INCLUSIVE ASEAN

SELECTED OUTPUTS OF THE SOUTHEAST ASIA REGIONAL PROGRAMME

SEARP TOKYO MINISTERIAL CONFERENCE
8-9 MARCH 2018

OECD

OECD Southeast Asia
Regional Programme

Inclusive ASEAN:

Selected Outputs of the Southeast Asia Regional Programme

SEARP Tokyo Ministerial Conference

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This compendium draws on the work streams of the Southeast Asia Regional Programme and the relevant reports produced pertaining to the issue of “inclusiveness”. The compendium supports the discussions at the 2018 SEARP Tokyo Ministerial Conference on 8-9 March 2018.

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Executive Summary

The first Ministerial Conference of the OECD's Southeast Asia regional programme (SEARP) will focus on "*Inclusive ASEAN*". The issue of inclusiveness has become increasingly prominent in the policy agenda of the Association of Southeast Asia Nations (ASEAN), as it works to address income disparities across and within member states, to ensure that economic growth is both sustainable and people-centred.

Southeast Asia is one of the world's fastest growing regions, and this growth has been sustained over a long period. The region is poised to reach average GDP growth of 5.2% between 2018 and 2022, relatively unchanged from the 5.1% rate achieved between 2011 and 2015. The bloc's newest member countries, Cambodia, Lao PDR and Myanmar, are expected to grow fastest over this period: between 7.1 and 7.4% on average. Despite this impressive growth, an estimated 36 million people in ASEAN (or 5.6% of the total population) still live below the international poverty line, and income disparities between neighbouring countries are much higher than in developed regions.

Inclusiveness is a cross-cutting issue and can only be addressed through a transversal effort spanning across a relatively wide array of policy areas. This compendium provides an overview of most relevant efforts addressing different aspects of inclusiveness which have been developed within SEARP by Regional Policy Networks and Initiatives drawing on the expertise of OECD bodies and in partnership with ASEAN committees and stakeholders. This work allowed for the identification of challenges, gaps, but also critical next steps which will be discussed at the Ministerial Conference. This research also demonstrates how important it is to have a horizontal and coordinated approach in order to meet the challenge of inclusiveness.

The papers featured in this compendium reflect the agenda of the Ministerial Conference. It includes two papers on "inclusiveness" from a *connectivity* perspective (indirect measures to boost inclusiveness, by increasing factor access) and four papers on "inclusiveness" from a *participation* perspective (direct measures to increase economic opportunities across different demographic groups). All provide a diagnostic and propose tools to enhance inclusion. The compendium discloses a number of key findings and policy options for the region:

Reforms to increase FDI in key service sectors

In many ASEAN Member States (AMS), services still account for a relatively low share of GDP compared to middle-income countries, and tend to take the form of traditional and low-productivity activities. Increased FDI and proactive investment policies could support the development of this sector and its spillovers to the domestic economy, through the transfer of know-how and technology. Despite strong performance in attracting FDI early on (particularly in the manufacturing sector), **many AMS currently absorb smaller inflows of FDI into services than**

their emerging market peers. **This is largely due to FDI entry restrictions in service sectors**. Policies to boost FDI in services would also benefit from measures to increase the development impact of FDI.

As a way forward, policymakers could consider:

- **Lifting outstanding FDI restrictions in services**;
- **Reviewing the menu of incentives** used (tax incentives may be more generous than required to draw investment and result in substantial fiscal losses) as well as the economic activities and companies targeted; and
- **Implementing policies to promote and deepen linkages between foreign and local firms**.

New instruments to boost private sector investment in infrastructure

The Asian Development Bank anticipates **regional demand for infrastructure investment to amount to USD 60 billion per year until 2020**, and that more work must be done to meet this demand if growth is to be sustainable and increasingly inclusive. This challenge can only be met by increased private sector investment. Despite liquidity in regional and global capital markets, relatively few PPP projects are currently underway in the region, and commercial and political risks appear to act as major deterrents to investment here.

As a way forward, policy makers could consider:

- A range of **different instruments to mitigate *commercial* and *political* risk**; as well as
- The **development of a sound, transparent and predictable legal and regulatory framework for infrastructure financing**.

Strengthening monitoring and evaluation mechanisms in SME policy

SME policies are an important tool through which policymakers can tackle inequality. As a "popular policy", however, they are prone to be used as a direct subsidy instrument rather than a set of policies and programmes to foster sustainable and inclusive development. Albeit with wide cross-country disparities, **many AMS have limited mechanisms for robust monitoring and evaluation, and this is partially hindered by a lack of comprehensive SME data**.

Looking ahead, measures to boost these mechanisms could support policymakers in ensuring that their interventions, as well as the associated fiscal outlay, fulfil their long-term objectives for SME policy. For instance:

- **Initiatives to support the development of productive and innovative enterprises may have a larger positive impact on income levels over the long-term than initiatives that subsidise microenterprises** and sole proprietors operating in low productivity activities;
- **The most appropriate policy mix for each country will be better informed by enhanced mechanisms for objective monitoring and evaluation**.

Financial Inclusion through Improved Financial Literacy and Financial Consumer Protection

In many countries, both in the OECD and globally, limited financial literacy is one of the most commonly-cited reasons for a rejected loan. Despite demonstrating overall improvement, **financial literacy levels across AMS vary significantly and tend to be positively correlated with income and education levels**.

Moving forward:

- **A strong and responsive financial consumer protection framework could promote trust and confidence in the financial system** and significantly reduce the likelihood of consumer detriment;
- **Financial education programmes could also support inclusion by equipping individuals with the understanding of how financial products may benefit them**, and providing them with the knowledge and skills to use financial products and services effectively.

Proactive policies are required to increase firm-level productivity

At an aggregate level, **productivity growth has slowed** across much of the ASEAN region over the last 10 years, and the gap between frontier and other firms is increasing. This suggests that **the diffusion of technology and knowledge is no longer sufficient**, and whilst economic growth continues to look favourable over the mid-term, a lack of policy action could constitute a downside risk, particularly for those countries that are experiencing decreasing returns to traditional growth drivers such as factor accumulation and favourable demographics.

As a way forward, to enhance productivity in non-frontier firms policymakers could apply a range of actions, such as:

- **Developing institutions that respond to challenges presented by the New Production Revolution**;
- **Enhancing ICT infrastructure**;
- **Facilitating the absorption of digital technologies amongst firms** through business and skills development programmes and services, and by promoting backward and forward linkages between domestic and foreign firms.

Provision of vocational education and training (VET) in ASEAN through training levies

Dynamic VET systems that can rapidly respond to skill mismatches are becoming increasingly important as the Fourth Industrial Revolution continues to disrupt labour markets. Currently a relatively small share of students at upper secondary level are enrolled in VET programmes in ASEAN compared to other emerging economies.

Moving ahead, policy makers could consider

- **Using more training levies** a programme through which employers contribute to a fund dedicated to training

- **Increasing the provision of VET and decrease youth unemployment**. Levies could also be targeted at specific groups, to provide additional support to marginalised groups or to address market needs.

Reforms required for women to transition from necessity to opportunity-driven entrepreneurship

Increasing women's participation in economic activity – thus ensuring a more efficient and equitable use of human capital is important to ensure that ASEAN's impressive economic growth rate is sustainable.

Looking ahead, to support women's transition from necessity- to opportunity-driven entrepreneurship, policymakers could consider:

- **Instruments to close remaining gender gaps in education and access to capital**, as well as;
- Interventions to address particular barriers faced by women in running a business or participating in the labour market, such as constraints on women's time, for instance by **increasing access to early childhood care and reassessing the terms of parental leave**.

Building on the private sector in achieving the development goals

The private sector could partner with the public sector to deliver infrastructure, new services and products to the poorest in society (through *Responsible Business Conduct, or inclusive business*) and productivity-enhancing technologies in ASEAN, amongst other products, services and facilities.

The region remains a highly promising one for the private sector, and the role for the policy-makers ***ahead*** would be to

- Sustaining efforts to **improve the business environment**, for instance through: enhancing infrastructure;
- **Removing barriers to trade;** and
- **Imbibing good regulatory practice in the development of regulation**.

Overview of Inclusiveness in Southeast Asia

1. Overview of Inclusiveness in Southeast Asia

1.1. Introduction

The ASEAN economic community has experienced a prolonged period of high economic growth since the process of enlargement was completed in 1999, and for many countries this trend can be observed since the late 1970s. This period of long-term economic growth has been supported by a steady supply of increasingly better-educated workers; a process of capital accumulation facilitated by a high domestic savings rate; by healthy FDI and foreign capital inflows; by the absorption and diffusion of new technologies; and by the utilisation of the region's vast natural resources endowments. In particular, and specific to ASEAN, this phenomenon has been facilitated by a high level of integration in global value chains (GVCs) and trade liberalisation, enabling ASEAN firms to increase their competitiveness as exporters – in 1995 the share of foreign value added (imports) used to produce exports (the buying element of GVCs) reached 29%, increasing to 33% by 2011. Recently ASEAN firms have started to increasingly source their inputs from regional providers, particularly those within the Asian Productive Network[1], replacing traditional providers in the European Union and the United States (OECD, 2016).

ASEAN member states (AMS) have been going through a process of rapid change, economic growth and a number of structural challenges. ASEAN as a region produced a remarkable progress with tackling issue of inclusiveness over the last years. The process of integration and the 2015 ASEAN Economic Community (AEC) Blueprint 2025 showcases ASEAN's aim to develop an inclusive, resilient, people-oriented, and people-centres community.

Although there has been progress, AMS still confront issues of related to inclusiveness. There are three types of economic diversity or inequality across ASEAN. The first is *inequality of income distribution across member countries*, which reflects different levels of economic development, as well as different levels of factor and natural resource endowment. The second is *income inequality within individual countries*. The third type is *divergence of economic opportunities for often marginalized groups of the population* – a type of inequality within individual countries that requires a targeted rather than a horizontal response. Finally, although not limited to three types of inequality, other important elements still play an important role such as the sustainability element, or inequalities of resource access between present and future generations, as well as access to the physical infrastructure.

1.2. Inequality type 1: Cross-country income inequality

The ASEAN economic community encompasses a group of countries that diverge widely in terms of gross national income (GNI) per capita, level of economic development, population size, factor and resource endowment, productive structure, institutional setting and legal frameworks. One of the most striking features of this disparity, from an economic perspective, is the high dispersion in average income per capita amongst AMS – and marked inequalities here is one of the region's key

[1] ASEAN, China, Japan and South Korea

structural characteristics, remaining high even after purchasing power parity (PPP) adjustment. As shown in Table 1.1, the gap between countries with the highest and lowest average PPP per capita income in ASEAN is higher than in other economic communities such as the European Union, NAFTA, the Pacific Alliance and Mercosur.

Table 1.1. Highest and lowest country average per capita income (PPP) among members of selected areas of trade and economic integration

AREA	Highest av. per capita income (PPP)	Lowest av. per capita income (PPP)	Highest/Lowest
ASEAN	Singapore	Cambodia	23.5
NAFTA (Canada, US, Mexico)	United States	Mexico	3.1
Pacific Alliance (Mexico, Colombia, Peru, Chile)	Chile	Peru	1.8
Mercosur (Argentina, Brazil, Paraguay, Uruguay and Venezuela)	Uruguay	Paraguay	2.3
EU-26	Luxembourg	Bulgaria	5.3

Source: World Bank Development Indicators, https://data.worldbank.org/indicator.

In ASEAN there is evidence that this catching-up process is taking place and gaining momentum, with GDP per capita growing at a significantly faster rate in the lower income countries – Cambodia, Lao PDR, Myanmar (CLM) – than in the region's highest-income countries (Singapore and Brunei) over the past three years.

This GDP growth has been driven predominantly by a process of rapid industrialisation and integration of the manufacturing sector into global value chains. Manufacturing activity in these countries is largely driven by medium and large enterprises engaged in labour-intensive assembly of semi-finished products, often owned by foreign investors or multi-national enterprises (MNEs) and located in Special Economic Zones or industrial parks.

Table 1.2 Real GDP Growth in ASEAN
(Annual percentage change)

	2016	2017	2018-22 (average)	2011-15 (average)
ASEAN-5 countries				
Indonesia	5.0	5.0	5.4	5.5
Malaysia	4.2	5.5	4.9	5.3
Philippines	6.9	6.6	6.4	5.9
Thailand	3.2	3.8	3.6	2.9
Viet Nam	6.2	6.3	6.2	5.9
Brunei Darussalam and Singapore				
Brunei Darussalam	-2.5	0.0	0.5	-0.1
Singapore	2.0	3.2	2.3	4.1
CLM countries				
Cambodia	6.9	7.1	7.2	7.2
Lao PDR	7.0	6.9	7.1	7.9
Myanmar	5.9	7.2	7.4	7.3
Average of ASEAN-10	4.8	5.1	5.2	5.1

Source: OECD Development Centre, Economic Outlook for Southeast Asia, China and India 2018
Note: The cut-off date for data used is 31 October 2017. ASEAN and Emerging Asia are the weighted averages of those of the individual economies in these groupings. Data for India, Lao PDR and Myanmar follow fiscal years. The projections for Indonesia for 2017 are based on the OECD Economic Outlook 102 database. *Source*: OECD Development Centre, MPF.

1.3. Inequality type 2: income-inequality across ASEAN member states

A second type of inequality relates to income distribution within the AMS. Gini index[2] data for the region suggests that in-country income inequality is growing rapidly in high-income AMS, whilst the same trend can be observed in middle-income AMS up until the early 2000s, when it began to quite significantly drop. Income inequalities are also gradually increasing in the low-income AMS, though from generally a lower base.

The IMF (2016) recently studied the performance of policies implemented in the various middle-income AMS to target poverty reduction, infrastructure development, access to finance and education for the poorest sections of the population – finding Thailand to have achieved the most significant results. Income inequality in high-income AMS follows the same long-term trend observed in OECD countries. The observed level of income inequality is however significantly higher than the OECD average[3], though it is comparable to the coefficient in emerging OECD economies such as Chile and Mexico. Since reaching a peak in 2007, income inequality in Singapore has also started to moderately adjust downwards.

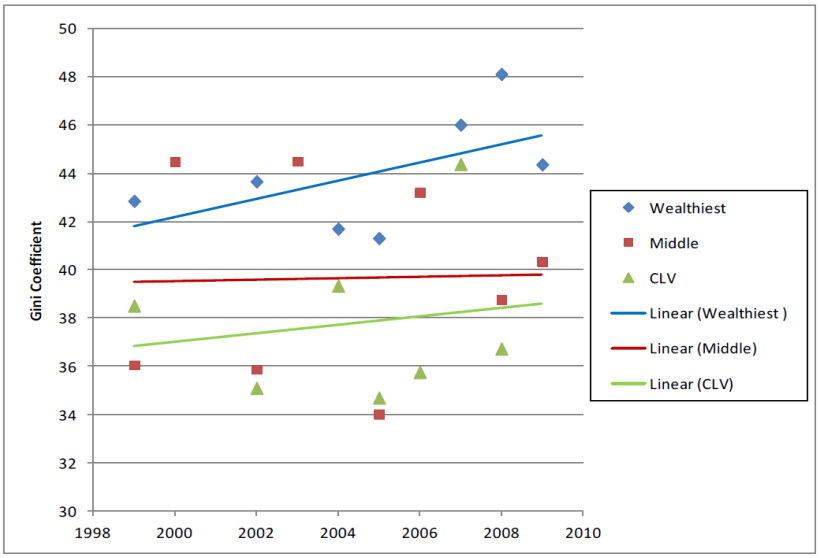
The in-country income inequalities that can be observed in low-income AMS are mostly attributable to the process of industrialisation that is currently taking place in those countries. Export-oriented manufacturing tends to be concentrated in a few geographic areas (for instance in SEZ), and in a few sectors in which the country has strong comparative advantages (such as garments in Cambodia and Myanmar, or consumer electronics and shoes in Vietnam). As a result, industrialisation tends to be coupled with a concentration of wealth amongst an emerging generation of entrepreneurs and technical professionals. It is also generally accompanied by widening of the income gap between rural and urban areas, as the higher wages offered by such enterprises, often located in urban areas, encourage rural inhabitants, often the most productive, to move to urban areas, leaving older populations and less productive workers engaged in subsistence farming. Corrective policy would be required to staunch this trend. In economic theory this trend will only begin to reverse naturally at a later stage of industrial development, as problems of congestion, pollution and labour market saturation begin to emerge, encouraging those residing in urban areas to leave the initial zone of economic development in search of new economic opportunities.

There are indications that this dynamic is taking place in AMS, with the relative reduction of income distribution observed over the past fifteen years in Malaysia, Thailand and the Philippines. In the case of Singapore, labour market and spatial saturation has encouraged the relocation of industrial activity to neighbouring areas in Malaysia and Indonesia in particular, and other, lower-income, Asian economies more generally. In-country income inequalities could be further reduced across the region by directing SME development policies towards the discovery and exploitation of new sectors – particularly those that can easily be translated to rural areas, such as tourism or agribusiness. Small-scale productive activity, typical of SMEs, also has the advantage of requiring a lower

[2] The Gini index is a standard tool to measure income inequality. The index varies between 0 (perfect equality) and 100 (absolute inequality).
[3] The Gini coefficient for Singapore, for instance, was 45.8 for Singapore in 2016, whilst the average in the OECD was 31.8 in 2014 [we should use the same year].

infrastructure endowment, meaning that higher-income countries may not necessarily have an intransigent competitive advantage in such activities. Policies to reduce inequalities in this area include those that support SME access to markets and finance, skill development and entrepreneurship promotion, and ensure that beneficiaries are spread across the country, not only in the main economic centres.

Figure 1.1. Wealth disparities within ASEAN countries



Source: World Bank, UNESCEP, ADB, ASEAN

1.4. Inequality type 3: divergence of economic opportunities amongst sections of the population

The third typology of inequality is related to difference in opportunities for special groups and sections of the population. Policy actions typically focus on four groups and population sections that are commonly recognized as having potentially lower opportunities for personal and business development than the rest of the population: the youth, women, persons with disabilities and ethnic minorities. These groups, on top of the traditional challenges that face micro, small and medium-sized enterprises (MSMEs), might find it particularly difficult to have access to finance, markets as well as business acumen and management skills. Often this happens because they do not have the same access to the business networks and infrastructure; they might also be disadvantaged with their educational backgrounds, physical handicaps or stigmas locally.

The challenge is that in many cases the targets groups turn to entrepreneurship in the absence of the necessary employment opportunities, but in reality become necessity-driven and not opportunity-driven entrepreneurs. For example, while self-employment rates for women in ASEAN are high: roughly 50% compared to an average of 13% in OECD countries, majority of those believed to be driven by necessity and often found in low value-added and disadvantaged sectors, and earn less than men (OECD, 2016 b). Yet although policy-makers may argue that these groups have the same access to the services as any other entrepreneurs, if the government really wants to make access to

the programmes and instruments inclusive and make an impact on the targeted groups, there is a need to walk an extra mile by developing targeted policies.

Policy-makers should enable a level-playing field for these groups by applying targeted policies and supporting entrepreneurship among those special group and population sections. "Inclusive" entrepreneurship policies aim to address any market failures that prevent an individual from setting up and operate a business, based on an aspect of their identity. This might include gender ("inclusive entrepreneurship policies for women"), age ("inclusive entrepreneurship policies for the youth"), the possession of handicaps ("inclusive entrepreneurship policies for persons with disabilities"), as well as any other dedicated focus which policy-makers might want to address. Such policies aim to level the playing field for entrepreneurship.

Targeted policies could have many approaches could range from development of specialized instruments to providing targets for performance in the overall policy documents specifically focused on the selected target groups. Associated policy interventions have typically also included subsidised credit, tax exemptions, social benefits and simplified business registration procedures.

Another way policy-makers can act is help develop an ecosystem of actors that could support these target groups in getting the same services. These actors could be social enterprises, inclusive businesses, impact investors as well as volunteers among others. In ASEAN social entrepreneurship has received much more awareness over the last decade. In some countries it has become a significant part of the agenda to enhance socio-economic wellbeing and has been recognised through a reference in the policy documents. Models combining business activity with social support may contribute to reduce inequality in opportunities and promote inclusive growth.

1.5. Other elements relevant to inequality

Connectivity is an important way how countries could promote inclusiveness. Access to the relevant infrastructure could play a crucial role in creating a more competitive, inclusive society with a greater sense of community. By developing physical infrastructure it is possible to link different groups, and integrate marginalized segments of population into the economic and social life. Infrastructure could also bring a number of economic benefits by promoting trade flows and ensuring access to work for less skills segments of population.

Skills and education is another element to take into account. Education and skills is a key lever of sustainable and inclusive development. As such, education and access to skills is essential to individuals' development as it is to the development of their families, of the local and national communities to which they belong. By providing more open access to skills and education opportunities governments can create a more inclusive society. This is also true to the access to the skills relevant for the digitalization, as it can in a long run help decrease a digital divide and help counties in ASEAN become more competitive in relation to the Next Production Revolution, where access to such skills will be essential.

Links with the private sector are crucial in order to mainstream the process of inclusiveness. Enterprises are playing an important role by providing jobs to many, but also by the models that they operate. ASEAN has recently seen an increasing growth of initiatives promoting inclusive and social ventures, as well as initiatives through the responsible business conduct. Governments can potentially leverage their impact by creating cooperation models with the private sector and by incentivising the private sector being more inclusive.

Macroeconomic Assessments and Economic Outlook for Southeast Asia

This is an excerpt from the OECD Development Centre's *Economic Outlook for Southeast Asia, China and India 2018.*

The Regional Outlook is one of the work streams of the SEARP.

2. Macroeconomic Assessments and Economic Outlook for Southeast Asia, China and India

Overall, growth in Emerging Asia – Southeast Asia, China and India – is projected to remain robust in 2017. Growth in many ASEAN countries and China has picked up on a strong trade rebound and resilient domestic consumption, while growth in India has edged downwards owing to taxation and monetary reforms. The region's growth is also projected to remain solid in the medium term. While growth will slow in China, it is expected to stay brisk in India. Southeast Asia is poised to maintain strong growth momentum from 2018 to 2022 on robust domestic private consumption and infrastructure initiatives planned by a number of governments.

The external positions of Emerging Asian economies have remained generally solid, although recent current account trends vary and net inflows of foreign direct investment (FDI) have weakened in some countries. Monetary authorities in the region are maintaining accommodative monetary policies, anchored on benign inflation, despite recent manifestations of renewed price pressures. Coupled with the perception that risk is low, this is supporting optimism in financial markets. Meanwhile, fiscal policy in many economies has been expansionary and looks set to continue as such in the near term with planned increases in infrastructure spending. A widening fiscal gap may be a concern in certain economies, but positions are generally stable.

2.1. Overview and main findings: The economic outlook for 2017-22

Gross domestic product (GDP) in Emerging Asia is expected to grow by 6.4% in 2017, unchanged from the 2016 rate (Table 1.2), and by an average of 6.3% during 2018-22, according to the OECD Development Centre's *Medium-term Projection Framework* (MPF-2018). Emerging Asia's estimated growth rate in 2017 is higher compared with the projected growth rates of Latin America and the Caribbean, 1.1%, and Africa, 3.4%. Growth in ASEAN and China is on a somewhat steeper upward trajectory in 2017 on the strength of the trade rebound and resilience of domestic consumption, whereas India's growth in 2017 appears to be retreating as the economy wobbles owing to the effects of demonetisation and the impact of tax changes. Over the medium term, however, China's growth rate is expected to slow to an average of 6.2%, while India's average expansion rate in the next five years will increase to 7.3%. Structural reform challenges in China are likely to slow the pace of growth from its 2011-15 rate. Southeast Asia is poised to achieve average growth of 5.2% between 2018 and 2022, relatively unchanged from 5.1% between 2011 and 2015. Growth prospects of ASEAN are anchored on robust domestic demand and on the infrastructure initiatives presented by a number of governments. Among the bloc's ten member countries, Cambodia, Lao PDR and Myanmar are projected to grow the fastest from now through 2022, while the Philippines and Viet Nam are expected to lead in growth among the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand and Viet Nam).

Table 2.2 Real GDP Growth in ASEAN
(Annual percentage change)

	2016	2017	2018-22 (average)	2011-15 (average)
ASEAN-5 countries				
Indonesia	5.0	5.0	5.4	5.5
Malaysia	4.2	5.5	4.9	5.3
Philippines	6.9	6.6	6.4	5.9
Thailand	3.2	3.8	3.6	2.9
Viet Nam	6.2	6.3	6.2	5.9
Brunei Darussalam and Singapore				
Brunei Darussalam	-2.5	0.0	0.5	-0.1
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CLM countries				
Cambodia	6.9	7.1	7.2	7.2
Lao PDR	7.0	6.9	7.1	7.9
Myanmar	5.9	7.2	7.4	7.3
Average of ASEAN-10	4.8	5.1	5.2	5.1

Source: OECD Development Centre, Economic Outlook for Southeast Asia, China and India 2018
Note: The cut-off date for data used is 31 October 2017. ASEAN and Emerging Asia are the weighted averages of those of the individual economies in these groupings. Data for India, Lao PDR and Myanmar follow fiscal years. The projections for Indonesia for 2017 are based on the OECD Economic Outlook 102 database. *Source*: OECD Development Centre, MPF.

2.2. ASEAN-5

- **Indonesia** is in a position to expand by 5.4% from 2018 to 2022, roughly the same pace seen from 2011 to 2015. Growth will mainly benefit from improvements in the investment climate, better fiscal footing highlighted by recent credit-rating upgrades and resilient private consumption, which grew by about 5.1% on average in the past ten years to 2017.

- Economic growth in **Malaysia** in the next five years will slightly soften to 4.9%. The influx of foreign investments since 2011 in mining, manufacturing and financial services is expected to anchor growth stability in the country moving forward.

- In the **Philippines**, average growth from 2018 to 2022 is expected to reach 6.4%, about 50 basis points higher than from 2011 to 2015. Consumption and fixed investments, which grew 6.1% and 11.7% on average from 2011 to 2016, respectively, will continue to fuel economic growth until 2022, mainly underpinned by robust remittance inflows from overseas workers, planned big-ticket infrastructure projects and the resilience of the offshoring and outsourcing industry.

- **Thailand**'s medium-term growth is expected to settle at 3.6% – an improvement from the 2.9% average growth between 2011 and 2015. The pick-up in trade activity augurs well for Thailand's economy, with exports comprising more than three quarters of GDP. Recent regulations easing investment and trade frictions, and the laying out of the Eastern Economic Corridor project, are expected to provide additional momentum.

- **Viet Nam** is likewise expected to outmatch the 5.9% average growth between 2011 and 2015, with an estimated expansion rate of 6.2% in the next five years. Private consumption, though gradually

slowing, will continue to be a reliable source of growth momentum. Exports will also boost GDP growth, if the global trade recovery continues.

2.3. Brunei Darussalam and Singapore

- **Brunei Darussalam** is showing signs of revival amid renewed (though still muted) optimism in oil and gas prices. The economy is projected to expand by 0.5% on average between 2018 and 2022, in line with better global trade prospects, barring another episode of steep energy price slides.

- **Singapore**'s GDP growth is also on the upswing in 2017 as manufacturing and trade-related services gain momentum. Growth is projected to remain steady at 2.3% for the period 2018-22. Investment in areas that foster digitalisation and the government's commitment to continue pouring funds into its social and infrastructure agenda are a boon to the country's potential output.

2.4. CLM countries

- Growth of the CLM economies (Cambodia, Lao PDR and Myanmar) is expected to stay strong through 2022. **Cambodia**'s growth will reach around 7.2% in the next half decade on the back of export recovery, consumption-supportive industrialisation policy and initiatives to develop capital markets.

- Growth in **Lao PDR** from 2018 to 2022 will remain robust at 7.1%, although this is lower than the average of 7.9% from 2011 to 2015. An impressive decline in poverty and an anticipated rebound in tourist arrivals bode well for private consumption. The new competition law, amendments to the investment promotion law and initiatives to broaden linkages of special economic zones with neighbouring ASEAN members should also facilitate capital infusion and trade.

- In **Myanmar**, leading indicators suggest a marked recovery after a steep pullback in tourist arrivals and exports took its toll on GDP growth in 2016. In the medium term, the economy is expected to expand by 7.4%, slightly above the country's average of 7.3% from 2011 to 2015. The renewed uptrend in exports and tourism, coupled with the passage of a new investment law, will likely keep investors interested in the country. Overseas remittances, which rose in 2016, stand to provide substantial fuel to private spending in the coming years.

2.5. Other key points of the economic outlook and assessment

- The accommodative monetary stances of central banks in many countries in the region persist, anchored on benign inflation, even though recent data indicate some manifestations of renewed price pressures. Headline inflation still diverges across Emerging Asia. Inflation firmed up in most of the big ASEAN economies, driven by the marked rise in food and transport sub-indices. Consumer price index growth in China is on a very gradual rise, owing to increases in housing and health care costs. Headline inflation in India is increasing gradually, supported by movements in fuel, clothing and housing prices. In contrast, headline inflation has waned in the CLM countries.

- The external positions of Emerging Asia have remained generally robust. The recovery of exports and of imports has had contradictory impacts on current account (CA) balances. Net FDI inflows to Emerging Asia have stayed largely on the uptrend in recent years. Factors that have kept investors interested in the region include improvement in trade prospects, the announcement of big-ticket infrastructure projects, the resilience of domestic demand, and the

aggressive drive of some governments to develop industries related to information technology and e-commerce through investment incentives.

- Fiscal policy in Emerging Asia has been largely expansionary this year. A widening gap may be a concern in some economies, but fiscal positions are generally stable. In the near term, many large ASEAN countries plan to increase spending, especially on infrastructure. China is maintaining a stable footing despite stronger spending of late. This may not be the case for India, Lao PDR and Viet Nam, which are trying to contain concerns related to budget deficits and the poor performance of financial institutions.

The Role of SME Policies in Fostering Inclusiveness in ASEAN

ASEAN SME POLICY INDEX AS A TOOL TO PROMOTE INCLUSIVENESS

The paper draws on inputs from a number of reports recently produced by the OECD and ERIA on the topics of SMEs policy, economic development, Global Value Chains (GVCs), women entrepreneurship and productivity dynamic in ASEAN. In particular the paper refers extensively to the evidence and the information collected through the compilation of the 2018 ASEAN SME Policy Index report (OECD, 2018, forthcoming) jointly conducted by the ERIA and the OECD with the support of the ASEAN Coordinating Committee for Micro Small and Medium Enterprises and funded by the Government of Canada.

This work has been developed by Southeast Asia Division of OECD in collaboration with the Economic Research Institute for ASEAN and East Asia (ERIA). This report has been shared with the members of the ASEAN Coordinating Committee of MSMEs.

This work contributes to the SEARP Regional Policy Network on SMEs.

3. The Role of SME Policies in Fostering Inclusiveness in ASEAN

ASEAN SME Policy Index as a tool to promote inclusiveness

ASEAN has exhibited a strong economic growth performance over the past three decades, supported by a steady supply of increasingly better-educated workers; a process of capital accumulation facilitated by a high domestic savings rate; healthy FDI and foreign capital inflows; the absorption and diffusion of new technologies; and by the utilisation of the region's vast natural resources endowments. However, this growth has not always translated into inclusive development patterns across and within the countries.

SME development could play an important role in fostering inclusive growth over the mid- to long-term. An effective SME policy would benefit from a better understanding of the main characteristics of SMEs across ASEAN member states. SME definitions vary across the region and globally, SMEs still constitute the vast majority of active enterprises accounting for 97 to 99% of total registered enterprises. The majority of active enterprises (65 to 75%) are micro-enterprises. Second, the SME population is typically highly diversified – in terms of size, ownership typology, sector, level of integration in domestic and global value chains – though two types of enterprises have the highest chance of contributing to economic growth: high growth enterprises, and innovative start-ups. Finally, most ASEAN Member States (AMS) host a substantial share of informal enterprises, mainly micro-sized. These enterprises can be classified as informal either because they remain unregistered or because they are not fully compliant with all regulatory requirements, even if they are in some sense "known" to the authorities.

There are a number of challenges that SMEs face across ASEAN, attributable to different phenomena including the changing landscape for international trade, a lack of resources to strengthen productivity, and the digitalisation and atomisation of manufacturing industries. Yet these developments have also brought new opportunities, for instance via integration into global value chains. The AMS are highly integrated into global value chains and often SMEs are strongly engaged as direct suppliers of intermediaries, hence GVCs may provide new opportunities for developing the economic activity of SMEs. An important element of SME internationalisation takes place through indirect exports – SMEs rely on larger national or multinational firms to engage in GVCs.

A number of AMS are increasingly using SME policy as a tool to promote economic and social development. Policymakers tend to have three different approaches to SME policy, including a) *SME policy as a tool ensuring market efficiency* and that all enterprises have equal market access conditions; b) *SME policy as a structural challenge that requires targeted pro-active government intervention*; c) *SME policy as a tool to achieve better social development*.

Generally, the AMS adopt an open policy-mix, combining elements from those three different approaches or adopting different approaches for different segments of the SME population with various levels of intensity. Each AMS has its own pace for integrating the issue of inclusiveness and has different issues they are focusing on. This paper identifies three approaches to SME policy through which AMS support inclusiveness in ASEAN. They include:

1 Enhancing SME economic integration at the sub-national, regional and global level. The prevailing economic growth model in the ASEAN region plays a strong emphasis on the integration into global value chains and on the development of export-oriented activities. Most AMS show strong trade growth during the last ten years. Faster export led economic growth contributes to generate new and better jobs, as export oriented enterprises are usually more productive than companies oriented towards local market and more likely to operate in a formal way. If export led growth is also associated to economic diversification. The productive base could be broadened and more resources to finance human capital development trough skill enhancement and better education could be generated, thereby contributing to more inclusive growth. When looking at public policy measures supporting GVCs integration and linkages with large enterprises a group of AMS (Indonesia, Malaysia, Singapore, Thailand and Viet Nam) stands out for the intensity and the quality of their initiatives. Some AMS also promote

SME greening or sustainability promotion initiatives as a way to facilitate access of green products into GVCs. Those countries are the leading manufacturing hubs and GVCs integration is crucial in supporting industrial growth. Finally, the dynamism of e-commerce in Southeast Asia has attracted significant amount of investment and a large number of e-commerce and e-business platforms are operating in the region.

2 Diffusing and supporting entrepreneurship though innovation policies. High-growth and innovative enterprises play a crucial role in fostering the development of a country enterprise sector, by ensuring that enterprise competition dynamic remains vibrant, by spurring productivity gains, by fostering technological upgrading and by generating new employment opportunities. As innovative and high-growth enterprise tend to concentrate in highly integrated hubs, their development may also increase geographic inequality within a country. But their contribution to economic growth, quality of living, widening of opportunities, is likely to compensate the negative impact on equality. The latest GEM report on ASEAN shows (GEM 2016) that framework conditions for high-growth entrepreneurs in ASEAN are relatively good. Innovative hubs have been established in several ASEAN cities, such as Singapore, Jakarta, Kuala Lumpur and Bangkok. However, SME productivity remains substantially lower that of larger enterprises, but there are indications that the gap may start to shrink and already some of the SMEs operating in advanced service sectors have achieved high productivity records. Also, while the most advanced AMS are moving closer to the technological frontier and they have put in place effective innovation supporting eco-systems, the less developed AMS are still engaged in early stage institutional development, while facing a lack of financial and human resources to support policy actions.

3 Enhancing economic opportunities amongst marginalised groups. Entrepreneurship promotion takes on a distinctly social approach in majority of AMS, and SME policy is predominantly used as a means to fulfil social policy objectives. AMS in many cases have developed dedicated policies for specific target groups such as *women*, *youth*, and *persons with disabilities*. Specifically for women, all AMS have agencies and coordination mechanisms to advance women entrepreneurship and enhancing women's economic activity has been widely acknowledged as a general aim in national strategies.

In summary, it is noted that ASEAN as a region has achieved remarkable progress on tackling the issue of inclusiveness through SME development over recent years.

The ASEAN SME Policy Index 2018, currently being developed could provide a useful tool for benchmarking existing relevant policies, to further enhance inclusiveness. Its findings, once launched in 2018, could help policymakers to fill information gaps and to have a better understanding of how their country's SME framework differs from that of their neighbours.

Moving forward, the AMS could further focus on strengthening monitoring mechanisms and increasing the volume of data available – both on the performance of SME policies as well as the performance and characteristics of active SMEs operating in their respective countries. Through use of this data, policymakers would be able to acquire a better understanding of the current status of SME development within their countries, and, supplemented by additional tools such as the ASEAN SME Policy Index or SME Policy tracking tools, identify gaps in order to develop more tailored policies.

3.1. Introduction

It is undeniable that ASEAN has exhibited a strong economic growth performance over the past three decades, but regional policymakers are increasing looking at ways to ensure this growth is inclusive. This growing commitment to ensure that growth is also distributive is reflected in the development of strategic documents at ASEAN level, such as the Strategic Action Plans for SME Development (SAP SMED), developed to cover 2010-15 and 2016-25 respectively, and the ASEAN Policy Blueprint for SME Development (APBSB) 2004-14.

This note will explore the role that SMEs and SME policy could play in fostering inclusive growth over the mid- to long-term. It will start by describing the main characteristics of its SME population. It will then address how each type of inequality can be addressed through a subset of SME policies. It will

conclude with suggestions on how a higher level of inclusive growth can be promoted through SME development policies. This note does not present the initial findings from the ASEAN SME Policy Index 2018.

Table 3.1. SME definition per AMS

	Type		Criteria			Sector approach		Upper threshold*
	Legal	Working	Employment	Assets	Turn-over	Cross-sectorial	Sector-specific	
Brunei Darussalam		✓	✓			✓		100
Cambodia	✓		✓	✓		✓		200
Indonesia	✓			✓	✓	✓		-
Laos			✓	✓	✓		✓	99
Malaysia	✓		✓		✓		✓	200 (M) / 75 (S)
Myanmar	✓		✓	✓	✓		✓	300 / 600* (M)
Philippines	✓			✓		✓		-
Singapore		✓	✓		✓	✓		200
Thailand	✓		✓	✓			✓	200
Viet Nam	✓		✓	✓	✓	✓		200

Note: *For employment
Source: Research based on the national legal documents of AMS.

3.2. Main characteristics of the SME population in ASEAN

Across countries at all levels of development, SMEs are key players in promoting economic growth, inclusiveness and sustainability. SME definitions vary throughout ASEAN (Table 3.1), and also globally, but across most economies SMEs constitute the vast majority of active enterprises, with large enterprises accounting for less than 1% of all registered enterprises (UNESCAP, 2014). The majority of active enterprises (65 to 75%) are micro-enterprises, and this share substantially increases where sole entrepreneurs – including those engaged in subsistence farming – are also included as micro enterprises in SME statistics. Generally micro enterprises are defined as firms with up to ten employees. Small enterprises take second place, accounting for around 20% of the enterprise population, followed by medium-sized enterprises, which generally account for no more than 5-10% of the total population.

In terms of their contribution to aggregate employment, SMEs generally account for a large share of private sector jobs, ranging from 60 to 70% in OECD countries. Yet they generate a significantly lower share of value-added in manufacturing (OECD, 2017). In the OECD, this is not generally the case for services, where they generally benefit from their proximity to the end-customer and more flexible structure, and do not require the same economies of scale and access to capital resources that benefit manufacturing activities.[4] In OECD countries this contribution – both to aggregate employment and the generation of value-added – has increased over recent years, largely due to larger-firm downsizing and

[4] SMEs are estimated to account for 60% or more of total value added generated in services across the OECD.

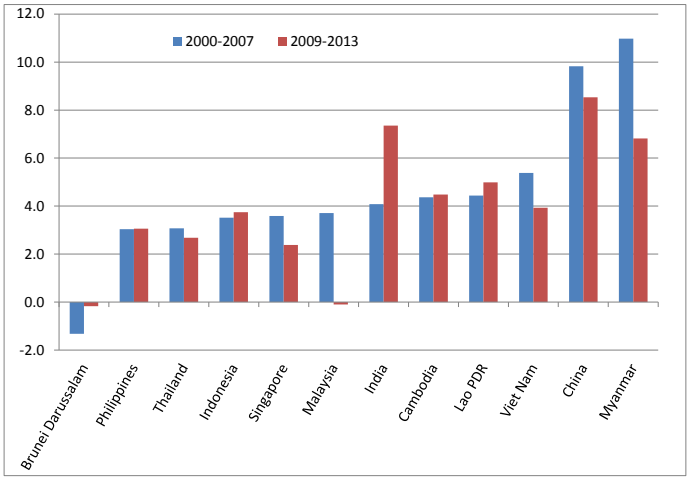
increased outsourcing, as technological developments reduce the importance of economies of scale, facilitate the development of business and service networks and foster the creation of an eco-system that supports small-scale entrepreneurship whilst increasing the demand for specialised and high value-added services.

Over recent decades developments in communication technologies combined with falling trade costs have facilitated the fragmentation of production across countries and the rise of Global Value Chains (GVCs), allowing ASEAN economies to become increasingly integrated into GVCs. (OECD Report, 2018 forthcoming) Production has become increasingly complex with value added increasingly crossing borders several times, combining the inputs of goods, services and intangibles of several firms along the way (OECD, 2013; DeGain et al, 2017). Productivity growth in the four years following the global financial crisis and its immediate aftermath (2010-13) has tended to be lower than in the four years preceding it (2004-07), except for multi-factor productivity (MFP) growth in Indonesia, the Philippines and Thailand, and labour productivity growth in Brunei Darussalam, Cambodia, India, Indonesia, Lao PDR and Thailand (OECD, 2017). Performance has varied across sectors, and there has been some evidence of faster growth in lower-productivity sectors in recent years (OECD, 2018 forthcoming).

SMEs are challenged by the changing landscape for international trade, but also have important new opportunities to contribute to greater engagement of SEA economies in global value chains, e.g. thanks to digital technologies. Strengthening productivity growth is another important challenge for SMEs. Recent OECD work has pointed to a growing gap between global productivity leaders (often large, multinational firms) and lagging firms (often smaller, domestic firms). An important question is the extent to which SMEs in SEA can benefit from ongoing technological changes in the global economy and strengthen their productivity performance, or whether they risk falling behind, as appears to be the case with SMEs in some OECD economies (OECD, 2015) through further integration into GVCs.

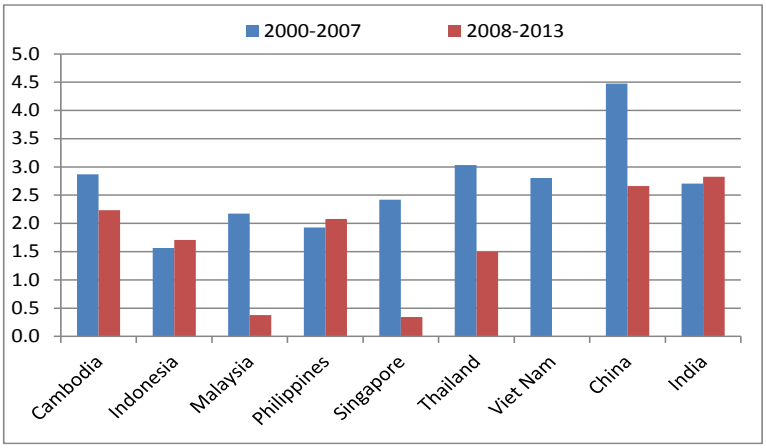
The SME population is typically highly diversified, in terms of size, ownership typology, sector, level of integration in domestic and global value chains, amongst other characteristics. However, two specific types of enterprises are increasingly being studied as having an important role in driving increased competition and economic development: *high growth enterprises; and innovative start-ups*. Those two typologies represent a small percentage of the total SME population, but they are crucial to the establishment of a vibrant, competitive and innovative SME sector, a goal pursued by government in developed and emerging economies.

Figure 3.1. Labour productivity growth in Emerging Asia
(Annual growth in labour productivity, 2000-2007 and 2008-2013)



Source: APO (2015), *APO Productivity Database 2015*, www.apo-tokyo.org/wedo/measurement

Figure 3.2. Multi-factor productivity growth in Emerging Asia
(Annual growth in multi factor productivity, 2000-2007 and 2008-2013)



Note: MFP data not available for Brunei Darussalam, Lao PDR or Myanmar.
Source: APO (2015), *APO Productivity Database 2015*, www.apo-tokyo.org/wedo/measurement.

There is no much statistical evidence of the performance of high-growth and innovative start-ups, but anecdotal evidence is quite significant. In particular a number of innovative and technological based start-ups from the region have been labelled "unicorn" firms, including *Garena*, *Lazada* and *Razer* (Singapore); *GrabTaxi* (Malaysia); *Tokopedia* and *Traveloka* (Indonesia); and *VNG* (Viet Nam). The rapid spread of technology incubators across the region is also indicative of strong market potential for start-ups in the region.

The characteristics of the population in ASEAN countries are very much in line with the stylised facts presented above. According to official national statistics collected for the 2018 SME Policy Index, SMEs account between 97 and 99% of registered enterprises in all AMS, with the exception of Myanmar (87%), where data is scarcer.[5] In terms of private sector employment, they generally account 61 to 97% of the total, with micro-enterprises accounting for the highest share of establishments and employment in all countries except Cambodia, where most formal employment is concentrated in medium-sized enterprises, predominantly in the highly labour-intensive garment sector. In terms of contribution to GDP, data is scarce, but the figure ranges from 61% in Indonesia (with the caveat that this figure is particularly high because the country counts independent farmers as micro enterprises, and as a result this group accounts for 99% of all enterprises) to 16% in Brunei Darussalam, an economy dominated by a large oil and gas sector (Brunei Darussalam Statistical Yearbook, 2015/data from 2010).

Where sectoral data are available, it appears that ASEAN SMEs mostly operate in the service sector. In the Philippines only 12.7% of the SMEs operate in manufacturing, whilst 46.5% are engaged wholesale and retail trade and another 13.3% operate in the hospitality sector (as providers of hotels, restaurants, and similar services). In Myanmar, SMEs are to be principally found in the food and beverages sector, accounting for 63% of all SMEs. Viet Nam is an exception to this trend, with 43% of the SMEs engaged in manufacturing operations and a considerable share of these firms integrated into global value chains. Vietnamese SMEs, along with FDI, have been one of the key drivers in turning the country into a major manufacturing hub in Southeast Asia, whilst state owned enterprises have continued to dominate heavy and basic industry, natural resources and utilities.

As previously mentioned, the AMS are highly integrated into global value chains. According to a study recently conducted by the OECD (2016) on the integration of manufacturing SMEs from four AMS (Singapore, Thailand, Indonesia and Viet Nam) into GVCs, SMEs are strongly engaged as direct suppliers of intermediaries. In Thailand 16% of direct exports used for further processing abroad are produced by SMEs, compared to 6% generated by larger enterprises. In general the findings from these countries suggest that regional SMEs mostly participate in GVCs as suppliers to larger firms than as producers of direct exports.[6]

Finally, SMEs in ASEAN are also constituted by informal enterprises. Those include enterprises that are not formally registered (total informality) as well as enterprise that are formally registered, but not fully compliant with all regulatory requirements. Informality is widespread across Southeast Asia, with the exception of Brunei Darussalam, Singapore, and – partially – Malaysia. Data is not available on the number of informal enterprises operating in the region, but – as a proxy – data collected on the rate of informal employment suggests a very high level of economic informality in the region (ILO). Informality appears to be most highly-concentrated in micro enterprises that operate in low value-added services and unskilled labour-intensive manufacturing. Where it is pervasive, informality can slow skill and capital accumulation whilst constituting a source of unfair competition vis-a-vis more formal peers. The net result can be a slowing of medium-term economic growth whilst increasing inequalities between the employees of informal and formal enterprises. Policies to address this group of enterprises should consider that it is in an economy's interest to decrease informality over the long-term, but that such activities often provide livelihoods for many in emerging markets, and individuals are generally driven to create and seek employment in such enterprises out of necessity rather than opportunity.

[5] In this country, SME data is only available for firms registered with the Ministry of Industry, and restricted to firms operating in industrial zones.

[6] In Viet Nam, for instance, direct exports account for 14% of total export products generated by manufacturing-SMEs, whilst indirect exports through larger firms account for 20%.

3.3. SME Policy as an economic and social development tool

SME policy is a tool commonly used by policymakers to promote economic and social development. Most countries have adopted explicit policies to support SME development and promote entrepreneurship, with the rationale that such enterprises make a significant contribution to employment generation. The argument follows that SMEs face pervasive market failures, such as structural under-investment in skills and technologies; higher transaction costs and wider information asymmetry gaps in dealing with financial institutions; and higher compliance costs, putting them at disadvantage relative to larger peers and increasing the probability that SMEs operate well below their optimal efficiency frontier.

The mainstream view is that public policy, if well designed and implemented, can address some of the most relevant market failures and generate a stream of social gains that are significantly larger than the direct cost of financing SME support programmes. Whilst there is general agreement on the overall logic underpinning SME development policies, such policies can adopt a number of different approaches. These approaches could also take into account other issues, such as sustainability (Box 3.3), or particular ways of collaboration with the private sector. These inform the type of policies that are selected and the structuring of such policies. They are as follows:

1. SME policy as a tool to improve market efficiency. This approach is broadly horizontal and laissez-faire. It aims to ensure that all enterprises have equal access to markets and factors, and to promote dynamic competition. It thereby focuses on removing the administrative barriers that may distort competition, reducing information asymmetries, promoting easy entry-exit procedures and stimulating entrepreneurship;

2. SME policy as a structural challenge that requires targeted support. This approach calls for a more proactive and ongoing policy intervention, direct support provided to enterprises until they have overcome most of their structural weaknesses. It places more emphasis on structural features that constrain SME growth – such as lack of economies of scales and scope, lower capacity to invest in human and physical capital, and weak R&D activity. It tends to target select groups of enterprises and sectors, which may change over time;

3 . **SME policy as a tool to increase human welfare**. The main objective of this approach is to increase social development and generate additional employment opportunities. To achieve these aims, policymakers mostly focus on introducing schemes to support entrepreneurship, particularly amongst the most vulnerable, and to develop microfinance schemes and start-up support programmes. This approach mostly targets micro and small enterprises, mostly the former, and tends to focus on those operating in traditional, but highly labour-intensive sectors, such as hospitality, construction, transport, and small-scale manufacturing.

Policymakers very often adopt a mix of these different approaches, with the dominant approach fluctuating over time, in-line with current, often political, policy priorities. There is also a tendency across the OECD to adopt different approach for different segments of the SME population. This is also the case in Southeast Asia.

A number of instruments are available at OECD in order to analyse a range of SME policies at national level or at a regional level, comparing several countries or territories. Typically in order to analyse a set of SME related policies there is an *OECD SME Policy Review*. While for the analysis of the series of countries and benchmarking their performance there is an *SME Policy Index*. Please find out more about SME Policy Index Methodology in Box 3.1. This approach was applied for ASEAN in 2014 and in 2017-2018 (forthcoming publication in 2018) and further described in Box 3.2 of the document.

Box 3.1. The SME Policy Index : Objectives and Methodology

The SME Policy Index (SME PI) is an analytical tool developed by the OECD, in co-operation with other international partners, to assess and compare progress in SME policies across economies and time. The SME PI was developed in the framework of regional programmes conducted by the OECD with partner countries.

The main objective of the SME PI methodology is to collect a wide range of information on policy inputs, harmonise this information and transform what are largely qualitative inputs into quantitative indexes that can be compared across economies and time. By regularly applying the SME PI over time, on average every three to four years, the participating economies are able to assess how their policies progressively align to internationally recognise good practices, respond to the needs of their SME population and converge towards a common set of goals and principles set at regional level.

All SME PI assessments share a common methodology. However, for each regional application, the methodology is adapted to respond to the specificities of participating economies in order to anchor the SME PI into the regional policy debate. The assessment is conducted through a questionnaire (the "assessment grid") developed by the OECD jointly with the partner organisations and with experts and representatives from the participating economies and OECD countries. Each dimension includes one or more sub-dimensions, defined as a distinct area within a policy dimension (i.e. "Actions promoting financial literacy" within the dimension on "Access to Finance for SMEs").

Each sub-dimension includes a number of indicators. Most of the indicators are qualitative in nature and aim at determining the key elements of the policy inputs. A number of indicators are quantitative, trying to measure the "intensity" of the policy actions. Assessment results are expressed in numerical indexes (scores) on a scale of one to five (one to six in the case of the ASEAN SME PI) and they are presented at the level of sub-dimensions and aggregated at policy dimension level. There is no single aggregate SME policy development score per country.

Please refer to *Box 3.2* in order to relate to the process of the ASEAN SME Policy Index 2018.

Box 3.2. The ASEAN SME Policy Index 2018 as a way to benchmark SME Policies

The ASEAN SME Policy Index (ASPI) 2018 aims to provide a tool to identify the strengths and weaknesses that exist in the current SME policy and benchmark the status of implementation of the new ASEAN Strategic Action Plan for SME Development (2016-2025) to complement the ASEAN SME key performance indicators. The ASPI, scheduled for publication in 2018, is a joint effort between the Economic Research Institute for ASEAN and East-Asia (ERIA) and the Organisation for Economic Cooperation and Development (OECD). The development of the report and its methodology were formally acknowledged by the ASEAN Coordinating Committee on MSMEs (ACCMSME).

The ASPI is composed of sets of analytical indicators organised in dimensions. The assessment will be based on a comprehensive policy framework which allows for benchmarking not only among participating countries but also with international best practices. It targets to measure progress on policy convergence at the regional (ASEAN) level, improve SME policy-making in participating countries and enhance the capacity of policy-makers.

The eight dimensions of the Index are: *Institutional Framework; Legislation, Regulation and Tax; Access to Finance; Access to Market and Internationalisation; Productivity, Technology and Innovation; Entrepreneurial Education and Skills; Green SMEs; and Social and Inclusive Entrepreneurship*. By assigning scores to policy implementation level, the index attempts to convert qualitative information into quantitative results, facilitating cross-country comparison and allowing for systematic monitoring of policy developments.

The SME Policy Index is used in a participatory way with an approach consisting of complementary assessments conducted by the ASEAN countries themselves, through the National Co-ordinators, the Independent experts / Consultants, and by the OECD and ERIA. Over 400 people contributed to the development of the document, expected to be launched during 2018.

Policy makers could also develop regular tracking tools for SME Policies such as SME Dashboard and SME Observatory which are applied in a number of countries and allow policy-makers have a more regular access to regularly updated information on SME population and crucial data.

3.4. Three approaches to support inclusiveness through SME policy in ASEAN

The previous chapters suggest that inequalities are pervasive across ASEAN, and that these inequalities take a number of different forms. The following chapter will explore how three areas of SME policy can be used to tackle inequalities of income and opportunity across ASEAN, and the actions that are currently being taken in these areas by ASEAN policymakers. The three areas of SME policy have been developed for the purpose of this paper, and are as follows:

1. *Enhancing SME economic integration at the sub-national, regional and global level*
2. *Diffusing and supporting entrepreneurship though innovation policies*
3. *Enhancing economic opportunities amongst marginalised groups*

Approach 1: Enhancing SME economic integration at the sub-national, regional and global level

The prevailing economic growth model in the ASEAN region plays a strong emphasis on the integration into global value chains and on the development of export-oriented activities. Within this model FDI has given a central role in driving capital accumulation, technology transfer, upgrading of managerial techniques and access to foreign markets. This approach has worked well in the case of ASEAN-6 and it is still largely guiding economic development in the ASEAN-4.

There is however a growing understanding in the region that the base of economic growth has to be enlarged to include a vast network of local suppliers of services and goods, while retaining the GVCs integration and export oriented approach. In a number of cases this is necessary to diversify the production base beyond the current narrow sector specialization (this is the case for instance of Cambodia with a strong concentration in the garment sector), to root the presence of FDI by making foreign owned assemblers closely integrated with a network of local suppliers (as it is the case of the automotive sector in Thailand of the electronic sector in Malaysia), or to ensure the presence of local enterprises in technologically advanced sectors (as in case of Singapore and Malaysia).

Most AMS show strong trade growth during the last ten years. Indonesia, Thailand, the Philippines, and Malaysia experienced 8.1%, 6.1%, 4.8%, and 4% of average trade growth from 2006-2016, respectively. Less developed AMS experienced stronger trade growth in recent years with Cambodia, Lao PDR, and Myanmar had 13.6%, 14.1%, and 21.2% of average trade growth from 2011-2016, respectively. Thailand, Malaysia and Singapore also experienced large current account surplus.

Faster export led economic growth contributes to generate new and better jobs, as export oriented enterprises are usually more productive than companies oriented towards local market and more likely to operate in a formal way. Export led growth is also associated to economic diversification broadens the productive base and generates more resources to finance human capital development trough skill enhancement and better education, contributing therefore to more inclusive growth.

Public policy may support regional and global economic integration in several ways. Governments may interact directly at enterprise level, promoting linkages between large export oriented enterprises and small-sized local suppliers, i.e. by facilitating business matching, by supporting technological upgrading of local suppliers, etc. Governments may also be engaged in direct export promotion, offering market intelligence services to SMEs, supporting the participation to trade fairs and commercial missions, helping local enterprises in navigating Free Trade Agreements and taking maximum benefits from the ASEAN economic integration process. In addition governments may take indirect actions, by promoting trade facilitation tools or and simplifying import-export procedures or by adhering to international

standards, by signing mutual recognition agreements and helping enterprises in adopting internationally recognized technical and quality standards. Finally, connection with e-commerce platforms – national, regional or global – may open new opportunities for SMEs. Although e-commerce is dominated by private platforms, governments play an important role in defining the legal and contractual framework, in promoting the adoption of a secure on-line payment system, in facilitating cross-country e-commerce and in helping SMEs in adopting digital technologies.

Table 3.2. Trade data in AMS per country

	Current account balance (% GDP)	Average Exports to GDP 2014-2016 (%)	Average Imports to GDP 2014-2016 (%)
Brunei Darussalam	4.80	56.84	30.82
Cambodia	-8.60	61.77	26.59
Indonesia	-1.70	21.30	9.80
Lao P.D.R.	-9.60	37.00	13.70
Malaysia	2.40	70.69	36.54
Myanmar	-6.60	19.44	6.42
Philippines	-0.10	28.42	14.16
Singapore	19.60	181.17	100.39
Thailand	10.10	69.14	39.62
Viet Nam	1.30	89.94	45.62

Source: OECD data

Approach 2: Diffusing and supporting entrepreneurship though innovation policies

High-growth and innovative enterprises play a crucial role in fostering the development of a country enterprise sector, by ensuring that enterprise competition dynamic remains vibrant, by spurring productivity gains, by fostering technological upgrading and by generating new employment opportunities.

High-growth enterprises are defined by the OECD as enterprises that have recorded organic growth in terms employment or turnover of over 20% for at least three consecutive years and enterprise are engaged in the development. Innovative enterprises are instead enterprises engaged in the development of new products, new processes, in the discovery of new markets and in the introduction of new management techniques. A specific sub-category within the innovative enterprise typology is constituted by innovative start-ups, innovative enterprises less than two years old. Innovative start-ups have been at the front of current the digital and technological revolution. The most successful among them have been growing at exponential rate, becoming therefore the high-growth enterprises and they have contributed to define the new technological and productive frontier. In many cases they are taken over by larger technological groups, in a more limited number of cases they remain independent and sometimes achieve notoriety as unicorn, start-ups that are valued in excess of over one billion USD.

Several studies have highlighted the role of those types of enterprises. About 4% of all start-ups create over 50% of all new jobs in France. A 2011 World Economic Forum study reviews the growth path of HGEs across the world, finding that the top 1% of all companies ranked by the level of revenue growth contribute 44% of total sector revenue – with parallel findings for job creation. In the US, the Kauffmann Institute (2010) found that the top 5% of companies measured by employment growth created two thirds of new jobs, while the top 1% generated 40% of new jobs.

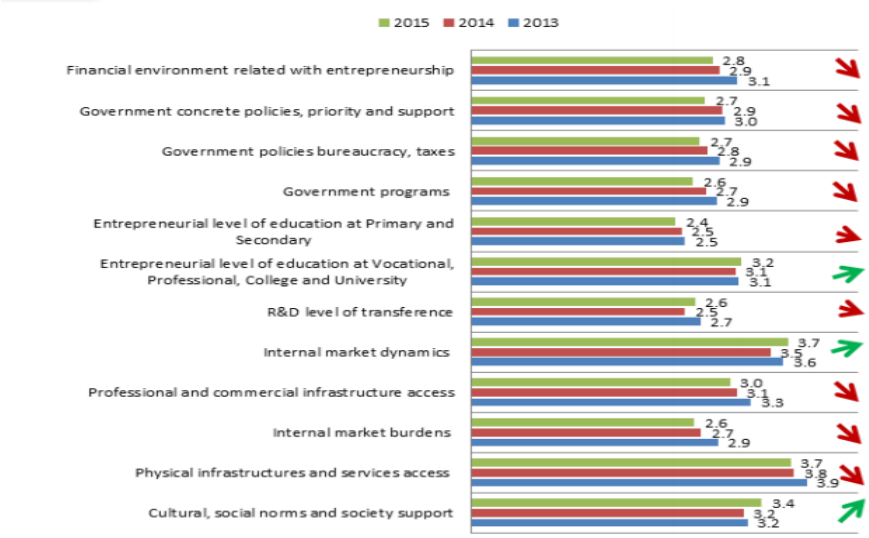
Governments often play an important role as coordinators, regulators and providers of basic research and early stage enterprise financing, but experience has shown that the government intervention has also clear limitations and cannot be a substitute for private sector players.

Innovative and high-growth enterprises may in the short term disrupt the activity of more established firms. This may have an impact on jobs and salaries for certain type of employees. As innovative and high-growth enterprise tend to concentrate in highly integrated hubs, their development may also increase geographic inequality within a country. But their contribution to economic growth, quality of living, widening of opportunities, is likely to compensate the negative impact on equality. Innovation if supported and complemented by policies that tend to re-balance the negative distributive effects and promote diffusion and participation, may be a force for greater inclusiveness.

The latest GEM report on ASEAN shows (GEM 2016) shows (Figure 3.3), framework conditions for high-growth entrepreneurs in ASEAN are relatively good, albeit in recent decline. The figure below shows experts perception of different aspects, graded on the Likert scale (the higher the score, the better). Aspects above average, potentially the source of future comparative advantage, include physical infrastructure and services, cultural and social norms, internal market dynamics, and perhaps, if the positive trend continues, entrepreneurial education.

As with most indicators, this varies significantly from country to country – with Singapore, Malaysia, and Thailand scoring well, and Cambodia, Lao PDR, Myanmar towards the bottom of the rankings. The difference is more pronounced when looking at factor conditions relevant to the ICT-enabled activities a large portion of HGEs engage in. The World Economic Forum's Networked Readiness Index finds that only Singapore, Malaysia, and Brunei Darussalam currently rank among the world's top 50 countries for the quality of their digital environment and the extent of their technology usage. Lao PDR comes in at 104th place out of 139 economies; Cambodia – 109th; and Myanmar – 133rd.

Figure 3.3. Expert evaluation of ASEAN framework conditions for entrepreneurship



Source: GEM 2016

As with most indicators, this varies significantly from country to country – with Singapore, Malaysia, and Thailand scoring well, and Cambodia, Lao PDR, Myanmar towards the bottom of the rankings. The difference is more pronounced when looking at factor conditions relevant to the ICT-enabled activities a large portion of HGEs engage in. The World Economic Forum's Networked Readiness Index finds that only Singapore, Malaysia, and Brunei Darussalam currently rank among the world's top 50 countries for the quality of their digital environment and the extent of their technology usage. Lao PDR comes in at 104th place out of 139 economies; Cambodia – 109th; and Myanmar – 133d.

Approach 3: Enhancing economic opportunities amongst marginalised groups

Entrepreneurship promotion takes on a distinctly social approach in majority of AMS, and few countries, SME policy is predominantly used as a means to fulfil social policy objectives. Consequently, there are numerous examples of initiatives across the region to engage women, youth, and PWDs in entrepreneurship in response to labour market challenges, poverty alleviation objectives, to promote social inclusion and achieve gender equality.

In the region, AMS are consequently relying on a gender mainstreaming approach to women's entrepreneurship development (OECD 2017). The Philippines is the only ASEAN country to have implementation formally fall under the lead SME agency, the Department of Trade and Industry. Women entrepreneurs in ASEAN have access to general SME support activities provided by governments, and the up-take of these services by women is relatively high in countries like Malaysia and Singapore.

Specifically for *youth*, many AMS recognised that youth entrepreneurship can be a policy tool to address issues of youth employment, social inclusion of disadvantaged youth, and informality within the labour market; and that in addition young people are capable of creating high-growth business ventures which may contribute to economic growth through innovation and job creation. Governments are also empowering and giving formal mandates to youth associations to carry out entrepreneurial activities.

Specifically on the *PWD*, nearly all AMS have laws and action plans to protect and enhance work and employment prospects for PWDs. Within ASEAN, Malaysia offers an array of support activities that range from start-up support, to export market access, to ICT training.

Conclusion: common and divergent themes

AMS have been going through a process of rapid change, economic growth and a number of structural challenges. Although many have been benefiting from the process of economic growth, the issue of poverty, income disparities and lack of support mechanisms for some marginalised groups is still an issue in some parts of ASEAN. Generally AMS often adopt an open policy-mix, combining elements from those three different approaches or adopting distinct approaches for each segment of the SME population with various levels of intensity. Each AMS has its own pace for integrating the issue of inclusiveness and has different issues they are focusing on.

AMS have also been catching up over the last years with the initiatives to tackle issues of productivity and innovation, and clearly these subjects have been high on the agenda of all of the AMS in the region. At the same time the region has achieved yet limited progress or uneven progress in the areas of promoting social entrepreneurship as well as entrepreneurship for marginalised groups. Similarly, few AMS have embarked on strategic approach to promote SMEs greening. By further promoting all three areas affecting inclusivity, ASEAN could move ahead with the development of a more inclusive society and region.

Throughout the literature it has been noted that it is challenging to have access to comparable data across the region, and hence it is advised to promote comparison tools allowing policy-makers across the region to learn from each other and develop more efficient policies. Tools like ASEAN SME Policy Index could not only help policymakers gain a better understanding from the policies applied by their peers, but also have a better understanding of the current situation in each AMS through dedicated and more regular data collection efforts.

Inclusive Productivity and SMEs

This section provides a summary of initial work undertaken by the OECD's Directorate for Science, Technology and Innovation (DSTI) as part of the Canada-OECD Project for ASEAN SMEs (COPAS). It is based on the interim report on "Encouraging SME productivity in the ASEAN region", which was presented at the 8th Meeting of the Regional Policy Network on SMEs in Manila in October 2017 to the ASEAN Coordination Committee for MSMEs (ACCMSME).. A final report will be completed by early 2019, and will be complemented by a separate study by the DSTI, also funded under COPAS, that will examine the bottlenecks related to the access and use of digital services by SMEs in Southeast Asia and identify good practices to help the digital transformation flourish in the region.

This work contributes to the SEARP Regional Policy Network on SMEs as well as to the SEARP Innovation Initiative.

4. Inclusive Productivity and SMEs

Productivity and inclusiveness are tightly linked. Recent analysis has revealed large productivity gaps between global frontier firms (the 100 most productive firms each year in each industry at a global level) and the rest, with this gap growing over time (OECD, 2015-FoP). At the same time, there has been a steady increase in wage dispersion, attributed mostly to differences in pay across firms operating within the same sectors. The evidence suggests that sectors in which the distribution of productivity becomes more polarised over time are also sectors in which wages polarise (Berlingieri, Blanchenay and Criscuolo, 2017); in other words, there is an important productivity-inclusiveness nexus, with critical implications for policy makers seeking to boost growth and well-being in their economies.

The rising gap in productivity growth between firms at the global frontier and other firms suggests that the capacity of other firms to learn from the frontier has diminished, and that the diffusion of technology and knowledge is not sufficient. Given the link between productivity and wages, and the fact that small- and medium-sized enterprises (SMEs) weigh heavily in most countries' firm population and employment profiles, it is clear that policy makers interested in boosting inclusiveness must look carefully at policies to improve diffusion as a way to strengthen productivity in their country's SMEs.

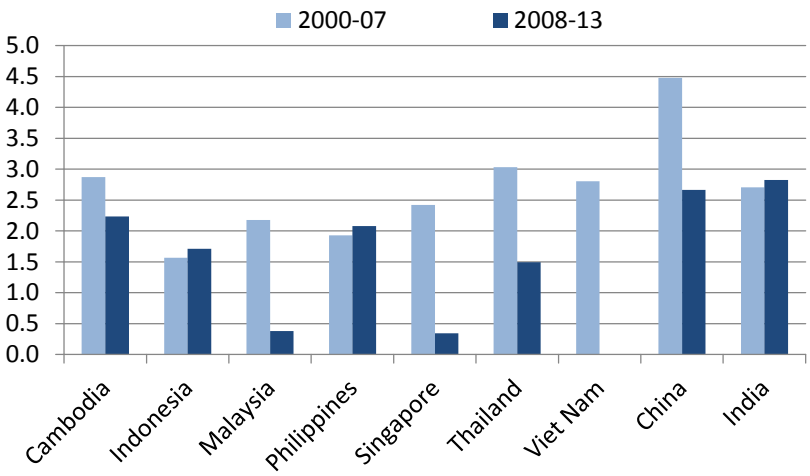
This backdrop provides strong motivation to OECD work on enhancing SME productivity in the ASEAN region, undertaken as part of the COPAS project and for which an interim report was presented at the 8th Meeting of the Regional Policy Network on SMEs in Manila in October 2017. The current chapter sets out some of the initial analysis and findings of the work on SME productivity, focusing especially on new evidence on SMEs' productivity performance in two ASEAN countries and on technological change (including digitalisation) and global value chains (GVCs) as important drivers of productivity.

A final report will be completed by early 2019, and will be complemented by a separate study under COPAS that will examine the bottlenecks related to the access and use of digital services by SMEs in Southeast Asia, as well as identify good practices that will enable the digital transformation to flourish. Both these studies will contribute evidence and policy considerations for building greater inclusiveness in ASEAN economies.

4.1. Productivity performance in ASEAN

At an aggregate level, productivity growth has slowed across much of the ASEAN region since the 2007-2008 economic crises. While economic growth is expected to be favourable over the near- to medium-term, the slowing of productivity growth is a downside risk, especially for those countries that are experiencing decreasing returns to traditional growth drivers such as factor accumulation and favourable demographics (OECD, 2017-EO).

Figure 4.1. Annual growth in multi-factor productivity in Emerging Asia



Note: Multi-factor productivity data not available for Brunei Darussalam, Lao PDR or Myanmar. Annual growth in multi-factor productivity in Viet Nam for the period 2008-13 averaged zero.
Source: OECD (2017-EO), based on APO (2015), *APO Productivity Database 2015*, www.apo-tokyo.org/wedo/measurement.

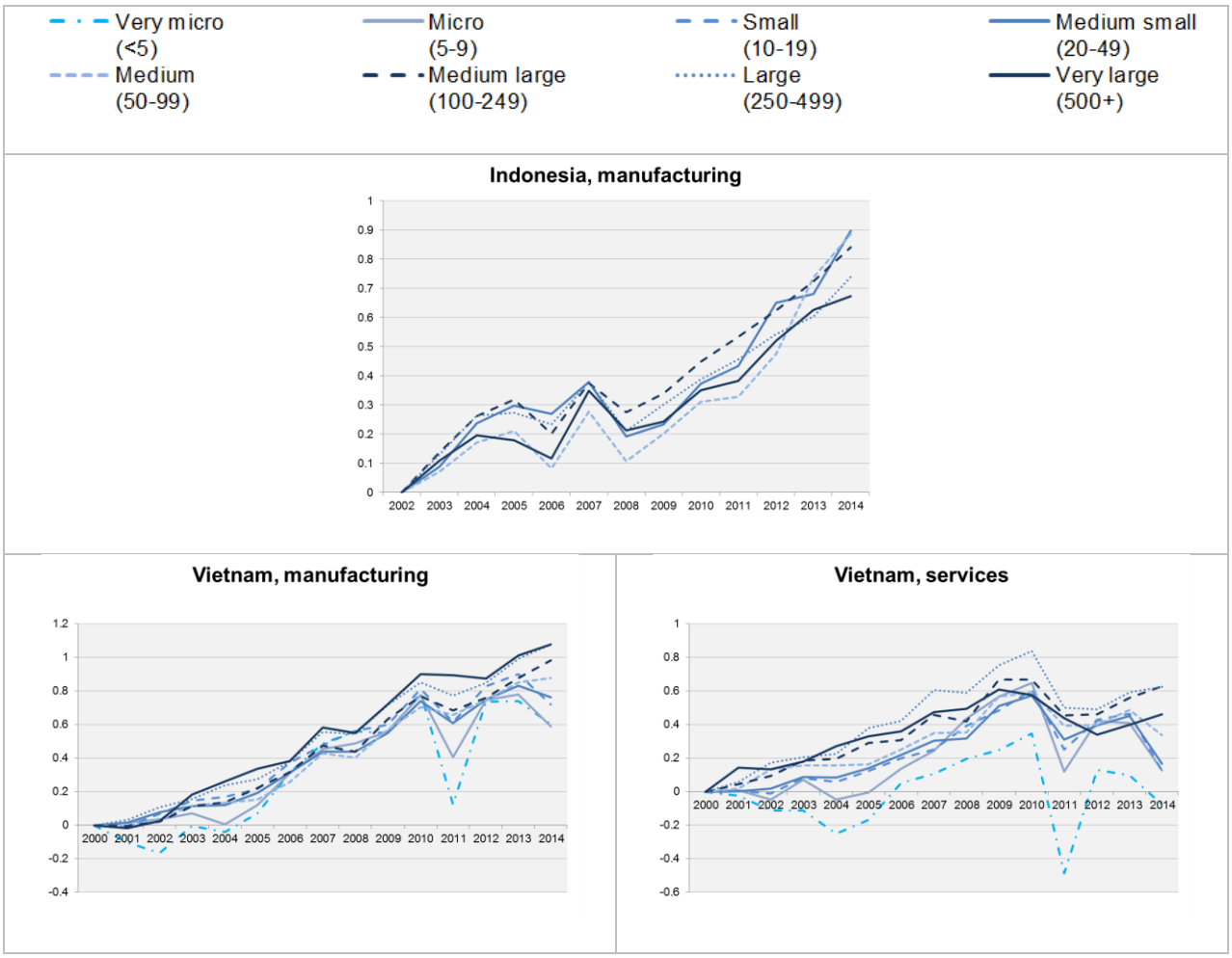
SMEs account for the vast majority of enterprises in SEA countries (92-99%) and employ the bulk of the workforce (58-91%), although they account for only around a third of value added or exports (Lopez-Gonzalez, 2017). Understanding more about the productivity performance of SMEs in SEA is therefore critical for policy makers seeking to improve overall productivity in the ASEAN region.

To look at the contribution of SMEs to productivity growth it is important to move from a macro-economic perspective to a more micro-economic one, where the contributions of individual firms can be taken into account. In this light, to examine SME productivity in ASEAN, the OECD has been working to incorporate ASEAN countries into its MultiProd project. MultiProd provides a comprehensive picture of productivity patterns across a large set of countries over the last two decades, based on annual firm-level data. To date, the OECD has integrated Indonesia (manufacturing firms only, 2002-2014) and Viet Nam (2000-2014) into the MultiProd dataset, and is keen to expand the coverage to other ASEAN countries which have appropriate data. For the countries involved, participation in MultiProd offers a rich base for analysis both at the country-level and across countries, and brings important insights into the productivity performance of firms and the effectiveness of various policy frameworks.

Interestingly, and unlike typical patterns in OECD countries, initial analysis of the Indonesian and Vietnamese data shows that firms in the bottom of the productivity distribution (i.e. the 10 percent of firms with the lowest productivity levels) and those with median productivity levels (i.e. at the 50th percentile) have outperformed firms at the top (the top 10 percent of firms, or the 90th percentile) with respect to labour productivity growth. The convergence pattern observed (especially for the median firm) is probably to be expected for emerging economies and points to a reassuring catch-up pattern, where firms with lower productivity levels are able to benefit from technology and knowledge from leading firms to strengthen their productivity performance. Unlike the experience in OECD countries, Indonesia and Viet Nam do not yet show a divergence in productivity between leading firms and others.

Furthermore, when disaggregating by firm size, the data show that labour productivity growth patterns are fairly similar in all size classes for both countries (Figure 4.2). In Indonesia, firms in all the available size classes (above 20 employees) displayed strong productivity growth over the period, with better performance of medium-sized firms. In Viet Nam, very micro enterprises (with fewer than 5 employees) experienced the lowest productivity growth, as well as a sharp decline in 2011 both in manufacturing and services.

Figure 4.2. Labour productivity growth (log), by size classes over time

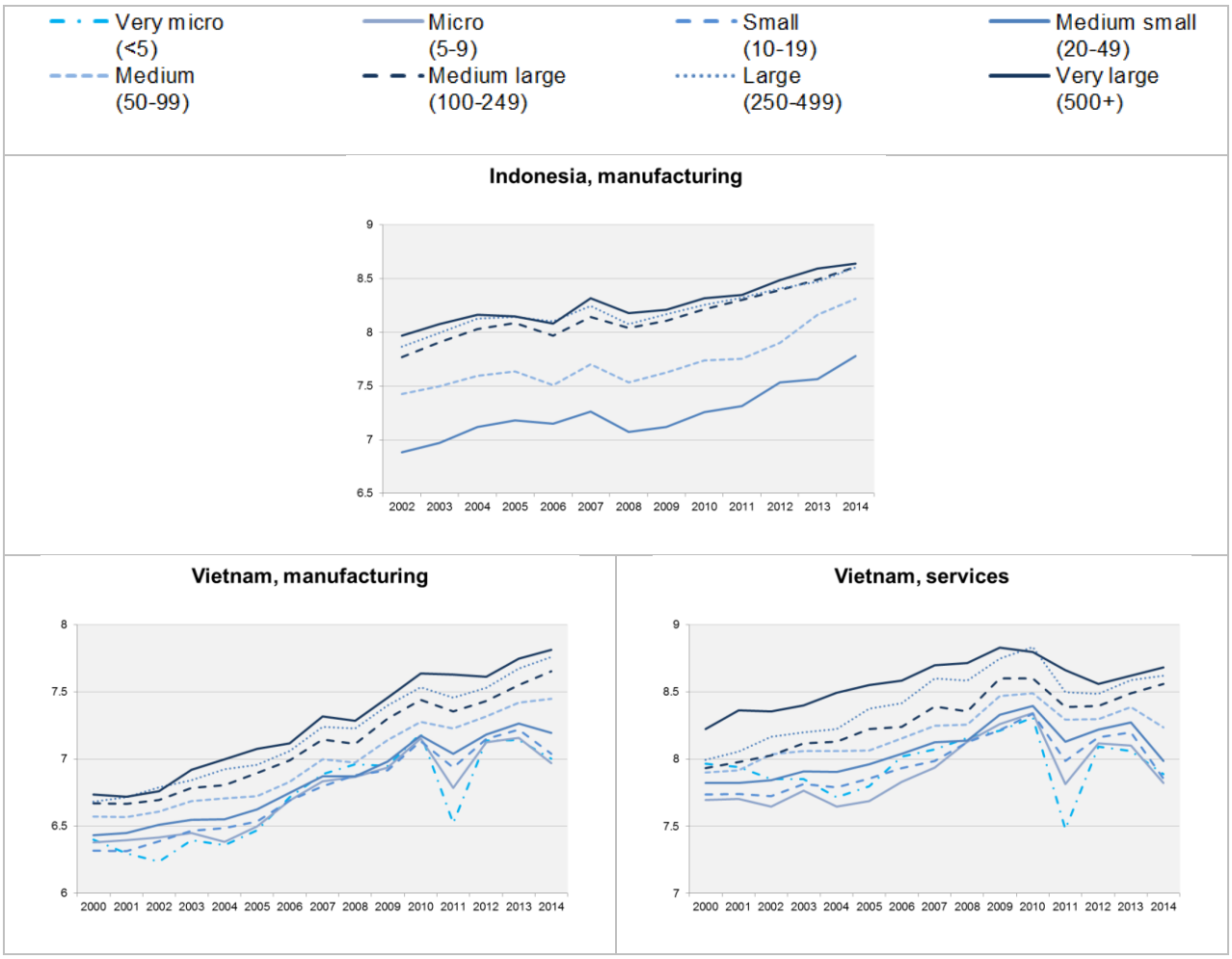


Source: OECD.

However, such productivity growth trends may mask large differences in the initial levels across different groups of firms. Figure 4.3 shows levels of labour productivity by different firm size classes. Here, the results show that productivity increases with size in both countries and sectors. In particular, productivity of SMEs (with fewer than 50 employees) is lower than that of firms of bigger sizes, with the gap staying rather constant (if not expanding) over time. The exception is the level of productivity of very small firms in Viet Nam, especially in the service sector. These firms were displaying a productivity level that, at the beginning of the period, was even higher than medium-

large firms. However, this productivity level advantage dissipated with very low growth over the period. This leads to very small firms displaying one of the lowest productivity levels in the last year of the sample.

Figure 4.3. Average labour productivity (log) by size classes over time



Source: OECD

These initial findings point to clear scope for improving the productivity performance of SMEs in Indonesia and Viet Nam. The OECD will continue to deepen its analysis of the Indonesian and Vietnamese data over the coming year and would welcome interest from additional countries in participating in the MultiProd project.

4.1.1. *Influences on productivity*

An important question is whether SMEs in SEA can benefit from ongoing technological changes and innovations in the global economy and strengthen their productivity performance. In broad terms, diffusion is boosted when firms can experiment with new technologies and business models; strengthen global connections, including through trade and participation in GVCs; invest in R&D,

skills and know-how that enables them to absorb, adapt and leverage new technologies; and benefit from an environment where scarce resources can flow to innovative firms (OECD, 2015-FoP).

This section focuses on technological developments (including digitalisation) and global value chains, as two critical influences on SME productivity that SEA policy makers must consider.

4.1.2. *Technological developments*

Many countries around the world are seeing the impact of next production revolution (NPR) technologies on their economies and societies. The NPR is driven by a confluence of digital technologies (such as 3D printing, the Internet of Things and advanced robotics), new materials (such as bio- and nano-based) and new processes (such as data-driven production, artificial intelligence and synthetic biology). As these technologies transform production, they will have far-reaching consequences for productivity, as well as employment, skills, income distribution, trade, well-being and the environment (OECD, 2017-NPR).

While the ASEAN region contains countries at different stages of economic development, successful absorption of NPR technologies could help raise productivity, speed structural transformation and stimulate sustainable economic growth. Indeed, some new production technologies are suited to economic conditions found in parts of the ASEAN region. For example, certain state-of-the-art robots are relatively inexpensive and do not require highly-skilled operators. And low-cost drone technologies could improve productivity in some agricultural processes. Especially with improved channels of knowledge diffusion, such as the Internet, opportunities for technological 'leapfrogging' could arise.

However, NPR technologies also raise the possibility of economic disruption in ASEAN countries. As the technologies lead to a realignment of relative costs and the development of new business models, the low wage advantage of many ASEAN countries may be eroded. Proficiency in NPR technologies may be the only route for many enterprises in ASEAN countries to withstand competition from technologically advanced foreign companies. Developments in China are also likely to play a role. Aside from the fact that China accounts for the leading share of global manufacturing output, China's goal of increasing the knowledge content of domestic production will expose ASEAN producers to acute competition, while also presenting opportunities for diffusing new production technologies in ASEAN markets through Chinese FDI. The more that ASEAN governments understand how production could develop, the better placed they will be to attract FDI that brings NPR technologies with it, to successfully diffuse NPR technologies across the productive base and, in a few cases, to play a role as technology producers.

4.1.3. *The digital transformation*

Digital technologies have particular scope for spurring innovation and productivity growth across many activities, transforming public services, and improving well-being as information, knowledge and data become more widely available. In Southeast Asia, the digital transformation could help in changing the development paradigm towards growth that is driven less on the demand side by exports and more on the supply side by productivity increases, enabling countries to "move up the value-chain". Already the uptake of digital technologies has grown rapidly, with over 80% of adults now connected to the Internet in Singapore, and around 20% in Lao PDR and Cambodia (OECD, 2017-SE). The rapid diffusion of mobile broadband, in particular, is enabling more people to connect to digital networks and digital services.

Box 4.1. Technologies driving the digital transformation

Digital technologies have come a long way since the invention of the first computer during World War II and the emergence of the Internet in the 1990s. Some of the key technologies and applications that are driving the digital transformation today include (OECD, 2016-STIO):

- The smartphone: The introduction of the smartphone in 2007 transformed computing by enabling constant mobile connectivity and providing individuals with access to a wide range of new applications and services. It has also enabled the development of the "platform" economy.
- The Internet of Things (IoT): The IoT comprises devices and objects whose state can be altered via the Internet, with or without the active involvement of individuals (OECD, 2015-DDI). The networked sensors in the IoT serve to monitor the health, location and activities of people and animals and the state of production processes and the natural environment, among other applications (OECD, 2016-IoTp).
- Big data analytics: Big data analytics is defined as a set of techniques and tools used to process and interpret large volumes of data that are generated by the increasing digitisation of content, the greater monitoring of human activities and the spread of the IoT (OECD, 2015-DDI). Firms, governments and individuals are increasingly able to access unprecedented volumes of data that help inform real-time decision making.
- Artificial Intelligence (AI): AI is defined as the ability of machines and systems to acquire and apply knowledge and to carry out intelligent tasks, e.g. sensing, processing oral language, reasoning, learning, making decisions and demonstrating an ability to move and manipulate objects accordingly. AI is making devices and systems smart and empowering new kinds of software and robots that increasingly act as self-governing agents, operating much more independently from the decisions of their human creators than previously.
- Blockchain or distributed ledger technology (DLT): Blockchain or DLT enables protocols for value exchange, legal contracts and similar applications. It is a distributed database that acts as an open, shared and trusted public ledger that cannot be tampered with and that everyone can inspect. The technology offers the potential for lower transaction costs by removing the necessity of trustworthy intermediaries to conduct sufficiently secure value, legal or other transfers.

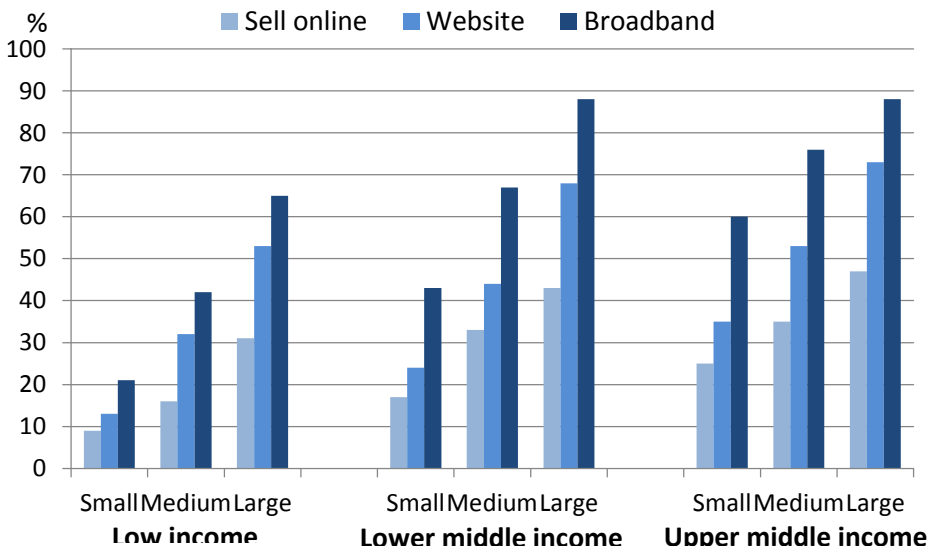
Many other technologies underpin the digital transformation that is currently underway - some with applications in almost all sectors of the economy (true "general-purpose" technologies); some with more narrow applications in specific sectors. But together, they underpin a wide-ranging and rapid digital transformation of economy and society, which are fundamentally different from the analogue era that we are used to.

SEA SMEs could gain substantially from harnessing the potential of digital technologies. In OECD countries, almost no business today is run without ICTs and most businesses in advanced economies now have access to the Internet and have developed a web page. Digitalisation is creating new economic opportunities, allowing firms of all sizes to access new markets and bring new products and services to consumers. It can help reduce transaction costs and enable more goods and services to be delivered remotely. Moreover, enhanced productivity of enterprises thanks to greater ICT use helps them to succeed better in domestic and foreign markets. Digital trade also opens opportunities for entrepreneurship, innovation and job creation, and digital tools can help SMEs overcome barriers to their growth, by facilitating payments, enabling collaboration, avoiding investment in fixed assets through the use of cloud-based services, and using alternative funding mechanisms (e.g. crowdfunding).

However, outside OECD countries, business uptake of digital technologies is often still much lower. Moreover, the use of more sophisticated applications, such as cloud computing, has a much higher variation across countries, with SMEs lagging significantly in many (Figure 4.4). In terms of connectivity, while over 25% of inhabitants had access to fixed broadband networks in Singapore in 2016, less than 1% did so in Myanmar, Lao PDR and Cambodia. Access to digital networks through mobile networks is much more widespread, however, with 43% of Asia-Pacific inhabitants possessing a mobile broadband subscription (ITU, 2016).

The policy response to the digital transformation has been mixed. Certainly SEA countries differ substantially in their starting conditions for the digital transformation, such as the level of economic development, the structural make-up and trade specialisation of the economy, geography, and institutional characteristics and approaches to policy. Nevertheless, there are some common challenges that all need to address and the need to close the "Technology 4.0 - Policy 1.0" gap is one that is both urgent and would have significant payoffs for economic development and social inclusion.

Figure 4.4. Larger firms use the Internet more than small firms



Source: Hussain (2015), in World Bank (2016)

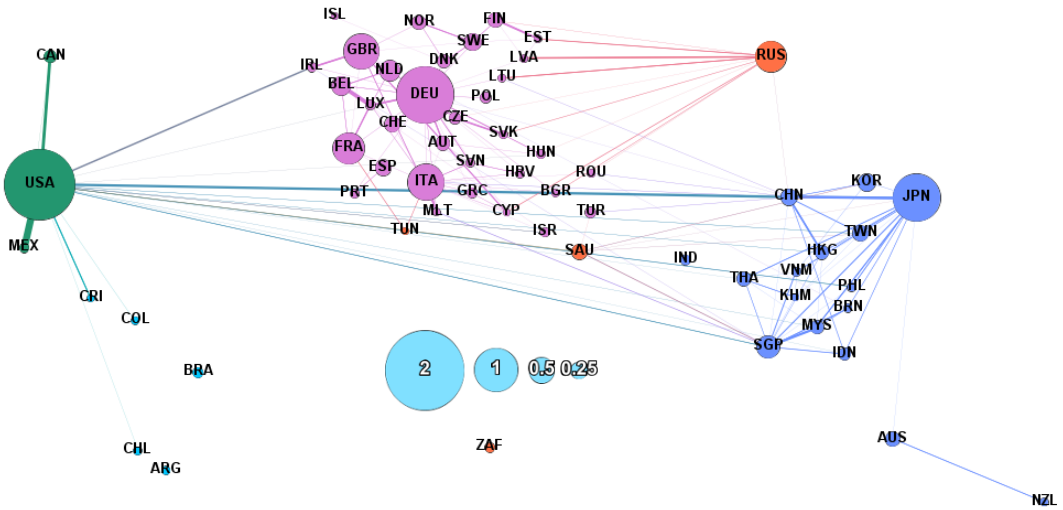
4.1.4. *Global value chains*

Over recent decades, developments in communication technologies combined with falling trade costs have facilitated the fragmentation of production across countries and the rise of GVCs, allowing ASEAN economies to become increasingly integrated into global production networks.

It is useful to analyse GVCs at a more granular level, however, as broad trends of increasing GVC participation can mask large changes in the organisation of Asian value chains, which have moved from being centred on Japan to increasingly turning towards China. One measure of this organisation is "centrality" within GVCs, where central hubs are those that are highly connected to other sectors and countries and are influential within global production networks. Conversely, peripheral sectors and countries exhibit weak linkages and so are less influential.

In 1995, a few key hubs dominated regional value chains: Asian value chains were predominantly centred on Japan, while Europe and North America were centred on Germany and the United States respectively as reflected by the size of the circles in Figure 4.5 (Criscuolo and Timmins, 2017). However, by 2011, although Germany and the United States remained dominant hubs within their respective regions, Asian value chains had undergone substantial reorganisation. Over 1995-2011, the position of Japan as a key hub within Asian value chains diminished substantially, while that of China rose.

Figure 4.5. Central and peripheral economies within GVCs - 1995



Note: Economies are placed according to their location. Node size denotes total (forward and backward) foreign centrality aggregated at an economy-level and includes all sectors within global production networks. Edges reflect direct input flows. For clarity only the largest input flows are reflected, those exceeding 2% of total inputs used in the importing or exporting economy. Calculated using the OECD Inter-Country Input-Output (ICIO) Database, 2015 edition
Source: Criscuolo and Timmins (2017).

More generally, there was a rising centrality and influence in GVCs of emerging economies within Asian production networks. Many of the economies in Asia that were relatively more peripheral in 1995 had become increasingly central by 2011. By 2011, influence within GVCs was much more evenly distributed across Asian economies, and there were strong intra-regional linkages within "Factory Asia".

Underpinning these aggregate changes were several developments at the industry level, reflecting the pivoting of some manufacturing industries from Western Europe and the United States towards emerging European and Asian economies and the increasing importance of services more broadly. These changes were particularly evident in digital sectors, reflecting a rise in importance of digital sectors in GVCs from emerging economies[7]. In ICT manufacturing, value chains in 1995 were

[7] Digital sectors reflect ICT manufacturing (ISIC rev.3 sectors 30, 32 and 33: Computer, electrical and optical products) and ICT services (ISIC rev.3 sector 72: Computer and related activities).

organised around a handful of central hubs in developed economies, notably the United States and Japan. However, these central hubs witnessed an almost universal and substantial decline in importance and a number of Asian economies saw large increases in centrality by 2011, not only China, but also Korea, Chinese Taipei and Malaysia. Indeed, China (20th in 1995) had replaced the United States as the most central economy-industry in 2011. In ICT services, in contrast, the period 1995-2011 saw this sector become more central in GVCs for almost every country, reflecting the importance of ICT services for global production as a whole.

This evolution of the position of countries in GVCs is important for productivity in SEA SMEs, as GVCs can present important channels for scaling up and gaining access to new knowledge that could improve business processes and competitiveness. It now appears that smaller firms, and those with lagging productivity performance, show faster growth in sectors that become central hubs of global production networks than in sectors on the periphery, and also in sectors with stronger linkages to faster growing foreign buyers or suppliers (Criscuolo and Timmins, 2017). In other words, centrality and being connected to more productive buyers may play a role in the catch up of non-frontier or smaller firms, if those firms can fully leverage these new sources of knowledge and technology. This implies an important role for policy, to ensure firms operate in a climate that enables investment in skills, management organisation, and new processes, and which enables resources to flow to innovative firms.

Ensuring that firms can respond in an agile manner is especially important given the broader technology changes taking place, described in the earlier section. New technologies, such as robotics, automation, additive manufacturing, artificial intelligence, could reduce the advantages of production in low-labour-cost emerging economies, hence curtailing the progress of international fragmentation of production (De Backer and Flaig, 2017). Many emerging economies will face the challenge of upgrading entire production systems for a future of interconnected production, which can be difficult to retrofit to outdated technologies (OECD, 2017-NPR). In addition, digital technologies like additive manufacturing and 3D printing, autonomous robots, big data, etc. may reduce the costs of small-scale customised production, incentivising production close to the destination market. However, any relocation of production will be moderated by growing demand in emerging markets.

Much of the focus on the future of GVCs has focused on the location of traditional production activities (such as assembly), but services and intangibles already account for the bulk of the value-added in production, and data will be central to 21st-century production. Global production networks are shaped by the quality and cost of services, including R&D, marketing, transport and logistics, finance, communication, and other business and professional services. These services are becoming increasingly important for GVCs in emerging economies, as well as the performance of domestic firms (Criscuolo and Timmis, 2017). Advances in technology may mean the future increasingly consists of international trade in services mediated through the transfer of data (designs, blueprints, software etc.) (De Backer and Flaig, 2017)

4.2. Policy issues and directions

The discussion above of technology development, including digitalisation, and the evolution of GVCs, raises a number of policy issues. What direction should SEA policy makers move in, in order to benefit from ongoing technological developments and boost the productivity of their SMEs? Below are some initial considerations, looking at how governments can begin to respond to the NPR and outlining the importance of enhancing digital connectivity and ensuring firms can take up the opportunities of digital technologies. These and other policy considerations will be further explored in the final report for the project.

4.2.1. *Responding to the NPR*

The range of policy issues relevant to the NPR is broad. Production is affected by many types of policy, from those on skills and training, to policies affecting domestic and international competition, to tax codes that affect investments in machinery and software, to policies which influence the efficiency of judicial systems and the effectiveness of bankruptcy laws, to policies on infrastructure and financial services. To begin to meet the challenges posed by the NPR, and to ensure that SMEs do not get excluded from the opportunities, ASEAN policymakers will need to design, implement, and in some areas coordinate, effective policies across such a broad range of themes.

Designing effective institutions for technology diffusion is one important area to consider. Institutions for technology diffusion are intermediaries, structures and routines that facilitate the adoption and use of knowledge, methods and technical means. Some of the institutions involved, such as technical extension services, tend to receive low priority in the standard set of innovation support measures. But there is evidence that they can be effective, if well designed, incentivised and resourced. An example of such an institution is Thailand's Industrial Technology Assistance Program (ITAP), which has been operated by the country's National Science and Technology Development Agency since 2001. ITAP's activities include information services, feasibility studies, technology acquisition, technology-business matching, networking, technical consultancy, industrial needs assessments, and a variety of dissemination activities (Shapira et al, 2015).

NPR-related financial services will also need strengthening in some SEA economies. Many emerging production technologies require large financial outlays. Investments in new technologies are often not limited to specific technologies but require a range of complementary expenditures. Investments in robots, for example, usually entail investments of similar size in peripherals (such as safety barriers and sensors) and system implementation (such as project management, programming, installation and software). Financing NPR investments can thus necessitate a range of financing institutions, such as venture capital firms and development banks, machinery-related term lending, and specialized SME and start-up lending. Such a breadth and depth of financial services is not equally available across the ASEAN region.

4.2.2. *Enhancing digital connectivity*

The digital transformation is an important part of the response to the slowdown in productivity growth than has occurred across much of the SEA region, helping to ensure higher incomes and stronger competitiveness in global markets. One critical factor is digital infrastructure, where wide access to efficient and reliable broadband communication networks is a key building block for the digital transformation. It is essential that governments promote investment in digital infrastructures and competition in the provision of high-speed networks and services, such as fibre networks, and ensure that key complementary enablers are in place (e.g. fibre optic back-haul, sufficient spectrum and increasing uptake of IPv6 Internet addresses). Fully benefiting from the NPR also requires comprehensive, reliable and secure telecommunications infrastructure, underscoring the importance of digital connectivity. Providing coverage to remote rural areas, a challenge in a number of ASEAN economies, will be essential to develop integrated markets, support the activities of SMEs and boost inclusiveness.

Regional cooperation on ICT, such as the ASEAN Broadband Corridor and inter-country projects, is increasing ICT connectivity in the region (ASEAN/UNCTAD, 2015). At present, low-cost, fast and high-quality broadband markets and infrastructure in ASEAN are concentrated in wealthy, urban, and/or coastal areas. Large differences exist in international fibre connectivity, domestic connectivity, competitiveness of telecommunications and Internet markets, fixed and mobile broadband infrastructure, and the affordability of broadband services (Ruddy and Ozdemir, 2013).

On some measures, such as international internet bandwidth, performance across ASEAN countries varies by a factor of 900.

4.2.3. *Taking up digital technologies*

While access to digital networks is necessary, it is not a sufficient condition for the digital transformation - people and firms need to be able to use the technology effectively. For firms, notably SMEs, a wide range of factors need to be addressed, notably skills; complementary investments in knowledge-based capital, including data, organisational capital and process innovation; as well as finance, taxation and regulation.

Greater use of digital technologies requires new skills. First, the production of digital products and services requires specialist skills in ICTs to programme software, develop applications and manage networks. Second, workers across an increasing range of occupations need generic and/or advanced ICT skills to use such technologies effectively. Finally, the diffusion of digital technologies is changing how work is done, raising demand for complementary skills such as information processing, self-direction, problem solving and communication. Generic ICT skills and complementary skills are also crucial to individuals' effective use of digital technologies in their daily lives. Effective skills policies are therefore important to help users make the most of digital technologies and also facilitate the transition from job to job.

It is also crucial that governments enable firms to invest in other knowledge-based capital (e.g. data, organisational change, process innovation) to help them realise the full potential of the digital transformation. A range of studies have shown that effective use of digital technologies relies on the degree and scope for organisational changes and process innovation within firms and organisations, as well as sound management and leadership. Closely related is the important role that governments continue to play in supporting the digital transformation itself, notably in undertaking or financing research on the underlying technologies or on key challenges affecting the digital transformation, such as security. The capacity of economies in Southeast Asia to engage in innovation is therefore important in determining the ability of countries to benefit from the digital transformation.

4.2.4. *Facilitating structural change*

Benefiting from the digital transformation not only depends on the diffusion of technology and the strengthening of capabilities within SMEs. It also requires structural change within ASEAN economies. This is because digital transformation of firms involves a process of search and experimentation with new technologies and business models, where some innovative SMEs succeed and grow and others fail and exit. Countries with a business environment that enables this process of creative destruction may be better able to seize the benefits from digital transformation than countries where such changes are more difficult and slow to occur.

In ASEAN economies, as in OECD countries, governments sometimes hamper SMEs' growth by imposing unnecessary regulatory restrictions. For instance, while it takes less than a day and only a few procedures to start a business in Singapore and Malaysia, it still takes more time in other ASEAN economies. Bad bankruptcy laws and contract enforcement may also translate into lower SME productivity. Young firms, which are typically small, have been found to be more volatile and more exposed to these national policy settings in developed economies (Calvino, Criscuolo and Menon, 2016). Moreover, unclarified property rights and complicated business registration processes may also impose additional challenges on SMEs (ERIA, 2014). Facilitating firm entry, growth and exit are therefore important for ASEAN economies. However, recent data suggest that the numbers of new business entries in ASEAN have stagnated over the last decade, with the exception of Singapore, raising concerns about the state of business dynamism (Asada, Nixon and Koen, 2017).

4.2.5. *Tapping into GVCs*

Access to finance is a key constraint to SME upscaling and their GVC participation. GVC participation often requires investment in product and process innovation to meet foreign standards and working capital to finance exports, but access to finance is a particular challenge for the upscaling of SMEs. This is particularly the case in less-advanced ASEAN economies, for example, due to inadequate protection of creditor rights, lack or centralised credit information systems or land registries or legal framework for non-bank sources of finance (ERIA, 2014). GVCs therefore highlight policies that address credit market imperfections and support development of complementary sources of financing, such as microfinance, leasing, factoring and venture capital (OECD and World Bank, 2015).

The informal economy means firms in ASEAN economies miss out on opportunities to access international markets. Informal sector firms are unlikely to be able to either access international markets directly, or as suppliers to exporters, due to the stringent quality and traceability standards required by foreign customers that cascade through their supply chains. In addition, informal sector firms face additional barriers to developing the scale needed to join GVCs, with limited access to formal sources of credit and services and these firms may intentionally stay small to avoid detection. However, the informal economy accounts for a large share of non-agricultural employment in some ASEAN economies: Indonesia (73%), the Philippines (70%) and Viet Nam (68%) (OECD, ESCAP and ADB, 2015). Policies that promote the transition to the formal sector, through reducing the complexity and cost of business registration, labour and product market regulations and taxation are all important.

4.3. Conclusion

ASEAN countries face a range of policy challenges in boosting SME productivity, ranging from the business environment, to engagement in GVCs, to within-firm factors such as innovation and skills, to the role of business dynamics. The OECD's interim report, on which this chapter draws, provided a preliminary assessment of key aspects to consider. Over the coming months, the OECD will further elaborate the report and develop policy recommendations, with a view to help ASEAN countries develop competitive, resilient and innovative SMEs that contribute to sustainable and inclusive development in the region.

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Driving Service Sector Reform in ASEAN: *Overview from the first Investment Policy Review of Southeast Asia*

This section was developed by OECD, Directorate for Financial and Enterprise Affairs by its Investment Division and provides an overview from the first Investment Policy Review of Southeast Asia. This publication has just completed its review by the OECD Investment Committee and will be released at the current Ministerial Conference on the 8th of March.

This work contributes to the SEARP Regional Policy Network on Investment Policy and Promotion.

5. Driving Service Sector Reform in ASEAN: Overview from the first Investment Policy Review of Southeast Asia

In spite of the success of AMS through sustained policy interventions, there are challenges on the horizon for Southeast Asia as it seeks to continue to attract and benefit from investment by multinational enterprises (MNEs). In many AMS in the past, success in attracting investors was based on partial openness for targeted investors, largely export-oriented ones. But many other emerging regions have moved beyond ASEAN in terms of openness and, as a result, six AMS are among the top ten most restrictive economies to FDI based on a sample of more than 60 countries covered by the OECD *FDI Regulatory Restrictiveness Index*. Furthermore, ASEAN faces the risk that growing automation will make wage costs an even smaller element behind investment decisions. Beyond cost factors, global investors and buyers are becoming increasingly attuned to potential reputational risks in situations where either the affiliate itself or a supplier is seen not to be acting responsibly. In an increasing number of home countries, multinational investors face legal obligations to address environmental and social impacts in their overseas operations.

The ability of ASEAN to continue to attract substantial FDI inflows is only one part of the challenge the region currently faces. Even more important is the need to increase the development impact of the investment received in terms of productivity and competitiveness, environmental sustainability and social inclusiveness. An OECD report on the investment challenges in four AMS prepared just after the Asian financial crisis suggested FDI policies had created distortions which hamper the traditional mechanisms through which foreign investors transfer technology and know-how to the local economy. As a result, indigenous capabilities had not been developed sufficiently (OECD, 1999). To some extent, the same is true today. Foreign investment has not always created linkages between foreign and local firms or led to the creation of a competitive domestic industry. Many AMS still depend in one way or another on foreign investors to sustain export growth.

ASEAN Member States generally recognise these challenges and are starting to address them. They are slowly moving away from a volume-based approach to investment promotion, with generous incentives and strong protection guarantees, to a more nuanced one where incentives are selective and designed to achieve specific outcomes rather than simply higher levels of investment. Standards of protection of investment are also becoming more clearly circumscribed to allow governments sufficient latitude to regulate in the public interest. Just as ASEAN took the lead in earlier decades in promoting FDI, so too now could the region take the lead in promoting responsible investment, together with a modern set of protection guarantees and some potential disciplines on the most generous forms of investment incentives.

This first *Investment Policy Review of Southeast Asia* looks at these common challenges from a regional perspective, building on country-level reviews undertaken so far of seven AMS which focus their recommendations on what each country can do to improve its investment climate. This review takes a broader perspective and considers regional solutions to common challenges and at the interplay between regional initiatives and national reforms. It focuses specifically on four components of an investment attraction and regulation strategy which are typically embodied to varying degrees in national investment-related legislation: investment incentives, investment protection, regulation of the entry and operations of foreign investors, and responsible investment. The review also includes a special focus on service sectors in ASEAN and at how further reforms could yield substantial benefits.

Foreign investors have limited access to key service sectors in many AMS

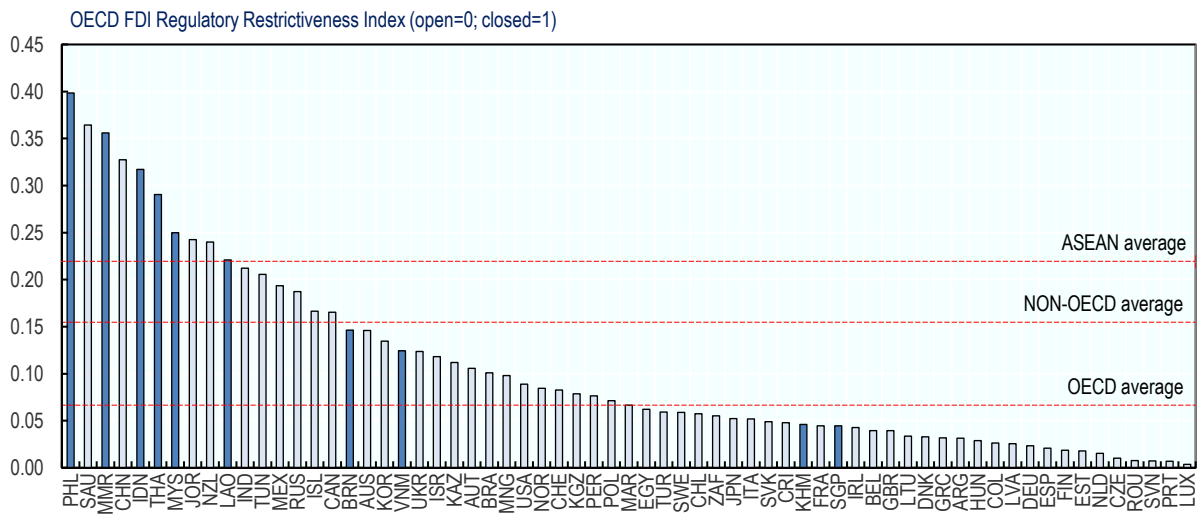
Despite the opportunities for inclusive growth and productivity, AMS have not yet reaped the full potential in services. In many ways, and in spite of wide diversity within the region, AMS remain trapped in traditional and low-productivity services – although progress has been made over the past decade. The average service sector share of GDP in ASEAN is around 50% which corresponds to the average contribution of services in low-income rather than middle-income economies. Given the importance of business services as inputs into advanced manufacturing production, it is particularly noteworthy that, with the exception of Singapore, AMS have not yet developed strong business services.

Foreign investors have limited access to key service sectors in many AMS

Services are also under-represented in FDI inflows, even if ASEAN has attracted increasingly larger investments in the sector over past few years. Excluding Singapore, the services share of FDI inflows into ASEAN over the past five years has been only 40%. For most AMS, the share of services in recent FDI inflows is below or at par with the share of services in the overall economy. Service exports are expanding but also remain below potential. In spite of the challenges of measuring productivity, efficiency and quality of services, labour productivity in services remains low throughout much of Southeast Asia, especially in backbone services. Partly as a result, the use of services in manufacturing production and exports is also relatively low.

The development of efficient services depends above all on a pro-competitive domestic regulatory environment, but liberalisation of FDI restrictions in service sectors can play an important complementary role. Services represent a diverse group of sectors, requiring country- and industry-specific policy solutions to domestic regulations. Market access barriers, on the other hand, share commonalities across service sectors. And unlike many other determinants of FDI patterns, such as market size or geography, restrictions are one element which governments have the power to change, and to do so relatively quickly.

Figure 5.1 OECD *FDI Regulatory Restrictiveness Index*, 2016



Source: OECD FDI Regulatory Restrictiveness Index database, ttp://www.oecd.org/investment/fdiindex.htm.

Services liberalisation remains an important challenge for achieving the ASEAN services integration agenda and its single production base aspirations. Entry restrictions in service sectors are still common across most ASEAN economies, usually in the form of foreign equity limitations. Cambodia and Singapore are very open to foreign investors, even compared to many OECD countries, and both have a relatively higher share of services FDI in their economies compared to many other AMS. Brunei Darussalam and Viet Nam have average levels of openness, while the remaining six AMS are among the restrictive among the more than 60 countries covered in the OECD *FDI Regulatory Restrictiveness Index*. In part because they started from a position of relative restrictiveness, some AMS have been among the biggest reformers since 1997 among all the countries for which a time series exists under the *Index*. First among these is Viet Nam which has reformed continuously and assiduously since *Doi Moi* in 1986.

Opening services would foster important domestic and foreign investment in telecommunications, logistics and financial infrastructure. While many advanced services can be imported in a world of increasingly digitalised consumer and production markets, core infrastructure services act as the glue to connect consumers and producers around the world. Their domestic availability is fundamental and their delivery by foreign services providers mostly requires a local presence. High quality and affordable infrastructure services would allow a wider access to goods and services for ASEAN consumers and producers (including SMEs).

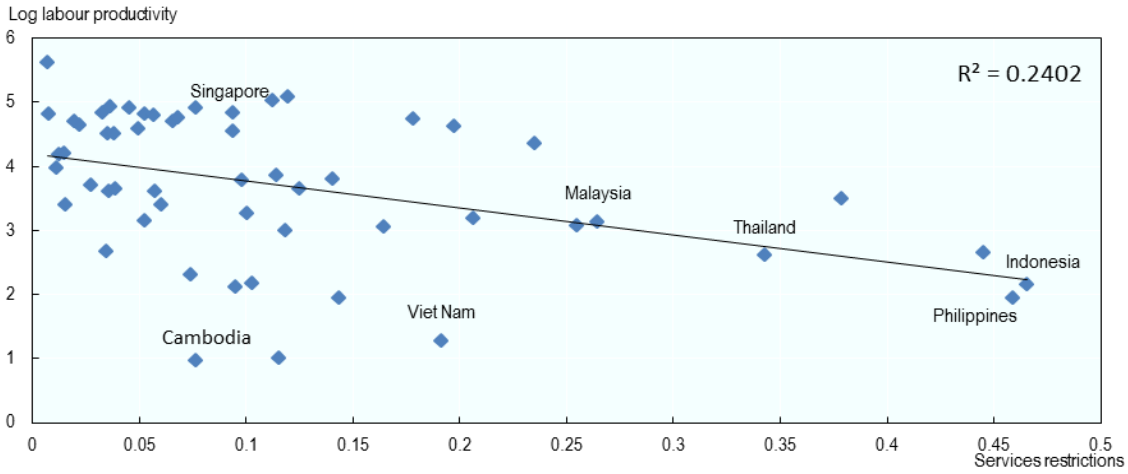
Competitive services can raise productivity, including in downstream manufacturing

The development of competitive service sectors has great potential to enhance inclusive growth and productivity. It can create productive jobs, enable access to goods and services for all parts of society as well as SMEs, and generate positive spillovers on manufacturing productivity in global value chains (GVCs). The role of services has increased over time for countries at all stages of development, contributing both to economic growth and jobs. A key driver of this shift has been the information and communications technology revolution and digitalisation, making services increasingly tradable, transportable and storable, and thus promoting productivity growth in services and downstream industries.

Despite the opportunities for inclusive growth and productivity, AMS have not yet reaped the full potential from the development of services which are generally still less well developed in AMS compared to countries in similar or higher income groups elsewhere, in spite of some progress. The productivity gap is particularly pronounced in backbone services such as telecommunications and transport. Underperforming services in many AMS impede exports, productivity growth and, importantly, the contribution of services to value added in manufacturing.

FDI restrictions constrain competition and contestability in service sectors and act as a barrier to raising service productivity levels. Further liberalisation could also help to raise efficiency in sectors still dominated by large state monopolies. Foreign participation can help to improve services efficiency and availability. High FDI restrictions in ASEAN service sectors have been found to be associated with low productivity levels in these sectors. Opening services for FDI could also have catalytic effects by creating opportunities for developing services that have not been available before and enable important knowledge and technological spillovers, not only in services but also in manufacturing and other sectors. It would also increase the use of high quality services in production and thus raise manufacturing productivity in ASEAN. Middle-income AMS exhibit a relatively low use of services in production and relatively low levels of productivity in manufacturing, compared to peers elsewhere. Both intensity of services use and productivity in manufacturing are negatively associated with services restrictions.

Figure 5.2 Labour productivity is lower in the presence of FDI restrictions in services



Note: Labour productivity is defined as value added per person employed in 1000 USD, in constant prices. Labour productivity data are not available for Brunei Darussalam, Lao PDR, and Myanmar.
Source: Authors' calculations based on OECD *FDI Regulatory Restrictiveness Index* and World Bank's World Development Indicators.

Ambitious international agreements can help to drive the reform agenda

Much of the reform progress in AMS has been unilateral, partly as a result of the intense competition for foreign investment in the region. Accession to the World Trade Organization was also an important driver for Cambodia, Lao PDR and Viet Nam, as these governments used the accession process to push forward a reform agenda.

At the regional and international levels, agreements such as the ASEAN Framework Agreement in Services (AFAS) and the ASEAN-Australia-New Zealand FTA (AANZFTA) have generally played more of a role in locking in standards of treatment and market access for covered services providers than in actually driving liberalisation. AFAS included relatively deeper liberalisation commitments, at least in some backbone services such as transport, but those commitments still mostly fall short in bringing ASEAN economies closer to levels of openness observed in advanced economies. Nevertheless, both AFAS and AANZFTA have achieved some positive results in terms of liberalisation but, overall, ASEAN agreements need to go deeper to provide the sort of catalytic liberalisation required to bring their overall level of restrictiveness closer to the average openness observed in other emerging regions.

Future agreements could become a force for further liberalisation by adopting a negative list approach. Although this approach is necessarily more burdensome, it could build on the negative lists already contained in national investment laws. The future ASEAN Trade in Services Agreement could also serve as a platform for AMS to further strengthen the agenda for co-operation, compatibility and harmonisation of services regulations across ASEAN which will ultimately be a critical factor in achieving ASEAN's single market and production base aspirations.

Investment protection regimes could be further streamlined

Many AMS were early adopters of bilateral investment treaties to provide added protections for covered foreign investments which was seen as a small price to pay at the time to attract needed

foreign capital and technology and access to global markets. In many regards, ASEAN stands as a frontrunner in investment-rule making innovations. 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 adopted over the past years. The progressive introduction of modern 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, which include promoting sophisticated arbitration mechanisms, increasing the awareness of the need to better delineate the scope of protection clauses in order to avoid any ambiguity and providing not only rights but also obligations for investors in investment laws.

While substantial discrepancies still arise in ASEAN countries' regulatory environments governing the protection of investment, AMS have made sustained efforts to move closer to achieving a more consistent and transparent legal landscape under the single ASEAN umbrella. Reform efforts are gradually paving the way for a more coherent and aligned regulatory regime for protecting investment. Through both domestic laws and international treaties, individual and collective efforts are progressively converging towards a regional, ASEAN-driven legal landscape.

Yet, more could still be done to streamline the regional network of existing investment treaties, where ASEAN-wide free trade agreements and bilateral investment treaties continue to coexist, adding layers of complexity to the overall regulatory environment for international investment in the region. In the regulatory harmonisation process that each AMS undertakes at its own pace, governments must also work towards more consistent overall legal regimes. They will ultimately need to fill gaps between protection guarantees given to domestic and foreign investors that are not justified by national development strategies. Unifying investment laws has helped countries to build more robust investment regulatory frameworks and signal a pro-investment stance, but it is only one way to create strong and consistent domestic regulatory frameworks. Bringing the future generation of investment agreements more in line with national investment policies will be equally important in creating strong and clear investment policies.

Furthermore, the issue of investor-state dispute settlement (ISDS) has become increasingly controversial in Southeast Asia as in many other parts of the world. To deal with this growing concern, AMS should consider further developing dispute prevention mechanisms, following what has been done in other regions.

Investment incentives are widely used in Southeast Asia and have been for decades

ASEAN Member States were among the first to employ incentives systematically to attract foreign investment, with most of the original six AMS introducing ever more generous incentives beginning in the late 1960s (Thomsen, 2004). Fiscal and non-fiscal incentives are now widely used in ASEAN to strengthen domestic and increase foreign investment.

Incentives are defined as measures to influence the size, location or industry of an investment project, by affecting its relative cost or by altering the risks attached to it. Incentive policies are among the few remaining tools at the disposal of policymakers in ASEAN to influence investment, in light of liberalisation of FDI policies, particularly in manufacturing. For some governments, it is simpler and more immediate to provide incentives than to correct deficiencies in infrastructure and labour skills, for example. Tax incentives may also be politically easier to deliver than other types of subsidies as they do not require additional funds.

ASEAN countries provide tax incentives widely across sectors and regions. Full income tax exemptions (or tax holidays) are used in all ASEAN countries, where the maximum length of time ranges from four years in Viet Nam to 20 years in Indonesia. Tax incentive schemes strongly reduce effective tax rates in all ASEAN countries, illustrating the magnitude of incentive competition. The wedge between the rate with and without incentives is above ten percentage points for each country.

Tax incentives can be costly…

International consensus on the effectiveness of different incentive instruments suggests that tax incentives that lower the cost of investment are preferred over profit-based tax incentives. Cost-based tax incentives comprise allowances lowering taxable incomes (tax deductions) or directly the taxes owed (tax credits). They make investment projects more profitable at the margin and are thus expected to attract new investment. By contrast, profit-based tax incentives (tax holidays or tax rate reductions) reduce the rate applied to incomes already secured. Profit-based tax incentives tend to attract mobile activities rather than long-term investment that are more likely to generate spill over effects.

Tax incentives can involve significant fiscal losses. Corporate income tax revenues are an increasingly important source of income for ASEAN governments; up to 35% of total government revenues in Malaysia. It is important to ensure that tax incentives and corporate income tax policies in general are not contributing to a disproportionate or unplanned strain on these resources. Tax incentives (particularly tax holidays) can impose significant fiscal costs on countries using them. In Cambodia, for example, the estimated revenue loss corresponds to approximately 6% of GDP, while in Viet Nam and the Philippines, tax incentives are associated with a revenue loss of around 1% of GDP.

…and there is little evidence that they are effective overall or in ASEAN

Overall, existing studies suggest that tax incentives play a limited role in attracting investment at the aggregate level. Tax incentives may be more effective if a strong investment climate exists (including good infrastructure, availability of skills, macroeconomic stability, and clear intellectual property rights). Incentives – and the tax burden more generally – is just one of many, and not always the most important, factor considered by potential investors when weighing up investment decisions. Stable, predictable and efficient tax administration may be more important than low tax rates and incentives.

Whether tax incentives are an effective tool to attract investment in Southeast Asia is unclear. Higher corporate tax rates are negatively associated with inward FDI in ASEAN, which is consistent with empirical studies[8] on the impact of tax rates on FDI, but there is little relationship between the generosity of incentives across ASEAN and the amount of FDI received.

Those AMS with the highest average effective tax rates (AETRs) are also among those with the highest AETRs after incentives. This suggests that incentives do little to affect the relative appeal of individual AMS and might help to explain why the distribution of FDI within ASEAN has changed very little over the past two decades.[9] Investment promotion agencies usually consider that they are competing not just against other AMS but also against other countries in Asia and elsewhere. But the importance of local and regional markets as destinations for sales by foreign affiliates suggests that many MNEs invest to benefit from proximity to those markets and hence are much less likely to consider alternate locations outside of the region.

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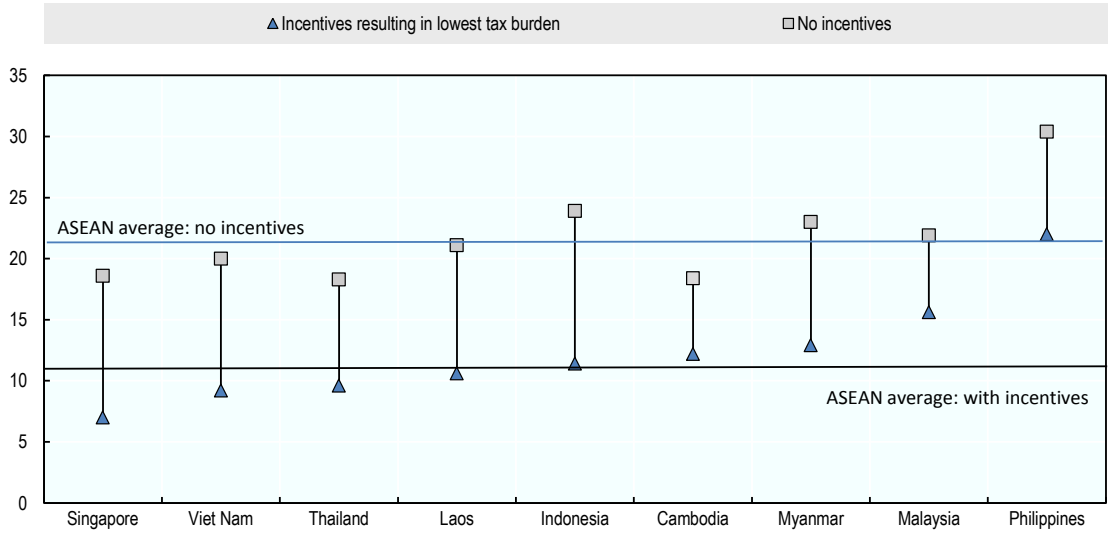
[8] Studies examining cross-border flows suggest that on average, FDI decreases by 3.7% following a 1 percentage point increase in the tax rate on FDI (OECD, 2008).

[9] Singapore and Malaysia together represent almost two thirds of the total stock of FDI, as they did in 1996 (although Singapore's share has increased at the expense of Malaysia); Indonesia, the Philippines and Thailand represent another 27%, compared with 28% in 1996; and CLMV countries have seen their share rise, but only from 5.8% in 1996 to 8.5% in 2016.

Figure 5.3 Incentive competition and race-to-the-bottom of corporate taxation in ASEAN



Source: Based on Wiedemann and Finke (2015).

Incentives should be more focused on achieving certain spillovers…

ASEAN Member States use targeted incentive schemes (such as tax deductions and tax credits) to promote and encourage investment activities that enable economic and social spillovers. Tax deductions allow firms to subtract certain expenses (e.g. on training programmes, R&D activities, capacity building of SMEs) or revenues (e.g. export revenues) from taxable income. Tax credits are similar but enable investors to use such expenses directly to reduce the amount of taxes owed. With the exception of Brunei Darussalam, all AMS have some targeting of specific regions either via special incentive provisions for less developed regions or additional incentives in special economic zones. More advanced countries within ASEAN, such as Singapore, Malaysia and Thailand, have a more nuanced approach to targeting, with specific tax incentives to promote SME linkages, skills, environmental protection, R&D, automation and high-tech activities.

International organisations and other institutions generally agree that more targeted approaches – both in terms of sectors and activities – should be preferred. Targeted tax incentives and their effectiveness are under-researched, but some evidence supporting targeted approaches is emerging. For example, investors optimise their supply chain and production strategies in GVCs by investing in cost-efficient locations. Evidence suggests that tax incentives are more effective if investors in GVCs can choose among locations with otherwise similar conditions. If investments are location-specific (e.g. in the case of natural resource extraction), they are likely to operate even without incentives. Moreover, targeted incentives for SME and supplier engagement, for example, have been demonstrated to be effective in Malaysia and Singapore.

Tax incentives in ASEAN should be increasingly targeted towards specific sectors and activities in line with development objectives. ASEAN countries could remove incentives in sectors that are not a priority for diversification and local linkages as well as in sectors that are known to be location-specific and therefore less sensitive to tax incentives (e.g. natural resources). Targeted incentives to promote specific policy objectives (e.g. environmental protection, R&D, SMEs and skills) could be strengthened. They require important administrative capacities however, and these capacities are still weak in less developed ASEAN countries.

Profit-based tax holidays and tax reductions should be phased out. ASEAN Member States could consider removing their tax holiday schemes, given that they are often associated with significant forgone revenue and are unlikely to foster broader development objectives.

…and better coordinated within and across countries in the ASEAN region

Tax incentives should be better coordinated within ASEAN countries, with an overarching institution responsible for guaranteeing that tax incentives fulfil sometimes distinct objectives of various government authorities. The Ministry of Finance as the tax authority is best placed to weigh different priorities, while also keeping costs of incentives manageable. Tax incentives including eligibility requirements may be prescribed and consolidated in one law, preferably the tax law. This would reduce the likelihood of conflicting or overlapping provisions, reduce uncertainty and unintended revenue losses, and diminish discretionary and distortive decisions on incentives.

Tax incentive practices should increasingly be discussed at the regional level. The ASEAN Secretariat and its Member States could develop a regional policy forum on smarter use of tax incentives. This forum could be informed by good practice examples from other regions, monitoring and analysis. A medium term objective could be to develop and agree on a code of conduct on the use, reporting and monitoring of tax incentives within the region. This would help increase transparency and cost-awareness over tax policy and incentives.

The use of incentives should also be better monitored and evaluated

Monitoring and re-evaluation of tax incentives is essential. The tax authority should regularly prepare tax expenditure statements to measure and monitor the costs of tax incentives and publish the results. This requires that investors file a tax return even if they are benefiting from a tax incentive. The tax administration should periodically carry out audits to ensure that tax incentives are not abused. Additionally, incentive policies should be reviewed to assess their effectiveness in helping meet desired goals. For this purpose, ASEAN countries could make incentive policy temporary rather than permanent, requiring regular reconsideration whether an incentive should be continued, reformed or repealed.

RBC influences the long term competitiveness of an investment destination

The social and environmental benefits of foreign investment are enhanced when investors uphold host country laws even when they are not effectively implemented and go beyond the requirements of host country laws when they do not adequately reflect international expectations. Expectations about responsible business conduct (RBC) are growing and are increasingly being reflected in international agreements and in home country legislation. AMS have made efforts to address responsible investment, both through the implementation of the AEC Blueprint which contains provisions on RBC but also at national level, such as through national action plans. These initiatives can not only bring about improved outcomes from investment in terms of broader value creation and sustainable development but can also help to position the region as a reliable location for production and safe sourcing by helping to reduce the reputational risks faced by investors.

AMS were early movers among emerging economies in this area…

ASEAN policymakers, in the tradition of leadership as early movers in welcoming FDI and promoting an export-oriented development strategy, have already recognised the importance of RBC in certain policy areas. This is true both at the regional level, as seen by the inclusion of RBC expectations in various ASEAN Blueprints, but also at the national level, even if specific government actions vary widely across the region. A promising trend has been the inclusion of RBC provisions in a recent wave of new investment strategies and laws, as well as the elaboration of comprehensive national action plans related to RBC.

But more could still be done to promote responsible investment in ASEAN

Nevertheless, more can be done to support and encourage responsible businesses and quality investment. Several objectives envisioned for the integrated ASEAN Economic Community will depend in large part on improving the business environment beyond investment liberalisation. While the export-oriented investment strategy implemented so far has made ASEAN one of the premier investment destinations in the world, in many cases it has not always led to lasting local capabilities. As ASEAN policy-makers continue to build a more resilient, inclusive, people-oriented and people-centred community, one integrated with the global economy, RBC can play a vital role in increasing absorptive capacity and participation in global value chains, while contributing to meeting the future competitiveness and skills challenges head on.

To further promote and enable RBC, ASEAN could develop a regional action plan in the context of integration in global supply chains which would set out an expectation for investors and ASEAN businesses to adopt RBC principles and standards consistent with international standards, such as those contained in the OECD *Guidelines* and UN *Guiding Principles*. Elements of RBC could also be included in investment incentives schemes.

Both national governments and the ASEAN Secretariat could clearly communicate RBC expectations to investors, including as part of investment promotion efforts on the Invest in ASEAN website and in supplier databases and matchmaking events. At the same time, policy dialogue among ASEAN members could be strengthened with a view to position ASEAN as a responsible investment region. The processes related to environmental and social impact assessments could be harmonised, clarified and strengthened, while encouraging early participation by affected stakeholders.

Governments in the region could also promote National Action Plans on Responsible Business Conduct in order to mainstream RBC across government agencies and as a way to prioritise and advance reforms needed to ensure an adequate legal framework that protects the public interest and underpins RBC.

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Availability of Risk Mitigation Instruments in ASEAN Member States

This section was developed by OECD Global Relations and Public Governance Directorate specifically for the ASEAN Connectivity Coordinating Committee of the Association of Southeast Asian Nations (ASEAN). This work was done within the framework of the ASEAN Connectivity Coordinating Committee's (ACCC) activities in coordinating and overseeing the effective implementation of the Master Plan for ASEAN Connectivity (MPAC).

This work contributes to the SEARP Regional Policy Network on Sustainable Infrastructure.

6. Availability of Risk Mitigation Instruments in ASEAN Member States

The ASEAN Connectivity Coordinating Committee of the Association of Southeast Asian Nations (ASEAN) mandated the OECD Southeast Asia Regional Programme's Regional Policy Network on PPPs to conduct a project on 'Access to Risk Mitigation Instruments for Private Infrastructure Investment in Southeast Asia'. The project was supporting the ASEAN Connectivity Coordinating Committee's (ACCC) activities in coordinating and overseeing the effective implementation of the Master Plan for ASEAN Connectivity (MPAC I). The report is based on ongoing OECD work on infrastructure and investments, along with numerous in-depth interviews and a survey on Project Risks and Mitigation instruments. Interviews have been conducted with selected public and private stakeholders, including: PPP units, Export Credit Agencies, EXIM banks, central banks, multilateral institutions, ministries, commercial and development banks, investors, project sponsors, private insurance companies, and construction companies. It has been carried out under the umbrella of the OECD Southeast Asia Regional Programme's Regional Policy Network on Sustainable Infrastructure.

6.1. Background

The OECD Economic Outlook for Southeast Asia, China and India 2016 identifies infrastructure investment as critical for most Member States of the Association of Southeast Asian Nations (ASEAN) to foster economic growth, reduce poverty and, in some cases, move beyond the middle-income trap.1 Growing populations, rapid urbanisation and increasing economic activity in the ASEAN region further increase the need for significant infrastructure investment. This chapter describes the infrastructure needs in ASEAN economies, national and infrastructure development plans and the persisting public financing gap.

Stronger private participation in infrastructure investment would strengthen infrastructure development by complementing insufficient public resources. National and regional development plans name public-private partnerships (PPPs) as an important procurement approach, however traditional infrastructure procurement will remain dominant. Furthermore, PPPs are no panacea and their selection should be based on value for money and an optimal allocation of risk.

Private participation in infrastructure is still relatively limited in ASEAN in comparison to other regions, and also varies widely among the ASEAN Member States. For instance, in Indonesia, Malaysia, the Philippines, Thailand, and to a lesser extent, Viet Nam, PPPs are increasingly used. Where the number of PPP projects is low, high perceived commercial and political risks in long-term infrastructure projects are cited as a major reason. Other risks mentioned by interviewed experts relate to political and governance frameworks such as complex and/or non-transparent procurement processes, as well as legal and institutional frameworks, along with limited public capacities to implement complex PPP projects. Further constraints include inefficient risk allocation and the lack of a national pipeline of bankable and financially viable projects. The different modes of private infrastructure participation and their contractual structures are discussed in more detail below.

Large-scale private infrastructure projects entail significant debt and equity financing needs. Access to financing for such large amounts depends on domestic capital markets, the development of which varies strongly between ASEAN economies. The liquidity of certain domestic markets, and of international capital markets, coupled with low long-term interest rates, should in theory provide a

satisfactory environment for financing private investment. In practice, access to debt and equity financing for PPPs is hampered by high levels of perceived, or actual, risks. Regional and East Asian banks have increased their exposure providing long-term commercial – rather than project – loans. These banks tend not to refinance these loans though are willing to keep them in their books due their perceived low risk profiles in the operational phase. However, an increasing volume of infrastructure loans might oblige banks to refinance these loans, as they approach country and single-borrower limits. The size of domestic capital markets and their risks/low ratings might constrain the ability to refinance loans on domestic and international capital markets.

Domestic credit and equity markets in most ASEAN economies have grown steadily over the past few years, however, remain small in comparison to other Asian economies. Domestic bond markets have deepened particularly in Malaysia, Thailand and Singapore, followed by Indonesia and the Philippines. The aggregated bond market of these five countries remains at USD 1127 billion in 2014, however, still relatively small in comparison to competing Asian countries. Private companies' access to the bond market might be even more limited, as government bonds dominate the market (at 70%) and state-owned enterprises (SOEs) might account for a high share of corporate bond issuance. The capitalisation of domestic equity markets in Singapore, Malaysia, Thailand, Indonesia and the Philippines has been increasing, reaching USD 2.37 trillion in 2014; however this market capitalisation represented only 3.4% of the global market and 10.5% of the Asia-Pacific region. These figures show that, despite progress made in deepening equity markets, ASEAN governments might wish to further develop domestic capital markets in order to ease access to financing.

Both international capital markets and well-developed ASEAN domestic capital markets should have been in a position to offer sufficient liquidity for financing private infrastructure projects over the recent years. Interviewed experts noted the contrast between different AMS: on the one hand, domestic capital markets in Singapore and Malaysia are sufficiently deep to finance large infrastructure projects and, in Thailand, the Philippines and to some degree Indonesia, smaller projects can be financed domestically. On the other hand, in Cambodia, Lao PDR, Viet Nam and Myanmar, access to local currency denominated loans is restricted, with investors having to rely mainly on international capital markets.

Despite the liquidity in international and domestic capital markets, relatively few PPP projects are currently underway in the region, which raises the question why available capital does not translate into realised infrastructure projects. For example, only 5.6% of global infrastructure projects were implemented East Asia and the Pacific in 2012.

To explain this paradox, recent studies have proposed a number of measures to promote private-sector infrastructure investments, including improvements to legal and regulatory environments and easing access to finance through improved availability to financial risk mitigation instruments. The need for the latter has been widely recognised on a global scale, for instance by the Camdessus Panel and the G8, which called for concessional risk mitigants and sub-sovereign lending to cover risks in crucial infrastructure investments. This report identifies the main project risks in private-sector infrastructure projects, along with the most effective risk mitigants applied in ASEAN economies. The analysis builds upon a comprehensive literature review, a qualitative survey and numerous interviews with experts from both the public and private sector, including: PPP units, Export Credit Agencies, EXIM banks, central banks, multilateral institutions, ministries, commercial and development banks, investors, project sponsors, private insurance companies and construction companies. Reflecting on the importance of political risk, the report assesses supply and demand for political risk insurance and guarantees, which are used to ease access to equity and debt financing.

Central to this report is the thesis that both commercial and political risks continue to act as major deterrents to debt and equity financing for private-sector infrastructure investments in the region,

hence the low levels of private participation in infrastructure investments that we observe on a sustained basis. Commercial and political risks constrain access to finance in a number of ways:

- *Commercial risks* relate to cash flow and return and can threaten the financial viability of a project. Our analysis finds that the main commercial risks relevant to private-sector infrastructure projects are construction and exchange rate risks, followed by counterparty, demand, and social and environmental risks.
- *Political risks* affect cash flow and the security of assets, and are of particular concern for investors and lenders in long-term and large-scale infrastructure investments requiring large upfront capital investments and with long payback periods. Our analysis finds that the main political risks relevant for private infrastructure projects are: adverse regulatory changes, breach of contract and non-honouring of (sovereign) financial obligations. In both our survey and interviews with experts, political risks were consistently mentioned as main constraint for investment decisions in infrastructure projects.

6.2. Key findings

This report makes the case for continued effort towards deepening capital markets and reducing risk levels in ASEAN economies, in order to offer investors more adequate access to secure finance, namely project finance. Without such access, implementing private infrastructure investments in emerging markets would face greater challenges. The availability of financial and legal risk mitigation instruments is crucial, particularly in countries with higher perceived risk levels. Encouraging investors to engage in long-term infrastructure projects will require both innovative financing solutions and strengthened institutional and legal protection frameworks for investment. Furthermore, new public support programmes such as the ASEAN Infrastructure Fund and the Asian Infrastructure Investment Bank promise to improve access to infrastructure financing.

The report started from the initial assumption that the 'infrastructure financing paradox' in the ASEAN region – high levels of available liquidity combined with few PPP projects – might be explained by higher perceived risks amongst potential investors and lenders in the region. Following the empirical research conducted for this report, several key findings of the report might help to form a more complete understanding of why ASEAN economies find themselves in this paradoxical situation:

1. **Commercial and political risks act as a significant constraint on equity and debt financing for private-sector infrastructure investments**. High perceived risk levels reduce the bankability of projects which depend mainly on stable revenue streams and safe assets as collateral. Perceived political risks also constrain private investors' willingness to make investment decisions for future infrastructure projects. The main perceived risks, based on the survey findings, are as follows:

    - The main **commercial risks** relate to construction and exchange rate risks, followed by counterparty, demand, and social and environmental risks. Whereas construction risks are perceived to apply across the region, exchange rate risks have greater prominence in countries, including Cambodia, Lao PDR, Myanmar and Viet Nam.
    - The main **political and legal risks** are adverse regulatory changes and breach of contract, followed by non-honouring of (sovereign) financial obligations and civil disturbance, terrorism or war.

2. **Risk mitigation instruments, if efficiently made available, can stimulate access to debt and equity financing**. Lenders and investors may deploy multiple strategies to reduce their exposure to, or lower the impact of risks. Financial risk mitigants such as insurance and guarantees, but also other instruments are reported as being effective in mitigating and transferring risks:

- For **commercial risks**, contractual arrangements are reported as the most effective strategy for transferring and mitigating risks, followed by insurance and public guarantees.
- For **political risks**, joint ventures or alliances with local companies, as well as political risk insurance (PRI), are reported to be the most effective instruments.

3. **Financial instruments for mitigating political risks are reported by interviewed experts as particular important.** Major constraints for private infrastructure investment include a 'lack of clear and stable legal and regulatory framework' and the 'capacity of the governmental counterparties' and 'Political risk'.

The growing importance of political risk cover can be observed in its augmented issuance whereby, **across the ASEAN region, demand for political risk insurance and guarantees strongly increased after 2007/08**, mainly driven by the need to ease access to debt financing. This increase in demand can be attributed to greater risk awareness following the global financial crisis, as well as the European debt crisis and political events since 2010. ASEAN countries can broadly be distinguished into four categories, according to interviewed experts:

- Countries where most commercial banks, especially larger Asian banks, feel comfortable with the perceived risk levels, hence usually do not require political risk cover: *Brunei Darussalam*, *Malaysia* and *Singapore*.
- Countries where political risk cover is required for certain infrastructure projects: *Indonesia*, *the Philippines* and *Thailand*.
- Countries where political risk cover is required for infrastructure projects: *Cambodia*, *Lao PDR* and – to a lesser extent – *Viet Nam*.
- Countries where investors and lenders perceive political risks to be high, hence almost always require political risk coverage: *Myanmar*.

By contrast, **the supply of political risk insurance (PRI) in certain ASEAN economies decreased in 2007/8**, mainly due to higher risk awareness amongst insurance providers and financial institutions. After 2008, supply started to increase again, but supply from private insurance companies varies between ASEAN economies which can again be distinguished into four categories, as follows:

- Countries where private insurance companies are willing to provide four-point PRI (cover for (i) breach of contract; (ii) expropriation; (iii) currency inconvertibility and transfer risk; (iv) unrest) for most infrastructure investments: *Brunei Darussalam*, *Malaysia* and *Singapore.*
- Countries where private insurance companies are usually willing to provide three-point PRI (which excludes breach of contract) for infrastructure investments, or four-point PRI (depending on involved stakeholders and sector): *Indonesia*, *the Philippines* and *Thailand.*
- Countries where most private insurance companies are reluctant to provide four- or three-point PRI: *Cambodia*, *Lao PDR* and, to some degree, *Viet Nam*.

- Countries where private insurance companies do not underwrite infrastructure investments, due to high perceived risks, lack of data and a missing track record: *Myanmar*.

The main significant gaps in the availability of political risk insurance and guarantees relate to specific cover for breach of contract and adverse regulatory changes, which also happen to be identified as the main political risks. In particular, such risks have been reported in Cambodia, Lao PDR and Myanmar.

4. In addition to private insurance companies, **bilateral and multilateral agencies provide political risk insurance**. Bilateral agencies, such as Export Credit Agencies (ECAs), dominate the market: Chinese SINSOURE and the Japanese NEXI, the two largest bilateral agencies, accounted for 77% of all PRI issuance from bilateral agencies, and 57% of total issuance (MIGA, 2014). Cover and costs from bilateral agencies depends on the projects risk level, is linked to national economic objectives and is tied to nationality. This might favour companies from countries with ECAs that are strongly engaged in the ASEAN region and may limit the degree of competition amongst international investors and lenders.

The report makes the key observation that **the availability of political risk insurance is most constrained in those markets where it is most required**. Ongoing efforts to reduce both levels and perceptions of political and regulatory risks should be encouraged to help address this issue. As part of this process, multilateral agencies can play an important bridging role, working with private-sector providers to extend cover in riskier environments.

5. **Strong and transparent institutional frameworks** have been reported by interviewed experts and in the survey as crucial to reduce risks and uncertainties for private lenders and investors. The framework has improved across the ASEAN region in the 2000s with the establishment of, for example, new PPP units and regulators. Yet further improvements are critical to reduce legal uncertainty and risks:

- Malaysia and the Philippines have established rather comprehensive institutional frameworks.
- Singapore has PPP policies in place and view PPP as a form of procurement approach but the institutional environment needs to be further developed.
- Indonesia and Thailand have recently established new institutions, but there remain challenges in their institutional frameworks.
- Viet Nam has recently taken significant steps to define an administrative framework for PPPs, but still needs to build its institutional capacity to support greater private participation in infrastructure.
- Cambodia, Lao PDR and Myanmar are in the early stages of establishing PPP programmes including frameworks. Lao PDR and Myanmar have yet to build their PPP agendas.
- In Brunei, there is no separate PPP-focused body.

6. Ensuring a **stable and clear legal framework** for investment, underpinned by consistent and clear rules, has been reported as paramount to reduce legal uncertainty and non-commercial risks for investors and lenders. Legal frameworks for investment are composed of two layers of legal

instruments, namely the international investment agreements (IIAs), and the relevant domestic legislation. The domestic legal and regulatory framework for investment encompasses the available dispute settlement systems, core guarantees of protection of property rights, such as the compensation in case of expropriation, non-discrimination between domestic and foreign investors and guarantees of free transfers of funds.

All ASEAN economies have progressively improved the treatment of investors by reinforcing core protection standards. For example, ASEAN economies have achieved a good level of protection of investment in case of expropriation, with some variations in the degree of protection against indirect expropriation:

- The Indonesian Investment Law provides that the government cannot take measures to nationalise or expropriate the proprietary rights of investors, unless provided by statutory law. The law specifies that compensation is based on the market value of the expropriated asset.
- In Malaysia, 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.
- In Viet Nam, the 2005 *Investment Law* protects against expropriation and defines the mechanisms for compensation.
- In Lao PDR, the legal protection against expropriation is in line with most accepted international standards. It states that protection is granted against government seizure, confiscation or nationalisation.
- Cambodia protects against nationalisation and is silent on methods of compensation.
- In Myanmar, the protection of investment still needs considerable improvements to meet ACIA standards and to catch up with the level of legal security granted in neighbouring countries.

6.3. Recommendations

Large disparities between ASEAN economies persist in terms of both risk environments and the availability of risk mitigation instruments. Working towards a lower-risk environment would ease access to risk mitigation instruments, finance and would encourage further private infrastructure investment in most ASEAN economies. In this regard, progress has been made, however further action is needed for ASEAN economies to realise their full investment potential:

1. ASEAN governments have progressively improved legal and institutional frameworks to incentivise private infrastructure investment. Improvements include strengthening the institutional PPP framework by, for example, establishing new PPP units and regulators. However, constraints on investments linked to the legal and institutional framework persist in certain countries. These frameworks are linked to two of the three main overall constraints reported in the survey: ’lack of clear and stable legal and regulatory framework’ and ‘capacity of the governmental counterparties’.

ASEAN governments are, thus, advised to further strengthen their institutional investment frameworks. More specifically:

- **Public authorities might wish to strengthen their understanding of and capacity to develop, procure and implement PPP projects.**

- **Regulators need to be sufficiently resourced and staffed** in order to conduct their responsibilities.
- **Clear responsibilities and authority** of involved authorities, such as PPP units in the MOF and line ministries, contracting and procurement agencies the central budget authority and the supreme audit institution.
- Strengthen the collaboration and exchange between **national and sub-national** government levels.
- **Greater public support for land acquisition** could accelerate the implementation of PPP projects.

2. Most ASEAN governments have progressively improved their legal frameworks for investment protection, thereby reducing legal and political risks. Improvements include a strengthened the rule of law, property rights and investor protection, as well as securing an accessible and efficient court system.

- Strengthening **legal protection** is likely to be one of the most effective ways of reducing investors' and lenders' overall risk perceptions in ASEAN economies with higher risk perception.
- **Red tape should be reduced** with regards to both regulations and the processes for applying for permits, licences and authorisations, in order to limit time delays, costs and uncertainties.
- Align domestic laws and regulations with the **ASEAN Comprehensive Investment Agreement** for ensuring investor protection, access to effective investor-state dispute settlement system, and non-discrimination, comprised of the principles of national treatment and most-favoured-nation (MFN) treatment.

3. Availability of financial risk mitigants for political risks is limited in certain ASEAN economies, particularly for cover against breach of contract and adverse regulatory changes, which could therefore be improved.

- **Governments might wish to promote competition in financial services** through, for instance, reducing regulatory barriers on market entry and limited foreign ownership. This might then also increase the supply of risk mitigation instruments whilst lowering their prices.
- **Government could further promote collaboration between private and public providers** of risk mitigants.
- Deeper and broader **domestic capital markets** could serve required financial instruments for risk mitigation, such as derivatives, futures and currency swaps.

4. **Financing for private infrastructure projects** depends on access to financing, which usually constitutes of bank lending and capital markets. Deep and broad domestic capital markets can be a source of locally denominated debt and equity financing. After the Asian Financial Crisis, several ASEAN economies successfully strengthened their domestic capital markets, yet disparities remain:

- In Brunei Darussalam, Malaysia and Singapore, domestic capital markets are reported as sufficiently deep and broad to finance large infrastructure projects.
- In Thailand, Philippines, and to some degree, Indonesia, projects of up to approximately USD 500 million can be financed domestically, with some interviewed experts even indicating larger amounts.
- In the CLMV countries (Cambodia, Lao PDR, Viet Nam and Myanmar), access to local currency-denominated debt from banks and on domestic capital markets is restricted. At the same time, access

to international capital markets is limited due to insufficient or expensive instruments to hedge against risks such as exchange rate risk.

- Overall, ASEAN economies might wish to further strengthen efforts to deepen domestic capital markets and improve access to regional and international capital markets:
- **Governments might wish to further strengthen domestic and regional equity markets** to ease access to equity financing for infrastructure projects. Well-functioning financial supervisory and capital market structures such as stock exchanges would strengthen the comparatively low liquidity of domestic markets.
- **Governments might wish to develop, or further strengthen, domestic credit markets.** Domestic debt capital markets like sukuk and bond markets could be a source of refinancing for infrastructure projects.
- As sources of long-term financing, debt and equity markets could benefit from the establishment of further national institutional investors such as pension funds. Policy lessons can be drawn from the experiences of countries such as Singapore and Malaysia, regarding the development of capital markets and required institutional frameworks.

5. Non- or limited recourse financing for infrastructure projects is commonly used internationally to finance large infrastructure projects, however its availability is limited in most ASEAN economies. Private-sector infrastructure investment is frequently financed through corporate loans. Single borrower and country limits might constrain infrastructure financing in the future, however, especially if countries succeed in expanding their pipeline of bankable, fiscally viable projects. **Governments might therefore wish to strengthen national and regional capital markets** to ease access to project financing.

   In summary, ASEAN countries can encourage greater private-sector infrastructure investment by deepening their capital markets, through enhancing project finance capacities, promoting innovative financing solutions and improving investor/lender access to political risk insurance instruments for a number of markets. Promoting institutional and legal protection standards will further help to encourage greater private-sector infrastructure investment.

Promoting Financial Inclusion in ASEAN countries

This report, which is expected to be published in 2018, is based on evidence and research conducted for the OECD-ADBI-SBV Conference on Financial Literacy and Consumer Protection held in Hanoi, Vietnam on 3-4 October 2017, co-organised with the Asian Development Bank Institute (ADBI) and the State Bank of Vietnam (SBV). The paper and the OECD contribution to the conference benefitted from financial support from the Japanese government.

This work could contribute to the SEARP Regional Policy Network on SMEs.

7. Promoting Financial Inclusion in ASEAN Countries

Financial education and financial consumer protection are essential ingredients in supporting financial inclusion, especially in the context of the advancement of digital financial services. An effective regulatory and policy environment can improve the supply of appropriate financial products and services to all and especially to those most in need, and encourage the use of new technologies in an inclusive way. A strong and responsive financial consumer protection framework can also promote trust and confidence in the financial system and significantly reduce the likelihood of consumer detriment. Financial education can also support inclusion by equipping individuals with the understanding of how financial products may benefit them, and providing them with the knowledge and skills to use financial products and services effectively and with a greater awareness of their rights and responsibilities in financial markets. This is especially relevant in ASEAN countries, many of which have low but rapidly increasing levels of access to financial services.

This report starts by investigating the current situation in terms of financial inclusion and financial literacy in ASEAN countries. Financial literacy levels in five ASEAN countries that participated in the OECD/INFE financial literacy survey – Cambodia, Indonesia, Malaysia, Thailand and Vietnam – are lower than average financial literacy in participating OECD countries and countries around the world. Financial literacy is especially low in Cambodia and Vietnam. In the five ASEAN countries, scores in financial knowledge and behaviour tend to be positively correlated with income and education levels in most countries, while there are hardly any gender differences.

Across the ASEAN, financial inclusion is relatively high in Malaysia, Singapore and Thailand, while it is quite low in Cambodia, the Lao PDR, Myanmar and Vietnam. Nevertheless, financial access has grown remarkably in Cambodia and Vietnam in recent years.

The report goes on to describe the policies and programmes developed to support financial inclusion, education and consumer protection. Across the ASEAN, Indonesia, Malaysia, Philippines and Thailand have dedicated strategies for financial inclusion. Indonesia, Malaysia and Singapore are implementing national strategies for financial education, in support of financial inclusion and financial consumer protection policies. National strategies for financial education are also under development in the Philippines and Thailand. Many ASEAN countries are in the process of developing and strengthening their financial consumer protection frameworks, and they vary in the degree to which financial consumer protection supports financial inclusion efforts at the national level.

In addition to these strategies and frameworks, a variety of public, private and not-for-profit stakeholders in ASEAN countries are active in supporting and delivering financial education programmes to provide information about basic financial products, including digital ones, increase awareness of related risks and more generally inform consumers of their rights and responsibilities in financial markets. Digital tools, such as videos and apps, are increasingly being used to engage young people and adults. Existing evaluation evidence suggests that there are effective initiatives, but the number of financial education programmes that are evaluated remains very small and the evidence is not always sufficiently robust to be used to inform new initiatives.

The report concludes with suggestions for policy makers in the region, including on the collection of evidence, on the development of integrated financial consumer protection and education frameworks to support financial inclusion, on the use digital financial services to improve financial inclusion while also addressing new challenges, on effective financial education delivery (including through digital tools) and on evaluating the impact of these initiatives.

Training Levies: What do they offer and how should they be organised?

This section was developed by the OECD, Centre for Entrepreneurship, SMEs, Regions and Cities. It is based on the survey conducted in April 2016 to explore the role of training levies in financing the expansion of vocational education and training in the region.

This work contributes to the SEARP RPN on Education and Skills Development.

8. Training Levies: What do they offer and how should they be organised?

8.1. The skills challenge in Southeast Asia

Economic growth in Southeast Asia will depend heavily on skills investment

Economic growth in Southeast Asia has been remarkable. Looking ahead, geographic location, an abundance of natural resources, diversifying economies, an expanding middleclass and a young population should in principle guarantee a bright economic future. But until now, much of the region's economic growth has depended on low wage industries, and despite increases, labour productivity in most countries remains low by OECD standards - often because of skills limitations (OECD, 2016a). Further growth will depend on more advanced types of economic activity, and therefore on a much stronger skills base to support economies as they move up the value chain. Greater investment in skills is therefore a necessity.

The skills challenge varies across countries

For low-income ASEAN countries, the emphasis lies on getting the basics right – ensuring that all children have access to high-quality secondary schooling and that they all achieve basic literacy and numeracy skills. For middle-income countries, attention to basic skills- alongside the development of technical and occupational skills- is needed; this includes post-school education and training. Countries with rapid economic growth also need measures to address the needs of the many adults who have missed out on secondary schooling that has now become routine for young people in those countries. Whatever the starting point, skills development is essential for countries to diversify and expand their economy. Singapore and Malaysia have actively promoted skills development through academic education, school-based and non-school vocational programmes and in-firm training (Mehrotra, 2015). Less developed countries in the region could adopt a similar approach to support industrial development and foreign direct investment (Koike, 1996; Kuruvilla, 1997).

Skills shortages and mismatches are common

Current trends indicate that by 2025, more than half of all high-skilled employment in Cambodia, Indonesia, Lao People's Democratic Republic, Philippines, Thailand and Viet Nam could be filled by workers with insufficient qualifications (ADB and ILO, 2014).Women could make a much greater contribution to the workforce as many of the ASEAN countries have substantial gender gaps in labour force participation – reaching 41 percentage points in Malaysia, 38 in Indonesia and 35 in the Philippines (WEF, 2016). In the face of these challenges, investment in education and training has become a key priority of development plans in the region (OECD, 2016a). The recent ASEAN Economic Community (AEC) Blueprint 2025 provides broad directions for the AEC from 2016 to 2025, and places human capital development at the heart of regional growth and integration (ASEAN, 2015).

There has been underinvestment in vocational skills

Gaps in the provision of vocational education and training (VET) are a major cause of skills mismatch. Education and training systems need to be aligned more closely with industry demand, especially in the fast-growing sectors that are critical to economic growth, and provide higher-quality jobs (Aring, 2015). Compared with other emerging economies, a relatively small share of students at the upper secondary level is enrolled in VET programmes. For example, Thailand has the

region's highest percentages of students enrolled in upper-secondary VET programmes at 34%, but this is still low compared to China where enrolment is 44% (UIS, 2016). Limited data exists on the share of post-secondary enrolment in VET versus academic higher education, but these also appear to be low in ASEAN countries.

8.2. Training levies as a possible response

Firms are doing little to compensate for limited initial vocational training

Lack of initial vocational education and training might be less critical if the shortfall were made up by subsequent occupational training. But employers, particularly those from small firms, provide limited on-the-job training to their employees. Even in more advanced ASEAN economies and among firms complaining of skill shortages, firms underinvest in training because of rapid restructuring, a poor investment climate, and the risk of newly trained workers being poached by competitors (Ra et al 2015).

One answer might be a training levy

While it makes sense to invest now in the skills required for future growth, the required investment often strains the public resources of developing and emerging economies. Training levies – whereby employers contribute to a fund dedicated to training – are used in more than 60 countries throughout the world and can offer a potential solution to this problem. Countries that make use of training levies are mostly in Latin America and Africa, but sectoral training funds for enterprise training are also common in Europe (CEDEFOP, 2008). Asia, particularly Southeast Asia, has relatively few training levy schemes, but those in Singapore and Malaysia are often regarded as strong examples for the region (Whalley and Ziderman, 1990; Dar et al., 2003; Johnson, 2009; Ziderman, 2003). Levies target three main population groups: young labour market entrants; the existing workforce; and adults in need of new skills. There are different economic rationales linked to targeting each of these groups.

Beyond the general rationales, training levies typically have multiple objectives

Training levies, and the way they are used to fund training, can have many additional objectives beyond the more general rationales. Levies may also aim to: 1) increase the revenue available for training; 2) encourage enterprises to invest more in training; 3) target training support to disadvantaged populations; 4) allocate funds according to employer priorities and market needs; and, 5) develop competitive training markets while fostering employer involvement and collaboration among stakeholders (Ziderman, 2003; Müller and Behringer, 2012). The OECD (forthcoming) argues that training levies should meet three main criteria:

Adequacy. The funds raised by the levy should be sufficient to cover the costs of the VET system and adapt to changes in resource needs over time;
Efficiency. A levy scheme must provide incentives (or sanctions) to minimise the administrative and compliance costs to stakeholders so that funds can be used efficiently;
Equity. It should help to improve equity between its stakeholders - *i.e.* employers, VET providers and students.

Levies sit alongside other policy instruments to support training

Governments use diverse instruments to support and encourage training. These include directly financing training through general government funds obtained from taxation (most initial VET systems are funded in this way); different forms of tax breaks that allow employers to offset

training costs against company taxation; and co-funding arrangements that allow government, employers, and trainees to share the costs of training. Other measures are not directly financial, but require or encourage employers to engage in training (such as targets for the percentage of trainees in company workforces). Many of these measures can complement training levies, or indeed, can be linked to a levy to obtain the required resources.

Both employer payments of the levy, and the funding of training have economic effects

Levies have two economic effects – according to how they raise funds, and how these funds are distributed and spent (expenditure). On the fund-raising side, a levy acts like a wage tax, but it can have distinct distributional or incentive effects according to the fund-raising rules. For example, in Singapore, the levy targets low wage paying employers- which may act as an incentive for them to increase wages (because ideally, the increased skills of their workers would justify an increase in wages). Very often, if smaller employers are exempt from a levy, they may benefit from the expenditure of the training levy. On the expenditure side, the effects are as diverse as the possibilities. In disbursement schemes the two economic effects are closely linked, since employers can directly or indirectly reduce the levy burden by undertaking training.

But they can also have non-economic effects

Levies, by design, are commonly intended to give employers a sense of ownership and involvement in training. This might be due to the employer's perspective that 'their' money is being channelled into training. For example, in disbursement schemes, employers have a direct incentive to train because they may be directly involved in managing the training fund and identifying training priorities. At an individual level, employers may even have to develop a training plan as a requisite to receive funding from the levy.

A training fund is a ring-fenced pot of money used to finance training, often supported by a levy

The funds obtained from training levies are typically channelled into a (more or less) dedicated training fund. Independent of any linked levy arrangements, training funds can sometimes unify diverse sources of training finance, foster engagement of social partners and other stakeholders and help match training to employer requirements (Johanson, 2009). Training funds are sometimes statutory, quasi-autonomous bodies, often under the general umbrella of labour ministries and directed by a governing board with varying degrees of representation by employers, trade unions and other stakeholders (Ziderman, 2003).

Purely sectoral levies have pros and cons

The advantage of sectoral funds is that there is more focused attention to the training needs of particular sectors. This can help address sector-specific skills shortages, and, therefore contributes to a greater sense of ownership among the involved enterprises (Johanson, 2009). Conversely, sectoral funds tend to lock up resources in one sector when national interest may require reallocation - either because of differential economic growth, or because some sectors are more efficient than others at using training (Johanson, 2009). Sectoral funding may also neglect the development of core skills which are transferable across industries, and may be ill-adapted to regional needs (Ziderman 2003; UNECVOC 2006; Johanson, 2009).

8.3. Training levies in Southeast Asia: the OECD questionnaire

8.3.1. *The OECD Questionnaire*

The OECD surveyed Southeast Asian countries

The levy systems of Singapore and Malaysia are well documented, but less is known about training levies in other Southeast Asian countries. The OECD conducted a survey in April 2016 to explore the role of training levies in financing the expansion of vocational education and training in the region. Table 8.1 summarizes the responses obtained from the questionnaire.

Table 8.1. Country responses to the OECD questionnaire on training levies in Southeast Asia

Country	Did country respond to the questionnaire?	Does the country have a levy system?	If not, are they considering a levy system?
Brunei	No	m	-
Cambodia	Yes	No	Yes
Indonesia	No	m	-
Lao PDR	Yes	Yes	-
Malaysia	Yes	Yes	-
Myanmar	No	m	-
Philippines	Yes	No	-
Singapore	Yes	Yes	-
Thailand	Yes	Yes	-
Viet Nam	No	m	Yes*

Note: The symbol m is used when the data is not available.
*While Viet Nam did not participate in the questionnaire, it appears that it has publically expressed interest in starting a training levy system as discussed in reports prepared by the ADB (2014) and UNESCO (2016).

- ***Philippines*** indicated that they did not have a training levy and cited that there would possibly be reluctance from companies to participate in a levy scheme.
- ***Cambodia*** reported that it is developing a National Policy on VET and hopes to establish a sustainable budget for VET by ensuring the participation and contribution of relevant stakeholders through public-private partnerships. The Cambodian delegate at the OECD's Southeast Asia Regional Programme Network (SEARPN) meeting in Cebu reported that the government is looking at the potential of training levies as a means to establish a sustainable funding base for skills development, however there is apprehension about the implementation challenges of these schemes. According to the respondent who completed the OECD questionnaire on training levies, there is concern that enterprises would prefer to train according to their own needs rather than by paying into a levy.
- ***Laos*** stated that it collected training funds through the use of levies. A policy review of VET in Laos in 2013 reported that: "According to Lao labour laws, firms should pay 1% and workers' pay 1.5% of their wages to the National Skills Development Fund (NSDF) managed by the Ministry of Labour and Social Welfare," as part of the 2010 Decree on VET and skills development (UNESCO, 2013). Through the levy, Laos aims to train or re-train workers, disabled people and other disadvantaged groups. However, the 2013 review found that there had been little progress in setting up the NSDF and discussions about the levy's implementation were ongoing. It was also noted that employers' organizations, in particular Chambers of Commerce, had not been involved in discussions at the time of the report.

- ***Thailand*** provides incentives to companies that train their employees through the Skill Development Promotion Act B.E. 2545 (2002). The Act established the Labour Skill Development Fund which promotes training efforts by granting a 200% tax deduction to enterprises for investing in skills development. The Fund aims to improve the skills standard of Thailand's existing labour force and is compulsory for companies with more than one hundred employees. Enterprises that provide staff with occupational training (approved by the Ministry of Labour) are eligible for certain privileges and benefits. The Act states that training should be organised on a yearly basis and provided to at least 50% of the company employees. The contribution to the Labour Skill Development Fund amounts to approximately 480 Baht per employee per year. In 2010, the amount of tax returned to enterprises for training totalled THB 936.71 million and 2.387 million people received training under the scheme (OECD, 2012). Research suggests that little was done to involve firms in the development of the Fund and the processes for approving training programmes and claiming the tax reduction are daunting (Ritchie, 2010).
- ***Viet Nam*** is placing a strong focus on reforming technical and vocational education and training as part of its objective to become an industrialised country by 2020. In addition to improving the quality and relevance of its training programmes, Viet Nam is considering a payroll levy to stimulate more enterprise-based training. However, the Viet Nam Chamber of Commerce and Industry has expressed doubts about whether employers would accept the levy and there are concerns about the potential bureaucratic burden and misuse of the fund's resources (ADB, 2014). Under the Skills Enhancement Project (SEP) with the ADB, a study to investigate the feasibility of an enterprise training levy in Viet Nam is under way.
- ***Indonesia's*** skills development strategy is focused on building a VET system. Workforce training seems to be used as a remedial and upgrading mechanism to address the deficiencies of the pre-employment education and training (Gropella et al, 2011). Some training programmes in Indonesia are supported by regulation passed in 1991 that requires firms with foreign employees to pay into a fund to provide education and training to Indonesian workers (ILO, 2016). Employers pay US$ 100 monthly per foreign worker, and the funds are channelled into the vocational training system (Allen, 2016). Given the vast need for training, and the government's funding constraints, more viable financing mechanisms are needed (Allen, 2016).

8.3.2. *Malaysia: integrating the needs of small and medium size companies while being sector specific*

Early policies encouraged training but had limited impact on smaller employers

After independence in 1957, Malaysia expanded basic education to promote national unity and social inclusion (Baker and Holsinger, 1996). Today, primary education is nearly universal and at 69%, net enrolment in secondary education has more than doubled since 1970; adults in 2010 had six more years of schooling on average than their counterparts in 1980 (UIS, 2016). Building on the expanded education system, Malaysia sought to link skills development to economic development. A double deduction incentive for training (DDIT), allowed employers to double their tax deduction for training expenses arising from either providing training themselves, or sending workers to approved training centres. This scheme tended to benefit larger firms that were already providing training to their workers, but failed to boost training for employees of small and medium enterprises (SMEs). In a survey of 1400 firms in 1989, only 300 firms reported making use of the DDIT scheme.

Introduction of the Human Resource Development Fund

In 1993 the Human Resource Development Fund (HRDF), linked to sectoral levies, was introduced The Human Resource Development Council, the body administering HRDF, is comprised of

employers, representatives from the Government and public sector agencies responsible for manpower development or training. It was tasked with the responsibility of developing the human capital needed to realise Malaysia's objective of becoming a high-income economy by 2020. Compared to DDIT, the new funding arrangements were marked by flexibility in terms of the training programmes, and a reduction in bureaucratic hurdles. The levy depends on the sector, the number of people employed and the amount of paid-up capital in the firm, but for some sectors, employers are levied at the rate of 1% of payroll. The funded training programmes are designed for each of Malaysia's core industries to ensure that training efforts are efficient and serve economic objectives. After the introduction of HRDF, the formal training in manufacturing enterprises rose from 47% in 1988 to 65% by 1998 (Tan, 2001). Between 1992 & 2006, 5.3 million workers were estimated to have benefitted from the reimbursement by HRDF, with firms recovering about 70% of the training cost incurred (Johanson, 2009).

The HRDF provides training incentives to employers, and a network of training providers to support training efforts within firms. The HRDF links skills development to national economic development goals, offering grants to employers for re-training; skills recognition (recognition of prior learning) and pre-employment training. Employers who have contributed for a minimum of 6 months are eligible to claim a portion of allowable training expenditure, and reimbursement rates depend on the type and amount of training. The HRDF emphasizes support for smaller employers through programmes including: the SME Training Partners Scheme; the SME Training Needs Analysis; and SME "On-The-Job-Training," which facilitate informal learning and minimize the disruption involved in sending a worker to external training (HRDF, 2016).

8.3.3. *Singapore: aligning the training levy to economic development*

Policies on skills evolved in line with Singapore's economic development

In the early sixties Singapore sought to build an education system that would develop the core skills necessary for further economic growth. Only marginal importance was given to skills and training; secondary vocational institutions and polytechnics existed but were largely responsible for meeting the short term needs for trained technicians. In the late sixties and seventies, the Singaporean economy entered an export-oriented industrialization phase, marked by an increase in foreign investment, and a need for higher skilled personnel. During this phase, foreign investors were given incentives to establish training centres in Singapore. An option for establishing training centres in collaboration with the State was provided to foreign investors, who were then given the right to hire a proportion of the graduates from these training centres. As the government participated in the management of these centres, it was able to integrate them into its existing skills system.

The Skills Development Fund

By the late seventies, there was an increase in the need for workers with general skills as well as specialized skills to work with higher value-added and more technologically-advanced products. As a result, the Skills Development Fund (SDF) funded by a levy, was established in 1979 The SDF provides financial incentives for training those in the workforce, those joining the workforce, and those re-entering. It also provides grants on the basis of approved training plans through the Total Company Training Plan Scheme, and promotes special training programmes designed for upskilling, including the Training Assistance Scheme. In addition, the SDF finances training vouchers and assistance for IT training for SMEs. Through the Skills Certification Plan, companies are encouraged to train at least a third of their workforce in certifiable skills over a three-year period. In addition, the SDF supports a training leave scheme for older workers and on-the-job training consultancy services to accelerate skills development in the knowledge economy.

The levy is imposed only on employers with lower-wage workers

The Skills Development Levy is imposed on employers with workers earning 4,500 SGD (roughly 3,011 EUR) or less a month. The current levy rate is 0.25% of monthly remuneration, or S$2, whichever is greater. In 2007 the SDF received S$108 million from the levy and in 2008 S$121 million. Employers have a major role: seven of fifteen members of the Singapore Workforce Development Authority (WDA), that controls the SDF, represent employers (including the Chairman and Vice-Chairman), with four for government and three for workers. Incentives for training are offered on the basis of a cost-sharing principle and the training must be relevant to the economic development of Singapore. The funding a company can obtain is not tied to the levy contribution.

Funds have been secured and training has increased

SDF has succeeded in ensuring a continuous flow of money dedicated to training, supporting skills investment while also engaging employers in line with a broader economic development strategy. By 2013, WDA had trained over 1 million trainees under the Workforce Skills Qualification (WSQ) system. In 2014 alone, 271 740 workers were trained under WSQ. WDA also has over 40 CET (Continuing Education and Training) centres all over Singapore which help deliver the targets of the SDF (WDA, 2016). The success of the system lies in the fact that skills and training were linked to economic development, and later on to foreign investment. The State made efforts to align the differences between the various ministries to co-ordinate the demands of the labour market with that of the skills supply. By giving incentives to firms to train Singapore succeeded in involving a diverse range of stake-holders. By granting employers the right to hire workers trained in their training centres, and measures against poaching, Singapore achieved a level of co-operation with employers that then helped in strengthening the national skills apparatus. A number of training centres were initially managed by both the state and companies, allowing some mutual knowledge transfer.

Three general principles emerge from the Singapore story

First, the close linkage between Singapore's stage of economic development and skills policy; second, the Economic Development Board's model of technology transfer that takes advantage of the expertise of foreign investors to train local workers; third, the strong role of the private sector in the process of skill training, and in terms of training their own workforce.

8.4. Conclusions: pros, cons and implementation issues

8.4.1. *The pros and cons of training levies for Southeast Asia*

Clarifying objectives: what is a training levy supposed to achieve?

As explained at the outset, economic growth in Southeast Asia will depend on investment in better occupational skills both for young people and the existing workforce. Although general taxation makes a substantial contribution, it may not be enough, and seeking contributions from the employers that will benefit from an expanded pool of skills makes sense. Training levies can be targeted to support: initial training for school-leavers (as part of the initial VET system); training for the existing workforce; and/or training for adults who are changing careers, need reskilling, or are unemployed. Some levies, such as the Singapore scheme, are designed to meet all these needs. In other countries, particularly those in Latin America, training levies have been primarily designed to raise funds for the initial vocational training of young people. Training levies can therefore clearly represent an attractive means of kick-starting faster skills development while providing a practical and systematic way to engage employers in addressing training needs.

Singapore and Malaysia show the potential of training levies

ASEAN countries that already have, or are thinking of introducing levy-based training funds, might study the examples from Singapore and Malaysia to reflect on how a levy might relate to their own

national context. This should not imply a simple transplantation, as these two examples were closely linked to the particular circumstances of their respective countries. Experiences in Singapore show that careful government planning can link education and VET to broader economic development strategies: when Singapore's economy was based on factor-driven growth and low-cost manufacturing, it prioritised universal basic education and low-level vocational training, establishing a strong foundation of good basic skills. When the economy shifted to the production of high value-added goods and services, the development of higher level skills became more important.

The downsides and risks of levies need to be carefully addressed

Despite these potential benefits, the case for training levies is far from clear-cut. Under the wrong conditions, training levies can become top-heavy bureaucracies, remote from employers, fund training that would have taken place anyway, and tend to leave out SME's, workers in the informal sector, the low-skilled, the disadvantaged and women- areas where upskilling is needed the most. To measure the pros and cons, it would be good to point to systematic evidence from countries around the world that have implemented training levies. Unfortunately, such evidence is limited, but experience points to the major issues and challenges which need to be addressed when developing and implementing levies.

Three requirements, to be considered in turn below, are particularly salient: training levies need to a) engage employers; b) minimise unintended effects and administrative costs; and c) reach the individuals and employers where training needs are greatest. This is particularly important for countries when considering a training levy scheme as the extent of employer engagement, levy design, and target beneficiaries to receive the training will vary. The challenges of executing a training levy are subject to the needs and commitments of the economies they are implemented in. For example, enterprises in rural sectors face barriers related to remote access of education and support facilities which can hinder participation in training. On the other hand, enterprises located near industry clusters- where comprehensive programmes can serve the training needs of the cluster- are likely to be more successful (OECD, forthcoming). This underscores the importance of levies having a high degree of flexibility to depict local needs and be designed in a way that most effectively engages employers and individuals.

Small enterprises need support to benefit from training funds generated through levies

Training funds linked to levies are often mainly used by larger employers (OECD, 2010; Johanson, 2009; Dar, et al., 2003; CEDEFOP, 2008). Smaller employers may perceive few benefits from training if trained employees are 'poached' by larger employers with more promotion opportunities once they have received training. Currently, most of the in-firm training conducted in Southeast Asia is done by large firms and not by the SMEs which dominate the region. SMEs in the ASEAN member states are a major source of employment, ranging from 52% in Viet Nam to 97% in Indonesia (

Table 8.2).

Training levies can be designed to support SMEs

Levies are one measure by which groups of employers, including SMEs, can be encouraged to collaborate and jointly fund training within a cluster where they produce similar products (Mehrotra, 2015). Governments can encourage improvements in the basic skill levels of entrants to the labour market, stimulate training for low-educated workers and workers in SMEs who have little access to training - and help build the capacity of trade and sector associations to provide training services to their members (Mehrotra, 2015). SMEs can particularly benefit from government intervention, as many may lack the capacity to determine training needs, plan appropriate training courses and file applications for cost reimbursement or grants (Müller and Behringer, 2012).

Table 8.2. Small and medium-sized employers in Southeast Asia

Country	Share of Total Establishments		Share of Total Employment		Share of GDP		Share of Total Exports	
	Share	Year	Share	Year	Share	Year	Share	Year
Brunei Darussalam	98.2%	2010	58%	2008	23%	2008	-	-
Cambodia	99.8%	2011	72.9%	2011	-	-	-	-
Indonesia	99.9%*	2011	97.2%	2011	58%	2011	16.4%	2011
Lao PDR	99.9%	2006	81.4%	2006	-	-	-	-
Malaysia	97.3%	2011	57.4%	2012	32.7%	2012	19%	2010
Myanmar	-	-	-	-	-	-	-	-
Philippines	99.6%	2011	61%	2011	36%	2006	10%	2010
Singapore	99.4%	2012	68%	2012	45%	2012	-	-
Thailand	99.8%	2012	76.7%	2011	37%	2011	29.9%	2011
Viet Nam	97.5%	2011	51.7%	2011	-	-	-	-

Source: Economic Research Institute for ASEAN and East Asia (ERIA), 2014, "- ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SME's", Jakarta, https://www.oecd.org/globalrelations/regionalapproaches /ASEAN%20SME%20Policy%20Index%2014.pdf.

The skills training and financing needs of SMEs should be coupled with entrepreneurial advice and support services to incentivise SMEs to promote training (Lee, 2016). Training levies designed solely as a financial incentive may fail to successfully engage SMEs as the latter might require more comprehensive support to fully develop their human resources. Moreover, programmes that are merely financial fail to provide the institutional, technical and information support which SMEs require for successful implementation of training programs (Lee, 2016). Such support can be a crucial element in the success of a levy scheme.

Individuals working in the informal economy can benefit from training opportunities

Training levies will find it hard to collect funds from the informal economy, and it may therefore not be easy to direct funds for training to employers in the informal sector. If smaller employers are exempt from levy payments (as in many schemes), small informal employers may see advantages in joining the formal sector in order to access training funds, but there are obvious difficulties in using training levies to fund training for those working in the informal economy. However, in South Africa, 20% of the revenues from the training levies on company payrolls are earmarked for strategic training initiatives for disadvantage groups and the informal sector (Maclean and Wilson, 2009). Low-skilled employees generally benefit less than high-skilled employees from levy schemes, often because employers tend to train those employees who are most likely to succeed and turn the skills gained into company profits. This is an argument for allowing individuals, rather than employers to access some of the training fund, so that those working in the informal economy have training opportunities.

Recognition of prior learning, and certification, can support the upskilling of those who have worked informally

Many of those with work experience, particularly those working in the informal economy acquire skills but, as they are not certified or recognised, they may find it difficult to get a job in the formal sector. Effective arrangements for recognising and certifying these skills are therefore important, allowing those certified to access further training, or build on their existing skills through training to obtain a formal qualification. Malaysia's levy system provides a means for recognition of prior learning. However, assessing prior informal learning can be a resource-intensive process in the context of an intricate package of occupational skills. Therefore funding, which could come from training levies, is also necessary to unlock the substantial pool of uncertified skills that exist in the informal economies of Southeast Asia.

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Strengthening Women's Entrepreneurship in ASEAN

This section provides a summary of the report developed by OECD Global Relations and Directorate for Employment, Labour and Social Affairs. It was formally presented to the ASEAN Coordinating Committee on Micro, Small and Medium Enterprises (ACCMSME). Through an extensive consultation process, the report received feedback from the ASEAN Committee on Women (ACW) as well as the ASEAN Women Entrepreneurs Network (AWEN) and other relevant stakeholders. This report was developed within the framework of the Canada-OECD Project for ASEAN SMEs (COPAS), as well as gender-related work conducted for OECD member and partner countries.

This work contributes to the SEARP RPN on SMEs and SEARP Gender Initiative.

9. Strengthening Women's Entrepreneurship in ASEAN

Key Messages and Recommendations to Strengthen Women's Entrepreneurship in ASEAN

The economic growth achieved by the Southeast Asia region over the past few decades has been accompanied by considerable gains in women's access to labour markets. In 2015, the average female labour force participation rate in Southeast Asian countries was close to 67%, exceeding the OECD average by over 7 percentage points. The region's male/female wage gap also steadily decreased between 2010 and 2015, although it remains significantly higher than the OECD average.

The majority of ASEAN governments have adhered to international instruments or apply elements of international recommendations to tackle gender discrimination, notably the OECD Gender Recommendations and the CEDAW. They have also worked to implement national gender mainstreaming strategies to address gender gaps in access to government programmes and services.

However, adopting a mainstreaming approach does not replace the need for targeted gender-specific policies and programmes, both at the national and regional level. Although the region has made strong progress in reducing gender gaps, there continue to be significant divergences in performance between countries, often the result of different inherited customs and social norms, as well as individual economic development patterns. Given this diversity, no one set of policy recommendations can be developed that are uniformly applicable to the region. This report thus aims to better understand the driving forces behind women's economic participation and entrepreneurship across the region and provide policy makers with recommendations on a range of policy levers and good practices that can help unleash women's full potential.

This section provides policy makers with an easily-accessible overview of the report's key messages and outlines the main recommendations contained in the three following chapters.

A comprehensive policy framework is needed to tackle gender gaps in Southeast Asia

Gender gaps can arise from a broad range of market and policy failures in areas such as access to education and labour markets, as well as in working time arrangements for mothers and fathers. These gaps also have a negative knock-on effect on women's entrepreneurship. For example, unequal access to education can hamper the productivity and profitability of women-owned businesses later on. Women's inability to access labour markets may incite women to start their own businesses, however often those businesses are necessity-based and their growth is hindered by women's lack of professional experience. Finally, women continue to bear the main brunt of unpaid household tasks and the provision of care to children, the elderly and disabled family members.

All in all, the evidence presented in this new report suggests that efforts to foster women's entrepreneurship must start with policies that tackle the underlying causes of gender gaps and gender discrimination, and cut across a range of policy areas. The OECD Gender Recommendations as well as other international instruments such as CEDAW provide this framework.

In this regard, the report identifies three key priorities for Southeast Asia:

- First, concerted policy action should be taken to close remaining gender gaps in education and access to capital that continue limiting women's economic opportunities. Higher educational attainments have not been fully translated into better labour market outcomes yet, but progress can

be seen already. More could be done to encourage girls to pursue studies in STEM subjects and to encourage female participation in tertiary education. Improving women's financial literacy is equally important.

- Second, combining financial education with knowledge on, and access to formal financial services (such as current accounts) and with entrepreneurial training is a powerful tool to improve women's overall economic, financial and entrepreneurial prospects.
- Third, interventions could be made to address all the factors that hamper the inclusion of women into labour markets, such as constraints on women's time. Improving access to early childhood care and educational institutions has proved not only to significantly free up women's time and facilitate labour market participation, but also to have a positive impact on child development. Making parental leave more effective through strengthening and encouraging the take-up of both maternity and paternity leaves can also contribute to reducing gender disparities in various labour market outcomes.

Further, policy making could focus on improving job quality and labour market security for female workers. Tackling social norms that promote stereotypical gender role models and removing gender biases from public laws and regulations is crucial to curb gender discrimination in the formal labour market. Addressing informality is key to improving the stability of female employment, reducing gender pay gaps and counteracting occupational segregation. Policy interventions that have proven effective in reducing the prevalence of informality in labour markets include increasing the benefits of formalisation, reducing the costs of formal employment and strengthening enforcement mechanisms.

Targeted policies to boost women's entrepreneurship can help overcome barriers and unleash firm development

Although policies to improve women's access to education and labour markets – such as those mentioned above – are essential to advancing women's broader economic participation, additional measures are required to foster women's entrepreneurship. Creating an environment where women with a viable business idea are able to make it a reality, is necessary for developing a dynamic, resilient and inclusive economy. Measures aiming at rising entrepreneurial prospects of productively self-employed women are the key to fostering growth and improving quality of female owned businesses. Policies that reduce the risk women face in engaging in a new entrepreneurial activity – such as the terms of external financing – could go still further. Increasing the number of female employers and women in leadership positions can set the pace for other women to follow.

Research has shown that the most common barriers hindering the development of women's entrepreneurship in Southeast Asian countries are the prevalence of inherited customs and social norms which create specific pressures on women, and access to finance. Support from husbands and families are important for women willing to engage in entrepreneurship activity. Limited access to capital and credit, which is often linked to gender inequality in property and land rights, hampers the potential for women's businesses to expand. In addition, a lack of business knowledge and skills, and a limited access to business networks and networking activity in certain countries where these could be further developed, are also common barriers that restrict women's entrepreneurship in the region. Large disparities in job quality and remuneration between men and women in the Southeast Asian region are also reflected in the low prevalence of women in leadership positions.

These limiting factors have tended to reduce the growth ambitions of women-owned businesses and led them to be concentrated in low productivity sectors in the informal economy, generally with low levels of profitability. While the AEC Blueprint is creating new trade and investment opportunities in the region, policies are needed to increase the competitiveness of MSMEs, particularly those that suffer from structural imbalances, in order to generate increased prosperity. Consequently, at the

enterprise level, women's entrepreneurship in the ASEAN region should be supported by gender-sensitive and responsive MSME policies and strategies (gender mainstreaming) in order to reduce the risk of women being left behind in the ASEAN Economic Community integration process.

In order to ensure that the broad policy framework tackles the obstacles of women entrepreneurs, national MSME development strategies could place further emphasis on gender inclusiveness and recognition of the potential economic gains from ensuring greater participation of women in their various support programmes and services. Establishing a clear focal point on women's entrepreneurship with government-wide accountability, and working on a co-ordinated basis to design and implement a comprehensive strategy to foster women's entrepreneurship development, would ensure that the range of actions implemented are properly coordinated among the various institutions

Finally, gathering more information on the existing obstacles through commissioned studies and collection and reporting of gender-disaggregated data on MSME ownership, including a gender analysis of the characteristics of MSMEs and their performance would help policy makers get better understanding of the existing problems and bottlenecks and would allow them to act more efficiently by developing more relevant policies.

The Women's Entrepreneurship Development (WED) assessment framework is a helpful tool for governments to assess the effectiveness of their national programmes and apply some of the policy recommendations listed below

Policy makers can make use of an internationally accepted framework to review and analyse the WED dimensions of their national-level programmes. The framework focuses on the dimensions of access to finance, provision of business development services, access to markets, and access to ICT and production technologies. Applying this framework to ASEAN countries has led to a comprehensive set of policies for strengthening enterprise support programmes for women entrepreneurs as presented in the section below.

Policy recommendations

Closing the gender gaps in education and labour market outcomes (Chapter 1)

- **Close remaining gender gaps in education.** Policy makers should focus on further reducing the direct and indirect costs of schooling for poor families, as well as on improving the quality of teaching. Apprenticeships can be used as a tool to close gender gaps in the school-to-work transition, particularly in the case of lower-income families. Conditional cash transfer programmes could also be considered.
- **Fight gender discrimination in the formal labour market**. Existing legal barriers impeding women's access to the labour market should be lifted. Access to justice should be ensured, and stereotypes and misperceptions fought through affirmative action for women.
- **Free up women's time and promote flexible employment.** Policy intervention should work on freeing up women's time by easing the burden of household responsibilities on them, and by encouraging men to participate more actively in household and family care. Greater flexibility in work scheduling can also help women in juggling household responsibilities with career advancement.
- **Make parental leave more effective.** Strengthening and encouraging the take-up of both maternity and paternity leave may help level the playing field between men and women, by reducing the relative cost of hiring female workers and by encouraging new fathers to share responsibility for childcare-related activities.
- **Curb informal employment.** An effective strategy to reduce informal employment should encompass a broad range of policies aimed at reducing the costs of formalisation, increasing its benefits and strengthening enforcement of labour codes. Special attention should be paid to

removing labour market obstacles hindering women from being hired in formal paid jobs. It is also important to eliminate administrative impediments that prevent the expansion of women's entrepreneurial activities.

- **End violence against women**. All countries should have a modern legal framework to deal with violence against women and especially domestic violence. Such a system should include special courts and the possibility for judges to issue protection orders. Countries that lack encompassing legislation on sexual harassment should introduce it. Such legislation should cover not only employment, as is typically the case, but also education.

Supportive policies and institutional structures for the promotion and strengthening of women's entrepreneurship (Chapter 2)

Ensure proper policy and institutional support for promotion of women's entrepreneurship.

- Countries should increase the level of gender inclusiveness in national MSME development strategies and alignment of MSME development policies and measures with policy directions set in national women's empowerment and gender equality strategies. This could be facilitated by closer linkages between the ministries responsible for women's affairs and the ministries responsible for MSME development and more effective implementation of gender mainstreaming in MSME policies and measures.
- ASEAN could consider strengthening the emphasis on women's entrepreneurship development in its Strategic Action Plan for SME Development by mainstreaming gender across all of the strategic goals. This action would provide an enhanced level of guidance to member states on MSME-related actions to support the development of women entrepreneurs and women-owned MSMEs at the national level.
- Business and industry associations, including chambers of commerce and industry, should be encouraged to extend and increase their memberships to businesswomen and aim to mainstream their interests and concerns in policy dialogue with the government.
- Governments should establish formal mechanisms for conducting policy dialogue with women entrepreneurs and ensure that they are represented in public-private dialogue fora and consulted on legislative and policy reforms.
- ASEAN countries should establish the appropriate institutions to ensure the coherence of policies and actions to support women's entrepreneurship across ministries and agencies. The designation of clear governmental focal points could be an effective tool in achieving this. Such a mechanism can help to improve the leadership and co-ordination of WED policies and programmes across relevant ministries and agencies and promote joint and complementary actions in support of WED.

Improve the MSME sector knowledge base on gender dimensions.

- Policy makers should work to develop accurate and comprehensive databases with sex-disaggregated data on MSME ownership and performance as inputs to create better informed and evidence-based public policies, measures, and programme interventions.
- A workable definition for "woman-owned business" should be established in order to develop criteria for targeted government incentives, such as public procurement.
- ASEAN countries could benefit from carrying out more systematic analyses of the barriers to women's entrepreneurship, to include: the distinct nature of barriers for start-ups and growth-oriented enterprises, and the gender gaps to be addressed in the MSME policy framework and business support ecosystem. Performing this assessment of the environment for women's entrepreneurship development at the ASEAN-country level, could serve as the foundation for national comprehensive strategies and action plans.
- WED-based enterprise support programme options (Chapter 3

- Facilitate improved access to credit and education on financial products.
- Raise the ceiling on micro-credit loans, so women entrepreneurs have greater access to more funding to expand their microenterprises.
- Help women micro-entrepreneurs transition from micro-credit to standard bank financing.
- Strengthen policy actions to improve women entrepreneurs' access to bank financing and close the gender gap in business lending (e.g. issuing instructions to banks to allocate a certain percentage of their loan portfolio to women-owned SMEs).
- Offer technical assistance in designing gender-responsive products and services in order to address the unmet demand of women entrepreneurs in the ASEAN countries for start-up and growth financing.
- Negotiate low-interest credit lines for relending to women-owned enterprises.
- Design special guarantee provisions for women-owned MSMEs in government-backed SME credit guarantee schemes.
- Provide gender-sensitivity training to bank managers and credit officers.
- Combine financial literacy education and training with access to formal financial products.

Facilitate better access of women entrepreneurs to business development support (BDS) services, including in rural areas. The provision of gender-sensitive and responsive BDS services is critical to the goal of supporting more women to start viable enterprises and improve their chances for success.

- Gender mainstreaming of BDS-providing organisations may be required, including provisions of gender-sensitivity training to counsellors and advisors in SME support centres (especially government-supported centres) to increase the level of gender awareness in dealing with women clients.
- Support BDS providers with technical assistance in modifying the content, delivery, and facilitation approach of training and advisory services to be more gender-responsive.
- Harness new technologies in improving the outreach of BDS services to women entrepreneurs in remote areas; this can be accomplished through mobile delivery and information communications technologies (ICTs).
- Ensure women have equal and formalised opportunities to participate in entrepreneurial and business management skills programmes, including equal opportunities for young women to participate in "Start-up Weekends" and other entrepreneurship challenge competitions.
- Support existing self-employed women with viable enterprises with advice and technical assistance so they can scale up their activities and integrate into the formal economy.
- Increase mentoring opportunities for women entrepreneurs. Successful examples include training women as mentors, then matching women entrepreneurs with mentors. Every effort should be made to create awareness among women entrepreneurs of the recently announced ASEAN Mentors-Entrepreneurs Network (AMEN) and to engage their participation in the offer of mentoring matches.
- Gender diversity should be promoted in government-funded and sponsored mixed incubator and accelerator programmes. Bridging the gender gap in access to the supports available in these facilities can help businesses grow and create jobs. In some cases, it may be advisable to introduce women-focused business incubators to help women entrepreneurs with high-potential business ideas scale-up their businesses. This is becoming a more common practice in many countries, with some evidence of this approach emerging in the ASEAN region as well.

Improve access to markets for women-owned enterprises. Women entrepreneurs can be disadvantaged in accessing markets due to lack of information, networks, skills, productive

resources, capital, and expansion capability. Within the context of the market opportunities created by the ASEAN economic integration, dedicated efforts to bring women entrepreneurs into larger markets should be a policy priority. This would entail programmes and initiatives to improve their export potential and opportunities, open up procurement opportunities for women-owned SMEs, and ensure that women-owned enterprises are integrated in the supply chains of large corporations and anchor firms. Specifically, governments could:

- Develop export-readiness programmes targeting women entrepreneurs (using models in Malaysia and the Philippines as a source of inspiration).
- Seek guidance from the UN International Trade Centre on good practices in gender-responsive public procurement policies, regulations and procedures with the objective of increasing the participation of women-owned SMEs in public procurement offers.
- Create and roll-out supplier development programmes for women-owned MSMEs with support from governments and donor organisations.
- Develop programmes that enable women-owned MSMEs to take advantage of corporate supplier diversity policies and programmes.

Develop initiatives to build the ICT skills and capacity of women entrepreneurs. In order to reduce gender gaps in digital inclusion, digital literacy and use of ICTs are important tools for the empowerment of women entrepreneurs in order to improve the productivity of their enterprises. Various initiatives are in place in the different ASEAN countries to improve women's ICT knowledge and skills generally, with some focused specifically on women entrepreneurs. Governments can strengthen their efforts through the following actions:

- Develop dedicated programmes to build and strengthen the ICT skills and capabilities of women entrepreneurs, including the application of ICT-enabled technologies to improve their efficiency and broaden their market access.
- Ensure women are fully integrated in government-supported programmes and initiatives aiming to facilitate ICT-based start-ups.
- Support women entrepreneurs associations in their efforts to aid women entrepreneurs in using ICTs to improve the performance of their enterprises.
- Enter in discussions with the United Nations Asian and Pacific Training Centre for Information and Communication Technology for Development (UN-APCICT) to implement the "Women ICT Frontier Initiative" (WIFI) programme. This can serve as a vehicle for building the ICT capacity of women entrepreneurs.

Business Statement

This section provides an example of collaboration of SEARP with the Private Sector. The third statement promotes collaboration with SEARP and specifically identifies areas of collaboration, which also incorporates inclusive business. The statement was developed in partnership with the Business at OECD (BIAC) and ASEAN Business Advisory Council (ABAC).

This work contributes to the SEARP RPN on SMEs as well as other activities.

10. OECD-ASEAN Business Statement

Business priorities and recommendations to promote digital transformation for an enhanced and inclusive business environment in Southeast Asia

August 2017, Bangkok

Preamble

Southeast Asia is one of the most promising markets globally. Close to two major economies and at the centre of major trade routes including the Strait of Malacca, $5.3 trillion of global trade passes through its waterways each year. The region also plays an important role in global value chains, with 4 ASEAN-5 countries becoming important alternative manufacturing destinations and 1 ASEAN hub ranked as a global leader in the Global Financial Centres Index, as well as the most technology-ready nation. At current growth rates, ASEAN is expected to become the fourth-largest market after the EU, U.S. and China by 2030. Real GDP grew at an average rate of 5.4% from 2011-13, and is expected to average 5.1% between 2017 and 2021.10 This growth is principally demand-driven. The region holds a population of over 600 million people and the share that is able to partake in discretionary spending is rapidly increasing – GDP per capita (PPP) reached US$11,009 in 2015, up from US$7,052 in 2007, an increase of 56.1%. It has been forecast that by 2025 more than half of the world's consumers will live within a five hour flight of Myanmar.11

The private sector regards the ASEAN project as crucial to realising the region's potential, and we support the recent commitment to create a "Post-2015 Vision" for further integration. We welcomed the launch of the ASEAN Economic Community and the AEC Blueprint 2025 in 2015, and good progress has been made on integration in the areas of trade, infrastructure and connectivity, as well as implementation of the IAI in order to decrease income disparities between member states. Yet more remains to be done – intra-ASEAN trade remains relatively low at just 25% of total trade turnover, and further harmonisation is required across multiple areas. We encourage continuation of the commendable work already done.

[10] OECD, 2016
[11] McKinsey Global Institute.

10.1. Important steps for the development of the digital economy in Southeast Asia

Southeast Asia is one of the most entrepreneurial economies in the world,12 and it is emerging as a strategic battleground for large industry players from other regions, with the ASEAN internet economy already estimated to be worth around US$50 billion.13 Its ICT sector has evolved at a remarkable pace over the past few years, and it has a huge number of digital consumers, with 230 million people in the region now14 'online engaged consumers' – a growth of 50% over the previous year. Southeast Asia has also strongly embraced mobile, with the region15 now home to around 854 million mobile subscriptions, covering 133% of its population. For ASEAN too, development of the digital economy could offer substantial windfalls. Industry players such as AT Kearney forecast that ASEAN's digital economy has the potential to add an incremental $1 trillion to GDP between 2016 and 2025.

To realise these gains, business proposes a number of steps.

- First, steps should be taken to ensure that adequate investment is made into the development of infrastructure. A number of countries still underperform relative to their income-group peers on the infrastructure pillar of the World Economic Forum's networked readiness index. The availability of secure internet servers remains a particular problem across most of the region's lower-income countries, even in comparison to their income-group peers. Resolving this will be particularly important for encouraging the take-up of certain digital technologies such as cloud computing.
- Second, regulation of ICT and the digital economy needs to be harmonised across ASEAN. Currently discrepancies exist on spectrum sharing, spectrum trading, cybersecurity governance and data protection. A concerted effort amongst member states to harmonise regulation in these areas will be critical in ensuring the growth of the digital economy in Southeast Asia.

Digitalisation is also an important instrument to progress in two areas that are currently priorities for multinational and domestic firms, as well as the OECD, in Southeast Asia: inclusive business and access to finance. Inclusive business practices are largely realised through transforming supply chains, and digitalisation is one of the most powerful tools to transform business processes and supply chains from traditional models. For instance digital technologies like blockchain can be used to track transactions in the supply chain and so can play a role in supporting responsible business conduct. On access to finance, the private sector is currently developing innovative approaches to enhance financial inclusion through mobile payments, digital currencies, and digital technologies like blockchain.

In order to enable enterprises to adopt digital technologies, we encourage Southeast Asian policymakers to consider a number of programmes and policies.

- To support firms considering new business models that integrate formerly disadvantaged groups into their supply chains, **we urge policymakers to consider developing new digital literacy initiatives**. The 2016 Microsoft Asia Digital Transformation Study found the lack of a digitally skilled workforce to be the top barrier, along with cyber threats and security concerns, to digital transformation in Asia Pacific, as identified by a survey of 1,200 business leaders. Increasing digital literacy programmes and making them national in scale could help to couple digital transformation

[12] The GEM survey incorporated 6 ASEAN countries for the first time in 2014. It found that 66% of the population view entrepreneurship as a positive career choice, above the GEM global average of 62.46%. This is largely attributable to a new business rate of 10%, which is the second highest regional average globally and almost double the GEM 2014 average.
[13] Bain and company (2017), *Digital Acceleration in Southeast Asia: Navigating Tectonic Shifts.*
[14] 2017
[15] ASEAN plus Timor-Leste, based on GSMA data (2017).

with new and better jobs, providing new opportunities for those who have formerly had limited participation in economic activity.

- **We urge policymakers to consider both demand- and supply-side policies to encourage the spread of new digital technologies** that could increase the availability and quality of financial products. For instance, digital government-to-person (G2P) payments can reduce the cost and increase the reach and transparency of social transfers, get more consumers into the system and habit of using digital financial services, and build the critical mass required to enable providers to develop viable business models.[16] On the supply-side, policymakers could work on developing clear guidelines for fintech at both country and regional level, including regulatory sandboxes that would involve key players in this relatively nascent field to ensure that guidelines are not prohibitive.

Finally, the development of policies to accelerate and harness digitalisation could benefit from increased coordination and knowledge-sharing between ASEAN member states. We support ASEAN-level recognition of this and measures already taken – for instance the recent high-level decision to set up the ASEAN E-Commerce Working Group, tasked with establishing a policy framework for e-commerce, which should result in a more comprehensive and harmonised framework for e-commerce. We would support the more active participation of the private sector in such working groups, and signal our commitment to assist with realising this.

10.2. Important steps for improving the business environment in Southeast Asia

Southeast Asian economies can reap important benefits from digital transformation, but steps to open up markets and improve business environments will remain key to realising the benefits of digitalisation as well as economic development more generally.

- **To increase investment**, we support the enhancement of an open, predictable and transparent investment regime, as well as regular investment policy monitoring. Southeast Asian economies have had an impressive performance in attracting FDI, managing to attract record levels whilst rates were still plummeting globally. However friendlier investment policies could be adopted, with restrictiveness varying significantly across the region (Singapore continues to account for a large share of FDI inflows), and a more systematic approach to investment policy developed, in order to increase policy and regulatory predictability.[17]
- **To increase trade**, we support efforts to reduce protectionism and overcome market barriers based on strong support for an open rules-based multilateral trading system. Two priority areas can deliver important gains from reform. First, addressing barriers to trade in services lowers costs for all sectors and can help promote digital access. Second, there is a need to address non-tariff measures that unnecessarily restrict trade, recognising that transparent and well-designed regulation can promote trade. Action is also needed to address growing restrictions on cross-border data flows. Given the regulatory barriers that remain in major service sectors, such as telecommunications and air travel, we encourage Southeast Asian countries to work with the OECD to develop accurate, regular and comparable data on the intra- and extra-ASEAN flows of trade in goods and services. Using such data, the OECD Services Trade Restrictiveness Index (STRI), and the OECD-WTO Trade in Value-Added database, countries should work with the OECD to identify remaining barriers, improve domestic policy environments, and open up international trade in services.

[16] ADB (2017), *Accelerating Financial Inclusion in Southeast Asia with Digital Finance.*

[17] The OECD's FDI Restrictiveness Index found FDI regulations in ASEAN countries to generally be more burdensome across sectors than those in OECD countries.

- **To ensure that regulation does not discourage private enterprise**, we support the enhancement of good regulatory tools and practices in Southeast Asia. One way of enhancing regulatory quality is through developing comprehensive frameworks for regulatory impact analysis (RIA). Most ASEAN economies have adopted this in some form, but more work must be done in certain countries to ensure that these are conducted systematically and comprehensively, and applied to all major new regulations, as well as existing regulations that may have become obsolete. We support reforms which ease unnecessary or burdensome travel restrictions for business travellers.
- **To ensure that adequate infrastructure is in place to allow businesses to operate**, we encourage substantial infrastructure investment. The ADB has projected Southeast Asia's infrastructure investment needs over the next 15 years to amount to $2,759 billion, or 5% of the region's projected GDP. This includes improving logistical infrastructure, with important transport corridors between trading ASEAN nations still missing, as well as transport infrastructure in cities, where private vehicle use, and consequently congestion and pollution, has ballooned – by as much as 600% in one case. We support the priorities outlined in the 2025 Masterplan on ASEAN Connectivity and encourage ASEAN policymakers to cooperate in implementing its proposals. PPPs are a way to achieve substantial investment without creating an unsustainable strain on public finances, but must be carefully devised, governed and monitored.
- **To ensure that the Southeast Asian workforce has the appropriate skills for industry,** we support measures to increase participation in secondary and higher education in Southeast Asia, as well as policies and programmes for skills development. Many Southeast Asian economies that are currently becoming important manufacturing destinations will have to invest in upskilling their workforces if they are to transition to higher value-added manufacturing. This means more investment in Technical and Vocational Education and Training (TVET) as well as increasing enrolment in primary and secondary education. It also means a more comprehensive approach to identifying skill shortages, as well as policies and programmes to address them over the medium- to long-term. Various ASEAN economies are best practice examples at doing this, so can be great sources for peer learning.
- **To boost MSMEs,** we support policies targeted at them through measures already outlined in the ASEAN Strategic Action Plan for SME Development 2016-2025, and aim for further regulatory integration and harmonisation. . Across ASEAN, SMEs account for the largest share of enterprises and the largest share of employment. We support policies that increase their access to markets and factors of production and reduce unnecessary red tape that limits their entry and exit. We support the collaboration between Southeast Asian governments and the OECD to develop SME policy reviews and the SME policy index, as an important step in identifying priority areas for future reform and intervention. Access to suitable funding instruments plays a decisive role in SME development. Therefore, we encourage all ASEAN countries to implement the G20/OECD High Level Principles on SME Financing, and for still more ASEAN countries to join the OECD SME Financing Scoreboard, as an important tool for mapping the types and volumes of finance available to SMEs.

Many of these actions will also require a coordinated effort between ASEAN states, and we support these efforts here, too. The ASEAN institutions can play a role not only in providing fora for policy dialogue and negotiation between ASEAN member countries, but also in promoting new policy areas and initiatives that may not currently be prioritised by or familiar to domestic policymakers but which could bring important benefits to those countries or to the region as a whole. Inclusive business is one such area. It is an area where the private sector can contribute to the Sustainable Development Goals, but where risks are high and a great deal of policy uncertainty still remains. We support ASEAN-BAC's initiative to increase the policy discussion around this issue, notably its decision to launch a Declaration on Inclusive Business at the next ASEAN Leaders Summit in November 2017.

10.3. Conclusions

The private sector strongly believes that digitalisation can offer substantial windfalls for increasing inclusion and economic growth in Southeast Asia, as well as substantial market opportunities for the private sector, and that policymakers could turn to the OECD as a knowledge base for developing policies in this area. To improve the business environment in Southeast Asia more broadly, the OECD is in a unique position to work alongside national policymakers in providing analysis and tools to enhance macroeconomic growth, investment policies, SME development, high growth enterprises, integration into regional and global value chains and the development of human capital, amongst other aspects. Such analysis could be used to inform policy discussions in a wide range of areas. Accordingly, we reaffirm our commitment to working with the OECD and regional policymakers on the development of policies that will mutually benefit the public and the private sector, whilst, most importantly, enhancing the lives of citizens in Southeast Asia.

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