-based investors can now benefit from state-of-the-art provisions for the treatment of investment and investors, which are enforceable by an effective investor-state dispute settlement (ISDS) system. It incorporates the principles of national treatment and most-favoured-nation treatment and embeds recent innovative practices in international investment rule making. ACIA also provides investors with guarantees of full protection and security, fair and equitable treatment, compensation in case of strife, protection against unlawful expropriation and the right to the free transfer of funds. Controversial provisions have been clarified and better detailed compared to the earlier Investment Guarantee Agreement. For example, the standards of fair and equitable treatment and full protection and security, which have raised a lot of debate over the past decade and which have led to highly controversial arbitration awards, have been clarified so as to limit possible ambiguities.

The core underlying principle of ACIA is that of non-discrimination, comprised of the principles of national treatment and most-favoured-nation treatment and the freedom to appoint senior management and boards of directors. In accordance with these principles, the Agreement contains no local content requirement and no condition on the entry of investment. ACIA also prohibits performance requirements, export requirements and trade balancing requirements.

ACIA provisions mostly draw on best practices encountered in bilateral investment treaties concluded by individual member states and in other regions. It also incorporates, through a set of general exceptions to the application of the protection provisions, a number of guarantees for host countries, such as the right to regulate, as well as environmental and social safeguards. Likewise, the Agreement contains a set of reservations to the implementation of the national treatment and most-favoured-nation treatment, which allow AMS to derogate from these principles under certain circumstances and in a number of economic sectors.

One of ACIA's guiding principles is to improve the transparency and predictability of investment rules, including the need for AMS to harmonise their investment policies in order to achieve investment policy convergence. This transparency requirement is reflected in the obligation for ASEAN members to notify the ACIA Council when introducing new laws or any changes to existing laws, regulations or administrative guidelines that could significantly affect the treatment of investment or the commitments of AMS to implement ACIA provisions. AMS are also required to make publicly available all relevant laws and regulations pertaining to investment. Individual countries must progressively bring their domestic laws in line with the provisions of ASEAN agreements in a transparent manner. Convergence towards the high standards of protection contained in ACIA requires countries to undertake a sustained regulatory reform effort.

A top-down approach: the ASEAN way towards a harmonised investment legal landscape

Completing ACIA is not sufficient to achieve the harmonisation of investment regimes. Not only must ACIA be implemented, but it also has to be incorporated into domestic laws of AMS. The implementation of ACIA provisions may require enacting new legislation and regulations or amending existing ones. This implies a substantive legislative endeavour for those AMS whose legal practice and rules are still far from being aligned with international standards.

The amendments of investment-related laws in AMS have evolved to reflect countries' successive stages of development. Meanwhile, the pace of legal modernisation that AMS have gone through has been greatly influenced by the regional endeavour, as illustrated by the evolution of investment protection provisions in successive ASEAN agreements. ASEAN countries have opted for a top-down approach to the legal harmonisation process in view of achieving the ASEAN Economic Community. The newest ASEAN member States, namely the CLMV countries, are granted special and differential treatment, which permits them to execute their ACIA commitments in accordance with their stage of development. The harmonisation process would be particularly beneficial to the CLMV that are lagging behind in terms of protection provided in their domestic investment laws. The regulatory convergence dynamic implies the need to find common standards, while avoiding agreeing on the lowest common denominators. The ultimate ambition is, through a convergence of national legal systems, to create a single

regulatory block which would in turn reduce transaction costs of foreign investors operating in the region (Darsa, 2012; Wong, 2014).

Although the top down approach of this harmonisation process seems to have yielded results, it may also potentially lead to a lack of domestic ownership of the legal reforms. It may also cause a problem of feasibility as it is undertaken among countries at very different levels of development. The effective implementation of ACIA depends on AMS' willingness to undertake regulatory reforms in line with the provisions of ACIA (Sallehuddin, 2012). Developing a regional approach towards the protection and liberalisation of investment in Southeast Asia brings opportunities to accelerate the harmonisation and modernisation of investment policies in individual member states. It also provides an opportunity for rationalising the international investment agreements (IIA) regime. If AMS progressively replace their respective BITs with an investment chapter of regional agreements, it would consolidate the global BIT network and thus ease the harmonisation between investment treaty policies and domestic investment regulations. But it also brings challenges as the current approach to regionalism, which consists in adding ASEAN treaties to the already existing network of bilateral treaties, leads to a multiplication of treaty layers. This may result, at least temporarily, in an even more complex network of international obligations, prone to overlap and inconsistency.

As shown in Chapter 2, Viet Nam and Cambodia, which have more recently started to liberalise their trade and investment regimes, have very liberal and favourable investment regulations to attract foreign investment, while Myanmar and Lao PDR are still lagging behind in terms of investment protection and liberalisation. Meanwhile, among more advanced economies, Malaysia does not apply a general principle of national treatment, so as to preserve its affirmative action policies. A third approach is adopted by countries like Indonesia and the Philippines, which still have rather complex investment legal frameworks as they have added several layers of regulations over the past years, as they extended incentives for foreign investors.

The unfinished unification process of investment laws

Since the 1980s, AMS have embarked upon major investment climate reforms (see Chapter 2). They all have progressively amended their laws to create more unified legal frameworks for investment. This unification process involves the creation of a single, non-discriminatory regime governing both domestic and foreign investment. Accordingly, many AMS have gradually unified their legal regime for investment by enacting a single omnibus investment law, under which all investors, regardless of their origin and nationality, benefit from the same core protection provisions.

Over the past decade, Cambodia, Lao PDR, Indonesia and Viet Nam have introduced all-encompassing investment laws that superseded a bimodal regime made of two distinct laws. Malaysia, the Philippines and Thailand do not have two separate laws for the treatment of domestic and foreign investments, but nor have they yet introduced a single piece of legislation. For example, in Thailand, the *Investment Promotion Act* 1977 governs all investments regardless of their origin, including foreign investments, while the *Foreign Business Act* 1999 governs the entry of foreign investment. But in terms of protection of investment, foreign and domestic investors both fall under the *Investment Promotion Act*. Likewise, in the Philippines, while the *Foreign Investment Act* regulates foreign businesses, the Philippine *Omnibus Investment Code* 1987 provides legal guarantees to both domestic and foreign investments equally.

All ASEAN countries except Myanmar have thus adopted holistic investment legislation regulating both domestic and foreign investment under the same general standards of protection. By doing so, they grant foreign investors a minimum standard of non-discrimination. Myanmar is the only country within ASEAN that still has two distinct laws governing foreign and domestic investments separately. The authorities are well aware of the need to push the reform process forward and have announced their intention to reform, over the coming years, the legal framework for domestic investment to pave the way for a more holistic, non-discriminatory regime applying to both domestic and foreign investment. Ultimately, Myanmar aims to align itself with the reform progress already made by its peers by enacting a single, all-encompassing investment law (OECD, 2014a).

Modernising a legal framework is a long-term endeavour. It took Viet Nam two decades to move from a rather hostile legal landscape to a modern, non-discriminatory piece of legislation (Box 2). The *Foreign Investment Law* in 1987 was amended four times in 15 years, including twice in the first five years. The revisions were intended to strengthen investor rights, to make the environment more investor friendly and to narrow the policy gap between foreign and domestic investors. It was eventually replaced in 2005 by an *Investment Law* covering both domestic and foreign investment, which was a significant watershed towards an improved, strengthened and harmonised investment regime. Viet Nam has positioned itself as a model of a progressive strengthening and harmonisation of the investment regime and provides a relevant example to follow for less advanced countries in this process, such as Myanmar.

In Indonesia, the *Investment Law* 25/2007, passed in 2007, provides national treatment for established enterprises, in contrast to the separate treatment for foreign and domestic firms in earlier laws. Compared to the earlier legislation, it also offers greater transparency in terms of the sectors covered, more extensive land use rights and a reduction in administrative burdens and longer work permits for key personnel (OECD, 2010).

In Lao PDR, the enactment in 2009 of the *Investment Promotion Act* merged the laws for domestic and foreign investment, which were previously regulated separately. Like in peer ASEAN countries, the merger aimed at harmonising and standardising the rights and requirements for domestic and foreign investors. Beyond standardising procedures and incentives, the new law also gave foreign investors access to land, under specific conditions that are detailed in the 2010 *Decree on the Implementation of the Investment Promotion Act* (UNCTAD, 2010a).

Meanwhile, in Malaysia, following the recession in the 1980s, a new policy was defined in the *Promotion of Investments Act* (1986). The PIA encapsulated a dualistic approach to foreign investment that was to remain in place until the Asian financial crisis in the late 1990s. This policy approach was modified somewhat as a result of the Asian financial crisis but otherwise persisted until the reforms announced by the government beginning in 2009 (OECD, 2013b).

Malaysia still has no comprehensive law governing foreign direct investment and containing general principles for foreign participation in local business. This policy choice has given the government maximum regulatory space to apply its affirmative action policy and to screen FDI to suit economic needs at a given time. In the absence of an all-encompassing foreign investment statute, FDI is regulated under sector-specific legislation. Protection of investors is granted in the Constitution and in the many bilateral investment treaties which have been signed. The regulation of FDI includes the *Promotion of Investment Act* (PIA) 1986, amended in 2007, which provides a spectrum of incentives to

attract FDI. The *Industrial Coordination Act* (ICA) 1975, amended in 2010, applies to the manufacturing sector.

Likewise, in Thailand, the *Foreign Business Law* 1997 replaced the *Alien Business Act* 1972, and the *Investment Promotion Act* 1977 contains provisions protecting investors against adverse shifts in government policies, rules and regulations as well as competition from SOEs. While there are still two laws governing investments, this does not mean that Thailand has two separate regimes for domestic and foreign investment. Both foreign and domestic investors can, for example, apply for incentives under the *Investment Promotion Act*. The Philippines stands at a similar stage of advancement in the unification process. As in Thailand, the way ahead will be to harmonise and unify investment laws.

Lastly, Myanmar has made laudable efforts to modernise its legal framework for investment at a very swift pace over the past couple of years. Starting in 2011, it initiated a broad reform process to improve its legal and regulatory framework for investment to create a more favourable investment climate. The new *Foreign Investment Law* (FIL) was approved in 2012 after months of debate between the government and parliament. The legislative reform process was initiated to revise the investment regime put in place following the change of government in 1988, when the country first opened its doors to FDI. It aims to enhance Myanmar's attractiveness as an investment destination. The *FIL* and its accompanying implementing rules mark a milestone towards a more open and secure legal environment for investment but are only a first step. Their importance is partly symbolic, to show the government's desire to welcome responsible foreign investment after decades of autarky followed by a first attempt at liberalisation after 1988, which offered few benefits in terms of inclusive and sustainable development. The 2012 *FIL* offers some improvements over the earlier 1988 *Foreign Investment Law* but still leaves many questions unanswered, notably with respect to investor protection (OECD, 2014a).

Box 2. Viet Nam: gradual improvements in the investment framework since the 1980s

Viet Nam's experience in building its legal framework over almost three decades to attract FDI clearly reflects how reforming the investment environment is a continuous and evolving process and how substantial changes in investment laws have further encouraged foreign investment. As part of the *Doi Moi* (Renovation) reform process initiated in 1986, Viet Nam began an open-door policy and enacted the Law on Foreign Investment. As FDI became increasingly recognised as critical for Viet Nam's economic development, the government repeatedly revised the law, in 1990, 1992, 1996, 2000 and 2003, and finally drafted, in 2005, a new Investment Law, which substantially improved the investment environment.

The investment framework has gradually improved over the years: registration procedures, tax policies, rights to transfer abroad capital and foreign exchange and access to land have been progressively relaxed, while the investment environment has been gradually brought in line with Viet Nam's international commitments (ASEAN in 1995, WTO in 2007, numerous bilateral agreements). The authorities have made major adjustments towards further transparency and stronger protection for foreign investors. The most notable change brought about by the 2005 Investment Law was to regulate both domestic and foreign investment under the same legal umbrella and to state clearly, for the first time, a principle of non-discrimination, ensuring that all investors, both foreign and domestic, are treated equally. Other investment guarantees were also considerably improved: the law introduced a legal stabilisation clause that protects investors against adverse effects of regulatory changes; it recognises intellectual property rights, and ensures consistent prices, fees and taxes for all investors.

These gradual and iterative reforms of the legal framework brought new waves of FDI into

the country. Chien and Zhang (2012) show that the 2005 Investment Law substantially increased the amount of registered FDI capital. Viet Nam's experience also illustrates that major changes in the policy framework over time, such as introducing non-discrimination principles, offering legal stability, and improving investment guarantee measures, contributed to raising not only the amount but also the quality of FDI inflows into Viet Nam.

OECD, 2014a; Chien N.D., Zhang K. (2012), 'FDI of Vietnam; two-way linkages between FDI and GDP, competition among provinces and effects of laws, in iBusiness, 2012, 4, 157-163 doi:10.4236/ib.2012.42018 Published Online June 2012 (http://www.SciRP.org/journal/ib)

The national treatment principle in ASEAN investment laws

National treatment is the core principle of the ACIA. It provides that "Each Member State shall accord to investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory. Each Member State shall accord to investments of investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments."

The national treatment standard, which ensures a degree of equality between foreign and domestic investors in like circumstances, is often, although not automatically, included in investment laws. When contained in an investment law, it is always subject to a number of exceptions, for example, for reasons of national security, developmental purposes, public health or protection of the environment. The effect of the national treatment standard is to create a level-playing-field between foreign and domestic investors in the relevant market. No country applies unequivocally the national treatment principle; the scope of the principle, where provided, is always circumscribed by a list of exceptions that must be transparent and clearly defined.

Among ASEAN countries, only Malaysia, Thailand and Myanmar have not enshrined the principle of national treatment. In Myanmar, the principle of protection against discrimination, as well as other fundamental rights contained in the Constitution, is granted to citizens of Myanmar only. Foreign investors remain subject to specific restrictions and are not given the same rights and business opportunities as domestic investors. The principle of national treatment has not been incorporated in Myanmar's new investment framework.

Likewise, Malaysia does not provide for an explicit principle of national treatment. As it has no overarching investment law and rather regulates investment in sector-specific legislation, the principle of non-discriminatory treatment between foreign and domestic investors has not been enshrined in the laws. This does not, however, imply that foreign investors are treated in a more discriminatory manner than in jurisdictions where a principle of NT is explicitly stated, nor does it mean that investments are less protected. The protection of property rights is granted throughout a broad range of legal provisions as well as in the Constitution.

All other ASEAN countries have progressively incorporated a principle of non-discrimination, or national treatment. For example, the 2009 Lao PDR *Investment*

Promotion Law, which governs both domestic and foreign investment, provides that "Investors have equal rights to invest and to have their benefits protected under the laws and regulations of the Lao PDR and international treaties to which Lao PDR is party" (Article 60).

Likewise, Indonesia, which has substantially liberalised its investment regime since the mid-1980s and has resisted calls for protectionism, has complied with the ASEAN obligation to incorporate a principle of non-discrimination. The national treatment principle is enshrined in the 2007 *Investment Law* and most remaining restrictions pertain to foreign equity. Article 4(2) of the all-encompassing *Investment Law* stipulates that the government "provides the same treatment to any domestic and foreign investors, by continuously considering the national interest". Both domestic and foreign business registration are overseen in the same manner by a single board. A negative list, regularly renewed, sets out sectors where foreign equity ownership is limited (OECD, 2010).

In the Philippines, many restrictions on foreign equity and land ownership remain (see Chapter 2). The 1987 Constitution has a clause that supports laws restricting foreign ownership of property to 40%, with minor adjustments by subsequent laws. Further reforms in foreign access to local land require constitutional amendments. Likewise, in Indonesia, Article 33 of the Constitution reserves land, water and natural resources to state control.

Meanwhile, the Vietnamese authorities commit to treat equally investors in all sectors, as well as to provide non-discriminatory treatment between domestic and foreign investors. This commitment to the non-discrimination principle was introduced with the merger of the two laws regulating domestic and foreign investment separately. The introduction of the principle of non-discrimination is the main innovation brought about by the 2005 all-encompassing investment law, which thereby brought Viet Nam in line with the requirement of non-discrimination contained in ACIA.

Affirming the non-discrimination principle in a law is a common practice that signals a positive and open investment policy, without prejudice to the possibility for the state to preserve its sovereign right to implement any developmental policies. The guarantee of non-discrimination, which is often provided for in the Constitution, can also be embodied within a Fair and Equitable Treatment (FET) clause. The FET provision protects foreign investors against discrimination and provides due process of law when discrimination is claimed. This standard, which is enshrined in ACIA, is sometimes contained in investment laws of host countries to protect legitimate expectations of foreign investors and incorporates principles of transparency, good faith and guarantees against denials of justice. AMS' domestic investment legislation has not incorporated such a standard, which rather features, in accordance with the most common global practice, in their bilateral and regional investment agreements.

The protection of property rights in domestic legislation of ASEAN Member States

All AMS have progressively improved the treatment of investors by reinforcing core protection standards, in particular against unlawful expropriation. Protection against expropriation without fair compensation is one of the most crucial rights of investors and must be granted in the regulatory framework for investment through provisions for transparent and predictable procedures. ASEAN countries have achieved a fairly good level of consistency with respect to protecting investment in case of expropriation. While a few AMS still lag slightly behind in this regard, most of their ASEAN peers have introduced

strong guarantees against expropriation that are, generally speaking, consistent with internationally recognised practices. Overall, Myanmar, and, to a lesser extent, Lao PDR, provide weaker legal guarantees to foreign investors than their peers.

For example, Article 7 of the Indonesian *Investment Law* provides that the government shall take no measures to nationalise or expropriate the proprietary rights of investors, unless provided by statutory law. The law brings a substantial improvement to the previous 1967 *Investment Law* in this regard as it specifies that in case of nationalisation, compensation shall be based on the market value of the expropriated asset. The law does not regulate procedures of compensation however, notably in terms of timing and effectiveness. This matter is left to international treaties, when applicable, thus providing a more protective, or at the very least a more predictable, treatment to foreign investors covered by such treaties. It should also be noted that the principle of national treatment that features in the *Investment Law* must apply to all provisions equally, including the expropriation provision.

Meanwhile, in Malaysia, in the absence of a dedicated investment law, the protection against expropriation is provided in the Constitution as well as in relevant IIAs, which usually provide a higher degree of protection against expropriation. Article 13 of the Constitution protects foreign and domestic investors equally against expropriation of property without fair compensation. The *Land Acquisition Act* also provides the conditions under which legal expropriation of land property can occur.

In Viet Nam, prior to the enactment of a single investment law, there was no substantial difference in the treatment of domestic and foreign investment, despite the fact that there were two distinct laws. The 1998 *Domestic Investment Law* already provided the same level of protection as the one granted to foreign investment in the *Foreign Investment Law*. The same protection against unlawful expropriation was contained in the law, as well as a general commitment to protect the right of ownership of assets. The protection against expropriation as stated in the domestic investment law was detailed and contained guidelines as to the compensation process and methodology.

The 2005 *Investment Law* follows along the same lines for protecting against expropriation and the mechanisms for compensation. Like the previous regulations, it also contains a legal stability clause, which is well delineated in order to ensure that legal predictability is granted to investors while leaving some leeway for the authorities to introduce new regulations. However, the guarantee that, in case of changes of law, compensation should be considered in some necessary circumstances, could be further detailed, so as to avoid any ambiguities on the extent of protection granted in that regard.

Like most of its ASEAN peers, Lao PDR also protects against expropriation in line with most accepted international standards. It states that protection is granted against government seizure, confiscation or nationalisation. As for the compensation mechanism, it might potentially be considered as problematic as it grants that expropriated assets shall be compensated "with the actual value at the prevailing market price at the time of transfer", while most often, the best compensation mechanism is considered to be based on the market value of the asset before the decision of expropriation.

In Lao PDR, the assets of both foreign and domestic investors are protected by a Constitutional guarantee, as well as by a specific provision of the *Investment Promotion Law*. Investors can freely repatriate their earnings through the banking system. Likewise, in almost all ASEAN countries, capital and profits can be repatriated freely. In Thailand and

Malaysia however, there is some control over foreign currency remittances and in Myanmar, the right to repatriate capital freely seems to be limited in practice, as transfers of foreign currency are subject to the permission of the Foreign Exchange Management Department (OECD, 2014a).

Core investment protection provisions in Myanmar still need considerable improvements to meet ACIA obligations and to catch up with the level of legal security granted in neighbouring countries. Although the new *Foreign Investment Law* incorporates a few welcome innovations that are likely to enhance the level of protection granted to investors, some of the core investment protection standards remain absent from the new legal framework and a few legal provisions would need further clarification as to the scope and level of protection they provide.

Myanmar's new *Foreign Investment Law* states that "the Union Government guarantees that a business formed under the law shall not be nationalised within the term of the contract or the extended term if such term is extended". This clause protecting against nationalisation does not differ from what was provided under the former regime. It remains a basic and rather unusual protection, limited to events of nationalisation only and not extending to indirect expropriation and other measures tantamount to expropriation. Moreover, it does not grant investors the right to compensation in case of a lawful expropriation and does not assert the state's right to regulate in the public interest. In this regard, the investment law is aligned with the constitutional protection against nationalisation. In order to offer a safe and attractive investment destination, Myanmar should improve the level of protection against expropriation and bring it in line with international good practice, including its ACIA obligations.

The new Myanmar investment law also innovates with a new clause protecting investors against future changes that would affect their right to conduct their activities, in the following terms: "The Union Government guarantees that it shall not cease an investment enterprise operating under a Permit of the Commission before the expiry of the permitted term without any sufficient reason". This is potentially an interesting step towards enhanced legal predictability and rule of law. As currently drafted, it is unclear what constitutes a sufficient reason to unilaterally terminate investment activities and whether this clause protects against regulatory changes that would have an impact on the investment. This provision seems to refer to indirect expropriations and non-compensable regulatory measures (when the termination is decided for "sufficient reasons", which can be understood as public interest purposes underlying the decision). For predictability and transparency purposes, and to avoid arbitrary decisions, the government should further delineate the notion of "sufficient reasons" and clarify whether the guarantee protects against arbitrary removals of permits or has a broader material scope.

Remaining discrepancies among AMS in the ease of using investor-state dispute settlement mechanisms

By virtue of ACIA, ASEAN investors can resolve their disputes with host states by using domestic courts or through international arbitration, including before ICSID tribunals or under UNCITRAL rules or any other ad hoc rules agreed upon by the disputing parties. Other alternative dispute resolution means are also available: investment disputes can be settled by means of mediation, consultation, conciliation and negotiations. The condition for investors to bring a claim under ACIA's ISDS provision is to prove that the dispute arose out of a breach of the host state's obligations under ACIA relating to the management, conduct, operation or sale of a covered investment. As for disputes between

AMS relating to the interpretation of ACIA provisions, the disputing parties must use the ASEAN State-to-State dispute settlement mechanism under the ASEAN Protocol on Enhanced Dispute Settlement Mechanism.

There are strong discrepancies, among AMS, on the ease for investors to use arbitration mechanisms to solve investor-state disputes. While Singapore and Malaysia have become internationally recognised arbitration places and have continuously promoted the use of arbitration for commercial and investment cases, some of their ASEAN peers provide no, or very uncertain, access to arbitration mechanisms.

Although ACIA provides the possibility to bring an investment case before an ICSID tribunal, Lao PDR, Myanmar and Viet Nam are not yet members of ICSID, while Thailand has only signed the Washington Convention, without following up with ratification. As a result, investors operating a business in these countries cannot resort to ICSID arbitration in the event of a dispute against the state authorities.

AMS have nonetheless all ratified the 1958 *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, which provides a legal mechanism for enforcement of awards that are not rendered under the auspices of ICSID. Specifically, the New York Convention requires courts of contracting parties to give effect to an agreement to arbitrate in a matter covered by an arbitration agreement and to recognise and enforce awards made in other states. Endorsing the New York Convention marks a collective commitment to recognise and enforce foreign rulings and arbitration awards, both between investors and state authorities and between private parties only.

Overall, there have been important reform efforts, in many ASEAN countries, to make arbitration available for the settlement of investor-state disputes. Malaysia has positioned itself as a leader in introducing sophisticated legal mechanisms for the promotion of international arbitration to settle investment disputes. It has adopted a holistic and integrated approach to arbitration, encompassing both domestic and international disputes in a single *Arbitration Act*. With the enactment of the Act, the region has embarked upon a trend towards a less interventionist approach with regard to arbitration.

Following the path of Malaysia and Singapore, Indonesia introduced in 2007 a dispute settlement mechanism and provided that disputes between the government and foreign investors shall be settled through international arbitration. Likewise, in Viet Nam, important developments have been made over time with regard to ISDS. The 1987 *FIL* was rather unclear on whether it allows foreign investors to resort to international arbitration to solve dispute cases. It gave access to domestic courts as well as to any domestic arbitration body, but was ambiguous on the availability of foreign arbitration bodies. The 1995 legislation brought some clarification as the by-law explicitly provided that international arbitration is available, among other dispute resolution bodies such as Vietnamese courts and arbitration bodies, to settle investment disputes. The law is now also more detailed and explicitly states that dispute arising from specific forms of contracts must be settled in accordance with the dispute resolution mechanisms agreed by the parties and stated in the contract.

In Myanmar, important ongoing amendments to the ISDS regime are being made. Yet, investors seeking to avoid bringing disputes before an unreliable court system are still confronted with a scarcity of suitable alternative dispute resolution means such as commercial arbitration, mediation and conciliation. According to the Attorney-General Office, the *Arbitration Act* should be updated in the future to bring Myanmar in line with

modern and harmonised practices on international and domestic arbitration. In 2013, President U Thein Sein announced that the government is forging ahead to bring Myanmar's arbitration system in line with accepted international standards. The government has already started amending the arbitration regime, drawing upon on the UNCITRAL Model Law on International Commercial Arbitration, as amended in 2006, which is widely used as a model for countries' arbitration laws. The upcoming *Arbitration Act* is expected to cover both domestic and foreign commercial disputes under the same regime.

A laudable step towards a standardised arbitration framework has recently been taken by Myanmar with the accession, on 15 July 2013, to the 1958 New York Convention. Myanmar's domestic courts now have the obligation to enforce foreign arbitral awards as if they were domestic awards, with very few legal grounds on which to refuse the enforcement.

The 2012 *Foreign Investment Law* also introduces for the first time a dispute settlement provision that recognises the possibility to settle "disputes arising in respect of the investment business". It provides that, when disputes cannot be settled amicably between the parties concerned, they should be settled in accord with the dispute settlement mechanism, if any, provided in the applicable agreement. It should be clarified whether the term "agreement" refers to contracts concluded between state authorities and individual foreign investors, or whether it also refers to bilateral investment treaties containing an investor-state dispute settlement provision. The clause is therefore vague on what options are de facto made available to investors seeking to resolve their disputes. Incorporating the dispute settlement clause into the FIL is not sufficient to give investors access to arbitration to challenge violations of the provisions of the law itself. For example, in the absence of a dispute settlement mechanism provision in the relevant agreement, be it a BIT or an investment contract, investors cannot seek redress for violations of the guarantees provided in Chapter 13 of the *FIL* elsewhere than before Myanmar courts.

Should Myanmar clarify and strengthen its ISDS provision, Lao PDR would be the only ASEAN country that does not grant investors a right to go to arbitration, whether domestic or international. Instead, Lao PDR has established a Committee for Economic Dispute Resolution, which provides an alternative to the court system. It merely provides that dispute resolution related to an investment can be carried out through amicable resolution, administrative resolution, dispute resolution by the Committee for Economic Dispute Resolution, or by filling a claim before domestic courts.

The progressive introduction of more innovative practices in AMS' domestic laws on investment

In many regards, ASEAN stands as a frontrunner in innovations of investment-rule making. Modern and innovative legal practices are encountered in the extensive network of regional and bilateral investment treaties and free trade agreements that the region has introduced over the past years. The progressive introduction of modern legal provisions at treaty level seems to have had some spillover benefits at domestic regulatory level as it has spread awareness on the need to modernise some investment rules. This is true of many investment policy areas, among which the promotion of sophisticated arbitration mechanisms, the increasing awareness of the need to better delineate the scope of protection clauses in order to avoid any overcommitments and the importance of providing not only rights but also obligations for investors in investment laws.

Towards more delineated scopes of investment laws

The progress made in many ASEAN countries towards a more sharply defined material scope of the laws is a good illustration of the regional evolution towards more regulatory convergence. Compared to previous ASEAN agreements, ACIA provides a more detailed definition of what types of investments are covered by the scope of the treaty, and that thus may benefit from the protection guarantees given in the treaty. Like the earlier agreement, ACIA provides for a broad, open-ended asset based definition of covered investments. But it also includes portfolio investment as it states that the term "investment" also includes amounts yielded by investments, in particular, profits, interest, capital gains, dividend, royalties and fees.

In Viet Nam, the definition of covered investment has been refined through the changes to the law. While the former *FIL* in Viet Nam excluded portfolio investment, the domestic investment law had no such requirement as to its material scope. The 1996 *Foreign Investment Law* removed any ambiguities as it used the term "direct foreign investment" instead of "foreign investment" as used in the previous version of the law. It means that the protection and incentives provided by the law were not applicable to portfolio investment. Before the merger of the two regimes for domestic and foreign investments, domestic investors had to operate in a rather less clear regulatory environment than foreign ones. In 2005, the new all-encompassing law defined in detail "direct" and "indirect" investment. According to the law, "investment means the use of capital in the form of tangible or intangible assets by investors to create assets for carrying out investment activities […]"; direct investment means a form of investment whereby investors use capital for investment and take part in the management of investment activities"; and "indirect investment means a form of investment through the purchase of shares, certificates, bonds, other valuable papers or a securities investment fund and through other intermediary financial institutions whereby investors do not directly participate in the management of investment activities*"*. The Viet Nam 2005 *Investment Law* thus provides a good example when defining indirect investment and direct investment, to which specific legal provision apply, notably with regard to the admission requirements and procedures and to the incentives that are offered.

Likewise, in Lao PDR, the 2009 *Investment Promotion Law* explicitly covers both indirect and direct investment, which are defined in the law as follows: "direct investment refers to an act of investing capital into a business operation by an investor or group of investors who becomes the owners of the enterprise, and manage or expand the enterprise"; "indirect investment refers to an act of an investor who purchases shares in company, in stock market including investment in financial guarantee funds, bonds and other valuable documents whereby the investor does not directly participate in the management of the enterprise". The scope of the laws, both in Lao PDR and in Viet Nam, is therefore very broad as it applies equally to any types of investment, with no condition of durability or any other specific requirement on the investment.

The *FIL* in Myanmar clarifies the material scope of the legislation, although it has not achieved the degree of detail contained in the laws of its CLMV peers. Article 2(k) provides for an open-ended, asset-based definition of investments covered by the law that is in line with common practice. Investments covered by the law are defined as "various kinds of property supervised by the investor within the territory of Union under this Law." In line with global practice and with the provision of ACIA, this broad definition is then illustrated by a non-exhaustive list of assets comprising "mortgages; shares and other rights in a company; financial rights, intellectual property rights; and rights of exploration and

production of natural resources". Regardless of whether or not the government decides to include portfolio investment under the provisions of the law, it would be well advised to follow the example of Viet Nam and Lao PDR and to provide clear definitions of direct and indirect investment.

Progressive incorporation of obligations for investors into investment laws

The incorporation into legal domestic frameworks for investment of an obligation for investors to preserve the environment and other public policy objectives seems to be increasingly common among ASEAN member states. This practice aims to strike the right balance between guarantees offered to investors and obligations that investors must respect in order to be eligible for these guarantees and for incentives, is increasingly common among ASEAN countries. Lao PDR, Indonesia, the Philippines, Viet Nam and Thailand have all incorporated, through legal changes mainly introduced in the past decade, a set of general obligations binding upon investors.

Viet Nam seems to have been ahead in this evolution: as of 1987, it provided a set of obligations upon foreign investors, mainly relating to tax and social obligations. Yet the 1995 *Investment Law* strongly improved the previous legal framework, as it provided a much wider range of obligations that are binding upon foreign investors. Specifically, foreign investments must operate in conformity with labour collective agreements and laws, and "respect the honour, dignity, and traditional customs of each other", and to comply with environmental obligations. The law also contains, as of 1995, an article aiming to encourage technology transfers. A few other obligations relating to the corporate governance principles (accounting rules, transparency principles, etc.) are also contained in the law.

Meanwhile, Indonesia introduced provisions on corporate social responsibility with the enactment of the 2007 *Investment Law*. In Lao PDR, alongside with general obligations such as tax obligations and those relating to labour laws, a specific provision obliges investors to protect the environment. Under article 70 of the *Investment Promotion Law*, investors must ensure that their business activities do not cause severe adverse impact on the people, national security, public order or health of workers. However, in all AMS' domestic laws and treaties, such obligations are always stated in very broad terms, with no specific requirements binding on investors. It is an interesting evolution in rule-making, which is also reflected in many OECD member countries' domestic laws, which increasingly often contain provisions to ensure that investors bind themselves to a responsible business conduct.

AMS have made impressive progress over the past decades towards the creation of a common legal landscape for investment. Despite strong discrepancies in their level of development, individual countries have achieved a fair degree of harmonisation in their investment regimes in a number of policy areas, such as ongoing modernisation efforts to promote the use of investment arbitration across Southeast Asia. Yet, further adjustments are still needed for ASEAN member states to fully meet their ACIA commitments and to turn ASEAN into a regional block with sound and consistent policies for the protection of investment.

Table 6. Core investment protection guarantees in selected ASEAN countries' legal frameworks

	Existence of a single investment law covering domestic and foreign investments	Principle of national treatment / non-discrimination enshrined in legislation	Negative list approach	Protection against expropriation	Guarantee of free transfer of funds provided by law	Possibility to recourse to investment arbitration provided by law	Adherence to international conventions on arbitration (ICSID Convention, & NY Convention)	Adherence to International Investment treaties (including BITs and FTAs)
Cambodia	Yes	Yes, except for land	/	Yes, but incomplete	Yes	Yes	Yes	Yes
Lao PDR	Yes	Yes	/	Yes	Yes	No	Not a member of ICSID	Yes
Indonesia	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Malaysia	No	No	/	Yes	Yes	Yes	Yes	Yes
Myanmar	2 separate laws for domestic and foreign investments	No	Yes, but inadequate	Yes, but incomplete	Yes	Yes, but unclear	Not a member of ICSID Adhered to NY Convention in 2013	Yes
Philippines	2 investment laws	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Thailand	2 investment laws	No	Yes	Yes, but incomplete	Yes	Yes	ICSID Convention signed but not yet ratified	Yes
Vietnam	Yes	Yes	Yes	Yes	Yes	Yes	Not a member of ICSID	Yes

Chapter 4

INVESTMENT PROMOTION AND FACILITATION IN SOUTHEAST ASIA

The ASEAN investment destination

Southeast Asia will be one of the world's fastest growing consumer markets over the next two decades, unleashing a combined population of 600 million through the ASEAN Economic Community (AEC). Intra-ASEAN trade is expected to increase to 30% after the implementation of AEC in 2015 (ASEAN, 2013b). ASEAN offers a diversified market, with countries boasting competitiveness in different sectors, ranging from low-cost manufacturing to biotechnology. In addition to the economic benefits of regional integration, established regional investment projects in ASEAN in the areas of banking, manufacturing, transport and communications prove that the region offers a wide range of opportunities for investors, from ASEAN and beyond. New growth areas, such as technology industries, were also responsible for the region being the only part of the world recording increases in FDI in 2012 (ASEAN, 2013b).

The ASEAN investment destination and the opportunities along its regional value chains need to be strengthened further. While some investment-related challenges need to be addressed over the long term, including costly and often complex investment climate hindrances like weak physical infrastructure or skills deficiencies, other investment climate enhancers can be improved in the short to medium run. Instilling greater regulatory simplicity, transparency and predictability offers one avenue. Good investment promotion and, especially, facilitation is key in this regard.

Many ASEAN economies have become export hubs and are thus linked into regional and global value chains (GVCs). However, the extent to which this is a reflection of ASEAN firms' competitiveness is unclear, as being linked in GVCs is not synonymous with high local value addition. The key issue is the competitiveness of local manufacturing and services. Attracting investment that contributes to productivity, especially if it creates linkages and spillovers with local manufacturers, is critical. This in turn can reduce imports through local sourcing and indirectly boost export competitiveness. Recent developments in measuring trade in value added (see chapter 1) can offer new policy options in this regard.

This chapter exhibits the varying approaches to promoting investment in the region, reflecting regional and global demand and the different capacities of ASEAN governments to undertake effective investment promotion and facilitation. Efforts to improve the ecosystem for investors, also as an avenue to retain and expand existing investments, are considered. Notwithstanding the efforts at national and regional levels, including ACIA, the Trade in Goods Agreement and the ASEAN Single Window, untapped opportunities to promote the ASEAN region as an investment destination remain.

Main investment promotion mechanisms and instruments

Investment promotion and facilitation depend by and large on the quality of the investment-related policies and the overall investment climate. Success in promoting investment requires a careful calculation of how to employ resources most effectively and how to organise investment promotion activities within the government so that the overriding goal of economic development remains at the forefront of policymaking. The importance of promotion and facilitation cannot be underestimated: badly designed investment promotion and facilitation measures can be costly and ineffective. Many investment promotion agencies (IPAs) rely on mixed approaches and measures for promoting and facilitating investment, often due to capacity constraints.

Promotion and facilitation of investment are two very different sets of activities. One is about promoting a country or a region as an investment destination, while the other is about making it easy for investors to establish or expand their existing investments. The underlying principle of good promotion is that it can only be as effective as the quality of investment and investment-related policies. In terms of facilitation, effective one-stop-shops with single-point authority are a critical element of implementation (OECD, 2014a). A core mandate of investment facilitation includes filling an information gap created due to policy weaknesses, incoherence or inaccuracies. This can provide investors with much needed clarity and security, especially when framework conditions are weak.

Investment promotion has at times played a critical role in developing countries' economic performance. In Southeast Asia, the promotion and attraction of export-oriented FDI enabled countries like Malaysia and the Philippines to shift quickly towards a manufacturing-based economy in which economic growth was driven by rapidly expanding exports. The record from this export performance speaks for itself, but so too does the manifest failure in many cases to translate this export success based on FDI into something more durable. Not only have exports been limited to a small number of products (usually intermediate ones) and sectors, but to varying degrees these export sectors have been virtual foreign enclaves within host countries. Investments in these enclaves have often been characterised by low value-addition (principally from labour-intensive assembly operations) and a poor record of technology transfer.

One size does not fit all, and different approaches are suitable for different countries. The Malaysian Investment Development Authority (MIDA) organisational structure reflects a clear strategy of dividing the responsibilities of promotion and facilitation into dedicated units where resources and expertise differ. The agency also has sectoral expertise, a difficult competence to master for many IPAs, divided into resource and non-resource industries (OECD, 2013b). Singapore's Economic Development Board (EDB) has a function that goes beyond investment promotion and facilitation, stemming from its earlier roles as an industrial development body. Yet, the EDB still qualifies as one of the best IPAs in the region and its services reflect a high level of sophistication. For countries with small budgets, the focus should be on investment facilitation, reducing the burden on investors. The risk of agencies trying to undertake too many activities at the same time, rather than focusing on doing selected core activities right, is well documented (OECD, 2014c). Please see Table 7 below.

Myanmar's recent economic and political opening, for example, has led to a focus on ambitious reforms, with numerous investment-related laws and regulations under review. This makes investment promotion and facilitation measures vital to provide the private sector with an avenue to interface with the government. The Directorate for Company Administration's (DICA) role as a co-ordinator of investment attraction to the various sectors is critical to avoid duplication of government efforts and uphold standards of practices in dealing with investors. DICA is well placed to tackle hurdles to improve the investment climate and is highly solicited. The *OECD Investment Policy Review* of Myanmar suggests that a gradual decentralisation of its functions should be foreseen to avoid untenable strains on its capacity to deliver. However, such decentralisation should be accompanied by capacity building measures in the other agencies and regional offices (OECD, 2014a).

Table 7. Range of IPA staff and resources

Very weak	Weak	Moderate	Sound	Good Practice
- Staff unwisely recruited and unlikely to be trained well - Several staff members have been taken over from other ministries and agencies without proper recruitment processes	- Staff drawn primarily from the public sector - IPA burdened by too many staff members who do not respond well to training - Training provision on a purely ad-hoc basis	- Staff drawn primarily from the public sector and university graduates pool - Limited knowledge about investment promotion and sectors - Good number of staff and management open to training and taking advantage of continuous learning opportunities	- IPA has done the most of its limited budget and has managed recruitments wisely - CEO or DG flanked by highly competent deputies - Private sector and university recruits outnumber public servants - Good training on marketing and project management offered and taken advantage of by staff - Staff recruited from strategic sectors that the IPA works to promote	- Marketing, project management and client-orientation recognised by private sector as of high standard - On-going training opportunities and strategic HR functions in place - IPA has developed strong sectoral expertise with direct linkages to industry - Private sector actively uses the services and advice from the IPA staff: signs of good after-care and policy advocacy skills in the IPA

Source: OECD (2014bc) and ICA, 2014

Companies from Singapore, Malaysia, Thailand, Viet Nam and the Philippines all have investments abroad, and represent some of the largest multinational enterprises (MNEs) in their sectors globally. Many ASEAN economies are thus also increasingly home to outward investors and their governments actively promote outward investment. In Malaysia, outward investment has surpassed FDI inflows since 2007. While a great deal of the outward investment is driven purely by market considerations, government policies have played an important role in promoting such investment. Some of the most important policies that have contributed to the steady increase of Malaysian outward investment since the early 1990s include the liberalisation of the capital account by Bank Negara Malaysia (BNM). This included easing capital outflow restrictions, as reflected in the Financial Sector Master Plan and the Capital Market Master Plan 1, launched in 2001 (Goh and Wong, 2010).

After-care services and policy advocacy

After-care services for investors are vital, especially in retaining investors, just as after-sales functions within a private company aim to sustain customer loyalty. At the same time, after-care adds value to a service or product beyond the selling point – the decision to invest. Numerous countries have struggled to retain investors, especially MNEs, after an investment peak. The experiences of China and Viet Nam, which have both seen drops in FDI in the early and mid-1990s respectively, prove how difficult this can be: after an initial phase of investment liberalisation, persistent regulatory and investment climate challenges showed a negative impact.

Good after-care and policy advocacy, namely feeding investors' feedback into policy making, can help address investment climate challenges in the short run. The most effective IPAs in terms of attracting investment devote considerable resources to policy advocacy (Morisset, 2003). Many IPAs have after-care services, and some have set up dedicated programmes, as is the case of the Philippines (see Box 3 below). Good after-care services are usually developed through many years of competent investor servicing and business facilitation. A big share of FDI is typically re-invested earnings, making the case for good after-care services. These services are critical in retaining hard-won investors and to get them to expand their activities to higher value-added activities to further upgrade in GVCs.

Malaysia's MIDA provides comprehensive hand-holding assistance to investors from the pre-establishment stage (e.g. in obtaining approvals and incentives) through to the post-establishment stage (e.g. overcoming any bottlenecks that may arise in implementation and operations). At district levels, the District Industry Implementation Units provide assistance to companies from application to project implementation through elaborate after-care services (OECD, 2013b).

Investors are nevertheless often critical of even the best IPAs in ASEAN in this area, testifying to the complexity of good after-care. For instance, while MIDA is consistently rated as one of the world's best IPAs, investors in Malaysia have recently highlighted that it could improve its aftercare services. This is partly a reflection of the investment climate in Malaysia, which is characterised by a vast array of reform initiatives, making constant updating of relevant information for investors critical, but also challenging (OECD, 2013b).

Box 3. The Philippines' investors after-care programme

The programme is implemented by the Board of Investments (BOI) Investment Assistance and Services Department to apply a pro-active approach with BOI-registered investors, rather than waiting for investors to seek assistance.

Services include:

- Regular company visits to discuss operational concerns
- Practical business advice
- Issues and concerns with regard to facilitation
- Updates on investment policies, rules and regulations
- Investors participation through feedback/suggestions

Central to its implementation is the Investment Promotions Unit Network (IPU Net) a collaboration of 28 government agencies which signed an agreement to act immediately to resolve the difficulties encountered by investors. The BOI acts as the secretariat to dispatch and monitor cases and tracks progress in resolving the issues.

The Office of the Ombudsman acts upon investment-related complaints involving violations of commitments of IPU Net member agencies. The Ombudsman issued guidelines on handling requests for assistance in 2013. To continuously improve the aftercare services, a Client Feedback Mechanism Form was introduced.

Source: http://investphilippines.gov.ph/en/setting-up/investors-aftercare/

Use of Incentives in ASEAN

Fiscal and non-fiscal investment incentives are a popular investment promotion instrument in Southeast Asia. The effectiveness of fiscal incentives in the form of tax holidays, reductions or exemptions is contested. They also significantly reduce the national resource availability to support critical investment climate reforms, including for improving and maintaining physical and social infrastructure.

Their effectiveness in attracting foreign investment remains uncertain. Experts agree that tax considerations are only secondary determinants of investment after business climate fundamentals such as market size, a sound regulatory framework, macroeconomic stability, and the availability of skilled labour and natural resources (OECD, 2013b). Non-tax determinants of FDI tend to be the dominant factors in an investment decision (Wunder, 2001; Kinda, 2014). A survey of 75 Fortune 500 companies has shown that non-tax factors were the dominant investment determinants (Wunder, 2001). IFC Investor Motivation studies also show that over 80% of the companies surveyed would have invested in Thailand and Viet Nam even without the fiscal incentives they currently enjoy (OECD, 2014b).

Despite this consensus, competition among countries over the past two decades has led to an escalation of incentives. Measuring the efficiency of incentives is difficult, as it

largely depends on the type of investment and investor targeted (Box 4). Local market-seekers are less likely to be sensitive to incentives, while export-seekers are generally more prone to incentives and import duty exemptions. Evidence from Hong Kong Chinese investment in ASEAN countries shows that incentives only had an effect on a limited number of industries, mostly export-oriented. This included food and electronics in Indonesia, metal manufacturing in Thailand, and other forms of manufacturing in Malaysia, the Philippines and Thailand (OECD, 2013b).

Box 4. The evolving role of incentives in Malaysia

The 1958 *Pioneer Industries Ordinance* was one of the first incentive-based policy measures to attract investment, providing tariff protection and tax allowances to pioneer firms (UNCTAD, 2011). This was followed by the *Investment Incentives Act* of 1968, and more recently the *Promotion of Investment Act* of 1986. Since then, incentives have been used by the government to promote FDI and domestic investments in targeted industries and sectors.

Malaysia began to offer incentives at an early stage, primarily tax holidays to import substituting firms. Tariff protection was also conferred, but the market was too small to allow viable infant industries to develop. The only lasting attempt to nurture a local industry has been in the automotive sector, with Proton Holdings Berhad. In the late 1960s, incentives were expanded to include an investment tax credit, which was aimed both at increasing employment and at pioneer industries, including capital-intensive projects. During this period, foreign firms accounted for over one half of the manufacturing sector, which for its part represented only 13% of GDP. In the 1970s, labour-intensive and export-oriented firms were favoured, including through the creation of export processing zones where firms were exempt from most of the restrictions on other investors (Thomsen, 2004). In the early 1980s, the government embarked on an industrialisation strategy based on local capital, but this strategy was curtailed by the recession in the mid-1980s, at which time a Reinvestment Allowance was introduced for foreign and domestic firms.

In the early 1990s, both the tax holiday and the investment tax allowance were made less generous for pioneer industries and their approval became more contingent on the fulfilment of certain criteria. After 1995, labour-intensive projects were no longer eligible for promotion unless they were located in certain areas or satisfied other narrow conditions. This tightening of incentive practices in traditional parts of the economy was accompanied by an expansion in other areas: high-technology, R&D, training, industrial linkages and multimedia (the development of the latter is supported through the establishment of the Multimedia Super Corridor). Since 2000, the government has offered customised incentives (both fiscal and financial) for investment perceived as "high quality" and in certain sectors deemed strategic. Incentives have also been tied less to economic performance (*e.g.* exports) and more to innovation and responsible business conduct: up-skilling of workers, R&D, and environmental protection (Thomsen, 2004).

Source: OECD, 2013b

Analysing and comparing regional incentive provisions is also difficult. This is partly because of their different nature (IMF, 2006). The most common forms of incentives in the region include income tax holidays, preferential tax rates, import duty and VAT exemptions, tax credits and other taxable income deductions. Non-fiscal incentives also

exist, such as the right to hire foreign nationals in supervisory, advisory or technical positions.

There are general commonalities with regards to the regulation of incentives in the region, as in most cases, they are part of national investment laws, but their implementation varies considerably. For example, while Cambodia's investment incentives granted to companies in special economic zones (SEZs) are aligned with the national legislation as stipulated in the Law on Investment and the Law on Taxation (IMF, 2006), other countries offer special and differentiated treatment to companies established in SEZs. For example, in Myanmar, the SEZ incentive regime is covered by the Myanmar Special Economic Zone Law and the Dawei SEZ Law, and in the Philippines SEZ incentives are governed by the 1995 Special Economic Zones Act.

International good practice recommends that incentives be included in tax laws and administered by a single authority, thus adding to policy consistency and transparency.[8] It makes tax and incentives administration less complex, which would clearly benefit the lower income ASEAN countries with stretched public administration resources and capacity. Assuming that tax administration is undertaken soundly, it would also add to the government's transparency and accountability to its people.

There are also differences as to when the incentives start to apply – the so-called trigger period – across the region. For instance, in Thailand and Lao PDR, the tax holiday begins after the project has begun its operations, whereas in other countries, like Viet Nam and Cambodia, the trigger period is later. Tax holidays can be triggered by a number of factors, including either when the project starts producing sales or when taxable income is realised (IMF, 2006). This adds to the complexity of designing a profile of incentive duration in ASEAN countries.

International tax competition is manifested primarily through a downward trend in statutory corporate taxes and a proliferation of tax incentives. Also, there is manifested tension within different public administrations on how to deal with fiscal incentives. While IPAs tend to be in favour of incentives motivated by a push to include these in their value propositions to potential foreign investors, authorities in charge of national budgets often advocate fewer incentives to reduce pressure on the public purse in the form of forgone revenue.

Aggressive incentive policies by countries in the same region using incentives to support their investment promotion efforts have implications that need to be seriously considered by policy makers. When each country ignores the adverse impact that its own tax policy has on other countries, it leads to a "race to the bottom", making countries collectively worse off. There are merits in pushing for regional harmonisation of incentive schemes.

Over the past couple of decades, increasing global integration has constrained governments' ability to design domestic tax policies in isolation. Unbalanced and incoherent tax policy choices, including incentives, taken in isolation, have led to distortive

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[8] OECD *Checklist for Foreign Direct Investment Incentives Policies*

effects on cross-border trade and investment. They have also significantly distorted competition and investment both within a country and regionally.

ASEAN has the essentials to form a regional investment incentive regime. ASEAN countries share a common interest in establishing a level playing field among themselves. Regional co-operation and agreements can help fight excessive incentives, protecting tax bases of the ASEAN member countries, and provide a comprehensive ASEAN-wide mechanism to address tax competition (OECD, 2014b). The completion of the ASEAN Economic Community (AEC) and strengthening the identity of an ASEAN investment destination would give political impetus for such a vision.

Regional co-operation on incentives could consist of a framework to assist policy makers in tackling associated challenges. This includes understanding the extent of divergences of tax incentives policies and practices across the member states; having a platform for dialogue on tax incentives-related policies; and forming a mechanism to improve knowledge-sharing between the ASEAN states as the countries compare their policies and practices and share their experiences in this challenging area (OECD, 2014b).

While benchmarking the use and effectiveness of incentives in ASEAN would be useful in this regard, ASEAN could begin by urging its member states to ensure transparency in incentives provision, and make forgone revenues from incentives publicly available, guided by international good practice. For instance, the OECD *Checklist for Foreign Direct Investment Incentives Policies* and its *Draft Principles to Enhance the Transparency and Governance of Tax Incentives for Investment in Developing Countries* suggests, among others, that governments:

- Make public statement of all tax incentives and their objective;
- Provide tax incentives through tax laws;
- Consolidate all incentives under the authority of one body where possible;
- Ensure tax incentives ratified through law making body or parliament;
- Administer incentives in transparent manner;
- Calculate forgone revenue and make it publicly available, collect data systematically, monitor effects;
- Enhance regional co-operation.

The rich experience of the European Union (Box 5) can offer some guidance, in particular in providing avenues for a code of conduct of members of a regional community.

Box 5. Managing tax competition in the European Union

The European Union is a large and culturally diverse market with 28 members. How it manages its economic affairs, particularly striking the right balance between regional harmonisation and national autonomy of its member states, provides interesting leads for other regional economic communities. One area of particular sensitivity is in managing tax competition regionally.

Recognising that tax competition can add to the tax burden on factors production that are less mobile than capital, particularly labour, the EU first took a first significant attempt to manage tax competition in 1997 through a "tax package". This included a Code of Conduct aimed to abolish tax incentives breaching good fiscal behaviour and to refrain from introducing new incentives. In 2000, the European Council made public a list of 66 incentives marked by the Code. While the Code is not legally binding, it has significant political clout.[9]

Another avenue for managing tax competition in the EU is through the Commission's state aid rules. Though there are no rules for fiscal aid per se, EU law provides for rules on state aid, including fiscal incentives. If a tax incentive meets all four criteria set out in the Commission's definition of state aid, it can be deemed to be incompatible with the common market and may be prohibited under EU law. The EU seems to be the only regional grouping of countries with such a sophisticated and comprehensive system of monitoring state aid in place, although such an approach is highly relevant for the good workings of intra-community trade and competition.

Recent action on state aid with regards to tax competition by the Commission includes requesting Luxembourg in March 2014 to deliver information on its tax practices. The information requested covers the intellectual property tax regime. Such incentives are frequently used by EU members to stimulate innovation and investments in new technologies. For example, in 2008, the Commission reviewed such practices in Spain, eventually concluding that the system did not qualify as selective aid. In 2009, the Commission also authorised the creation of 22 urban tax-free zones in Italy to support small and micro-enterprises.

Source: European Commission, Press Releases (28 October 2009, 24 March 2014)

Institutional set-up of investment promotion in ASEAN

ASEAN governments rely on dedicated structures for investment promotion and facilitation. These often take the form of dedicated IPAs, as is the case in Brunei, Malaysia, or the Philippines, or units within ministries with considerable clout, such as the ministries of planning and investment in Lao PDR and Viet Nam (see Annex 1). To date, no ASEAN government has followed the strategy sometimes adopted by emerging economies to place the IPA under the President's or Prime Minister's offices, though Myanmar is considering such an option.

[9] http://www.eatlp.org/uploads/Members/GeneralReportSchoen.pdf

The establishment of an IPA should proceed by law to give it the necessary powers to undertake its mandate. The IPA should also be guided by a board consisting of both public and private sector representatives. It should attract competent staff with private sector experience. Offering attractive salaries is often a challenge, but the important strategic mandate of the IPA as well as a corporate culture could be attractive factors for potential employees. Thailand's Board of Investment, Malaysia's MIDA and Singapore's EDB are often cited as model IPAs. Their structure and services are readily available on their websites.[10]

Effective co-ordination between various authorities with investment promotion mandates, including at local government levels, and implementing agencies (be they in charge of export promotion, business registration, or land allocation) is challenging. Many ASEAN economies have pushed through reforms to decentralise investment promotion and facilitation. Delegating some functions of IPAs to the provincial level may contribute to swifter management of investment applications. Viet Nam's experience with decentralising licensing processes was positive in this regard (OECD, 2014a). At the same time, this decentralisation led to problems of co-ordination. Viet Nam set up three investment promotion centres under the Foreign Investment Agency at the Ministry of Planning and Investment, in the north, centre, and south of the country, as well as teams charged with facilitating FDI in each provincial Department of Planning and Investment. Their experience has been mixed, with significant challenges remaining in the co-ordination of the different agencies, while aiming to ensure consistency with the national and provincial development plans (OECD, 2009).

Some ASEAN countries face particular challenges in this regard. The Philippines, for example, is home to 17 IPAs. While advocates of the system claim that it allows for more targeted and better tailored services to investors, it is clear that it increases co-ordination costs in the administration, while making it more difficult for investors, especially foreign ones, to find information on the country in a single source. These challenges are recognised by the government, which has rolled out some reforms. These include strengthening the Board of Investments' role as a national co-ordinator for investment promotion and organising joint investment promotion tours. The Board of Investments also acts as the Secretariat of the national Investment Priority Plans, which highlights strategic sectors for investment. To ensure adequate private sector ownership, these plans are guided by private sector-led industrial roadmaps.

IPAs can also play an essential role as good policy advocates. Strong communication mechanisms with the business community are thus essential, especially in view of informing policy formulation. One lesson from ASEAN that can serve as a global good practice for IPAs is frequent performance evaluation. Malaysia's MIDA for example is well known for its effective client charter and Key Performance Indicators (OECD, 2013b).

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[10] http://www.unescap.org/tid/publication/indpub2322.pdf

Strengthening the ecosystem for investment in ASEAN

Anchoring investors in an investment location through deep linkages with the local economy is an effective investment retention strategy. As seen above, dedicated measures, including investor targeting and after-care services, can be powerful in attracting and keeping investors satisfied, motivating them to re-invest and expand their investments. Yet, it is the broader and more sophisticated, and hence more complex, efforts to strengthen the investment ecosystem that will determine a country or region's investment competitiveness. This covers the complex need to provide investors with competitive local suppliers, getting them to source locally, develop the necessary hard and soft infrastructure, including institutional support, and keeping policy and macro-economic fundamentals in order. In an environment characterised by fierce competition among neighbours, many ASEAN economies have taken such an approach which goes beyond classical investment promotion and facilitation measures.

ASEAN experience with Special Economic Zones

Many governments opt for Special Economic Zones (SEZ) to meet various development objectives, from job creation, increasing export and government earnings, to attracting investment, especially FDI. Lao PDR has nine SEZs, including Savan-SENO, Boten Dan Kham and Dokyil Kham, while Myanmar is developing the Thilawa SEZ to support its investment attraction strategy (OECD, 2014a). Common features include a geographically defined area, streamlined procedures – such as for customs, special regulations, tax holidays – which are often governed by a single administrative authority. Evidence of free zones dates back to 1704 in Gibraltar and 1819 in Singapore (OECD, 2008).[11] By the latter half of the 20th century, they had become a widely used tool to promote economic development. The development of the Chinese Shenzen free zone in 1979 is particularly well-known for marking this trend (OECD, 2014a). By 2008, there were over 3000 SEZs in 135 countries (World Bank, 2008).

A zone-based strategy may be effective in attracting investors in the short-run by offering adequate infrastructure, services and duty-free access for capital goods and other inputs. Yet, such zones have often stagnated in terms of sustaining innovation and competitiveness, failing in technological upgrading and new firm creation. Economic activities within free trade zones, allowing for import and export cost reduction measures, have proven to have weak linkages with the rest of the economy.

In Viet Nam, 15 SEZs and 260 industrial parks have been established over the past twenty year. These have contributed to some 1.6 million jobs.[12] In HEPZA zones in Ho Chi Minh City, over 900 enterprises and 170 000 workers are said to have contributed to the industrialisation and modernisation of the city.[13] Up to 2011, the three export processing zones and ten industrial parks in Ho Chi Minh City have attracted 1 216 investment projects. They have contributed to export growth, serving major markets, such as Japan,

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[11] OECD (2008), http://www.oecd.org/mena/investment/41613492.pdf

[12] http://www.khucongnghiep.com.vn/en/tabid/129/articletype/ArticleView/articleId/478/default.aspx

[13] http://www.hepza.hochiminhcity.gov.vn/web/hepza-eng/development-history-of-hepza

Europe, the United States, Chinese Taipei and China. Companies in Viet Nam's SEZs are recognised for the unusually high number of local investors, about 50% in 2008. There are other rare cases, like Malaysia for instance, that started with a high number of FDI projects in SEZs and eventually became dominated by local players (Farole, 2011).

In the Philippines, FDI in SEZs accounted for a quarter of total FDI in the 1980s, and 78% of its total exports in 2005 (Farole, 2011). There are numerous SEZs in the Philippines, in fact the Philippines Economic Zone Authority (PEZA) alone owns three SEZs and administers the incentives for over 300 zones which are privately managed. These include 17 agro-industrial economic zones, 197 IT parks and centres, 66 manufacturing economic zones, 18 tourism economic zones, and two medical tourism zones. Other major SEZs include Subic Bay Metropolitan Authority and Clark Development Corporation. While their impact on the domestic manufacturing productivity is questionable, these SEZs have undoubtedly contributed to attracting export-oriented FDI. Some of the zones boast good business frameworks. PEZA for example is ISO 9001:2008 certified, while Clark has a Corporate Social Responsibility unit which promotes responsible business in the zone. Subic inherited approximately USD 8 billion in infrastructure from the former US base, thus saving the government significant infrastructure development resources. Every PEZA zone also has a PEZA staffed monitoring office which makes sure the zone developers and locators comply with the national social and environmental legislation.[14]

Indonesia's Batam Free Trade Zone managed to attract over 150 major maritime companies, including McDermott International and Drydocks World. These have contributed to a booming shipbuilding and shipyard industry, also facilitated by the advantageous position of the Riau Islands Province. In addition, Batam is becoming an electronics manufacturing hub and has attracted global leaders such Panasonic, Sanyo and Siemens. This is in part due to the quality of its infrastructure, which is higher than in the rest of Indonesia.[15]

While many governments established SEZs or Export Processing Zones to attract investment, to promote linkages with local SMEs and hence develop local industries, several states, including Penang, Johor, and Klang Valley in Malaysia, have followed a more elaborate and comprehensive strategy of cluster development. Industry clusters are an integral part of Malaysia's industrial policy, as clearly stipulated in the three Industrial Master Plans. Dynamic clusters rely on the smooth interaction of a number of pillars, combining public policies and initiatives at the firm-level. Besides being agglomerations of companies in a geographical area, clusters typically exhibit the following characteristics, critical for their generation of new technology, innovation, and firm creation:

- Strong role of government (federal or state) in promoting stability and basic infrastructure.

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[14] OECD onsite interviews with PEZA, Subic and Clark, February 2014

[15] http://www.gbgindonesia.com/en/main/business_updates/2014/upd_a_look_into_indonesia_s_special_economic_zones.php

- An institutional environment that stimulates technological acquisition and transfer, including through high intellectual property rights standards.
- Global connectivity of clusters through value chains and markets.
- Competent intermediary organisations in place to promote the horizontal connectivity and co-ordination of economic agents.

As outlined above, ASEAN economies boast a rich experience with SEZs which have been a vital element in their export-oriented investment strategies. As such, they have been by and large successful in both attracting FDI and increasing exports, but they have also created enclaves of economic activity, with relatively few links with the domestic economy. Companies in Southeast Asian SEZs source little locally. Indonesia with around 30% of local sourcing is an exception, given largely by its market size. In the case of Viet Nam, the establishment of SEZs during the country's opening contributed to an increase in manufacturing as a share of exports compared with the pre-zones period (Farole, 2011).

In some cases, they have also led to real estate and land price speculation by private developers, in many cases domestic companies, outweighing the very benefits and objectives of SEZs to facilitate business operations. Yet, there are cases where SEZs have contributed to up-skilling domestic enterprises and have actually instilled higher standards of responsible business conduct than provided through national frameworks. Lower-income ASEAN economies embarking on zone-based strategies should be provided with a regional platform to benefit from the successful SEZ experiences driven by their regional peers (see Box 6 below).

Box 6. Good practices in Special Economic Zones

- Foreign/local ownership: No limitations, equal treatment
- Catering to the domestic market: Liberalised, criteria based, subject to regular, non-zone based import regulations
- Purchases from the domestic market: Companies eligible for exporter benefits since these should be treated as exports from domestic markets
- Eligibility for benefits: No mininimum export requirements, foreign and domestic companies, private zone developers, manufacturers and service providers
- Labour and environmental policies: Full consistency with international norms, including ILO labour standards and OECD MNE Guidelines, full consistency with national legislation, monitoring office in the zone
- Private zone development: Competition with government managed zones on a level-playing field, developers eligible for full benefits, clearly defined in legislation, including criteria
- Enhancing GVC integration: Training facilities for local staff and companies in the zones, policies to develop clusters around the zones that cater companies located in the zones

Source : OECD (2014a)

ASEAN skills enhancement

A skilled workforce that can cater to the needs of investors is a vital part of the investment ecosystem. Creating an integrated framework for skills enhancement in a diverse environment such as in ASEAN is challenging. Such a framework often needs to address the specifics of a higher-skilled export sector, a medium-skilled domestic economy, and a low-skill informal economy (Martinez-Fernandez and Choi, 2012).

The role of the private sector in developing skills is widespread in many ASEAN economies. This is a crucial element of skills development as the private sector knows best what skills it needs. Examples from the Philippines include students of the Bataan School of Fisheries receiving on the job training with the Subic Bay Apparel Corporation, Jollibee Balanga and the Crown Royale Hotel, and former trainees of the Aboitiz Foundation – an industry partner of the Subangdaku Technical and Vocational High School – being employed by Metaphil and the Aboitiz Group of Companies (Martinez-Fernandez and Choi, 2012). Also, "Learning by doing" within the firm is recognised as an effective skills promoter. In fact, many MNEs have their own skills development programmes, as the example from Lao PDR below will show.

Viet Nam has shown results in terms of making its vocational training offering more demand-driven in recent years, including through the involvement of the private sector. For instance, the number of trainees in its vocational training institutions increased threefold from 1998 to 2010. The government is also spending significant resources on vocational training for rural labourers: in 2009, the Prime Minister signed a USD 1.4 billion vocational training programme through 2020 (Martinez-Fernandez and Choi, 2012).

The role of policy and the importance of public initiatives to promote skills should not be ignored. For example, the Malaysian Industry-Government Group for High Technology, a think tank under the purview of the Prime Minister's department, supports start-ups in high-technology sectors. It develops strategies for companies to grow during their first three years and has been offering consulting services for companies in biotechnology, nanotechnology, and sensor technology. Such initiatives form a critical element of Malaysia's 2020 Vision to break away from its middle-income trap (OECD, 2013b).

- To speed up needed adjustments to meet business needs, the Malaysian government has launched ambitious policies and promising local skills initiatives. For example, it has stepped up efforts to enhance co-operation between business and higher learning institutions to address skill shortages such as the Industrial Skills Enhancement Programme and the Graduate Employability Management Scheme. Education and training managers have established local partnerships with the business sector in order to quickly identify new needs and deliver new courses. Malaysia has scored some impressive advances in this regard, such as through the Penang Skills Development Centre (PSDC), which offers a wide variety of training for both member companies (from whom it receives fees) and the unemployed (through government grants) (OECD, 2011).

To support the effectiveness of this triple helix type of co-operation (government, training institutions, industry), training institutions and universities need to be have greater flexibility in curriculum development – all while ensuring that high standards of training

are upheld. This calls for effective co-ordination of skills enhancement strategies, an area where Thailand can provide some good practices. Its National Training Co-ordination Committee guides the Ministry of Education and the other twenty government agencies providing training (Martinez-Fernandez and Choi, 2012).

Regional initiatives in ASEAN include the Southeast Asian Ministers of Education Regional Centre for Educational Innovation and Technology hosted by the Philippines.[16] The ASEAN University Network also represents a promising network of co-operation among 26 of ASEAN's top universities to promote a regional identity. This is complemented by initiatives such as the Cha-am Hua Hin Declaration on the Roadmap for the ASEAN Community, 2005-2015, with specific goals to promote intra-ASEAN education through staff and student exchanges and the creation of research clusters (ASEAN, 2013b).

ASEAN experiences in promoting linkages

Business linkages between MNEs and local companies, especially smaller suppliers, can generate powerful local development impact. Linkages can be effective avenues for technology and knowledge transfer, given the appropriate policy setting and absorptive capacity of domestic suppliers. East Asia is known for its dynamic linkages and domestic spin-offs from MNEs that have successfully tapped into premium export markets. In Southeast Asia, successful linkages are fewer. Malaysia's electronics industry features some cases, but export-oriented investment attraction strategies have seldom led to strategic linkages with domestic SMEs, linkages that can potentially lead to more local value addition and technology uptake in the economy. At the same time, the regional value chain dimension of investing in ASEAN offers avenues for ASEAN suppliers to MNEs and ASEAN MNEs to capitalise on cross-border firm activities and production networks.

MNEs do not automatically engage in linkages with domestic suppliers. In fact, many MNEs are bound by international contracting arrangements that tie them to international suppliers, offsetting the effectiveness of public policies to promote linkages. This has consequences for a country's investment attraction strategy, as investors with a tradition of working with and supporting local suppliers in their efforts to upgrade should be targeted.

Committed long-term relationships between MNEs and SMEs usually involve a transfer of technology and proprietary knowledge from the large to the smaller enterprise. Unless MNEs are given safeguards against intellectual "piracy" and illicit diffusion of their know-how, they will be reluctant to share technology, making intellectual property protection an important part of policies aimed at fostering business linkages. At the same time, market-seeking investors are more likely to develop linkages, including forward linkages and associated spillovers, than are resource-seeking or export-oriented investors.

Countries' experiences with linkages depend on the sector. Viet Nam for example has been able to upgrade suppliers in the consumers goods market, as the experience of Unilever illustrates. Unilever accredits its success in the early 2000s largely to its focus on working with local suppliers, including through its *Manufacturing Sustainability*

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[16] http://www.seameo-innotech.org/

Improvement Programme. The impact of its linkages included an increase of total turnover of some suppliers from USD 900 000 to USD 6.67 million over a period of five years (UNCTAD, 2006). However, in its automotive sector, Viet Nam seems to have missed an opportunity to tap into the demand of foreign car manufacturers that import most of their inputs. Significant numbers of local suppliers are active in the motorcycle sector, however (see Chapter 1). The technology level of the manufacturing industry is considered relatively weak, making it difficult for domestic firms to join regional and global production networks (Truong and Nguyen, 2011).

Lao PDR, with abundant natural resource, provides some interesting insights for linkages, including in the mining sector. Extractive industries rarely exhibit significant spillovers for the domestic economy, with limited technology and knowledge transfer. The Seppon Mine in Lao PDR, for example, hires mostly expatriates, owing to the high technical skills requirements – skills which are scarce in the country. It also sources close to 80% of the value of production inputs internationally. Some training is nevertheless provided by Seppon, which includes an apprenticeship and training programme done jointly with the Royal Melbourne Institute of Technology, offering support in areas that are not available in Lao institutions. In other sectors focused more on the Lao market, one can also observe linkages with smaller indigenous firms. For example, Lao Beer sources all the rice locally, making up 30 % of its raw material, and uses local distribution networks extensively. Its staff also receives training in areas such as sales and marketing, including study trips abroad.[17]

Thailand has successfully tapped into global car manufacturing networks, with virtually all major car and car parts manufacturers having a presence in the country – making the sector one of Thailand's most important manufacturing sectors. Beyond production, a number of MNEs invest in R&D activities in Thailand, such as Toyota through a technical facility for R&D in product design, testing and evaluation. The country's skilled workforce and the ease of exporting have contributed to the economy's competitiveness in the sector.[18] The role of policies and support institutions however has been rather weak in this regard, as a big part of the activities described above are purely company-driven (Intarakumnerd et al, 2012). Also, while R&D intensity can provide opportunities for the Thai economy to move up the value chain into higher technology and knowledge-based activities, it does not automatically translate into more competitive suppliers. Sourcing automotive parts locally from indigenous suppliers, not from foreign-owned first tier suppliers, is often limited to basic parts, such as plastic bolds and simple presses. Nonetheless, this has contributed to making Thailand's moulding industry one of the most advanced in ASEAN.[19]

In Indonesia, market-seeking FDI has gained importance vis-à-vis natural resource-seeking investments. FDI has played an important role in Indonesia's competitiveness. MNEs in Indonesia have been found to have generally higher productivity than domestic firms, and these productivity advances have been spilled-over to domestic firms. The

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17 http://s3.amazonaws.com/zanran_storage/www.gtz.de/ContentPages/59657342.pdf

18 http://www.business-in-asia.com/automotive/thailand_automotive.html

19 http://www.ide.go.jp/English/Publish/Download/Apec/pdf/1998_09.pdf

productivity of domestic manufacturing firms is positively correlated with contacts with foreign suppliers, but not with contacts with foreign customers. Transferring knowledge to its customers is often in the interest of foreign firms. However, backwards spillovers, arising from the presence of MNEs in downstream sectors, are shown to be limited (Molnar and Lesher, 2009). These tend to be high in developed countries, such as high-income EU countries, implying that the level of development of a supplier base matters to benefit from linkages. FDI in upstream activities has been linked to higher productivity in local manufacturing, as well as an increase in local sourcing, thus substituting some imports of production inputs (Narjako and Takii, 2012). This is an important consideration for countries seeking to enhance their export competitiveness and increase local value-addition in their GVC-linked activities.

With only a small population and limited resources, Singapore chose to focus on R&D instead of broader industrial development. The government also has policies for attracting foreign researchers and developers in order to increase the pool of researchers. In the past few years, such policies have greatly contributed to attracting foreign investors to the biomedical industry and to establishing R&D centres in Singapore (KOTRA, 2006).

In Penang, Malaysian public-private arrangements and other collaborative efforts have led to a number of spin-offs and to the creation of new enterprises by former employees of MNEs. Some prominent examples include Globetronics and Shintel, established by former Intel employees, and Loshta and BCM Electronics, set up by former Motorola employees (UNCTAD, 2010b). Also, Malaysia saw the rise of Composite Technology Research Malaysia, from a small local company to a global player supplying Airbus and Boeing.[20] Despite these success stories, participation in product research and development by local enterprises is generally low, even in Penang (Rasiah and Vinanchiarachi, 2008). To some extent, this illustrates weaknesses in local companies' capacity to contribute to cutting-edge technological innovation (OECD, 2013b).

With the AEC approaching and with enterprises spreading their activities throughout Southeast Asia as part of an ASEAN supply chain, governments need to adapt their GVC policies. SME development, particularly upgrading indigenous suppliers to MNEs, can no longer be undertaken from a purely national perspective. Suppliers that are able to tap into regional production and service networks will be the ones contributing to up-scaling the overall competitiveness of ASEAN as an investment destination. Linkages policies need to be designed and implemented taking into account this regional dimension. This can imply careful targeting of specific investors in growth sectors along the ASEAN supply chains and those that have exhibited good records of upgrading local suppliers and linkage generation.

Business facilitation measures: what can ASEAN governments do?

Some ASEAN economies have applied pragmatic, focused and highly effective strategies and measures over many decades to improve the enabling environment for businesses. At the same time, some ASEAN members are clearly lagging behind in this

[20] http://www.theprospectgroup.com/mohd-yusoff-sulaiman-president-malaysian-industry-government-group-for-high-technology-might-8704/

area, both on regional and global scales. Chapter 2 showed that the region has both the top and worst performers according to the World Bank's *Doing Business* indicators. There is thus a lot of room for convergence, especially for lower-income ASEAN countries with complex investment climate challenges to learn from the experiences of their peers.

Malaysia has strengthened the business climate through initiatives driven by the Economic Transformation Programme (ETP) and the Special Task Force to Facilitate Business (PEMUDAH). Malaysia currently ranks 6th out of 189 economies according to the *Doing Business* Report.[21] The quality of Malaysia's investment promotion and facilitation is internationally recognised and often considered to represent best practice. To drive the ETP, the government, together with the private sector, has identified 12 National Key Economic Areas based on the sectors that are expected to generate the highest growth over the next decade. These cover several industries and one geographical territory: oil, gas and energy; palm oil; financial services; tourism; business services; electrical and electronic equipment; wholesale and retail; education; healthcare; communications content and infrastructure; agriculture; and the Greater Kuala Lumpur/Klang Valley.[22]

In 2007, the prime minister formed PEMUDAH and its task forces to simplify business operations in Malaysia by improving the government delivery system. PEMUDAH is also the government's primary vehicle for addressing issues arising from the *Doing Business* indicators. PEMUDAH has introduced various initiatives, including innovative measures to improve government delivery and foster collaboration between the public and private sectors. One of the most notable efficiency improvements is the Business Licensing Electronic Support System, which offers a total of 102 licences/approvals/permits online, as well as a simple and user-friendly 6-step online business licence application system.[23] Other initiatives include:

- enhancing services at the district and local levels, integrating services across agencies and increasing public confidence in electronic services, mainly through the use of ICT;
- streamlining processes and procedures as well as establishing commercial courts to reduce the cost of doing business;
- establishing one-stop centres to expedite approvals;
- streamlining immigration procedures to facilitate employment of high skilled expatriates and reduce processing time for employment visas; reducing the time for the approval of licences; and
- greater use of ICT for government services through the "myGovernment" portal (OECD, 2013b).

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21 http://www.doingbusiness.org/reports/global-reports/doing-business-2014

22 http://etp.pemandu.gov.my/upload/Media_Release_Five_ Regional_Cities_and_Economic_Corridors_to_Propel_National_Transformation_Agenda.pdf.

23 https://open.bless.gov.my/bless/action/login?show.

Recent private sector reforms in Viet Nam include efforts to strengthen investor protection by introducing greater disclosure requirements for listed companies in cases of related-party transactions. The government also granted the first private credit bureau licence after a decree in 2010 on the legal framework for setting-up credit bureaus.[24] The Philippines has done particularly well in improving business regulation in 2013 according to the World Bank. Notably, it has introduced a fully operational online filing and payment system easing tax compliance for business, it has improved regulations around construction permits, and has strengthened borrowers' rights with regards to its credit bureau. This is likely to improve the business environment for SMEs.[25]

Myanmar's Directorate of Investment and Company Administration in the Ministry of National Planning and Economic Development is the designated authority to manage and thus streamline regulations and procedures for business. It has taken significant steps over recent months to improve its operations and efficiency, driven by its investment administration department, including reducing administrative layers and waiting time for foreign investors from months to a few weeks. The *Doing Business* 2014 report ranks Myanmar 182 out of 189 economies. This is the first time Myanmar was ranked according to this methodology and it illustrates the early stages of business climate reforms in the country. This initiative allows Myanmar to benchmark itself against regional peers and global reformers (OECD, 2014a). Since then, Myanmar has pushed through pragmatic approaches in dealing with an strong increase of investment applications. This includes a mechanism of pre-establishment certification which is assessed after a period of 6-months, similar to regular post-notification mechanisms that other governments have used.

In Cambodia, private sector reforms are at times induced through the Government Private Sector Forum, and the Steering Committee on Private Sector Development and its related sub-committees.[26] More informal public-private working groups are also recognised as a pragmatic way to address doing business concerns. The mechanism has also helped in strengthening the relationship between the government, civil society and the private sector.[27]

Governments can play a crucial role in facilitating business operations and investment. Measures such as the ones illustrated above, are complementary to the macroeconomic and broader investment policy measures governments take to boost local and foreign investment. Measures aimed at improving the enabling environment can also contribute to increasing the development impact of FDI as seen above. ASEAN's top business climate reformers provide opportunities for peer learning and exchange of experience among ASEAN economies. Such opportunities should be promoted and platforms for regional

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24 http://www.worldbank.org/en/news/press-release/2013/10/29/vietnam-ranks-99th-for-ease-of-doing-business-in-new-report

25 http://www.worldbank.org/en/news/press-release/2013/10/29/singapore-continues-to-be-most-business-friendly-economy-in-world-philippines-among-top-ten-in-improving-business-regulation

26 Presentation by H.E. Chea Vuthy, CDC, OECD Greater Mekong Investment Policy Forum, Phnom Penh, 28-29 March 2012

27 http://www.sa-asia.com/downloads/brochure.pdf

exchange created to address country-level challenges in an ASEAN context, and generating ASEAN solutions to these challenges.

Opportunities for regional and sub-regional investment promotion

This chapter takes a broad brush to the different ways investment is promoted and facilitated in Southeast Asia. Pragmatism and results-oriented strategies, including through the use of key performance indicators, have led to impressive advances at national levels, providing experience from which lower-income ASEAN countries can draw. Yet, ASEAN as a region could see more concrete initiatives to be promoted as one investment destination. This is despite the obvious and manifested interest of MNEs to invest in ASEAN economies owing to the regional market and the expected further integration through the AEC. For example, a Baker McKenzie survey found that only 5.4% of company respondents run their ASEAN operations from an office outside the region.

The ASEAN regional value chain offers opportunities for companies to distribute design, R&D, manufacturing, sales and services across the region. The prospects of a harmonised ASEAN wide custom system greatly enhance the potential of integrated supply chains across the region, facilitated by an unrestricted movement of goods across borders. The ASEAN Plan of Action for Energy Cooperation, the energy component of the AEC Blueprint, promotes ASEAN-wide goals such as intra-ASEAN cooperation on ASEAN-made products and services, and develop ASEAN as a hub for renewable energy. In this regard, the free flow of ASEAN engineers to work throughout the region with designated engineers, under the Mutual Recognition Arrangement, is an exemplary measure for other sectors (ASEAN, 2013b).

Opportunities also exist for sub-regional investment promotion and facilitation. Supported by the Asian Development Bank, the Greater Mekong Sub-region (GMS) for example has a joint tourism strategy and planning framework to harmonise the overall sub-regional tourism planning framework and complement national tourism development plans (ADB, 2012a).

Some corporate experiences in ASEAN speak for themselves. AirAsia has become a truly ASEAN brand. The low-cost airline includes short-haul carriers in Malaysia, Thailand, Indonesia, and the Philippines, as well as a long-haul carrier and the regional base AirAsia asean. Caterpillar, the world's leading mining and construction equipment manufacturer, has spread its operations across ASEAN taking advantage of sub-regional comparative advantages. It has manufacturing facilities in Jakarta and Batam in Indonesia and is expanding to Thailand. The group also has a remanufacturing facility in Singapore and distribution centres in Singapore, Malaysia, Thailand and the Philippines.[28]

Drawing on some key messages from this chapter, actively promoting the ASEAN region as a single destination would strengthen national investment climates, while offering investors the differentiated opportunities of a market of 600 million consumers. The ASEAN Secretariat could take the lead in building the image of the ASEAN investment

[28] http://investasean.asean.org

destination, while promoting country-level initiatives to facilitate investment. ASEAN's dedicated website in this regard, www.investasean.org, is a good repository of regional investment information, including information on regulatory and legal frameworks and company testimonies. The ASEAN Investment Forum, bringing together the heads of the region's national IPAs, provides a good platform to discuss joint projects and initiatives. While promoting investment jointly, greater convergence in investment promotion instruments would help to instil greater transparency. These would need to include measures aimed at overcoming protectionism, rivalries and lack of trust, which are inherent to any regional investment approach.

ASEAN has a number of factors in its favour to successfully promote itself as a regional investment destination. It boasts a large market, strong growth rates, and regional policy momentum. It is home to new investment frontiers, such as Myanmar under is current drive of economic and political opening, and host of hyper-efficient business regulations such as in Singapore. Using these to develop regional guidelines and associated indicators agreed at the ASEAN level could set the region apart from other regional economic communities.[29]

[29] For example, despite the Lisbon Treaty ratified in 2009, which included FDI under the Common Commercial Policy, the does not have a regional approach to investment promotion, leaving it up to individual countries and sub-regions to promote investment.

ANNEX 1: INVESTMENT PROMOTION AGENCIES IN ASEAN

Country	Agency	Website
Brunei	The Brunei Economic Development Board	www.bedb.com.bn
Cambodia	The Council for the Development of Cambodia	www.cambodiainvestment.gov.kh
Indonesia	Indonesia Investment Coordinating Board (BKPM)	www.bkpm.go.id
Lao PDR	Investment Promotion Department (Ministry of Planning and Investment)	www.investlaos.gov.la
Malaysia	Malaysia Investment Development Authority	www.mida.gov.my
Myanmar	Directorate for Investment and Company Administration (Ministry of National Planning and Economic Development)	www.dica.gov.mm
Philippines	Board of Investments (DTI)	www.boi.gov.ph
Singapore	The Singapore Economic Development Board	www.edb.gov.sg
Thailand	Thailand Board of Investment	www.boi.go.th
Viet Nam	Foreign Investment Agency Viet Nam (Ministry of Planning and Investment)	http://fia.mpi.gov.vn

Chapter 5

INFRASTRUCTURE CONNECTIVITY IN SOUTHEAST ASIA[30]

ASEAN economies have grown rapidly in the last decades, achieving significant economic and social transformations. Greater integration into the world economy facilitated by the easing of investment and trade barriers, increasing foreign direct investment into the region and between ASEAN members, and the expansion of regional production networks have played an important role in this process. However, existing infrastructure disparities among ASEAN economies remain a challenge for further regional integration and economic development, and particularly towards enabling more inclusive growth.

Building the necessary infrastructure to meet the demand from a growing population and increasing economic activity in the region will require nearly USD 1.1 trillion in investment in national infrastructure systems, besides additional investment in cross-borders infrastructure projects. Greater co-operation among ASEAN member states is needed in order to facilitate resource sharing and a more efficient use of infrastructure assets. ASEAN governments have recently increased investments in infrastructure following the 2008 financial crisis as part of economic stimulus packages, but the necessary investment cannot be financed with public funds alone. Meeting the financing gap will require increased private sector participation in terms of capital, skills and capacity. In many cases, foreign investment will be necessary. This may prove a challenge since private participation has been historically limited in the region. Attracting private investment in infrastructure will require additional efforts to build adequate regulatory environments and to strengthen countries' public-private partnerships (PPP) implementation capacities.

The importance of enhancing connectivity to boost regional competitiveness

Recognising the importance of enhancing and deepening connectivity between ASEAN members states and with the rest of the world, ASEAN Ministers decided to adopt a Master Plan on ASEAN Connectivity in 2010 (ASEAN, 2011). The Plan seeks to facilitate economic growth, narrow development gaps, further ASEAN integration, enhance regional competitiveness and promote deeper social and cultural understanding as well as greater people mobility. It is both a strategic document for achieving overall ASEAN Connectivity and a plan of action for implementation in the period 2011-2015. Three types of connectivity are identified as needing to be addressed: regional and national physical, institutional and people-to-people linkages. In terms of physical connectivity, the challenges identified include addressing the poor quality of roads and incomplete networks in some countries, missing rail links, inadequate maritime and port infrastructure and aviation facilities, the widening digital divide and the growing demand for power.

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[30] This chapter focuses on ASEAN9 countries: Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, The Philippines, Singapore, Thailand and Viet Nam.

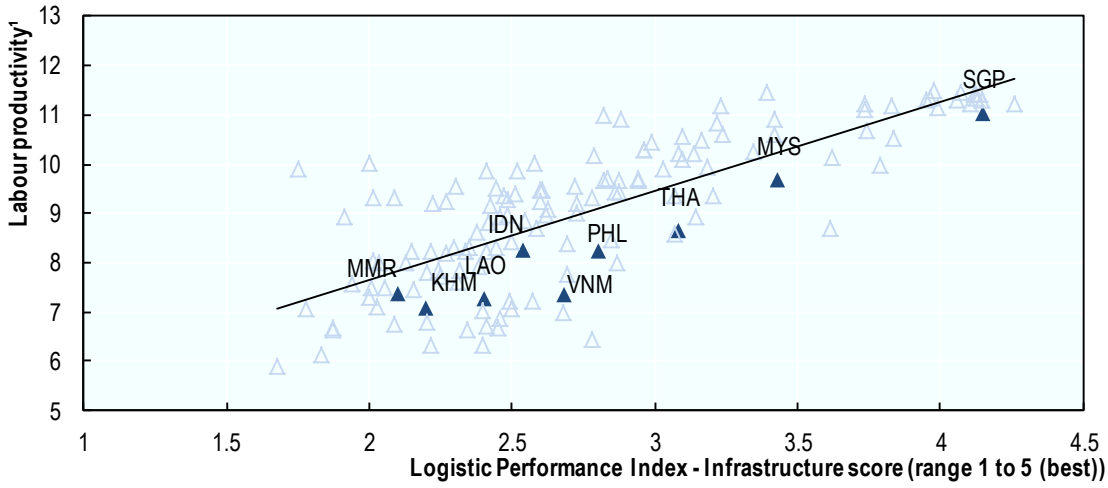
Among other barriers, improving physical infrastructure remains a key challenge for boosting efficiency and productivity in the region and for allowing countries to fully enjoy the benefits of greater trade and investment integration. The quality and availability of infrastructure still varies greatly among ASEAN economies, with notably less developed countries in the region facing greater infrastructure bottlenecks, another group of countries standing in transition towards superior infrastructure performance and one country among the top performers worldwide. To the extent that infrastructure development is strongly associated with higher productivity levels across countries (Figure 15), ASEAN economies stand to benefit greatly from more competitive infrastructure systems at the country level.

Poor infrastructure systems are a major determinant of overall logistics costs, which in turn are among the primary causes of trade costs. Portugal-Perez and Wilson (2010) estimate that improving physical infrastructure in a number of ASEAN economies[31] to the level of Malaysia could boost exports in these countries by about 5%-30%, which would be equivalent to a 3%-20% reduction in the value of tariffs on goods. Reducing logistics costs worldwide by half is estimated to lead to a 15% increase in international trade and a 5% increase in global production (World Bank, 2014a). In addition, better logistics systems allow countries to move into higher-value added industries due to increased competitiveness and therefore facilitates economic and trade diversification (WEF, 2008). In a globalised world, having relatively poor logistics systems can have important economic costs in the long term, not only in terms of lost investment and trade opportunities, but notably in terms of lower access to technology and know-how associated with these flows.

Individual countries are not the only ones to gain from enhancements in infrastructure connectivity within their borders. In the context of growing global value chains and regional production networks, infrastructure connectivity becomes an even more important factor in investors' decisions about where to locate and from which partners to source production inputs. It increases the regional capacity to adequately support business operations in the various stages of the supply chain, contributing to the region's overall competitiveness and ultimately allowing the region to enhance its position in global value chains and regional production networks (Chapter 4).

[31] Thailand, Cambodia, Indonesia, Viet Nam and Philippines.

Figure 15. Enhancing infrastructure systems can help boost productivity



Source: World Bank and ILO.
Note: ¹Labour productivity refers to the log of output per worker in constant 2005 international dollar.

Taking stock of infrastructure development and its impact on economic development

Table 8 provides a summary of infrastructure indicators across ASEAN economies. There is a marked difference in the overall level of access to infrastructure goods across the region and in nearly all sectors. In general, infrastructure development in CLMV countries lags behind that of other ASEAN members, although Viet Nam's level of infrastructure development is closer to, and sometimes better, than some non-CLMV countries. These differences would probably be greater if the comparison discriminated between rural and urban populations. Disparities in these indicators partially reflect past investment priorities and the efficacy of policies adopted in the past, providing insights into areas where countries should concentrate their efforts.

Most countries in the region have achieved nearly universal access to electricity. Cambodia and Myanmar are lagging behind in this regard. In these countries, poor access to electricity is aggravated by the limited funding that has been directed towards upgrading and maintaining existing electricity systems, reflected in the high level of electricity losses. In Myanmar, for instance, the relatively poor state of the transmission and distribution system implies losses of 21% of the output. Despite an installed capacity superior to peak load in the case of Myanmar, the frequent power shortages oblige investors to rely on costlier energy sources to cope with scheduled and non-scheduled blackouts (OECD, 2014a).

Table 8. Comparative infrastructure indicators across ASEAN

	Electricity		ICT			Transport			Water & sanitation	
	Household electrification rate, 2011	*Electric power transmission and distribution losses (% of output), 2011*	*Telephone lines (per 100 people), 2012*	*Mobile cellular subscriptions (per 100 people), 2012*	*Fixed broadband Internet subscribers (per 100 people), 2012*	*Ratio of paved road to total road length, 2010*	*Road length per 1000 square km, 2010*	*Quality of port infrastructure, WEF, 2013[1]*	*Improved water source (% of population with access), 2012*	*Improved sanitation facilities (% of population with access), 2012*
Cambodia	34.0	28.1	3.9	128.5	0.2	6.4	15.8	4.0	71.0	37.0
Indonesia	72.9	9.1	15.4	114.2	1.2	57.0	146.0	3.9	84.9	58.8
Lao PDR	78.0	..	1.8	64.7	0.1	13.7	22.9	2.6	71.5	64.6
Malaysia	99.5	6.4	15.7	141.3	8.4	80.9	331.0	5.4	99.6	95.7
Myanmar	48.8	21.2	1.1	10.3	0.0	20.9	42.1	2.6	85.7	77.4
Philippines	70.2	11.1	4.1	106.5	2.2	77.2	80.0	3.4	91.8	74.3
Singapore	100.0	5.3	37.5	152.1	25.4	100.0	4,756	6.8	100.0	100.0
Thailand	99.0	6.9	9.5	127.3	8.2	80.7	361.0	4.5	95.8	93.4
Viet Nam	96.1	10.1	11.2	147.7	4.9	64.4	573.0	3.7	95.2	75.0

Source: World Bank WDI database; ASEAN Transport Statistics database. Note: [1] 1=extremely underdeveloped to 7=well developed and efficient by international standards.

In ICT, almost all countries have well developed mobile telecommunication systems, in most cases following reforms implemented in the late 1990s and early 2000s that aimed at liberalising the sector and opening it to private investors. Myanmar has just recently engaged in this reform path, while Lao PDR saw investment in the sector from private and public operators increase eightfold from 2000 to 2008 following the introduction of competition in 2001 (USAID, 2009). While the country has yet to catch up with the leading performers in the region, it has improved its ICT infrastructure considerably over the period in terms of network coverage, technology and number of users. However, a few regulatory barriers still partially prevent a more rapid expansion of ICT services in the country. While operators are encouraged to share their facilities, there is no legal obligation to do so, which in some cases has led to the duplication of networks by operators. Moreover, among other issues, the government still holds important stakes in four of the largest operators in the country, and the sector lacks an independent regulatory agency (USAID, 2009).

A similar situation has occurred in Indonesia. Even following partial liberalisation and opening to competition in 2001, the dominant operators partially owned by the government have been able to erect entry barriers to newcomers and maintain relatively stable market shares. Although the sector has been developing rather rapidly (17% on year-to-year average from 2008 to 2012), allowing Indonesia to narrow the gap with its more developed peers, there are still some important differences. For instance, the penetration of fixed broadband internet per 100 people is still seven times lower than in Malaysia or Thailand, four times lower than in Viet Nam and about half that in the Philippines. In Malaysia, the government has played an important role in facilitating the expansion of internet broadband in the country. Access to internet broadband services expanded from around 10% of households in 2006 to 50% in 2010. This rapid increase comes partially from a strong government commitment to make broadband access an essential utility service in the country in the same vein as water and electricity (OECD, 2013b).

The transport sector is an important barrier for domestic and foreign investors in a number of countries in the region. In Indonesia, for instance, where only 57% of the road network is paved, compared to much higher levels in many of its peers, investors have ranked transport shortcomings among the main obstacles in the country for business operations (OECD, 2010). The relatively poor performance in transport infrastructure reflects to some extent limited private and public investment in the sector since the Asian crisis. Among other regulatory barriers that prevented further private investment in the sector was a complicated land acquisition process. The government has made it a priority to improve transport infrastructure and has begun to address the bottlenecks affecting investment in the sector, including by adopting measures that facilitate land acquisition and ensuring it takes place before the tender process to select private concessionaires commences. In Viet Nam, for instance, strong public commitment and financing has enabled a considerable expansion of the road network at higher growth rates than population growth rates. But challenges remain to improve the quality of the network (Seneviratne and Sun, 2013).

In the Philippines, the relatively high availability of paved roads hides some important bottlenecks in the country's transport infrastructure system. Since 2001 the number of paved roads has expanded slowly and the quality of the national road system has deteriorated overtime, partly due to relatively low levels of investment in the sector (ADB,

2012b). Moreover, the inadequate maintenance of the road system has contributed to a rising number of accidents and remains an important barrier to an improved investment climate. Despite the natural importance of water transport in the Philippines, road transport is still the dominant mode of passenger and freight transport in the country. Nonetheless, the country also needs to improve its port infrastructure, particularly to improve inter-island transport connectivity. The quality of port infrastructure in the country is perceived to be relatively low in comparison to other ASEAN countries, despite having improved considerably since the government adopted a national programme to support the development of roll-on roll-off ferry system. The system allows vehicles to drive onto and off ferries, eliminating the need for cargo loading and offloading, and consequently reducing the time and costs associated with transiting goods in the country, particularly inter-island. However, large investments are still needed to build and rehabilitate more port facilities to this system. The government is working to facilitate private sector participation to meet these needs (ADB, 2012b).

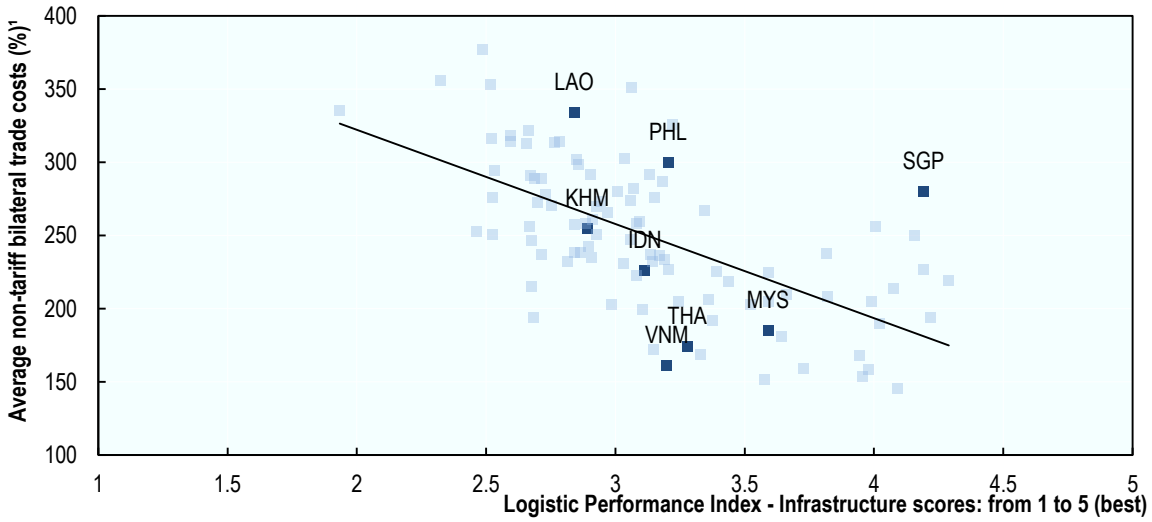
The existing difference in infrastructure availability and quality across ASEAN countries, particularly of logistics infrastructure, has important consequences for trade and investment connectivity among ASEAN member states and with the rest of the world. Trade and investment-related infrastructure are important drivers of non-tariff trade costs (Figure 16). While ASEAN countries have improved their infrastructure networks over time, logistics performance continues to vary widely in the region with important implications for countries' competitiveness. In a number of ASEAN countries, transport-related costs are among the main factors contributing to higher trade costs. For instance, the distance from Japan to Lao PDR and Cambodia is not that different from Japan to Thailand, and yet bilateral trade costs between these countries are 3.3 and 2.7 times that of Thailand with Japan (Figure17). In Indonesia, inefficiencies of both hard and soft infrastructure make the cost of shipping goods from Jakarta to Hamburg lower than to Padang, despite the significant difference in distances between cities.

Greater efforts to improve logistics systems in these countries could have significant trade-and-investment-inducing effects. Estimates suggest that improving port facilities in the region, for instance, could expand trade by up to 7.5% (Shepherd and Wilson, 2008). In addition, improved infrastructure connectivity can help enlarge regional demand, allowing countries to offset the medium-term effects of the economic slowdown in more advanced partner economies.

Greater infrastructure connectivity also facilitates economic diversification and upgrading (WEF, 2008), and can be particularly important for the development of small and medium-sized enterprises. Access to affordable and reliable electricity is likely to be among the top criteria for investors in higher-value added industries where the electricity cost is a major component of the cost structure of the business. Frequent power shortages lead companies to rely more often on costly generators, increasing operational costs, but also risking damages to electronic equipment. In a few ASEAN members, the bottlenecks of underdeveloped electricity systems are reflected in relatively high prices. Table 9 shows the average electricity tariff in Euros cents per kWh to end-users in countries' major cities. In Cambodia, an investor willing to set up an industrial plant will pay 8 to 21 times more for electricity than in Indonesia, the country with the lowest tariffs. In the Philippines, an investor would have to pay 3.4 times more for electricity than in Indonesia. While this simple comparison leaves aside the issue of electricity subsidies which are significant in a

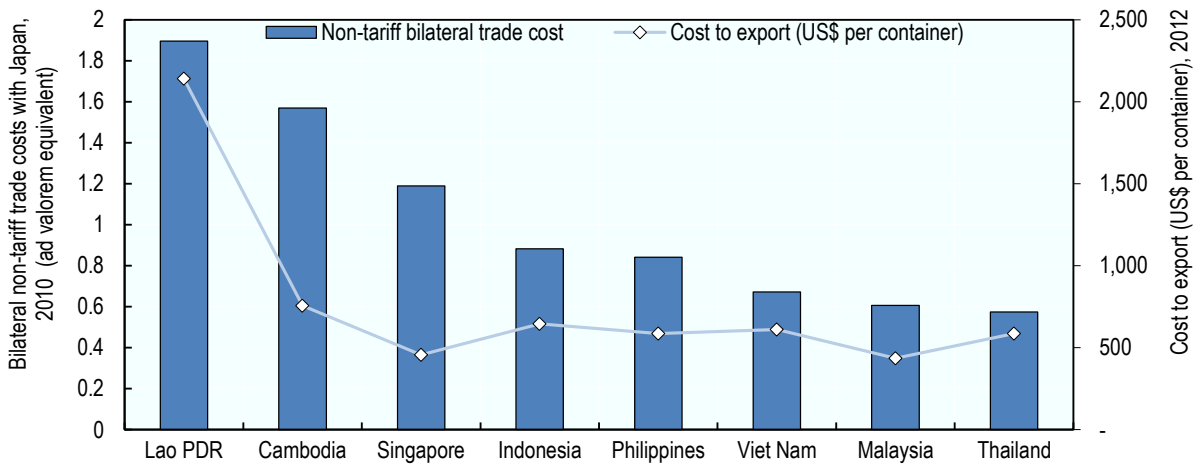
number of these countries, it highlights important differences in the investment environment across countries in the region. Even more so if one takes into account important differences in purchasing power across countries.[32]

Figure 16. Infrastructure weakness is a deterring factor for ASEAN trade integration



Source: ESCAP International Trade Costs database and the World Bank's Logistic Performance Index database. Note: ¹Average non-tariff trade costs includes all costs involved in trading goods internationally with another partner (i.e. bilaterally) relative to those involved in trading goods domestically (i.e., intra-nationally). It captures trade costs in its wider sense, including not only international transport costs but also other trade cost components, such as direct and indirect costs associated with differences in languages, currencies as well as cumbersome import or export procedures.

Figure 17. Non-tariff bilateral trade costs with Japan and shipping export costs in ASEAN



32 In Indonesia the government has ceased to subsidise large industrial electricity consumers (OECD, 2010).

Source: ESCAP International Trade Costs database and the World Bank's World Development Indicators.

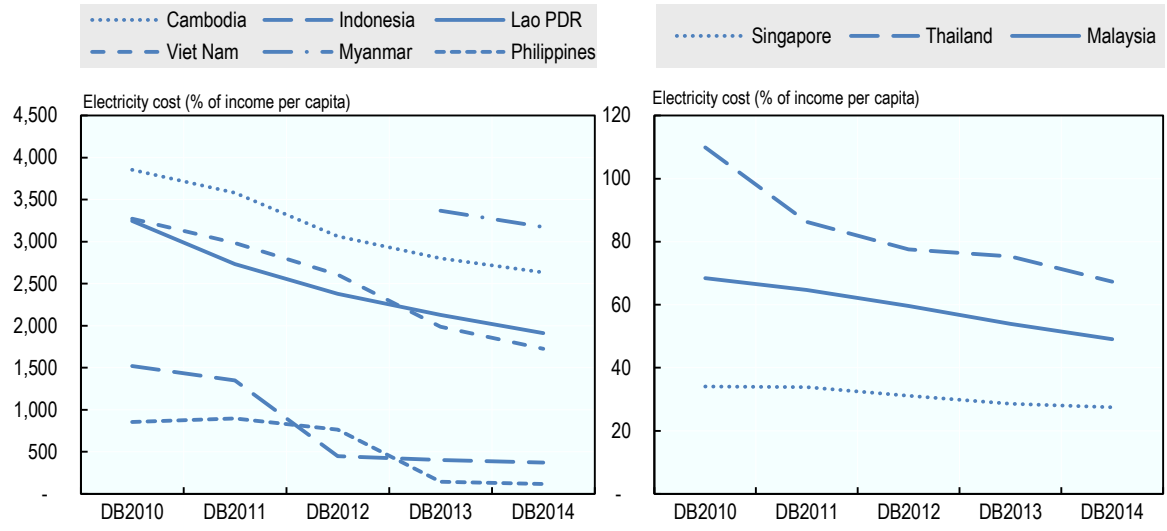
In many countries, including a few in ASEAN, the bottlenecks of underdeveloped electricity systems are reflected in the difficulties in connecting to the grid. Getting an electricity connection can take several months and be rather costly, particularly for SMEs. The high costs associated with gaining access to an electricity connection is sometimes associated with the limited availability of electricity supply, but also with low levels of competition and poor regulatory frameworks. The performance of countries varies considerably, with investors in Malaysia, Singapore and Thailand facing significantly lower costs to obtain an electricity connection. In CLMV countries, however, obtaining an electricity connection is an important barrier to start a business. In Myanmar an investor setting up a manufacturing plant in Yangon will find that getting electricity costs almost 115 times more in relative terms than for an investor in Singapore (Figure 18).

Table 9. End-user power costs, Euros cents per kWh

	Residential	Commercial	Industrial
Cambodia	20-50	20-50	20-50
Indonesia	3.92	4.07	2.36
Malaysia	6.42	5.9	4.41
Philippines	9.12	9.33	8.09
Singapore	11.7	7.82	7.42
Thailand	3.55	2.4	2.38
Viet Nam	4.57	6.19	2.44

Source: EC-ASEAN COGEN Programme Phase III, seminar on "Cogen 3: a business facilitator".

Figure 18. Cost of getting electricity across ASEAN countries, 2010-2014



Source: World Bank Doing Business Ranking database.

Investment needed and financing conditions

Between 2010 and 2020, ASEAN economies need to invest nearly USD 1.1 trillion in national infrastructure systems to meet the demand from the region's growing population and increasing economic activities. Around 68% of the amount needed is to build new infrastructure capacity and around 32% is for the maintenance of existing capacity. Regional infrastructure projects will require significant additional investments to build physical connectivity in the region.

Moreover, a number of countries in the region are vulnerable to climate risks and natural disasters. These countries are likely to require additional investments to build climate resilient infrastructure systems. Beyond climate change issues, green infrastructure can help countries address the infrastructure challenges associated with growing urbanisation and industrial development while ensuring an efficient and sustainable use of available resources. Low-cost, efficient green energy infrastructure such as off-grid renewable energy systems for instance can improve access to energy in rural areas. In fast-growing cities, where local air pollution and health issues are likely to arise in upcoming years, investment in public transit systems can help improve local air quality, reduce traffic congestion and enhance mobility (Corfee-Morlot et al, 2012; Ang and Marchal, 2013). For countries like Myanmar that have yet to build much of the infrastructure required to meet development objectives, there is a need to take advantage of the possibility of favouring green infrastructure solutions at an early stage to avoid locking-in carbon-intensive and climate vulnerable development pathways. Infrastructure choices are long-term and difficult to reverse.

National infrastructure investment needs are relatively similar in terms of GDP across ASEAN, averaging 8%, with the exception of Lao PDR. Indonesia is the country with the largest investment needs in the region, but in Lao PDR investment needed reaches 14% of GDP (Figure19). In most countries, the transport sector requires the largest amount of investment, followed by electricity and ICT. On average, investment in the transport sector amounts to 3.6% of countries GDP. In electricity and ICT, investments needed amount to 1.9% and 1.5%, respectively.

In Malaysia and Thailand, investment in new electricity capacity is critical for sustaining economic growth prospects and development. The large amount of investment needed also highlights the need for further co-operation among ASEAN states in order to facilitate resource sharing and a more efficient use of infrastructure assets. For instance, meeting future energy needs in these two countries could be facilitated by exporting energy from energy-surplus countries to the energy-deficient countries. Within the Greater Mekong Sub-region[33], energy exports could save the region nearly USD200 billion in total energy costs (Battacharaya, 2009).

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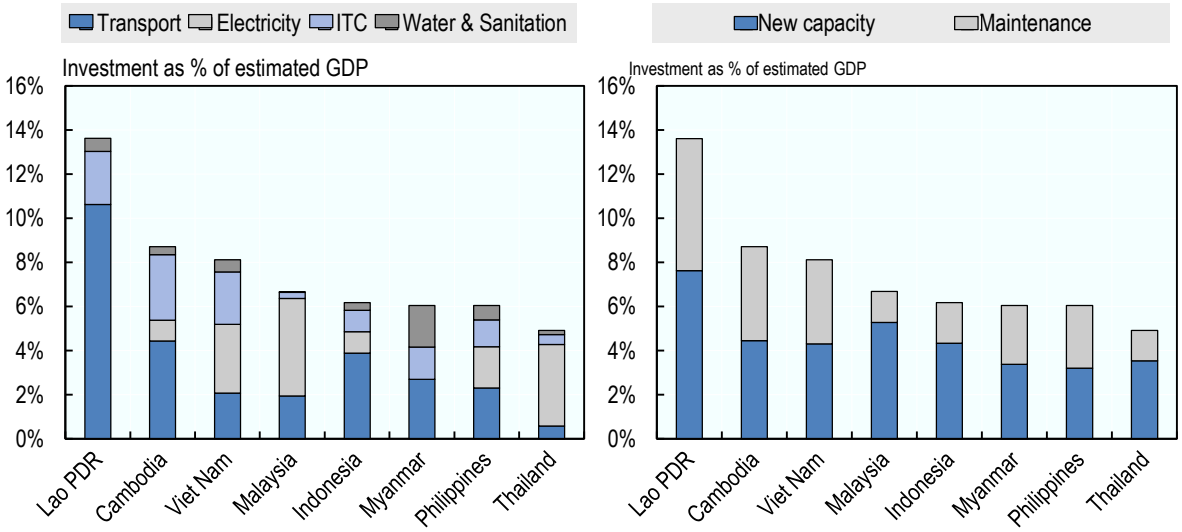
[33] GMS countries consist of Lao PDR, Cambodia, Myanmar, Viet Nam, Thailand and the Yunnan Province in China.

Figure 19. Infrastructure investment needs in ASEAN, 2010-2020



Source: Bhattacharyay (2010)

Meeting such investment needs is one of the key challenges facing ASEAN economies. In general, investment in infrastructure across the region has been much below needed levels, around 1%-4% of GDP (World Bank, 2005). Following the Asian crisis, limited public financing led most governments to cut investments in infrastructure. Even in Viet Nam, where investment in infrastructure as a share of GDP has been maintained at relatively high levels (around 7%) mostly due to investment by state-owned enterprises, the amount is still lower than needed. In other countries, such as Indonesia and the Philippines, the collapse in infrastructure investment has prevented these economies from growing at their potential growth rates (Greenwood, 2006)[34], although in recent years Indonesia and the Philippines have both had relatively high growth rates.

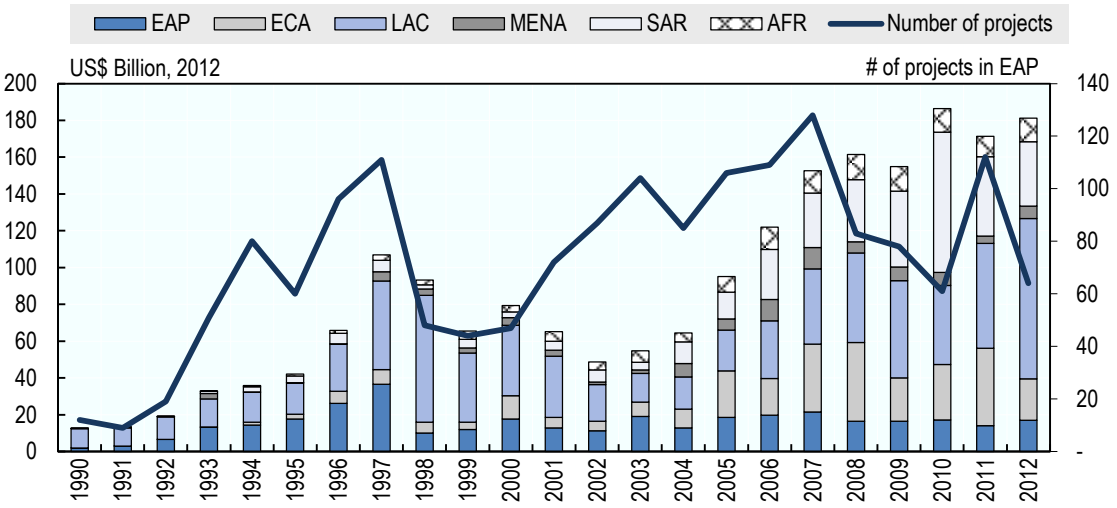
Policy-makers in the region are giving more attention to these pressing needs. Since the 2008 global financial crisis, ASEAN governments have raised investments in infrastructure as part of fiscal stimulus packages provided to support their economies. In the Philippines, the government has allocated almost USD 10 billion for infrastructure projects and capital outlays, while in Indonesia the government planned to spend USD 20 billion in infrastructure in 2013. Malaysia also plans to increase the amount of public funds allocated to investments in infrastructure under the Economic Transformation Programme (Basu Das and James, 2013). In 2009, Singapore, one the countries that was hit the hardest in the region by the crisis, planned infrastructure investments around USD 12-13 billion as a response to the economic slowdown. Although these stimulus packages will be critical for infrastructure development in the region, they are far from bridging the financing gap. Total stimulus packages amount to only 1.1% to 4% of GDP in ASEAN's more developed countries, except in Malaysia where it amounts to 8.1% of GDP (Battacharyay, 2009;

[34] In Battacharyay, B. N. (2009), Infrastructure development for ASEAN integration, *ADBI Working Paper No. 138*, May.

Abidin, 2010). They also put additional strains on countries' already limited fiscal space, leaving less room for greater public commitment to infrastructure spending in the future.

Meeting the financing gap will require increased private sector participation in terms of capital, skills and capacity. This is an important challenge for the region considering the historically low levels of private investment in infrastructure. In most ASEAN countries, infrastructure projects have been traditionally funded with fiscal resources. Private participation has been relatively limited in comparison to other regions (Figure20). Since reaching a peak before the Asian crisis, it has never recovered to the same level, remaining relatively stable while other regions have seen great improvements in the level of private investment, although the number of projects being implemented by the private sector has recovered since then. From 2000 to 2012, average private investments in ASEAN have been less than 3% of GDP, with the exception of Lao PDR where a few large infrastructure projects in the energy sector boost the share of private participation to much higher levels (Table 10). The majority of investments are in greenfield projects mostly awarded through competitive bidding or licencing schemes (World Bank PPIAF, PPI project database).

Figure 20. Private investment in infrastructure across regions, 1990-2012



Source: World Bank PPIAF, PPI project database.

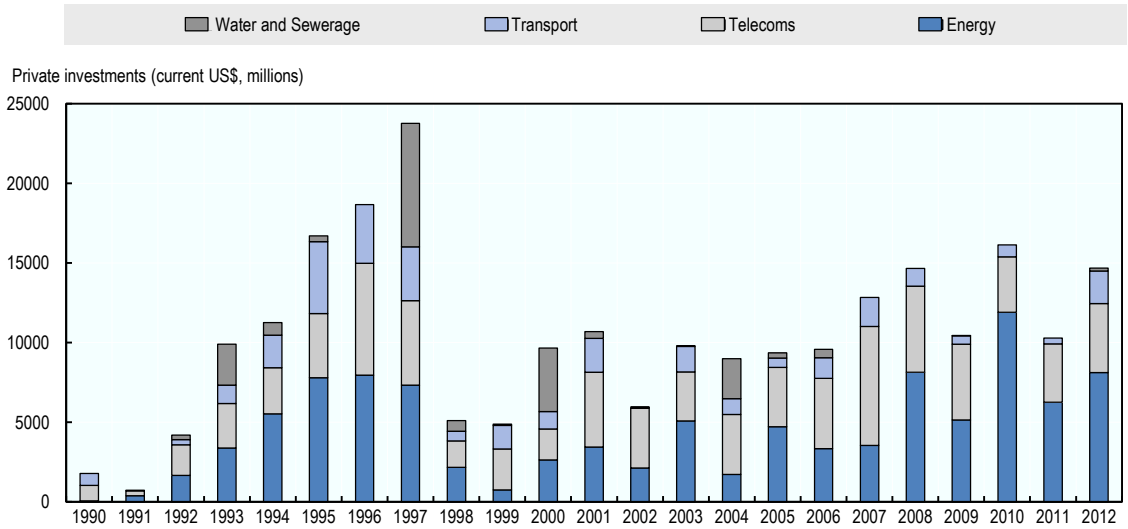
Table 10. Private investment in infrastructure (% of GDP, simple average)

	1990s[1]	2000-2012
Cambodia	1.7%	3.0%
Indonesia	1.3%	0.6%
Lao PDR	6.5%	12.8%
Malaysia	3.5%	1.8%
Philippines	3.3%	1.8%
Thailand	1.3%	1.0%
Viet Nam	0.5%	1.2%

Source: World Bank and PPIAF, PPI project database; IMF World Economic Outlook. Note: [1] Data year coverage is not the same across countries. It is calculated based on the available data.

Moreover, mobilising private investment in the transport sector, where the bulk of investment is required, is likely to prove particularly difficult (e.g. Findlay and Goldstein 2004 on air transport). Private participation in infrastructure has been concentrated in telecommunications and electricity generation (Figure 21). In general, the private sector has shied away from investing in transport projects, often due to governments' weak capacity to adequately select and implement projects in partnership with private investors. However, private participation varies across transport segments. In more commercially driven transport sectors, such as ports and airports, greater levels of private participation have been achieved. Road and rail transport projects have had more difficulty in attracting private investors. Rail transport projects are characterised by high up-front costs with long-term payback periods and normally only a limited capacity to extract revenue from user fees, adding considerable barriers and complexity to attracting private investors. Road projects' commercial viability is also complex, sometimes requiring the government to take part of the responsibility for commercial risks of the project, besides often facing public resistance. Therefore, private investors are particularly sensitive to the investment environment and have been less attracted to such projects.

Figure 21. Private investment in infrastructure in ASEAN, 1990-2012, by sector

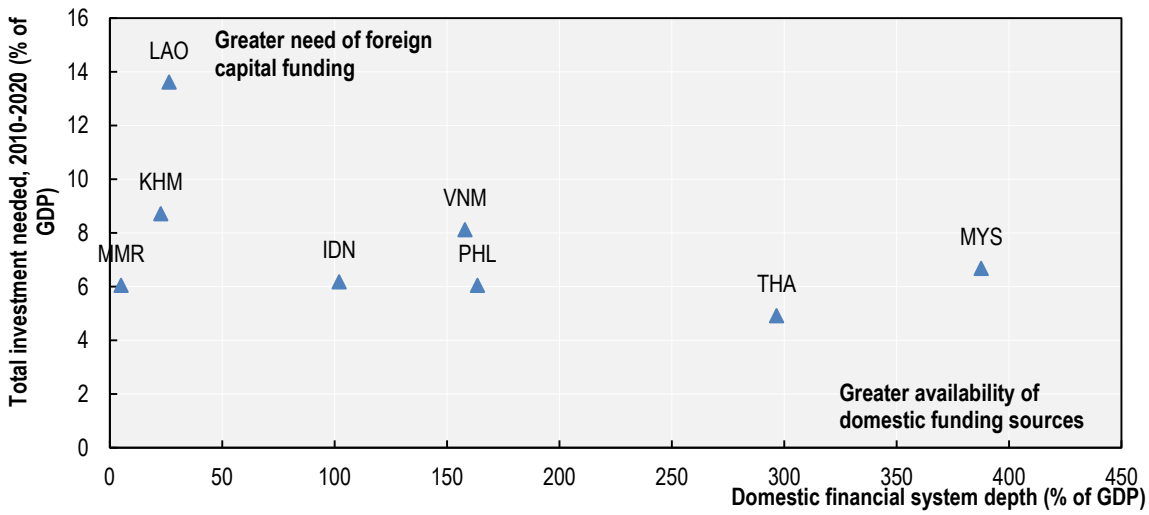


Source: World Bank and PPIAF, PPI project database.

Another barrier to raising infrastructure investment is the limited availability of domestic resources in some countries. The capacity of countries to mobilise domestic resources to finance infrastructure either through the private or public sector varies considerably across ASEAN (Figure 22). While Malaysia and Thailand are more capable of financing investment needs with domestic resources, Lao PDR, Cambodia and Myanmar will probably have to significantly rely on foreign capital for such investments. But even in countries with more developed financial systems, there are challenges in raising their ability to mobilise funds to infrastructure. In some cases, the banking system, which is often unsuitable for financing long-term infrastructure projects, dominates financial intermediation. Local capital markets are relatively underdeveloped with only a few having longer-term maturities, and most of them offering limited depth and liquidity. Institutional investors also sometimes face regulatory barriers that prevent them from investing in infrastructure projects and infrastructure project bonds.

In the more financially constrained countries, the investment framework will play an even more crucial role in facilitating investments if they are to mobilise foreign private investment. Besides restrictions to foreign equity participation in a number of countries that hamper foreign investment (see Chapter 2), foreign investors are generally more sensitive to weaknesses in regulatory environments due to a relatively weaker understanding of local market conditions and opportunities. They are also likely to be relatively more sensitive to weaknesses in countries' investment frameworks, particularly in terms of access to investment protection and dispute-settlement mechanisms (see Chapter 3). Local investors have greater understanding of local market practices, being able to price and mitigate risks more effectively. For these countries in particular, tapping into different sources of financing is key for meeting investment needs. Besides multilateral financing from international financial institutions, official development assistance can play a role in leveraging the conditions for greater private sector participation by backing up government commitments towards private investors and providing investors with risk guarantees, as well as by assisting governments to improve their planning and implementation capacity. Any support towards improving projects' bankability is important in advancing infrastructure development in these countries.

Figure 22. Domestic financing capacity varies considerably across ASEAN



Source: Asian Bonds Online and World Bank Development Indicators. *Note*: Financial depth refers to the value of bonds, stocks and domestic credit (as % of GDP) in 2010. Data for Lao PDR, Cambodia and Myanmar do not include the value of stocks and bonds, capturing only the value of domestic credit provided by the financial system.

Further advancing ASEAN financial integration and deepening local capital markets in the region is important to enlarge the pool of resources that can be used for infrastructure financing across ASEAN. In this sense, the establishment of the ASEAN Infrastructure Fund by ASEAN finance minister in 2010 was an important achievement towards mobilising regional and international financial resources for infrastructure. The fund will allow tapping into some of the USD 700 billion foreign exchange reserves of countries in the region for the benefit of priority infrastructure projects. The fund's initial size is nearly USD 500 million and through 2020 it is expected to commit about USD 4 billion in lending for infrastructure projects in the region. The initial funds come from ASEAN member states, as well as the ADB that has contributed about 30% of the fund's equity and has been designated its administrator. One of the goals is to support the implementation of the Master Plan on ASEAN Connectivity through investments into priority regional connectivity projects, including through private-public partnerships (PPPs). The fund is likely to play a critical role in the development of more complex cross-border infrastructure projects, which are more difficult to implement through PPPs. It is also expected to play a key role in raising the bankability of national projects and facilitate the involvement of private investors in these projects.

Remaining challenges in cross-border transport projects

A number of cross-border infrastructure projects have been identified under different regional connectivity programmes involving several ASEAN member states. These projects are key for enhancing regional connectivity and with other important economic partners. Major regional infrastructure projects involving ASEAN member states include:

- The Greater Mekong Sub-region Programme established in 1992 seeks to improve connectivity through transport, energy and telecommunication projects among Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam and two provinces of China. The GMS Programme has identified nine economic corridors that form the sub-region transport network. By end 2011, about USD 15 billion had been invested in GMS infrastructure projects, mostly in transport, with considerable economic impacts. For instance, improvements in one of the priority corridors - the East-West Economic Corridor that goes from Danang in Viet Nam to the Mawlamyine Port in Myanmar totalling 1 600 km - has reduced travel times between Dong Ha in Viet Nam and Savannakhet in Lao PDR from 12 to 3 hours. Under the GMS Programme, energy co-operation has also been furthered to link countries with high energy production potential and net energy importers. Lao PDR, Myanmar and Viet Nam, together with the two Chinese provinces that are part of the programme, account for roughly 94% of the hydropower potential in the region (ADB, 2013b; ADB, 2013c).

- The Asian Highway and Trans-Asian Railway networks were also established in 1992 and aim at improving economic links among 32 Asian countries. The Asian Highway network totals 143 000 km of standardised highways, including 155 cross-border roads and linkages to Europe. About 29% of the network still belongs to class III (minimum desirable standard) and below (ADB, 2013b). In Myanmar, the only land bridge linking South Asia

and Southeast Asia, about 60% of the 3 018 km road network of the Asian highway crossing the country are still class III roads and require considerable upgrading (OECD, 2014a). The Trans-Asian Railway network comprises about 117 000 km of rail network across 28 countries and with links to the pan-European rail network, connecting countries to major ports in Asian and Europe. The development of the network has been hampered by different technical standards applied in some countries and by missing links amounting to about 25% of the expected network (ADB, 2013c).

- The ASEAN Highway Network comprises 23 designated routes totalling 38 400 km aiming at expanding the Asian Highway Network within ASEAN and deepening intra-regional links. Many routes therefore overlap with the Asian network and follow the same standards classification. About 50% of the network still belongs to class III type or below (ADB, 2013b).

- The ASEAN Power Grid Project seeks to develop interconnection of the power grid among member states. Fourteen interconnections have been identified and five have been completed and are operational through cross-border electricity trade agreements between power utilities and energy authorities of ASEAN countries involved. Four interconnections are under construction. ASEAN power authorities are working together to harmonise regulatory and technical standards to facilitate implementation. The project expects to save USD 600 million at current electricity prices with the nine interconnections to be completed by 2015 (ADB, 2013c; Abidin, 2010).

- The Trans-ASEAN Gas Pipeline aims to provide member states with reliable energy supply. The network consists of seven gas pipelines totalling 1 659 km, involving Indonesia, Malaysia, Myanmar, Thailand and Singapore. The recently completed gas pipeline between Myanmar and Thailand allows Myanmar to export about 80% of its offshore gas fields to Thailand (ADB, 2013c).

Cross-border infrastructure projects pose significant additional implementation challenges. Besides the funding challenge, it involves having compatible regulations and procedures across borders and dealing with limited government experience with such projects. Government funds are likely to be the main source of financing available for such projects together with multilateral financing, but greater private participation is possible.

Measures to support greater private sector participation in infrastructure

As seen earlier, PPPs have had a relatively limited role in overall ASEAN infrastructure development to date. But as countries realise that infrastructure investment needs cannot be financed with public funds alone, more attention is given to establishing credible regulatory and institutional environments to attract more private infrastructure investments in these economies. Worldwide, failure to enhance private participation in infrastructure has often been attributed to inadequate financing options, with proposed solutions being mainly concentrated in finding innovative financing mechanisms. Very often, however, the problem results from the lack of cash flow of selected projects for PPPs (Klein, 2012).

There are many reasons why PPP projects sometimes do not meet private sector expectations. Often uncertainties related to pricing policies give rise to private investors'

concerns about the projects financial viability. Pricing policies that allow tariffs to be set at cost-recovery levels so that investors are adequately compensated for the risks they face are necessary for attracting private investors. Besides, private investors will only commit to commercially viable infrastructure projects that are backed by a credible regulatory environment, providing investors with regulatory predictability and adequate investment protection and dispute-resolution mechanisms. Independent regulatory agencies are often seen as an important factor in ensuring policy predictability and stability, and constitute an important driver for enhancing private sector participation in infrastructure.

In ASEAN, despite significant improvements in the regulatory environment across the region in the 2000s, many governments have yet to build more credible regulatory environments in a number of sectors. In telecommunications, CLMV countries have only recently established separate regulators (Table 11). In the electricity sector, a number of countries still rely on line ministries as regulators, even if they often operate in the sector through vertically-integrated enterprises. While the existence of separate regulators is not a guarantee of regulatory independence from the government, since separate regulators have varying degrees of relationship with the government, to some extent, it inspires market confidence that the regulator will be able to act objectively and transparently. A regulator's independence helps prevent regulatory capture and improve the quality of regulation. When coupled with incentives-based regulation having independent regulators has positive effects on investment levels (Sutherland et al., 2011). If the lack of separate regulatory agencies in sectors where private investment is more likely can be an obstacle for enhancing private sector investment in these sectors, its absence in other sectors is likely to have greater negative effects in the level of private sector participation.

Table 11. Presence of separate regulators in ASEAN: electricity and telecommunications

	Separate regulators	
	Electricity (year established)	Telecom (year established)
Cambodia	Yes (2001)	Yes (2012)
Indonesia	No	Yes (2003)
Lao PDR	No	Yes (2007)
Malaysia	Yes (2001)	Yes (1998)
Myanmar	No	No (but foreseen in the new Telecommunications Act)
Philippines	Yes (2001)	Yes (1979)
Singapore	No	Yes (1992)
Thailand	Yes (2007)	Yes (2004)
Viet Nam	No	Yes (2011)

Source: ITU Telecommunication/ICT Regulatory database and Energy Regulatory Commission of Thailand (2013).

While improved regulatory and institutional frameworks are important for enhancing private sector participation in infrastructure, these must be accompanied by enhanced government capacity to implement such projects. Adopting PPPs is not an easy task for governments, requiring significant changes to traditional public sector management. A whole new set of skills, instruments, institutions and procedures are required from governments to appropriately design, budget, implement, monitor and evaluate PPPs, including for instance: identifying, selecting and designing projects based on value for money, establishing and monitoring output-based contracts, budgeting and managing allocated project risks, among others. In many cases, poor project development capacity leads to the preparation of projects with limited bankability and interest from the private

sector. In some cases, state-owned enterprises are given the preference over more commercially viable projects and badly designed projects, based on inadequate feasibility studies and inappropriate risk allocation, are pushed to private parties. Poor project development also increases the risks of projects facing distress or getting cancelled.

In ASEAN, attracting private investment in infrastructure will require among other things strengthening countries capacities to deliver. PPP implementation capacity is still relatively weak in a number of countries in the region even for more experienced countries, such as Malaysia and the Philippines (EIU, 2011, and Shishido et al, 2013). This is partially reflected in the relatively low number of projects with private participation as seen earlier, but also in the relatively important amount of projects cancelled or in distress in energy, transport, ICT and water and sanitation sectors (Table 12). To some extent, the relatively higher share of cancelled projects or those in distress for more experienced countries reflect their early start in PPPs, but also points to potential shortcomings that other less experienced countries in the region may face in moving with their PPP programmes. While the long-term nature of infrastructure projects inevitably raises the risks of such projects being affected by macroeconomic shocks, bad project design and implementation are among other driving factors behind cancellations, particularly in more difficult sectors for PPPs (e.g. water and sanitation, road and railroad transport) (Harris and Pratap, 2009). Regardless of the reasons for project cancellation, reputational costs associated with cancellations can have an important impact on the willingness of private investors to commit to future projects, besides generally contributing to increased public resistance to PPP projects in general.

Table 12. Cancelled or distressed infrastructure projects with private participation in ASEAN, 1990-2012

	Projects reaching financial closure		*Projects cancelled or distressed*		*Cancelled or distressed projects as % of total*	
Country	*Number*	*Invesment commitments (US$ millions)*	*Number*	*Invesment commitments (US$ millions)*	*Number*	*Invesment commitments (US$ millions)*
Cambodia	31	3,969	1	8	3%	0%
Indonesia	101	55,447	11	8,014	11%	14%
Lao PDR	18	8,864	1	-	6%	0%
Malaysia	101	59,324	22	14,217	22%	24%
Myanmar	5	1,325	*n/a*	*n/a*	*n/a*	*n/a*
Philippines	123	58,223	10	6,354	8%	11%
Singapore	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
Thailand	121	41,378	3	674	2%	2%
Viet Nam	81	11,322	1	154	1%	1%
Total ASEAN	581	239852	49	29421	8%	12%

Source: World Bank and PPIAF, PPI project database. *Note*: Distressed projects are those in which the government or the private parties have either requested contract termination or are undergoing international arbitration.

Faced with regulatory and capacity challenges involving PPPs, ASEAN governments have recently taken a more comprehensive approach towards building appropriate PPP

regulatory and institutional environments. Many countries have upgraded existing policy frameworks supporting PPPs or have established completely new PPP frameworks. Recent reforms have given particular attention to enhancing the institutional environment for PPPs, while earlier reforms focused more on upgrading the selection process and bidding regimes for contracting private investors (EIU, 2011). Despite these improvements, ASEAN countries PPP implementation capacity still varies considerably with only few countries having established dedicated PPP units for instance (Table 13). While a PPP unit does not ensure better results, it facilitates bringing together the necessary skills to identify, develop and negotiate projects suitable to private participation. It also diminishes the costs associated with co-ordinating interaction and responsibilities of various government agencies. Malaysia and the Philippines have established rather comprehensive institutional and regulatory frameworks. Indonesia and Thailand have recently established new institutions and upgraded their regulatory environment to support PPP development, but there are still remaining challenges in their institutional frameworks. Viet Nam has yet to move from its recently established pilot PPP framework and needs to build its institutional capacity to support greater private participation in infrastructure. Lao PDR and Myanmar have yet to build their PPP agendas. Singapore has established a PPP programme but the institutional environment still needs to be further developed.

Table 13. Existence of dedicated Public-Private Partnerships units in ASEAN

	PPP Unit (year established)
Cambodia	No
Indonesia	No (but a central PPP unit is being developed)[1]
Lao PDR	No
Malaysia	Yes (2009)
Myanmar	No
Philippines	Yes (2010)
Singapore	No
Thailand	Yes (2012)
Viet Nam	No

Source: ESCAP (2014) and Indonesia (2013).
Note: [1]A dedicate PPP department was created in 2010 within BAPPENAS.

Malaysia has been an early mover in attracting private investors to infrastructure projects. In 1983, it established a PPP programme and since then more than 500 projects have been implemented through PPPs or have been privatised (Finlayson, 2013). In 2009, the government set up a Public-Private Partnership unit (3PU) attached to the Prime Minister's office. The unit is responsible for planning, structuring, negotiating, co-ordinating, monitoring and evaluating PPP projects. It also acts as a risk management unit to some extent as it is responsible for managing the Facilitation Fund, a sort of viability gap fund. In the Philippines, a PPP programme was established in 1990 when the BOT Law was first introduced. Since then, the country has gained experience in developing PPPs with projects being managed and supervised by the BOT Centre under the Ministry of Trade and Industry. In 2010, a dedicated PPP unit reporting to an inter-ministerial committee was established under the National Economic and Development Authority to facilitate the co-ordination, implementation and monitoring of PPPs. While the government has yet to establish a formal risk management unit which is under consideration, the PPP

Centre has access to critical advisory services through the Project Development and Monitoring Fund, established to support the agency and the development of PPPs in the country. The government also provides assistance to PPPs projects, including for land acquisition, through the Strategic Support Fund (Finlayson, 2013; ERIA, 2014).

Indonesia established a PPP programme in 2005 and reserved the planning and implementation of PPP projects to BAPPENAS, the country's development agency. The PPP unit within BAPPENAS operates as a dedicated PPP unit, but it shares some responsibilities with other agencies, which gives rise to some co-ordination issues for project selection and decision-making (EIU, 2011; OECD, 2012). Together with the Co-ordinating Ministry for Economic Affairs, BAPPENAS co-chairs the Committee for Acceleration of Prioritised Infrastructure Development, a ministerial steering committee responsible for co-ordinating infrastructure policy implementation and structuring of projects.[35] In 2010, the government implemented important reforms to the regulatory framework to address risk-allocation, competitive tendering, as well as fiscal and financial support to PPPs. As a result, Indonesia has established a comprehensive institutional framework to support the development of PPP projects, particularly to provide government support and manage the associated risks. A project development fund (PT SMI) has been established to assist in PPP projects preparation and advisory needs, and land acquisition funds were established to facilitate land acquisition primarily for road transport projects, but can also be used in other PPP projects. Moreover, under the Ministry of Finance, a risk management unit assesses the need for government support and manages contingent liabilities. The Indonesia Infrastructure Guarantee Fund provides guarantees to mitigate policy-related contractual risks in PPPs; the Viability Gap Fund provides finance to improve the financial viability of well-prepared projects (Finlayson, 2013; ERIA, 2014).

Viet Nam and Thailand have each established inter-ministerial task forces to develop their PPP agendas. In Viet Nam, PPPs are an emerging policy orientation and the country has yet to establish the regulatory and institutional framework to support such projects. Pilot PPP regulations were issued in 2009-2010 to support the development of pilot projects announced by the government in 2007. The BOT Law from 2009 was largely revised in 2011. Amendments aimed essentially at streamlining procurement processes, and other regulations issued in the same year provided guidance on implementing a number of provisions of the Law. To date there is no dedicated PPP unit in the country, but the Ministry of Planning and Investment has been tasked with establishing a PPP steering committee to assist authorised state bodies in formulating and commencing PPP projects. Current plans to establish a project development fund to support project preparation are welcomed as the country has only limited experience with PPP projects and the institutional environment is rather fragmented across agencies. But as the other countries in ASEAN, Viet Nam would benefit from establishing appropriate institutions to enhance risk management capacity in the country, as well as from upgrading its current regulations to address risk allocation issues (Finlayson, 2013; ERIA, 2014; EIU, 2011; ESCAP, 2014).

Thailand has had experience with private sector participation in infrastructure since the early 1990s, but the supporting regulation did not address several important issues for PPPs, such as risk allocation, project selection and procurement methods (EIU, 2011). In

[35] The KPPIP is the inter-ministerial steering committee.

2013 the government issued a new *PPP Law* that replaces its 1992 one. The new Act essentially aims at streamlining project approval processes and supporting the development of PPP projects through the establishment of a PPP Policy unit under the State Enterprise Policy Office. The unit, chaired by the Prime Minister, is responsible for developing a long-term PPP strategic plan and for PPP projects approval. A new PPP project development fund is also to be established to support government agencies with funding for PPP project preparation and advisory services (ERIA, 2014; ESCAP, 2014).

Cambodia, Lao PDR and Myanmar have yet to establish PPP programmes. In Cambodia, a *Concessions Law* was issued in 2007, but implementing regulations are still lacking. In spite of the absence of regulations and of dedicated PPP units, there are a few BOT projects undertaken by the private sector. Likewise, in Lao PDR and Myanmar there are no dedicated PPP units to assist in the development of PPP projects, and there is a lack of regulatory frameworks as well as important fiscal challenges. Nonetheless, Lao PDR has managed to attract some private investment, although limited, into a few concessions, mostly in the energy sector; and in Myanmar private investors have engaged in a few transport infrastructure projects through local BOT-type contracts (ADB, 2012c). In Singapore, the government established funds and a PPP programme in 2004, with the Ministry of Finance as the responsible agency for the development of PPP projects. There is strong government commitment and financial support to PPPs, but the dual role of the public sector as regulator and operator poses a challenge to enhance PPP development in the country (Shishido et al, 2013).

Despite different maturity stages of countries' PPP regulatory and institutional environments, there is growing political support for PPPs in the region. Adopting PPPs is not straightforward. It takes time for governments to adapt and implement the required reforms to support credible PPP programmes. But there is strong regional commitment and multilateral support to help countries advance in building their capacity to deliver and manage PPPs. This is in the interest of all ASEAN member states. The entire region stands to benefit from improvements in national infrastructure systems, besides enhanced regional connectivity associated with cross-border infrastructure projects.

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