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Foreword

This first *OECD Investment Policy Review of Southeast Asia* builds on national reviews of seven countries in Southeast Asia. It looks at common challenges across the region and at the interplay between regional initiatives and national reforms. The regional *Review* allows for a discussion of more thematic issues than are usually considered in the country-level reviews, including the possible role of regional initiatives in driving reform. It includes the following chapters: trends in foreign direct investment (FDI) in Southeast Asia, particularly in services; the unfinished agenda of FDI liberalisation in the region; the role of liberalisation in boosting both service sector and overall productivity in ASEAN; the evolution of investment protection in Southeast Asia; towards a smarter use of tax incentives in the region; and at how promoting and enabling responsible business conduct can help to maximise the development impact of investment.

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This Review was discussed by officials from OECD and ASEAN countries at a meeting of the Regional Policy Network on Investment in Tokyo, Japan, on 7 March 2018. It has been circulated for further comment and a revised version may be issued later in the year.

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Acronyms and abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ACFTA	ASEAN-China Free Trade Agreement
ACIA	ASEAN Comprehensive Investment Agreement
ADR	Alternative Dispute Resolution
AEC	ASEAN Economic Community
AETR	Average Effective Tax Rate
AFAS	ASEAN Framework Agreement in Services
AKFTA	ASEAN-Korea Free Trade Agreement
AMS	ASEAN Member State
ASEAN	Association of Southeast Asian Nations
ATISA	ASEAN Trade in Services Agreement
BIT	Bilateral Investment Treaty
BOI	Board of Investments
BSP	Bangko Sentral ng Pilipinas
CAMEX	Foreign Commerce Chamber
CAO	Compliance Advisor/Ombudsman
CDC	Council for the Development of Cambodia
CIT	Corporate Income Tax
CLMV	Cambodia, Lao PDR, Myanmar and Viet Nam
CSR	Corporate Social Responsibility
DICA	Directorate of Investment and Company Administration
DPP	Dispute Prevention Policy
EITI	Extractive Industry Transparency Initiative
ESG	Environmental, Social and Governance
ESIA	Environmental and Social Impact Assessment
EU	European Union
FDI	Foreign Direct Investment
FEP	Foreign Equity Participation
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GVC	Global Value Chain
IIA	International Investment Agreement
IADB	Inter-American Development Bank
ICC	International Criminal Court
ICSID	International Centre for Settlement of Investment Disputes
ICT	Information and Communications Technology
IFC	International Financial Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	Investment Promotion Agency

IPR	Investment Policy Review
IPD	Investment Promotion Department
IPP	Investment Priorities Plan
ISDS	Investor-State Dispute Settlement
ITA	Investment Tax Allowance
Lao PDR	Lao People's Democratic Republic
M&A	Merger and Acquisition
MAAS	Multilateral Agreement on Air Services
MAFLFAS	Multilateral Agreement on the Full Liberalization of Freight Air Services
MAFLPAS	Multilateral Agreement for the Full Liberalization of Passenger Air Services
METR	Marginal Effective Tax Rate
MFN	Most-Favoured Nation
MIC	Myanmar Investment Commission
MNE	Multinational Enterprise
MOFAT	Ministry of Foreign Affairs and Trade
NAP	National Action Plan
NCP	National Contact Point
OECD	Organisation for Economic Co-operation and Development
OHCHR	Office of the United Nations High Commissioner for Human Rights
OID	Ombudsman for Direct Investments
OIOT	OECD Input-Output Table
PEZA	Philippine Economic Zone Authority
PIC	Productivity and Innovation Credit
PPP	Public Private Partnership
PS	Priority Status
QIP	Qualified Investment Project
RCEP	Regional Comprehensive Economic Partnership
R&D	Research and Development
RBC	Responsible Business Conduct
SAR	Special Administrative Region
SEZ	Special Economic Zone
SME	Small and Medium-sized Enterprise
SIFAI	Investment Attraction Facilitation System
SDG	Sustainable Development Goal
SOE	State-Owned Enterprise
TFP	Total Factor Productivity
TPP	Trans-Pacific Partnership
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollars
VAT	Value Added Tax
VIF	Vector Inflation Factor
WBES	World Bank Enterprise Survey
WTO	World Trade Organization

Overview

Southeast Asia has been one of the most successful emerging regions in terms of export-led development in part through foreign direct investment (FDI). The region punches above its weight globally in terms of both exports and FDI inflows and has been a leading destination for multinational enterprises from all parts of the world for at least three decades. While global FDI inflows are still 8.5% below their 2007 peak, FDI inflows into Southeast Asia recovered after only two years. The region has retained and even slightly expanded its share of global trade and emerging economy FDI over the past two decades in the face of growing competition from other emerging regions (Figure 1) and still receives more investment than mainland China and India combined. Relative to GDP, FDI inflows over the past five years have been at record levels for many countries in the region and some have started to become important outward investors in their own right.

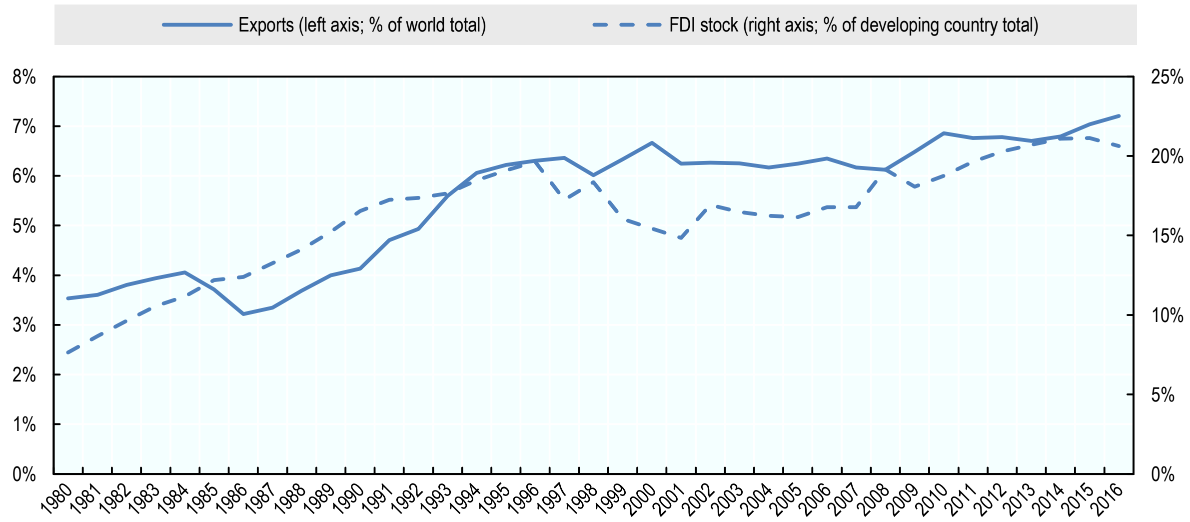
These FDI inflows have contributed to sustained development, making Southeast Asia the envy of many other emerging regions. Economic growth has been strong, even during the global financial crisis, and average growth in the region is expected to exceed 5% over the next few years (OECD, 2017). As a result, poverty has been substantially reduced, even if development has been uneven both within and across countries.

Economic performance in Southeast Asia owes much to the policy stance of successive national governments over decades. Many countries in the region were early movers in welcoming FDI for its contribution to exports through a mix of incentives, selective liberalisation and strong investment protection guarantees. Export promotion became the governing philosophy well before other emerging regions abandoned attempts at import substitution. Over time, governments have continued to refine and reform their investment legislation by, for example, opening more sectors to foreign investment and clarifying protection provisions. Beyond national reforms, countries in the region have been assiduously pursuing regional integration through the Association of Southeast Asian Nations (ASEAN) which was formed in 1967. Although integration is still a work in progress, the ASEAN Economic Community Blueprint sets out ambitious goals by 2025. ASEAN Member States (AMS) have also negotiated many free trade and economic partnership agreements with an investment chapter, both collectively and individually.

In spite of the success of AMS through sustained policy interventions, Southeast Asia still faces challenges on the horizon 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.

Figure 1. ASEAN share of world trade and FDI stock is little different from 20 years ago

(share of world merchandise exports and developing country inward FDI stock)



Source: WTO, UNCTAD.

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 that 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.

Services are still relatively under-developed throughout much of Southeast Asia

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.

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.

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

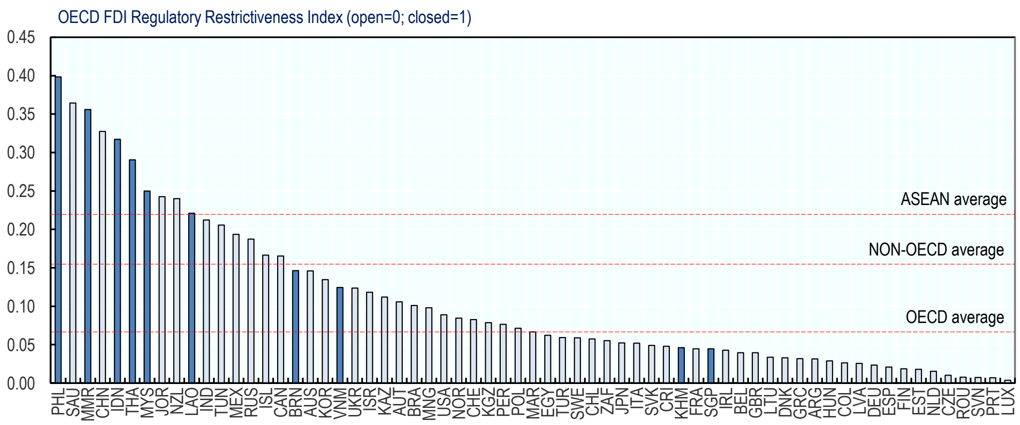
The development of efficient services depends above all on a pro-competitive domestic regulatory environment, but liberalisation of FDI restrictions in service sectors can play an important complementary role. Services represent a diverse group of sectors, requiring country- and industry-specific policy 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.

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* (Figure 2). 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 small and medium-sized enterprises).

Figure 2. OECD *FDI Regulatory Restrictiveness Index*, 2016



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

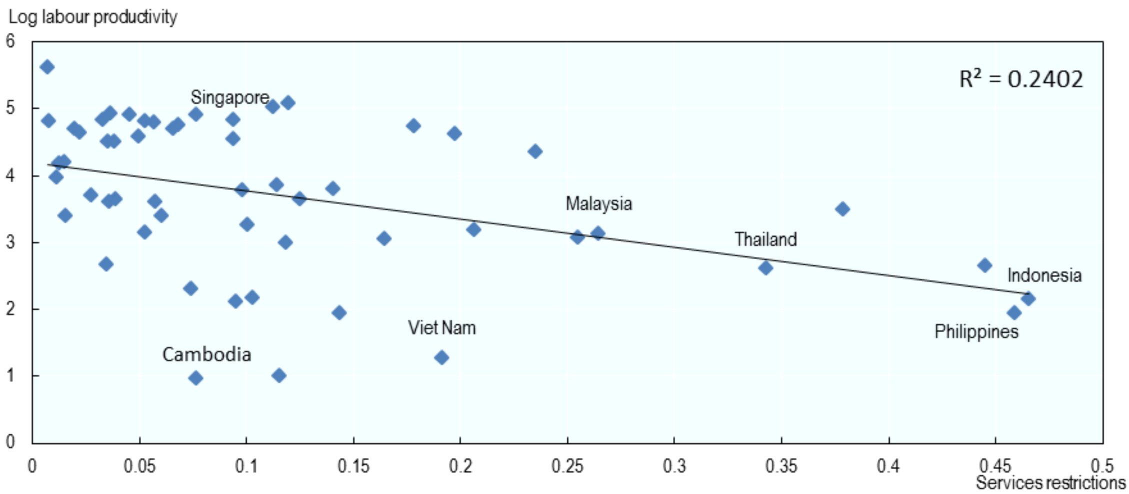
Competitive services can raise productivity, including in downstream manufacturing

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 (Figure 3). 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 3. 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 (WTO) 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 free trade agreement (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. Overall, ASEAN agreements need to go deeper to provide the sort of catalytic services liberalisation required to bring their overall level of restrictiveness closer to the average openness observed in other emerging regions. This comes in contrast to the latest AEC Blueprint 2025, which contains no agenda for further work on services.

Future agreements could become a force for further liberalisation by adopting a negative list approach. This approach has been adopted in some of the most modern agreements, such as the Trans-Pacific Partnership (TPP) for instance, of which four ASEAN countries are parties. Although such an approach is necessarily more burdensome, it could build on the negative lists already contained in national investment laws and other agreements. 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 spillover 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[1] 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 (Figure 4, Panels A and B).

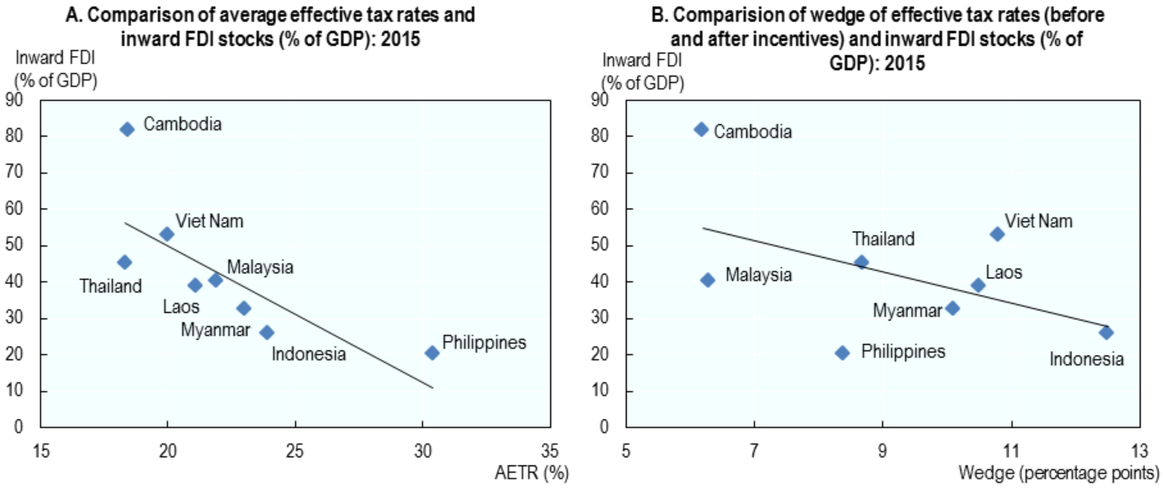
Those AMS with the highest average effective tax rates (AETRs) are also among those with the highest AETRs after incentives (Figure 5). This suggests that incentives do little to affect the relative appeal of individual AMS and might help to explain why the distribution of FDI within ASEAN has changed very little over the past two decades.[2] 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.

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.

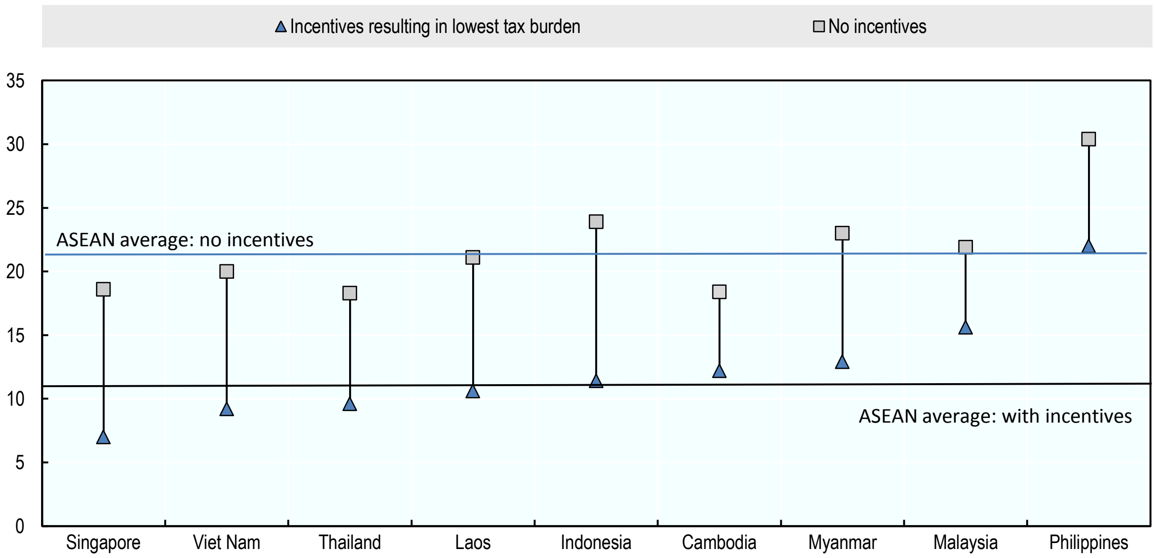
Figure 4. Corporate tax rates are negatively associated with FDI intensity in ASEAN



Note: Singapore is not included in the figures as it is somewhat of an outlier with a share of FDI stocks in GDP of 370%. Singapore's AETR before incentives is 18.6% and the wedge is 7 percentage points. Including it would make the negative slopes in the figures steeper but with some weakening of the overall fit.
Source: Authors' illustration based on Wiedemann and Finke (2015) and UNCTAD (2017), UNCTADStat (database), http://unctadstat.unctad.org.

Figure 5. Incentive competition and race-to-the-bottom of corporate taxation in ASEAN

Average effective tax rates (AETRs) with and without incentives (in %)



Source: Based on Wiedemann and Finke (2015).

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 (i.e. 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.

Notes

1. 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).
2. 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.

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Chapter 1.

FDI trends in Southeast Asia, with a focus on services

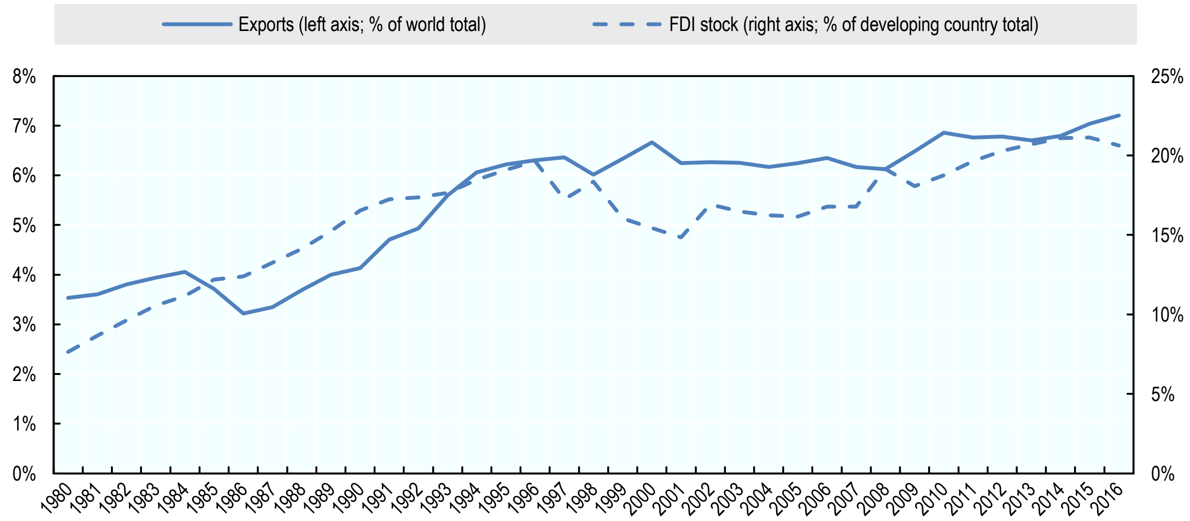
This chapter reviews the relative performance of ASEAN Member States in attracting FDI vis-à-vis both the rest of the world and other AMS, with a special focus on the importance of FDI by MNEs in service sectors into the region.

ASEAN has historically performed well in attracting global investors

Southeast Asia has done very well historically in attracting foreign direct investment. It was one of the first emerging regions to welcome FDI as part of a strategy of export-led development and, as a result, its shares both of emerging market FDI inflows and of global exports grew quickly in the period between the currency realignments after the Plaza accord in 1985 and the Asian financial crisis beginning in 1997 (Figure 1.1). Since then, the ten ASEAN Member States (AMS) have managed to maintain and even slightly increase their share of FDI at a time when emerging market economies worldwide have started to embrace a more liberal approach and actively compete for footloose FDI, not least China and India. But the rapid growth in the shares witnessed in the late 1980s and early 1990s has not been repeated.

Figure 1.1. ASEAN share of world trade and FDI stock is little different from 20 years ago

(share of world merchandise exports and developing country inward FDI stock)

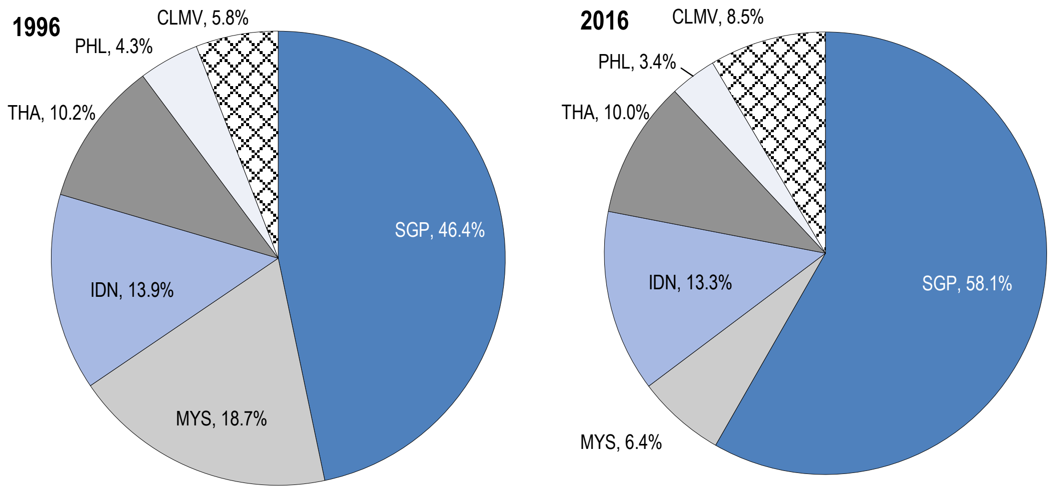


Source: WTO, UNCTAD.

All countries in the region have benefited from the growth in FDI inflows and, with one notable exception, there has been little movement in the share of inward FDI obtained by each country since 1996. The only major realignment across ASEAN has been the sharp rise in the share of FDI going to Singapore and the concomitant decline in the share going to Malaysia (Figure 1.2). Together, Singapore and Malaysia still account for roughly two thirds of the total stock, while Thailand, Indonesia and the Philippines account for just over one fourth – down slightly from 20 years ago. And while FDI in CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) is growing quickly, it still represents only 8.5% of the total. Much of this increase occurred in Viet Nam, although all CLMV have seen increased inflows.

Figure 1.2. Changes in the distribution of the FDI within ASEAN

(share of total ASEAN inward FDI stock)



Note: Brunei Darussalam not shown.
Source: OECD, UNCTAD.

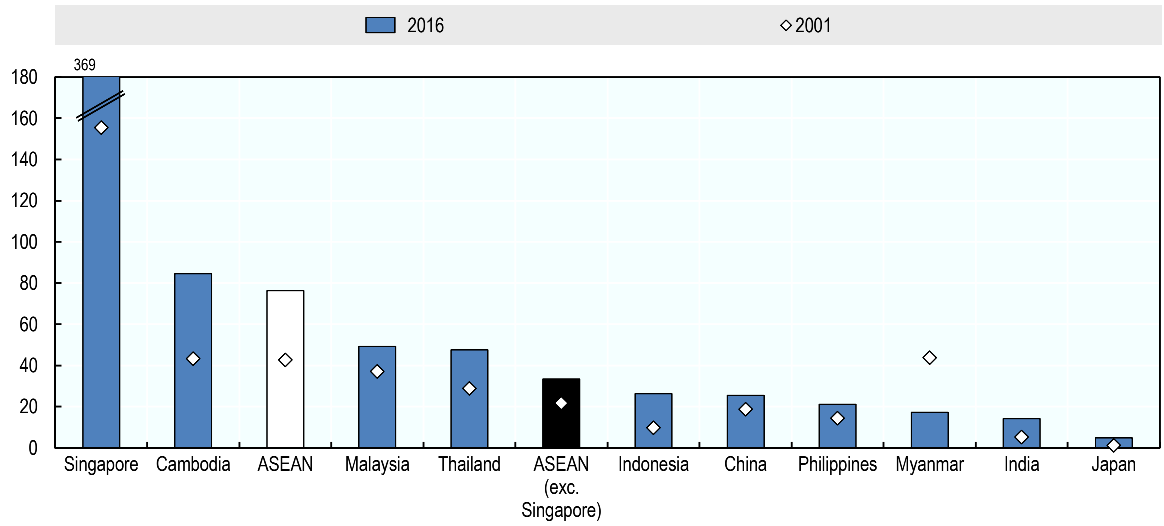
While the performance of each AMS relative to the rest of the region in attracting FDI gives an idea of which countries are doing better at providing a hospitable environment for investors, what matters more for an individual economy is the share of FDI relative to the size of the domestic market. FDI inflows have been increasing relative to GDP in almost all AMS and are now at record levels relative to GDP. For six countries in the region, the period 2010-16 witnessed the highest FDI inflows relative to GDP and for three others it has been the second highest period. Only for Thailand were inflows slightly higher as a share of GDP slightly higher in the two preceding periods.

In 2016, the total stock of FDI represented 76% of ASEAN GDP, up from 43% a decade earlier (Figure 1.3). Excluding Singapore, the ASEAN FDI stock represented less than 40% of GDP in 2016. While this ratio is still higher than for China or India, it is lower than in OECD countries on average. Within the region, the inward FDI stock as a share of GDP varies greatly across AMS, with high shares in Singapore and Cambodia and low shares in the Philippines and Myanmar. In the past decade, the ratio between the FDI stock and GDP increased in all AMS, except in Myanmar which is a special case given the poor economic performance until recently.

Beyond the strong performance of Southeast Asia in attracting FDI, the region also benefits from one of the most diversified sources of investment (Figure 1.4). It has historically received investment in roughly equal proportions from the developed economies in East Asia, Europe and North America, as well as investments from Chinese Taipei, Hong Kong (China) and now China itself. Different investors have a preference for locating in different AMS and the sectors involved vary widely, but this ability to attract investment from a diverse and increasing number of countries has been one of the traditional strengths of the region and remains so today. Another important element is the share of investment from within the region itself which can help in developing a truly integrated market. Intra-ASEAN FDI has typically represented around one fifth of total inflows but increased to one fourth in 2016.

Figure 1.3. FDI stocks as a share of GDP in AMS and selected economies

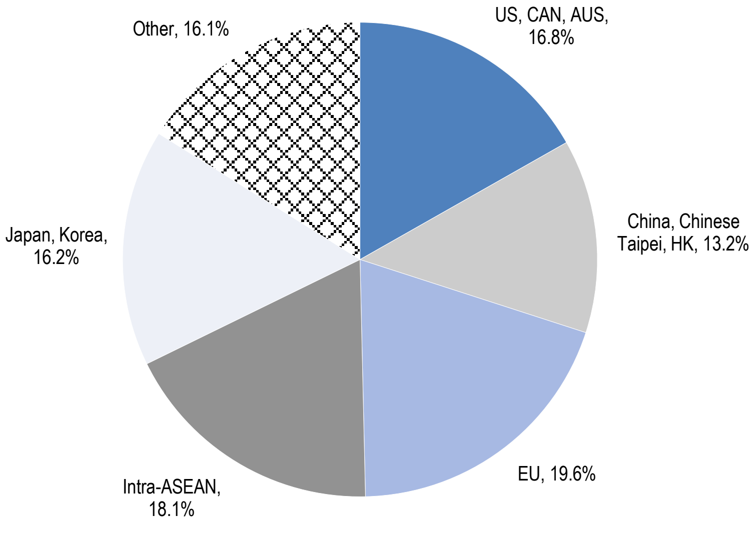
(inward FDI stocks as a percentage of GDP, 2001 and 2016)



Note: ASEAN does not include Brunei Darussalam and Viet Nam. Data for China is for 2004.
Source: OECD based on IMF Balance of Payment Statistics (BOP) Database

Figure 1.4. FDI in ASEAN is highly diversified by country of origin

(share of ASEAN inflows, 2010-16)



Note: The category "other" includes offshore fiscal havens which in some AMS are important investors.
Source: ASEAN statistical database.

FDI in ASEAN by sector: the growing importance of services

The rest of this chapter considers the growing importance of services within ASEAN and the role that FDI plays within that process. This information will serve as a reference for the discussion of the remaining discrimination against foreign investors in service sectors in ASEAN in Chapters 2 and 3.

In 2016, services accounted for 73% of ASEAN inward FDI stock, similar to the share in OECD countries (70% in 2015) and to global trends (ASEAN, 2017; UNCTAD, 2017). In the early 2000s, services represented around 50% of total FDI flows received by ASEAN, rising to more than two thirds a decade later (2012-16), with Singapore capturing the bulk of services FDI (Figure 1.5). Finance, wholesale and retail and real estate activities attracted most of services FDI. Manufacturing has represented less than a quarter of total inward FDI received by ASEAN in the past 15 years. Services FDI has been also on the rise in the rest of emerging Asia. In China, services drew more than 60% of inward FDI since 2010 compared to 40% in the late 2000s (2005-09).[1]

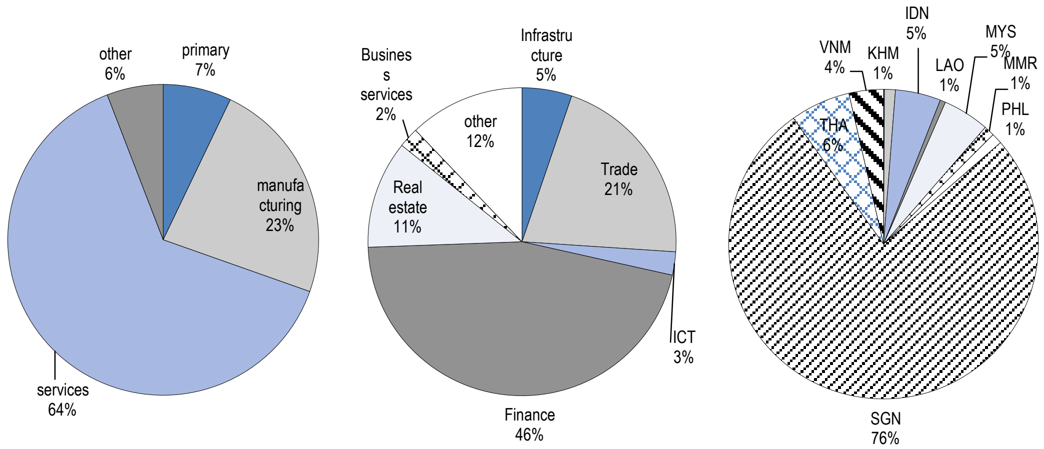
Cross-border mergers and acquisitions (M&A) purchases and greenfield FDI data indicate that services are relatively under-represented in ASEAN, although the region has attracted increasingly larger shares. ASEAN's share of world services M&A has more than doubled in the past 20 years (Figure 1.6). Services cross-border M&A deals in ASEAN have also grown relative to other sectors. They represented in value 57% of the region's deals since 1997, a ratio that is nonetheless lower than worldwide (63%). The surge in services M&As in ASEAN occurred mostly in the mid-2000s and partly reflects a cyclical rather than a structural upward shift. It is also sensitive to cross-border M&A operations in Singapore (38% of ASEAN services M&As). In the aftermath of the global financial crisis, cross-border M&A in services declined strongly, both worldwide and in ASEAN, while M&A purchases in the manufacturing sector proved more resilient to short-term fluctuations.

Figure 1.5. The bulk of recent inward FDI flows to ASEAN went to the services sector

a. by sector, 2000-16

b. by services, 2012-16

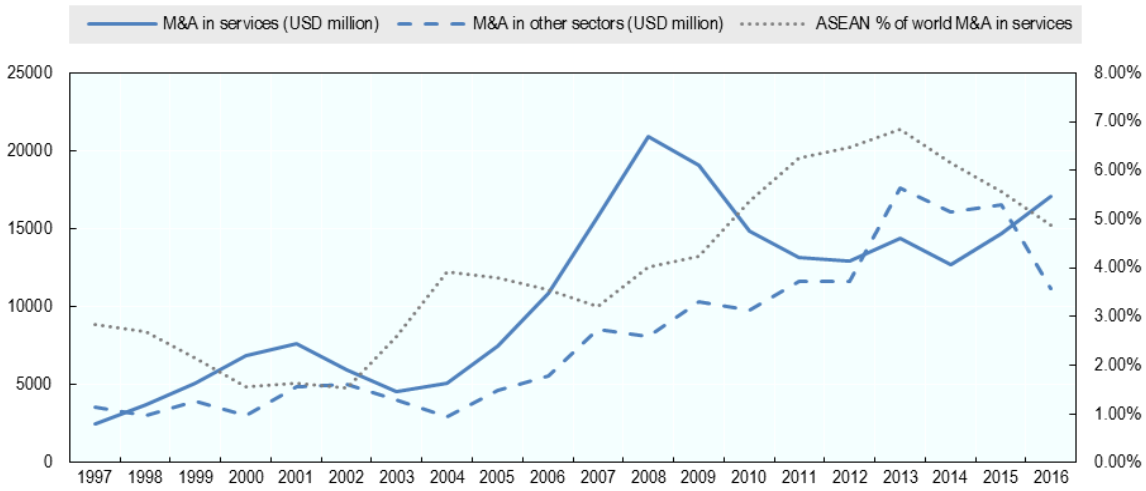
c. by AMS (only services), 2012-16



Source: OECD based on ASEAN FDI Database.

In contrast, announced greenfield investments worldwide have grown more steadily for services relative to manufacturing since the 2000s, mostly driven by infrastructure and business services. Services have represented half of the worldwide value of announced greenfield investments since 2010 compared to 41% in AMS – the same as in manufacturing (excluding Singapore and Malaysia). The services share in announced greenfield investment nevertheless have grown relatively quickly in the last ten years, although this was partly due to plummeting greenfield investments in the primary sector.

Figure 1.6. Services cross-border M&A in ASEAN have grown relative to other sectors



Note: the data represents three-year moving average. M&As in holding companies is excluded from ASEAN.
Source: OECD based on Dealogic M&A Analytics; UNCTAD World Investment Report 2017.

The magnitude of cross-border investment in services, particularly in ASEAN, may be overstated for a number of reasons. First, this shift is happening in a context where the boundaries between manufacturing and services have been increasingly blurred with the emergence of global and regional production networks (Miroudot and Cadestin, 2017). With the growing importance of services for value creation in manufacturing value chains, some of the shift to services in FDI patterns, including in ASEAN, captures in part the services content of regional value chains in manufacturing (ASEAN, 2017). In ASEAN, the multiplication of agreements to strengthen regional integration through trade and investment, including in services, has facilitated the emergence of such regional production networks (Hamanaka, 2011).

Services FDI may be also inflated due to international FDI and industrial statistical classifications. A large part of FDI allocated to services in FDI statistics reflects regional headquarters functions or operations carried out by holding companies, even when parent companies operate in the manufacturing or primary sectors. Recent estimates indicate that FDI in the services sector may be overestimated by more than a third because of the current industry classifications (UNCTAD, 2017). This may be also the case in ASEAN where a large proportion of FDI in services in Singapore (as well as in Malaysia and Thailand) that is reported in the statistics consists of financial holding companies of MNEs (in other sectors than services). In 2016 US-owned holding companies in Singapore represented the bulk of the FDI stock in services in the country.[2]

Lastly, the share of services in inward FDI is strongly sensitive to whether Singapore is included in the ASEAN aggregate. Besides being one of the most important financial destinations worldwide, Singapore is also the main location in ASEAN for MNE regional headquarters, which further inflate the amount of services in reported FDI. Without Singapore, the services sector share in total FDI drops sharply from 70% to less than 40% of the total inward FDI accumulated by ASEAN between 2012 and 2016, and the manufacturing sector becomes the main recipient of inward FDI flows.

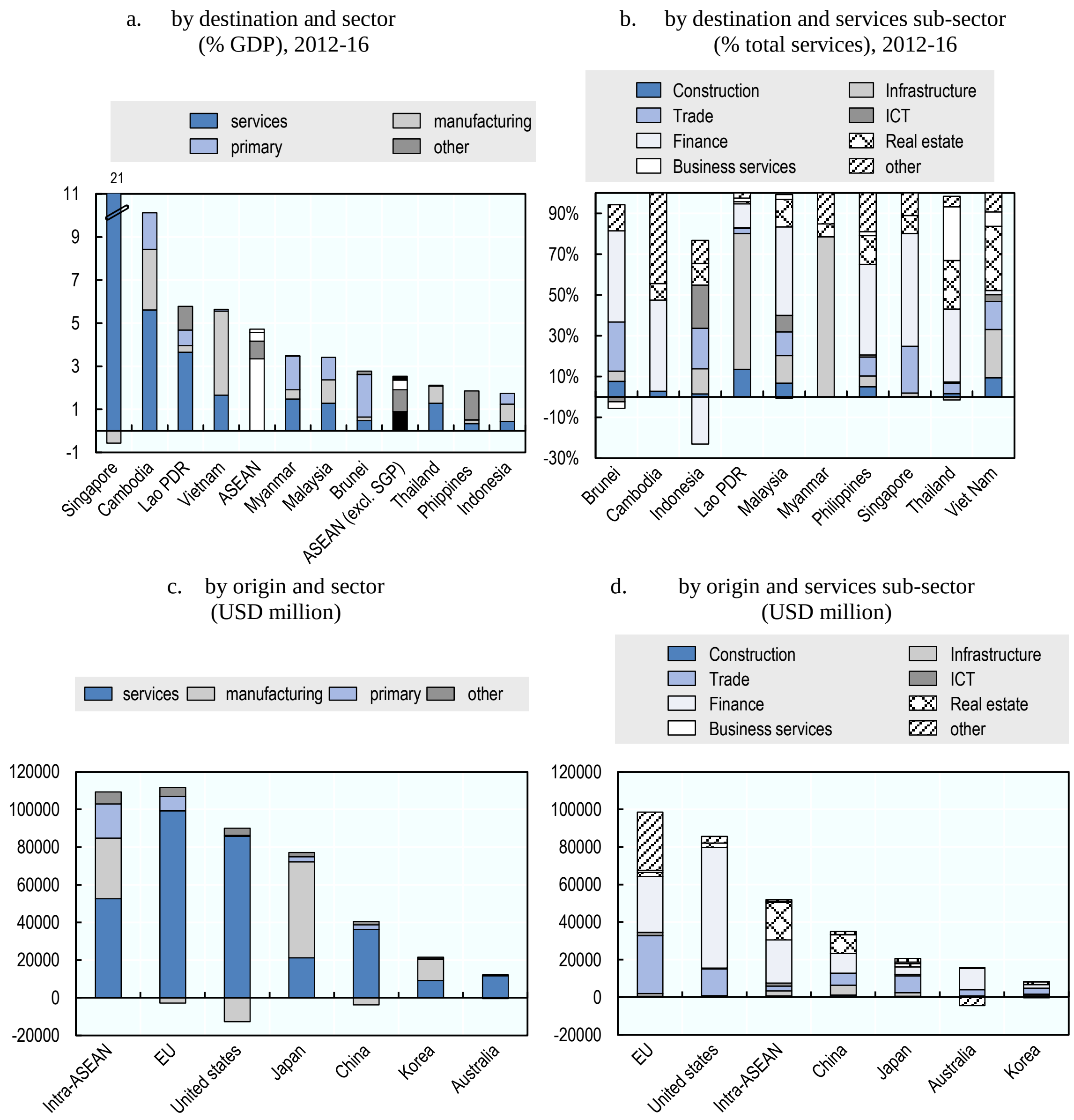
Services FDI plays an important, yet uneven, role in ASEAN economies

The weight of services FDI in total FDI and in the overall economy varies significantly across AMS (Figure 1.7 a). The services sectors of Cambodia, Lao PDR, Singapore, Thailand, and the Philippines attracted more than 50% of the total inward FDI between 2012 and 2016, above Myanmar (43%) and Malaysia (38%). Manufacturing represented only one third of total inward FDI flows in Malaysia, although the sector still accounts for more than 40% of the total FDI stock.[3] Indonesia and Viet Nam registered lower shares of services FDI than other AMS (less than 30%). Indonesia recently witnessed large divestments in the financial sector that lowered its share of services FDI. Over a longer period, services FDI in Indonesia increased strongly between 2004 and 2010 (yet in similar amounts to manufacturing), but has progressively declined since then.[4] The bulk of recent inward FDI in Viet Nam has been in manufacturing, as 60% of FDI stock in 2015 was in manufacturing.[5]

Finance, wholesale and retail, infrastructure, and real estate activities represented the bulk of services FDI in most AMS (Figure 1.7 b). FDI in infrastructure utilities was particularly prevalent in Lao PDR (electricity generation), Myanmar (transports), Viet Nam, Indonesia and Malaysia.[6] In Cambodia, approved FDI (in fixed assets) in the construction sector has increased strongly, bringing the share of the accumulated FDI stock between 2000 and 2015 in the sector to 19% of GDP.[7] With the exception of Thailand, FDI inflows in business services were negligible in AMS. Indonesia has the highest share of inward FDI flows in information and communications strategy (ICT), followed by Malaysia, where the sub-sector represented 8% of FDI stock.[8] The real estate sector in Viet Nam has represented most of the inward services FDI received by the country, and in a proportion much higher than its neighbours, representing 18% of the accumulated FDI inflows in 2015.

From the perspective of the main foreign investors in ASEAN, outward FDI in the past 15 years were higher in services than in manufacturing, except for Japan and Korea (Korea's outward FDI position in ASEAN was larger in manufacturing in 2015).[9] The European Union (EU) and the United States were the principal sources of services FDI in ASEAN (Figure 1.7 c). The bulk of US outward FDI to ASEAN went to the finance industry, but most of the investments related to holding company operations in Singapore. EU firms have invested strongly in ASEAN services sector in past years, mostly in wholesale and retail and finance (Figure 1.7 d). Yet, in terms of the outward FDI stock, large EU investors in the region such as the Netherlands still exhibit a higher position in manufacturing.[10] While ASEAN was the third largest investor in the region's services sector (13% of inward services FDI), it also continued to invest in manufacturing and in agriculture. Most intra-ASEAN services FDI was in finance and in real estate, a sector that has received little FDI from non-AMS countries in the past.

Figure 1.7. The prevalence of services in inward FDI flows varies strongly across AMS



Source: OECD based on ASEAN FDI Database.

Cross-border M&A are more widespread in services than greenfield FDI

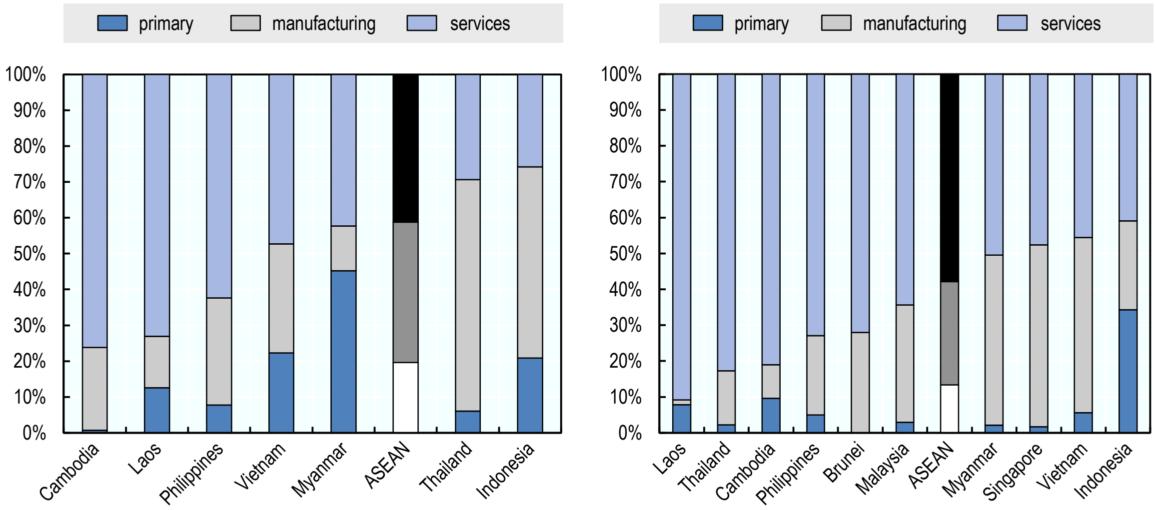
FDI types may respond differently to policies intended to attract investment. In ASEAN, cross-border M&A purchases were more widespread in services than greenfield FDI announced between 2010 and 2016. Services FDI prevail over manufacturing however in both entry modes and in most AMS (Figure 1.8). These patterns are in line with those observed worldwide (Davies et al., 2015). The data reveal once again that the share of services FDI is relatively high in Cambodia, Lao PDR, and the Philippines while comparatively small in both Indonesia and, to a lesser extent, in Viet Nam. Cross-border M&A purchases are highest in finance, infrastructure and ICT, a sector that received little

FDI according to aggregate FDI statistics. M&A data confirm that AMS attracted only few foreign investments in business services, contrary to the global trends (ibid).

Figure 1.8. Cross-border M&As prevail in services more than greenfield FDI

a. Announced greenfield investment, 2010-16

b. Cross-border M&A purchases, 2010-16



Note: The ASEAN aggregate excludes Singapore. M&As in holding companies are excluded.
Source: OECD based on fDi Markets and Dealogic M&A Analytics.

Nonetheless, the distribution of FDI across industries differs strongly in some AMS whether the data observed are cross-border M&A, announced greenfield investments, or aggregate inward FDI inflows. In Singapore, the share of services in cross-border M&A is much lower than the one observed with FDI statistics, yet this difference may be due to the small contribution of M&A to aggregate FDI. In Viet Nam, announced greenfield investments in services outweighed those in manufacturing, in contrast with what is suggested by M&A data. The case of Thailand is more puzzling, as less than 30% of announced greenfield investments were in services, while aggregate FDI and M&A statistics suggest that services amounted to much higher shares. These variations may be due to the sensitivity of investors' entry mode choice to sector-specific characteristics. For example, global trends reveal that textiles are one of the top sectors for greenfield FDI while they are under-represented in M&A (Davies et al., 2015).

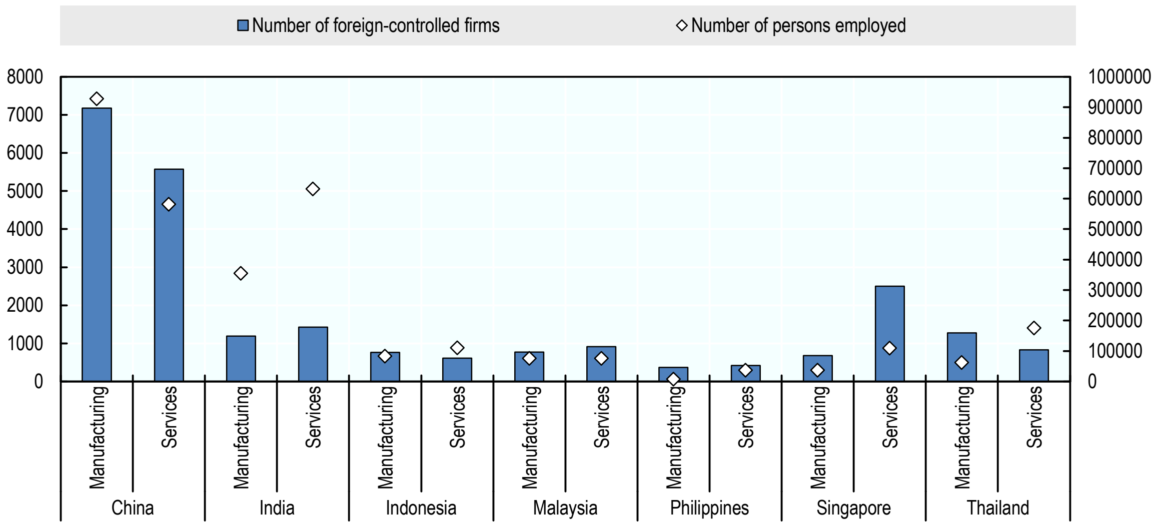
The presence of MNEs under foreign control is higher in the services sector

FDI data do not reflect the socio-economic importance of MNEs in terms of employment, output and exports. The MNE presence is higher in services in Southeast Asia, particularly in wholesale and retail, trade and logistics (large network of subsidiaries within ASEAN), ICT, and real estate (ASEAN, 2017). From the perspective of OECD-controlled firms, however, services MNEs in Indonesia, Malaysia, the Philippines and Thailand were only as numerous as those in manufacturing in 2014, unlike in China, where OECD-owned firms were predominant in the manufacturing sector (Figure 1.9). Services MNEs also, on average, employed more persons than those in manufacturing, particularly in Thailand.

A more detailed look at overall foreign-affiliate statistics from national statistical offices provides additional insights. For instance, data from the Bank of Thailand Foreign Affiliates Statistics confirm that there are only slightly more foreign affiliates in Thailand's manufacturing sector than in services (mainly in wholesale and retail), although their output is three times as high. In Malaysia, at the end of 2016 more than 57% of all foreign affiliates were in manufacturing against 34% in services.[11]

In addition to having their own affiliates abroad, MNEs are also increasingly making use of arm's-length contracts with independent partners (e.g. contract manufacturing, franchising and licensing, etc.). Such partnerships, which offer more flexible arrangements, are becoming building blocks in GVCs. In ASEAN, the majority of alliances concluded between 2010 and 2016 were joint ventures in the services sector between domestic and foreign partners.[12] Cross-border non-equity modes of production helped ASEAN firms to create linkages with MNEs and improve their capabilities in technology, business processes and management (ASEAN, 2017).

Figure 1.9. OECD-controlled firms in ASEAN are equally present in services and in manufacturing (2014)



Source: OECD Activity of MNEs Database.

Notes

1. Chinese Ministry of Commerce
2. US Bureau of Economic Analysis, Balance of Payments and Direct Investment Position Data.
3. Malaysia Department of Statistics
4. Central Bank of Indonesia

5. General Statistics Office of Viet Nam
6. In Lao PDR, electricity generation counts for a third of total FDI stock (OECD, 2017).
7. Foreign Direct Investment Survey, July 2016, the National Bank of Cambodia
8. Malaysia Department of Statistics
9. OECD Foreign Direct Investment Database
10. OECD Foreign Direct Investment Database
11. Malaysia Department of Statistics
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Chapter 2.

FDI liberalisation in Southeast Asia: An unfinished agenda

This chapter looks at trends and drivers of investment liberalisation over time and across ASEAN, with a particular emphasis on remaining discrimination against foreign investors in service sectors. It benchmarks the reform experience of ASEAN Member States against over 50 other countries using the OECD FDI Regulatory Restrictiveness Index and assesses the extent to which regional and plurilateral agreements covering investment have contributed to further investment liberalisation in Southeast Asia.

Summary

The success of Southeast Asia in attracting FDI and the varied performance across the region over time have multiple causes and cannot be explained by any one factor alone. But one element is clearly the differing pace of policy reforms worldwide and within the region. Unlike many other determinants of FDI patterns, such as market size or geography, it is one element which governments have the power to change, and to do so relatively quickly. This chapter benchmarks discrimination against foreign investors across countries and over time using the OECD *FDI Regulatory Restrictiveness Index* (Box 2.1).

The early success of countries such as Malaysia and Thailand in attracting foreign investment was based partly on selective openness, with derogations from existing restrictions for export-oriented projects or strategic investments (OECD, 1999). Given that import substitution was the prevailing policy in many developing countries and that few emerging economies were actively seeking to attract export-oriented foreign investment at the time, this selective approach was sufficient to entice investors – particularly at a time of currency realignments in East Asia. Over time, other emerging economies started to promote manufacturing FDI in earnest and by now there are few restrictions on foreign investors in manufacturing sectors either in Southeast Asia or in the rest of the world – particularly for greenfield projects.

Perhaps because of their continued success in attracting manufacturing FDI, many ASEAN Member States (AMS) may have felt less pressure to liberalise other sectors. As a result, the majority of countries in the region have fallen behind other parts of the world in terms of openness to foreign investment. Six AMS are now among the top ten most restrictive countries for FDI among the over 60 economies currently covered by the *Index*. Many of these restrictions concern service sectors, holding back potential productivity gains throughout the economy (Chapter 3).

Southeast Asia is a diverse region and the same diversity applies to FDI policies. Cambodia and Singapore are very open to foreign investors, even compared to many OECD countries. Brunei Darussalam and Viet Nam have average levels of openness under the *Index*, while the remaining six AMS are highly restrictive. 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.

There is a close link between levels of restrictiveness as measured by the *Index* and the per capita stock of FDI worldwide, as well as across ASEAN. Indeed, ASEAN members have roughly the stock of investment that would be predicted based on their population or market size and level of restrictiveness. This same relationship holds to some extent over time for individual countries. The relationship is not always strong but it does suggest that investors respond to reforms – particularly once a critical mass of liberalisation has been achieved.

Drivers of reform have been a mix of unilateral, regional and pluri- and multilateral efforts. Faced with competition for FDI from China and within ASEAN, many AMS have reformed unilaterally to match levels of openness found elsewhere. Crises, such as the Asian Financial Crisis in 1997 may have temporarily accelerated the process in some cases but are not by themselves a sufficient explanation. Cambodia, Lao PDR and Viet Nam undertook substantial reforms as a result of accession to the World

Trade Organization. This chapter looks at the possible role of the ASEAN Framework Agreement in Services (AFAS) and the ASEAN-Australia-New Zealand FTA (AANZFTA) in promoting liberalisation. It finds that such agreements have generally played more of a role in locking in standards of treatment and market access for treaty-party services providers than in actually driving liberalisation.[1]

AFAS had 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 needed to bring their overall level of restrictiveness closer to the average openness observed elsewhere in the developing world.

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.

Overall trends in liberalisation of FDI restrictions in ASEAN

Many AMS are among the most restrictive to FDI worldwide…

Countries in the Asia-Pacific region, including many ASEAN economies, tend to be relatively more restrictive to FDI than in other regions (Figure 2.1). All governments discriminate among investors in one way or another, whether deliberately or unwittingly. This is the case even in OECD countries where restrictions on foreign investment tend, on average, to be lower than in other parts of the world. Foreign investors, for example, might face restrictions on their ownership in a local company, particularly in key sectors. Larger countries also tend to be more restrictive, partly because larger markets – or sometimes more abundant natural resources – give them more scope to impose discriminatory conditions and still attract investors. But the extent of restrictiveness of FDI regulations in ASEAN economies is considerably higher than observed elsewhere.

Box 2.1. Calculating the OECD FDI Regulatory Restrictiveness Index

The OECD *FDI Regulatory Restrictiveness Index* seeks to gauge the restrictiveness of a country's FDI rules. The FDI Index is currently available for all OECD countries and over 30 non-OECD countries, including all G20 members and non-OECD countries adhering to the OECD *Declaration on International Investment and Multinational Enterprises*. It is used on a stand-alone basis to assess the restrictiveness of FDI policies in reviews of candidates for OECD accession and in OECD *Investment Policy Reviews*, including reviews of new adherent countries to the OECD *Declaration*.

The FDI Index does not provide a full measure of a country's investment climate since it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the Index, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining the varied performance across countries in attracting FDI.

The FDI Index covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, financial and professional services). Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a simple average of individual sectoral scores. For a detailed description of the scoring methodology, please refer to the technical working paper by Kalinova et al. (2010).

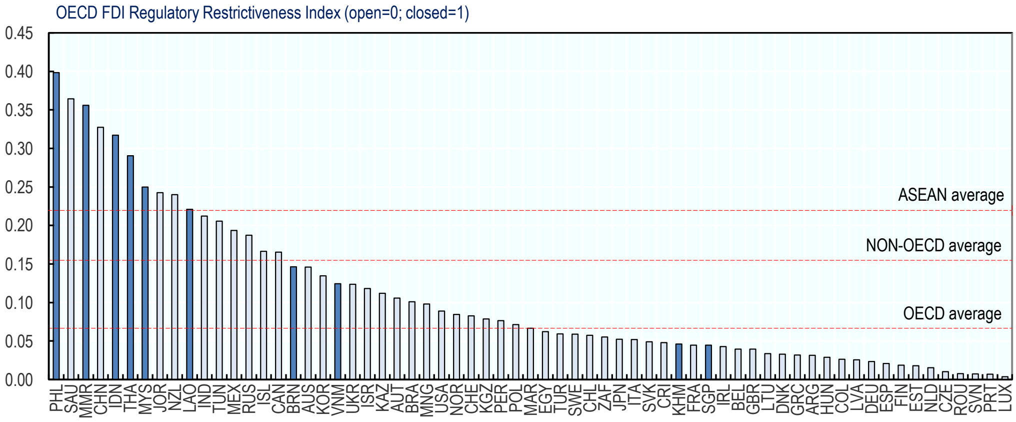
For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted,
- the screening/approval procedures applied to inward foreign direct investment;
- restrictions on key foreign personnel; and
- other restrictions, e.g on land ownership, corporate organisation (branching).

The measures taken into account by the Index are limited to statutory regulatory restrictions on FDI, typically listed in countries' lists of reservations under FTAs or, for OECD countries, under the list of exceptions to national treatment. The FDI Index does not assess actual enforcement and implementation procedures. The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. Preferential treatment for special-economic zones and export-oriented investors is also not factored into the FDI Index score, nor is the more favourable treatment of one group of investors as a result of an international investment agreement.

Source: For more information on the methodology, see Kalinova, Palerm and Thomsen (2010). For the latest scores, see : www.oecd.org/investment/index.

Figure 2.1. OECD *FDI Regulatory Restrictiveness Index*, 2016



Notes: (1) See Box 2.1 for a description of the *FDI Index.* Data reflect restrictions as of end-December; (2) Scores for Brunei Darussalam, Thailand and Singapore are preliminary.
Source: OECD FDI Regulatory Restrictiveness Index database, www.oecd.org/investment/fdiindex.htm.

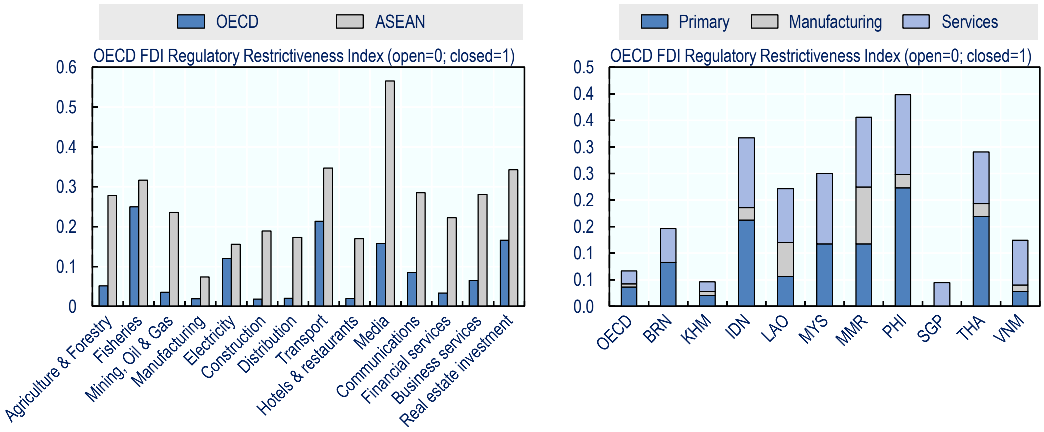
This finding may seem at odds with the common notion that many AMS have largely relied on FDI as part of their export-led development, but the regime in export processing zones or for exporters more generally – often more liberal – is not captured in the *Index*. Manufacturing industries as a rule are subject to fewer FDI restrictions, except when a horizontal measure applies across economic sectors, such as for foreign acquisitions of local companies or in the case of foreign investors' access to land. Foreign ownership of land is prohibited in several AMS although long-term leases are usually offered. Over time, greater efforts have been made to dismantle barriers to FDI in manufacturing industries as most governments have come to accept the potential benefits of industrial FDI for development.

…many primary and service sectors remain partly off limits to foreign investors, holding back potential economy-wide productivity gains…

Outside of manufacturing, FDI liberalisation remains an unfinished agenda in the region, as many governments still discriminate against foreign investors in service sectors and primary industries (Figure 2.2). Although this varies greatly across countries, the sectoral pattern of restrictions tends to be similar in both advanced and emerging economies worldwide, but the extent of restrictiveness is normally much greater in the latter group, notably in ASEAN. As discussed in Chapter 3, excessively stringent regulations on FDI, particularly in service sectors, hinders market contestability and competition in these markets, consequently raising service input costs, such as in financing and logistics, for other economic sectors, including the manufacturing sectors which these countries have been eager to promote to support broader economic development.

Figure 2.2. FDI restrictions by sector, ASEAN versus OECD members

(Panel A - by sector; & Panel B - sector contribution to overall score)

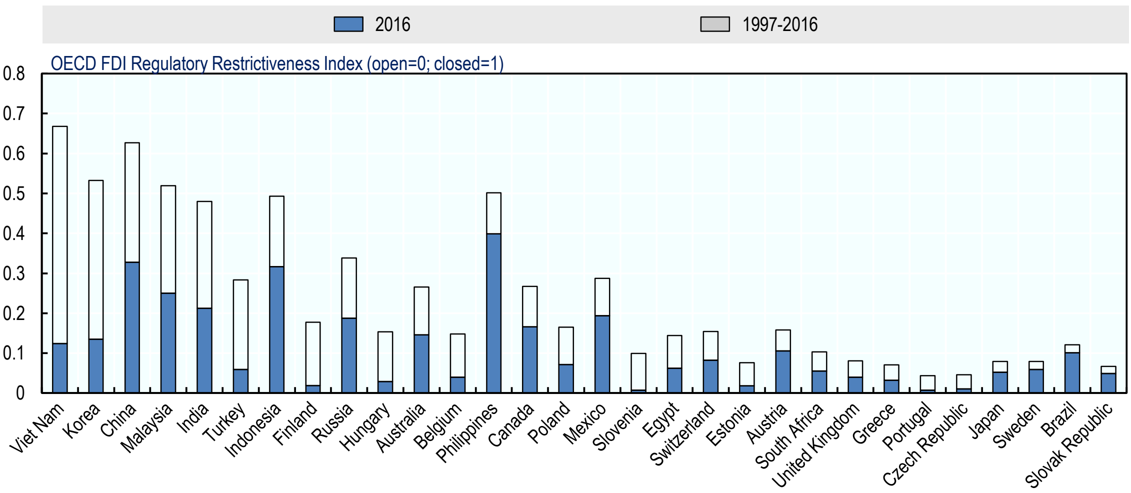


Note: See Box 2.1 for a description of the *FDI Index*.
Source: OECD FDI Index database, www.oecd.org/investment/fdiindex.htm

…but they have been among the most active FDI reformers since 1997

Seen from a broad perspective, most economies have significantly liberalised restrictions on international investment over time, albeit with some occasional sectoral relapses but with limited backtracking overall. ASEAN economies have been latecomers to some extent, but they have nevertheless been among the most active FDI reformers in the past two decades in absolute terms, consistently moving towards levels of FDI restrictions observed in more advanced economies (Figure 2.3).

Figure 2.3. ASEAN members are among the top FDI reformers since 1997



Note: See the description of the *FDI Index* in Box 2.1. The sample of countries is restricted to those covered in the 1997 *Index*; only the top 30 reformers are shown.
Source: OECD *FDI Index* database, www.oecd.org/investment/fdiindex.htm

The biggest reformers since 1997 in absolute terms have all been in Asia, as one might expect given that many of these countries started the period with a relatively high level of restrictiveness. To a lesser extent, this also holds for ASEAN Member States. For advanced economies, notably members of the European Union, reforms mostly occurred in earlier decades and hence have been fewer in the observed period. Most of the Adherents to the OECD *Declaration and Decisions on International Investment and Multinational Enterprises* are also now fairly open.

Liberalisation has mostly occurred on a unilateral basis in ASEAN economies, although the pace and timing of reforms may have also been influenced by external factors such as WTO membership, regional FTAs or economic crises. Causality is difficult to establish as governments sometimes take advantage of external pressures to push through reforms that were already being considered.[2] But some evidence exists to suggest that external pressure from increased competition for FDI by peer countries has sometimes induced policy liberalisation (Cooray and Vadlamannati, 2014).[3]

Much of the recent liberalisation in **Malaysia**, for example, has been unilateral. At the time of the Asian crisis, Malaysia was already relatively open compared to other Asian countries, and the crisis triggered only minor FDI reforms. In the decade that followed, however, Malaysia saw its share of inward FDI stock in ASEAN decline rapidly (Chapter 1), partly as a result of increased competition for FDI by other countries in the region. Then in 2009 Malaysia unilaterally undertook reforms to its investment regime, lifting many restrictions on foreign investors, to strengthen the economy in the face of the challenges of globalisation. In 2011, an additional wave of reforms further eased barriers to FDI in various services sectors.

Viet Nam, on the other hand, implemented important reforms in the run up to its accession to the WTO on November 2006 (effective January 2007) after 11 years of negotiations (OECD, 2018 forthcoming). Among other things, it adopted a new *Law on Investment* and a new *Law on Enterprises* in 2005, later replaced in 2014. Together these laws helped to modernise and simplify establishment procedures for investment and provided for a common legal regime for both foreign and domestic investors, although discrepancies remained (Chapter 4).

In terms of liberalisation, the new legislation narrowed the scope of investment projects subject to investment evaluation (approval requirement) and provided greater market access to foreign investors. The reform also set the scene for aligning domestic regulations with commitments under international agreements. The new list of conditional sectors to foreign investors, implemented in tandem with the new laws, included a reference to any sector subject to conditions on market access under an international treaty, of which Viet Nam was a member – a clear reference to Viet Nam's WTO commitments. This paved the way for some further liberalisation following its accession, since in some cases commitments enshrined gradual liberalisation. More recently, Viet Nam further lifted a restriction preventing foreign investors from acquiring shares of listed securities in excess of 49% of their voting capital. In the absence of other sector-specific restrictions or unless the enterprise activity is in the list of conditional sectors, foreign investment is no longer restricted.

Indonesia has also significantly liberalised FDI restrictions over time, mostly on a unilateral basis. The most recent reform came with the issuance of the new negative list in May 2016, which lifted or eased foreign equity restrictions in key sectors and brought Indonesia's FDI regime closer to international and regional levels of openness. Most importantly, it reaffirmed a more positive attitude towards foreign investment, coming at a critical moment as the previous negative list of 2014 had partly reversed the liberalisation trend by introducing more stringent and discriminatory rules for foreign investors in some key sectors, such as mining. Yet, the current framework remains fairly restrictive to foreign investors overall.

Myanmar has, likewise, implemented a range of reforms in recent years that have significantly improved the environment for investors. While international assistance has played a role in shaping such reforms, the push has mostly come from domestic constituencies supporting the transition to an open, market-based economy. The *Myanmar Investment Law*, in effect since 2016, provides a unified regime for both foreign and domestic investors, enhancing the transparency of the investment regime and reducing potential discrimination; ultimately contributing to a level playing field. It provides for improved standards of treatment, streamlined procedures and a narrowed scope of projects subject to admission approvals by the Myanmar Investment Commission. It also adopts a negative list approach, which clarifies the sectors and activities where foreign investment is prohibited, restricted and promoted

The implementing regulations were issued in 2017, notably the Myanmar Investment Rules[4] and the list of restricted activities[5] containing some important liberalisation. For instance, the number of sectors requiring joint ventures with domestic investors was reduced from 92 in the previous list[6] to 22, notably in sectors such as retail distribution, oil, print and broadcasting media, real estate and pharmaceuticals.

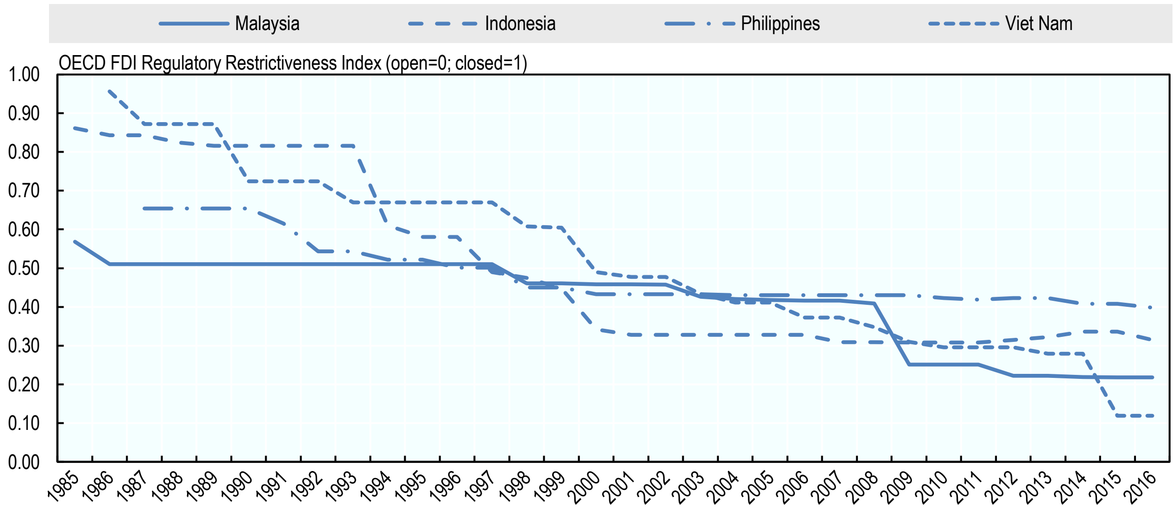
This recent liberalisation trend is not unique to ASEAN and has also been intensifying in other large Asian economies such as China and India that have also made impressive strides in terms of FDI liberalisation over time. India, as part of its Make in India initiative to promote foreign investment in the manufacturing sector, has deregulated FDI in several sectors over the past two years. And China, after easing foreign investment screening requirements in 2016, further revised the *Catalogue for the Guidance of Foreign Investment Industries* in 2017 – the main instrument governing foreign investment. The previous catalogue issued in 2015 already helped to ease entry conditions for foreign investors in key services sectors such as distribution and rail transport. While these countries remain fairly restrictive to FDI as a number of activities are subject to tight conditions and approval, altogether they bring their regimes closer to international levels of openness and transparency, potentially enhancing competition for FDI across Asia.

Historical scores using the *Index* currently exist for four AMS (Figure 2.4). They suggest a gradual convergence towards global practices. While reforms of discriminatory policies tend to occur in waves, many countries have continued to reform over time and there has been almost no backtracking, although in some countries such as Indonesia and the Philippines reforms have slowed down since 2000. While some reforms did occur around the time of the Asian financial crisis after 1997, the gradual yet persistent nature of reforms suggests that they are part of a long-term strategy sustained over numerous administrations and not simply the result of IMF conditionality or other measures taken during a crisis.

Reforms have had an impact on FDI performance

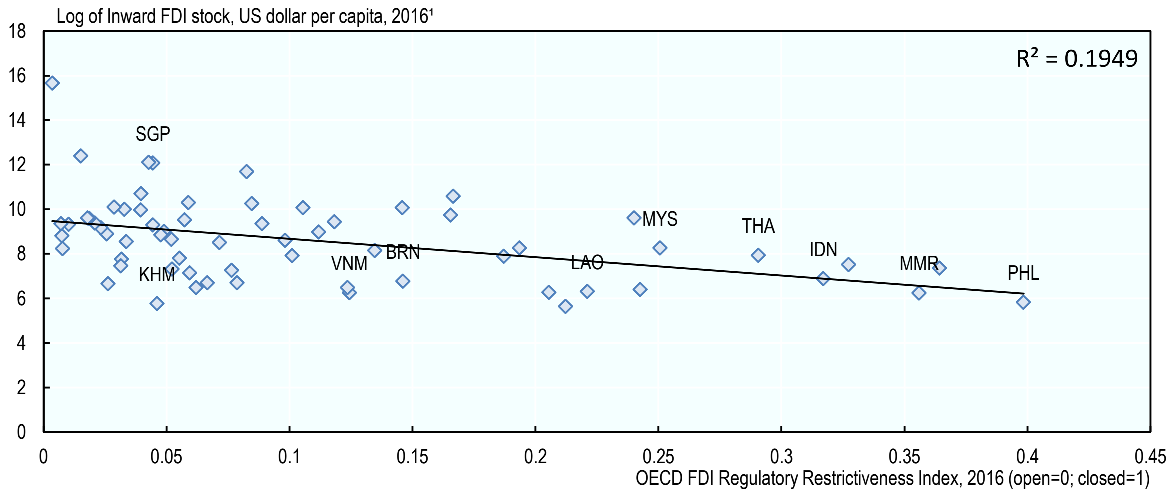
Figure 2.5 compares the scores under the *Index* with the per capita stock of inward FDI for each country. More restrictive countries tend to receive less FDI. Southeast Asia is not an outlier in this respect: almost all AMS have roughly the amount of FDI that would be expected in this simple model, while Singapore receives more FDI than predicted in spite of its high level of openness and Cambodia receives less than expected. This same relationship holds for ASEAN countries alone: the most open economies (Singapore and Cambodia) receive the most investment relative to their population size, while the most restrictive (the Philippines and Myanmar) are among the worst performers in attracting FDI.

Figure 2.4. FDI liberalisation trends in selected AMS



Note: The historical series might not perfectly match the current Index score due to slight methodological accommodations made to ensure consistency overtime.
Source: OECD (2018) *Investment Policy Review of Viet Nam* (forthcoming).

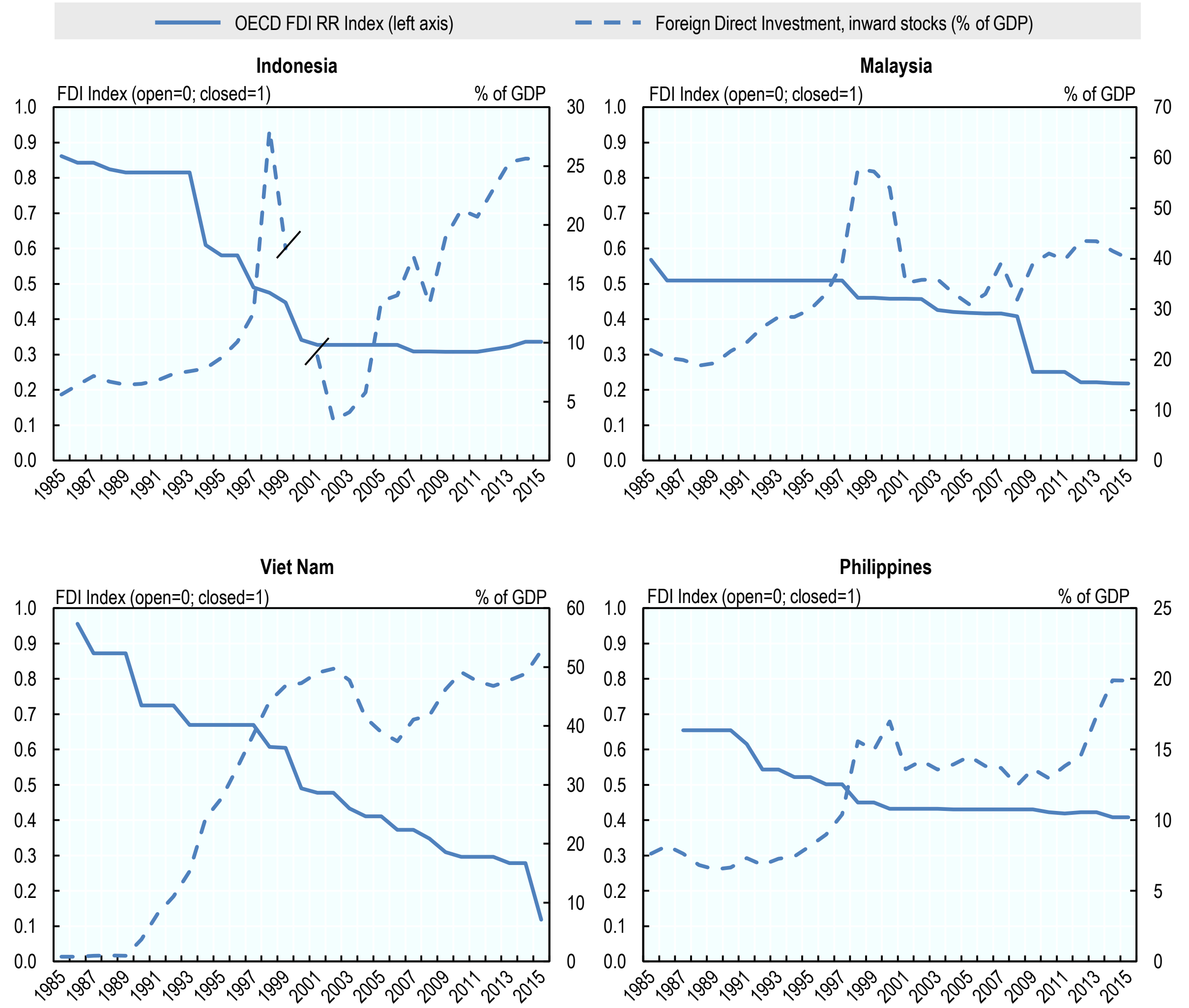
Figure 2.5. FDI restrictions are associated with a lower stock of FDI per capita



Note: Data are from 2016 or 2015 when not available.
Source: OECD and IMF for FDI and population; OECD *FDI Regulatory Restrictiveness Index* database.

The same relationship between FDI restrictions and the stock of inward investment also holds across time for many individual countries. Figure 2.6 relates the historical series provided in Figure 2.4 with FDI stocks relative to GDP for Indonesia, Malaysia, the Philippines and Viet Nam. The inverse relationship is not always strong but does suggest that foreign investors respond to reforms – particularly after a critical mass of reforms has been achieved. The relationship is less strong in the case of Malaysia because early reforms were only partial and geared towards exporters and hence are not covered in the *Index*.

Figure 2.6. Liberalisation and FDI in selected AMS



Note: The historical series might not perfectly match the current Index score due to slight methodological accommodations made to ensure consistency overtime.
Source: OECD *Investment Policy Review of Viet Nam* (forthcoming) and UNCTAD statistics.

Service sector liberalisation trends across ASEAN

Governments worldwide generally recognise the overall benefits of trade liberalisation as a key channel for raising the performance of manufacturing industries through increased competition from imports, thereby stimulating innovation and technological diffusion and lowering costs, including for industries relying on imported inputs. At the same time, services liberalisation has often lagged behind. For many developing economies, liberalisation of services trade became more prominent in national development strategies only in the 1990s, at a time when services were becoming more tradable through advances in ICT. The increasing fragmentation of production processes across countries increased demand for world-class services in tandem with demand for more integration, harmonisation and standardisation of services inputs.

Reform of services is typically resisted by domestic interest groups, often in sectors dominated by state-owned enterprises. The nature of services activities also makes them more complex to trade, partly because, unlike trade in goods where factors of production are built-in, it often requires the actual relocation of capital and labour across borders. This implies that services reforms need to address not only market access barriers but also non-efficient regulations behind the borders for them to deliver expected results.

A strong push for comprehensive service sector reforms materialised largely at multilateral level. The recognition of the importance of services in the global economy led to attempts to negotiate and develop compatible and mutually advantageous agreements on services. The General Agreement on Trade in Services (GATS), which came into force in 1995, was the keystone. Subsequently, various regional and bilateral services agreements have been signed borrowing from the same GATS structure.[7] Yet, while the GATS established a basis for further negotiations, not much progress has been made at the multilateral level since then. Within Southeast Asia, the ASEAN Framework Agreement on Services (AFAS), and the few ASEAN+1 regional trade agreements[8] also follow the GATS framework of negotiations rounds, where in each round countries make commitments on two aspects of liberalisation (market access and national treatment) across the four modalities of supply of services.[9]

Many observers have expressed discontent with the results achieved through the multilateral/regional channel, including by ASEAN Member States (Fukunaga and Ishido, 2012; World Bank, 2015; Cornish and Findlay, 2011; Dee, 2015). AFAS negotiations, for instance, have mostly failed to meet goals stipulated up-front within the approved timelines. To some extent, they failed even to bring greater transparency and clarification to the process as demonstrated by how challenging it can be to access the latest AFAS schedules. This is not to say that these agreements did not contribute in any way to extending preferential access to services providers from partner economies. In their regional trade agreements, ASEAN Member States typically made commitments that go beyond their commitments in the GATS on average (Thanh and Bartlett, 2006); and, as one would expect, commitments are more extensive in the AFAS given their ambitions for the ASEAN Economic Community (Ishido, 2011).

Agreements may have generally played more of a role in locking in standards of treatment and market access for treaty-party services providers than in actually driving liberalisation. Only rarely have commitments made under these agreements imposed constraints on the applied domestic policy, *i.e.* providing better preferential market access and treatment conditions than those observed in domestic legislation. The World Bank (2015) found that AFAS has not resulted in significant additional liberalisation on the ground. Some of these agreements protected AMS policy space through commitments which are far more restrictive than the actual legislation.

This report shares the view that ASEAN agreements need to go deeper in order to advance the unfinished services reform agenda. Relatively deeper liberalisation commitments were made under AFAS in a few key backbone services, and these are important for achieving the ASEAN single production base aspiration as discussed below. But, AFAS commitments still mostly fall short in bringing ASEAN economies closer to levels of openness observed in advanced economies. As such, more meaningful services liberalisation has thus far been mostly the result of unilateral efforts. Potentially, autonomous liberalisation efforts may have benefited from windows of opportunities to reform arising from domestic constituencies in contrast to externally negotiated reforms which are possibly less likely to synchronise with any kind of domestic impetus.

The next generation of ASEAN agreements, notably the future ASEAN Trade in Services Agreement (ATISA) which AMS have agreed to negotiate and implement to further integration of services sectors in the region, could go deeper in order more effectively to support the services liberalisation agenda. Drawing on the lessons learned from the experience with the AFAS, ATISA could shift from the current negotiation modality from a positive- to a negative-list approach. In principle, these two approaches can achieve equivalent results, but in practice evidence suggests that the negative list approach typically achieves more ambitious outcomes (Ochiai, Dee and Findlay, 2010; Dee, 2015; Fink and Molinuevo, 2008). This approach may be somewhat more burdensome for governments at first, but many ASEAN economies have already started to adopt a negative list approach within their domestic regulatory frameworks. Such an approach has also already been adopted in some of the most modern agreements, such as the Trans-Pacific Partnership (TPP) for instance, of which four ASEAN countries are parties. The agreement is expected to have profound and divergent implications for the countries in region, partly thanks to the more ambitious commitments expected.

ATISA could also serve as a platform for AMS to further strengthen the agenda for co-operation, compatibility and harmonisation of services regulations across ASEAN. These issues were kept to a large extent outside the current work of the AFAS (World Bank, 2015), despite being crucial for achieving ASEAN's single market and production base aspirations. The costs of regulatory heterogeneity can be high, as suggested in the case of OECD economies (Fournier, 2015), providing a real barrier for full services integration in the region.

Deepen ASEAN agreements to advance the unfinished service sector reform agenda

The objectives of trade and investment agreements are often much broader than preferential market access outcomes. They typically seek to provide a more transparent and predictable environment for traders and investors through a range of legal protections, transparency mechanisms and regulatory disciplines. Most bilateral investment treaties do not address market access issues. Hence, assessing the extent to which agreements have contributed to further liberalisation of domestic regimes in treaty partners tells only part of the story, and certainly cannot be enough to allow an assessment of their success. Nevertheless, market access and national treatment are an important component of the services agenda and consequently of the various instruments at the disposal of governments for advancing this agenda, particularly through agreements. Thus, while not the only important result that can be derived from agreements covering services, their capacity to support liberalisation immediately or in the future should not be neglected.

Recognising the importance of services to competitiveness and inclusive growth, ASEAN economies have set ambitious goals for services integration within Member States. The ASEAN Framework Agreement on Services (AFAS) and the ASEAN Economic Community Blueprint set the course for achieving such objectives by 2015.

The AEC Blueprint set explicit targets to be achieved for services liberalisation under all four modes of supply through successive rounds of AFAS negotiations. For modes 1 and 2, there should no restriction in any of the 128 services sub-sectors identified for negotiation under AFAS. For mode 3 (commercial presence), targets were set gradually with regards to foreign equity limitations and other market access restrictions depending on the sector. For priority integration sectors (i.e. air transport, e-ASEAN, health and tourism) and logistic sectors, the target was to allow not less than 70% of ASEAN equity participation by 2010 and 2013 respectively; and for other services sectors, between 51% and 70% should be allowed by 2015. No other market access limitation was to be in place in any of these sectors by 2015. For mode 4, targets were not explicitly set, and since 2012 it has been the objective of a stand-alone ASEAN Agreement.

ASEAN has also entered into FTAs and comprehensive economic partnership agreements covering services with dialogue partners, most notably with Australia and New Zealand, Korea, China and India. As with AFAS, these agreements mostly follow the GATS 'positive list' structure of negotiation for their services component: countries make commitments with regards to market access and national treatment across the four modes of services supply.[10]

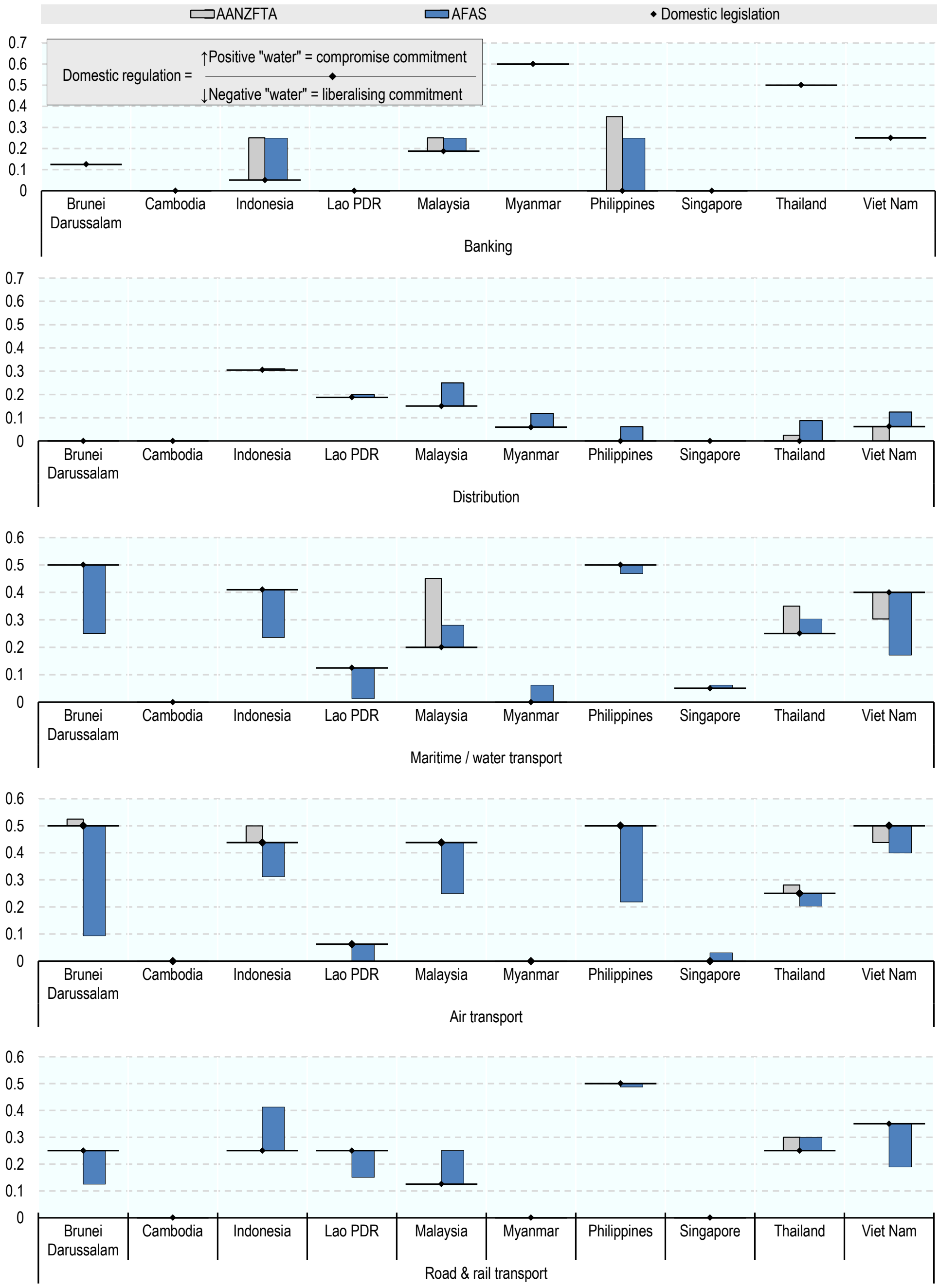
An analysis of AMS commitments under the AFAS and the AANZFTA in some of the key backbone services sectors for achieving a ASEAN single production base reveals that both agreements have achieved some positive results in terms of both liberalisation and partial commitments, defined as commitments which fall short of actual levels of openness (Figure 2.7), albeit to varying degrees (see Box 2.2 for the methodology). But it also reveals that ASEAN agreements need to go deeper to provide the sort of catalytic services liberalisation needed to bring their overall level of restrictiveness closer to the average openness observed elsewhere in the developing world (see section above). This comes in contrast to the latest AEC Blueprint 2025, which contains no agenda for further work on services.

Under AANZFTA, liberalising commitments (negative water) in selected services were rather minimal with respect to foreign equity limitations. Only Viet Nam made liberalising concessions to AANZFTA partners, notably in air and maritime and water transport. Partial commitments (positive water) were generally more common across ASEAN and widespread in terms of sectors. Brunei Darussalam, Indonesia, Malaysia, Philippines and Thailand all made commitments in one sector or another, although the observed levels of water in those commitments were typically high, meaning that governments sought to protect their policy space considerably. But the limited results achieved with respect to foreign equity limitations in these service sectors should not overshadow other potentially important results attained in other areas, such as transparency, investor protection, "WTO plus" regulatory disciplines and even liberalisation in other services sectors, such as professional services (Government of Australia, 2009; World Bank, 2015).

In addition, AANZFTA also encompassed a "built-in agenda to review market access commitments in services three years after entry into force of the Agreement, and periodically thereafter as determined by the FTA Joint Committee. The aim of these reviews is for Parties to further improve specific commitments so as to progressively liberalise trade in services" (Government of Australia, 2009). To date, however, the built-in-agenda in services has not been fulfilled. The parties have agreed to extend the timeframe and committed to undertake work focusing on liberalising in 'sectoralclusters' of particular importance in GVCs and in key sectors of the economy, but this work has been put on hold so as not to prejudice the Regional Comprehensive Economic Partnership (RCEP) negotiations which have been underway since 2013 (AANZFTA FTA Joint Committee, 2015 and 2017).

Figure 2.7. Water in AFAS and AANZFTA, selected sectors, foreign equity limitations

OECD FDI Regulatory Restrictiveness Index (open=0; closed=1)



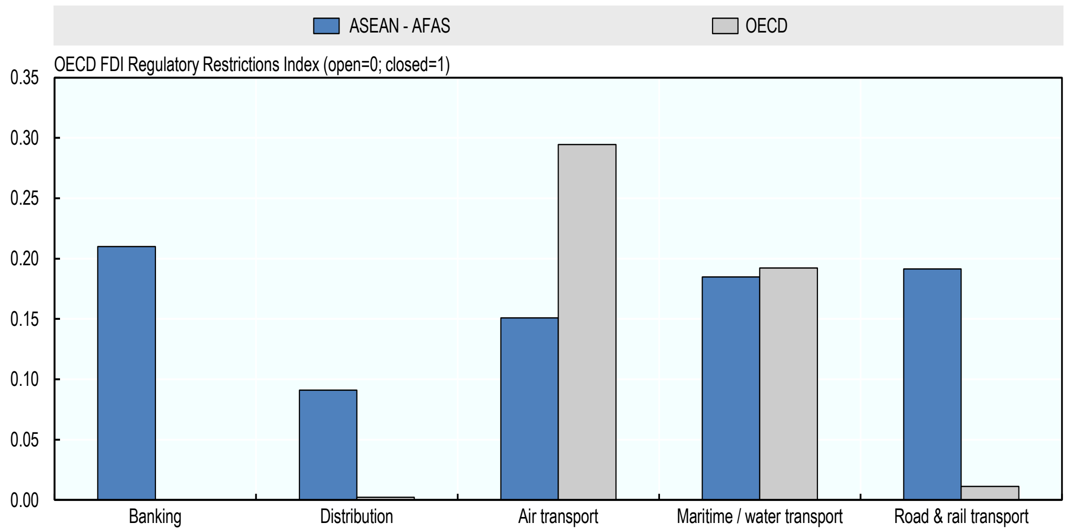
Source: Author's calculation. See box 2.2 for the underlying methodology and certain caveats regarding this approach.

AFAS, on the other hand, achieved some important liberalisation that should help to strengthen ASEAN integration, notably in transport sectors. In distribution there has been almost no liberalisation, but AMS have made partial commitments which lock-in conditions fairly close to applied regimes. This provides greater certainty to ASEAN investors that any eventual backtracking from current levels of openness will be limited. Only in banking have AMS mostly refrained from commitments of any sort.

Yet, despite such outcomes, the average level of restrictiveness observed in AFAS across the five key services sectors is still much greater than that observed in advanced OECD economies (Figure 2.8). The starting point of negotiations is fairly restrictive for the average ASEAN economy, which may make meaningful liberalisation more difficult to achieve. Even if negotiations accomplish some important liberalisation, commitments may still be relatively far away from international levels of openness. This challenge is possibly compounded by the very nature of the "positive list" approach typically retained for such trade in services negotiations (Broude and Moses, 2016). Although easier to negotiate, the positive list approach is often found to achieve less ambitious results (Ochiai, Dee and Findlay, 2010; Dee, 2015).

Figure 2.8. OECD FDI regulatory restrictions index: AFAS commitments vs OECD

(foreign equity limitations only)



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

Adopting a negative list approach in future agreements:

Following the adoption of the ASEAN Economic Community Blueprint 2025, which reaffirmed ASEAN's goal to further increase services competitiveness and broaden and deepen services integration, AMS agreed to negotiate and implement the ASEAN Trade in Services Agreement (ATISA). One option that could help to advance and deepen the services reform agenda is to switch from the current positive list approach to a negative list in negotiations (Dee, 2015). Some evidence exists to suggest that a negative list approach could yield more ambitious outcomes (Ochiai, Dee and Findlay, 2010; Dee, 2015; Fink and Molinuevo, 2008). While both approaches could *a priori* achieve equivalent results, in practice negative list agreements tend to promote further liberalisations more effectively, partly because negotiations are grounded on the applied regime, reducing considerably the scope for water in agreements (Dee, 2015).

Under this approach, all sectors are open to foreign investors from treaty partners, except those explicitly listed as a non-conforming measure to the agreement. Typically these are listed under two annexes. Annex I, for which there is a standstill obligation, lists non-conforming measures on the basis of existing restrictions as per domestic regulations. Countries are required to provide the relevant legal authority; otherwise it is not admissible as a restriction under Annex I which also adds to transparency. Annex II lists the measures or sectors for which the government wishes to retain policy space for the future. Standstill does not apply in this case. The negotiation serves to put pressure on parties to keep this list short, by limiting its scope to the most domestically sensitive policy areas. Such an approach has been adopted, for instance, in the Trans-Pacific Partnership (TPP) for instance, of which four ASEAN countries are parties.

Another common tool to ensure that agreements are supportive of further liberalisation is to include a ratchet mechanism aimed at aligning treaty commitments with any autonomous liberalisation effort enacted after its entry into force (Fink and Molinuevo, 2007). By this, the liberalisation measure becomes the country’s commitment under the agreement, i.e. if the existing non-conforming measure is lifted or is made less restrictive; the new applied regime automatically becomes bound under the agreement.

Negative list-based negotiations are often more demanding than ones based on a positive list, requiring greater preparation by governments which need to make significant efforts to take stock of existing regulations and co-ordinate across the government. This is not the case under the positive list approach, where countries make commitments only in those sectors and sub-sectors where they voluntarily choose to make a commitment, regardless of the existence of supporting measures in any underlying legislation. Nonetheless, once a negative list has been established, future negotiations require rather marginal efforts. Many ASEAN economies have already adopted or are in the process of adopting a negative list approach within their domestic regulatory frameworks, although to varying degrees of sophistication (e.g. Indonesia, Philippines, Myanmar, Viet Nam and Lao PDR). This should facilitate the adoption of such an approach in future agreements and negotiations.

Using ATISA to enhance regulatory co-ordination and compatibility across ASEAN

In addition to market access and national treatment conditions, the future ATISA could be more strategically used to improve the quality and enhance the compatibility and harmonisation of regulatory frameworks within ASEAN. To a great extent, services reforms need to address not only discriminatory market access barriers and national treatment exceptions, which are typically part of the liberalisation agenda, but also non-efficient regulations behind the borders for them to deliver expected results.

Regulations are needed to correct for market failures that may hinder economic and social outcomes, including investment. They need to be designed efficiently to achieve the expected public policy objectives at a minimum cost to society. This issue has been addressed extensively by the World Bank (2015) and only a brief discussion is provided here since it is another area where ATISA could play a role in the future.

A variety of regulatory measures still exist in ASEAN, as well as other non-discriminatory market access barriers that may hamper service sector efficiency (World Bank, 2015). For instance, market access is sometimes restrained by limits on new licences and opaque and discretionary approval procedures. Although not necessarily discriminatory (though they can be, e.g. licensing quotas for foreign services providers), they make market access uncertain and unpredictable for both domestic and foreign investors. The necessary regulation is also sometimes missing, which adds to the uncertainty perceived by market participants (World Bank, 2015). Some progress has already been achieved in this respect, as in the case of professional services, for which AMS have concluded a number of Mutual Recognition Agreements (e.g. engineering, architecture, accounting, dentists etc.), recognising professional qualifications obtained in other AMS and allowing professionals to practice across ASEAN economies. But the results of which are yet to be seen, as there is limited evidence that these arrangements have been used so far.

Regulatory heterogeneity and differences in regulatory quality across ASEAN may also work to deter service sector integration and development. Evidence suggests that differences in regulatory settings both in terms of substance and procedures generate costs that can affect firms' decisions to invest abroad. In OECD economies, for instance, the effect of regulatory heterogeneity on FDI has been found to be large, with estimations suggesting that a reduction in regulatory divergence – as measured by differences in product market regulations – by one fifth could increase FDI by around 15%. These effects are particularly prominent with regards to divergence of command and control regulations and of protection of incumbents (e.g. antitrust exemptions, entry barriers in networks and services) (Fournier, 2015).

Regulatory matters and issues of heterogeneity of approaches across ASEAN have not prominently featured in the current work on AFAS (World Bank, 2015). Addressing these matters will be important to move towards an effective single market and production base. For this, AMS need to strengthen the agenda for co-operation, compatibility and harmonisation of the different domestic regulatory frameworks, and ATISA could provide a good a platform in this respect.

Box 2.2. Methodology to assess the level of "water" under AFAS and AANZFTA

Restrictions on foreign equity limitations versus equivalent in domestic legislation

Overall, the outcomes of ASEAN and ASEAN+ agreements have generally been seen as disappointing in terms of liberalisation (Fukunaga and Ishido, 2012; World Bank, 2015; Cornish and Findlay, 2011; Dee, 2015). AFAS is typically seen to have achieved more ambitious results (Ishido, 2011) and to have contributed to greater regional policy certainty, but not to significant liberalisation on the ground (World Bank, 2015). The assessment provided here shares the view that ASEAN agreements need to go deeper in order to advance the unfinished services reform agenda but with a slightly different perspective, at least for AFAS, because it applies a somewhat different methodology and takes a much narrower scope, both in terms of measures and sectors covered.

Previous studies have mostly assessed results against the potential outcomes that could be achieved. The approach used here provides a different and complementary perspective by assessing results against the status quo in the absence of an agreement. It is less comprehensive than various other assessments by narrowly focusing on only foreign equity limitations which, though an important entry barrier to foreign investors in many services sectors, are not the only one. Other assessments may therefore be better at capturing non-discriminatory measures which can also be crucial in service sectors, but foreign equity limitations are likely among the most important and common type of foreign investor discrimination and thus should well reflect the specific conditions for foreign investors.

The approach used here compares AANZFTA and AFAS mode 3 commitments with domestic legislation in terms of restrictiveness of foreign equity limitations in five sectors using the OECD *FDI Regulatory Restrictiveness Index* methodology (see Annex 2.A for a description of such measures). Other market access and national treatment restrictions are not considered, although they may be equally or collectively important. Examples include: limitations on the number of service providers; limits on the total value of services transactions or assets; measures which restrict or require specific types of legal entity through which a service may be provided; and limits related to government approval requirements. But foreign equity limitations are typically the most common and important entry barrier for foreign investors.

Both agreements adopt a positive list approach to liberalisation of services trade where countries make commitments on market access and national treatment in specific sectors or sub-sectors offered for negotiation or horizontally across all sectors. Once a commitment is made, the specified level of market access and national treatment is bound and the government cannot impose any new restriction. Typically, commitments take the form of: i) 'none', where the government commits to full liberalisation, i.e. no specific limit is imposed on treaty parties services providers; ii) 'unbound', where the government does not commit to any liberalisation, retaining its right to introduce or maintain measures inconsistent with market access or national treatment principles; and iii) a description of the market access or national treatment offered to treaty partners services providers. The combination of horizontal and sector-specific commitments, unless otherwise specified, determines the overall level of commitment made.

AFAS commitments assessed here come mostly from the 9th Package of Commitments, which is the latest in effect. Commitments regarding the banking sector – financial services are negotiated separately under AFAS – refer to those made under the 7th Package of Commitments for Financial Services, the latest in effect. Air transport services are also negotiated separately, with the latest round of negotiation in effect being the 9th AFAS Package for Air Transport Services. The package on air transport services, however, does not cover measures affecting air traffic rights and services directly related to the exercise of such rights, including control and ownership of air transport companies. This information was thus complemented by AMS' commitments under the ASEAN Multilateral Agreement on Air Services (MAAS), the ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services (MAFLPAS) and the Multilateral Agreement on the Full Liberalisation of Freight Air Services (MAFLFAS).

AANZFTA also does not cover such air transport traffic rights-related measures. Thereby, it was assumed that any such measures were equal to the domestic regulation. Thus any observed water reflects differences in the air transport services covered in the agreement only.

For the purpose of assessing the level of "water" in mode 3 commitments with regards to foreign equity limitations, the following scoring was applied:

- Foreign equity limitations observed in the commitments for the five selected services sectors were scored following the FDI Index methodology, after subtracting the score associated with foreign equity limitations encountered in the domestic regulation. The resulting score is the level of water observed in the agreement in each sector. A positive result indicates a more open regime than the one committed to by the country under the agreement; a negative result indicates that the commitment is more liberal for treaty partners.
- Whenever the schedule of commitment is unbound, it is assumed that the domestic level of restriction applies. The same is applied for sectors or sub-sectors not covered by the

commitments. This approach may seem more generous than other scoring methodologies (see Hoekman, 1995; Miroudot and Pertel, 2015; World Bank, 2015; Marchetti and Roy, 2008; Roy, 2011), which would typically consider this as fully restrictive since countries preserve the right to impose any sort of limitation on foreign equity participation. Nonetheless, it is believed that the approach taken here more closely reflects the underlying rationale of positive negotiations. In principle, commitments should reflect a concession of preferential market access to treaty partners; hence, should be of a liberalising nature. Implicitly, the basis of comparison is the applied regime. The approach here allows for easy understanding of the implications of commitments compared to the status quo, i.e. without any agreement.

- As such, cases of ’negative’ water would reflect the ultimate goal of such agreements: actual liberalisations. And cases of ‘positive’ water, i.e. where commitments are made at a level more restrictive than the applied regime, can be interpreted as a midway compromise, where the country is not ready to make a liberalising commitment but willing to lock-in a minimum level of openness to provide some surety for treaty partners’ service suppliers. Although not the ultimate objective of negotiations, such a partial approach at the very least prevents governments from backtracking to a level of restrictiveness above the one to which it has committed. The extent of “positive” water is therefore an indicative of how much policy space the government sought to preserve. One caveat of this approach, however, is that significant “positive” water (implying only a weak restraint on the policy space) possibly represents a situation closer to an “unbound” position where no water is identified. The results should therefore be interpreted cautiously.
- The alternative approaches to assessing water in commitments reported above are more standard in the literature and have the merit of pointing to shortcomings of agreements in relation to their full potential. But they also penalise countries for the incompleteness of their agreements compared to the situation where no such agreement exists. Under these approaches, most of the water in agreements comes from sectors that are unbound (see Miroudot and Pertel, 2015 for water in GATS). But such water may have only limited implications as compared to the case in the absence of such agreements. The comparison across countries may give rise to careless interpretations of the resulting level of water, because countries with a relatively liberal regime but only limited commitments may be seen to have high levels of water.

Following Miroudot and Pertel (2015), this chapter also refrains from scoring commitments where it was not possible to distinguish the real difference vis-à-vis the domestic regulation. This was sometimes the case with regards to the scope of application of sub-sectors offered in negotiations. Hence, in case of any doubt about the legal interpretation or scope of application, the commitment has been scored as equivalent to the provision found in the domestic regime. If, however, there was a clear difference in the scope of sub-sectors committed and that of the applied legislation, the scores were adjusted somewhat to reflect such differences. This may sometimes fail to capture the real magnitude of such differences, but should rightly point to their direction in terms of restrictiveness.

Notes

1. The authors thank Deborah Elms for the insightful and enriching comments received.

2. Only a handful of studies have looked into the determinants of FDI policy liberalisation. Beyond the increasing need for long term finance seen in the 1980s and the widespread recognition of the benefits of FDI to host economies, other possible reasons for FDI

policy liberalisation may have come from pressure by international organisations, such as the IMF or World Bank, or directly by partner countries affected by such policies. Kobrin (2005) finds evidence supporting a more rational approach towards FDI liberalisation, which can be explained by market size, trade openness and a better educated workforce, with only a limited role for external pressure.

3. Cooray and Vadlamannati (2012) suggest that changes in a country's FDI regime influences changes in FDI policy elsewhere in peer economies, and notably among developing economies whose structural determinants of FDI may be relatively weak. The authors rely on the number of annual changes in FDI laws and regulations favourable to foreign investment to analyse if countries compete for FDI by liberalising their FDI policy regimes. Their indicator is based on information reported by UNCTAD and available for 148 countries from 1992 to 2009. It covers measures related to approval procedures, sectoral restrictions, operational conditions, incentives, investment guarantees and corporate regulations on FDI.

4. Notification No. 35/2017.

5. Notification No. 15/2017.

6. Notification No. 26/2016.

7. Under the GATS, liberalisation commitments are made with regard to market access and national treatment limitations across the four modalities of supply of services: 1) cross-border supply; 2) consumption abroad; 3) commercial presence; and 4) presence of natural persons. The GATS also identified a number of areas for further negotiations, including on questions of safeguards, subsidies, procurement and domestic regulation (Ishido, 2012).

8. For instance, the ASEAN, Australia and New Zealand FTA (AANZFTA), the ASEAN-China (ACFTA), and the ASEAN-Korea FTA (AKFTA).

9. GATS-type agreements mostly follow the WTO Services Sectoral Classification List, referred to as W/120, which covers 155 sub-sectors and is generally based on the UN Provisional Central Product Classification.

10. Some agreements, such as AANZFTA, use a mix of negative and positive list approaches: a positive list approach for negotiating commitments in services sectors and a negative list for the general chapter on investment. This is also the case in RCEP, although some members have opted for the negative approach in both chapters.

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Annex 2.A. Statutory restrictions of AMS: Foreign equity limitations in domestic regulations, AANZFTA and AFAS, selected sectors

Country	Domestic legislation	AANZFTA	AFAS
Banking			
BRD	None	Not covered	Not covered
KHM	None	No commitment pertaining specifically to foreign equity limitations	No commitment pertaining specifically to foreign equity limitations
IDN	FDI is allowed up to 99% in banking activities	Horizontal commitment: Commercial presence of the foreign service provider(s) may be in the form of joint venture and/or representative office, unless mentioned otherwise. Joint venture should meet the following requirements: [...] Not more than 49% of the capital share of the Limited Liability Enterprise (Perseroan Terbatas/PT), may be owned by foreign partner(s). Sector-specific commitment: With the exception of the existing branches of foreign banks, foreign services provider shall be in the form of locally incorporated joint venture banks with the following requirements: (a) Unbound for new licence; (b) Only financial institutions are permitted to establish joint venture banks. The conditions of ownership and the percentage share of ownership as stipulated in the respective shareholder agreement establishing the existing individual joint venture bank shall be respected as the basis of ownership of the foreign service provider(s) and their respective Indonesian partner(s). No transfer of ownership shall take place without the consent of all parties in the joint venture bank. [...] Acquisition of locally incorporated banks listed in the stock exchange is allowed through the purchase of shares in the stock exchange up to 51% of the shares.	Horizontal commitment: Commercial Presence of the foreign service provider(s) may be in the form of joint venture and/or representative office, unless mentioned otherwise. Joint venture should meet the following requirements: a) Should be in the form of Limited Liability Company (Perseroan Terbatas/PT), b) Not more than 49% of the capital share of the Limited Liability Company (Perseroan Terbatas/PT) may be owned by foreign partner(s). Sector-specific commitment: General Conditions on Banking Subsector: 1.All Market Access and National Treatment limitation specified in the banking subsector will be eliminated by the year 2020 subject to similar commitment by other members [not considered in the analysis since conditional]. 2.Foreign bank(s) and foreign legal entity (ies) are, in cooperation with Indonesian national(s) and/or Indonesian legal entity(ies), allowed to establish or acquire locally incorporated banks in accordance with existing regulations. [...] 4. Acquisition of local existing banks through the purchase of in the stock exchange is allowed up to 51% of the listed shares in the stock exchange. 5. The conditions of ownership and the percentage share of ownership as stipulated in the respective shareholder agreement establishing the existing individual joint venture bank shall be respected as the basis of ownership of the foreign service provider(s) and their Indonesian partner(s).
LAO	None	No commitment pertaining specifically to foreign equity limitations	No commitment pertaining specifically to foreign equity limitations

Country	Domestic legislation	AANZFTA	AFAS
MYS	FDI is allowed up to 30% in the case of acquisition of commercial banks, and up to 70% in the acquisition or establishment of investment & islamic banks.	Unbound for new licences. Entry is limited to equity participation by foreign banks in Malaysian-owned or controlled commercial banks and merchant banks and aggregate foreign shareholding in a commercial bank or a merchant bank shall not exceed 30%.	Commercial banks, merchant banks and international Islamic banks: Unbound for new licenses except for new licences for the establishment of international Islamic banks operating through a wholly foreign-owned subsidiary or branch to conduct international Islamic banking business. For licensed international Islamic banking business, unbound except as specified in the respective sub-sectors. Entry is limited to equity participation by foreign banks in Malaysian-owned or controlled commercial banks and investment banks and aggregate foreign shareholding in a commercial bank or an investment bank not to exceed 30%.
MMR	Foreign ownership not allowed in retail banking. Corporate banking is subject to joint venture with local banks. Full foreign ownership allowed only in banks exclusively servicing foreign companies in foreign-denominated currencies.	Not covered	No commitment pertaining specifically to foreign equity limitations
PHL	None	(a) Acquisition of up to 55% of the voting stock of an existing domestic bank; (b) Investing in up to 51% of the voting stock of a new locally incorporated banking subsidiary. Existing investments of foreign banks beyond the 51% level will be maintained at their existing levels. In banking, the Monetary Board shall ensure that at all times 70% of the resources or assets of the Philippine banking system is held by domestic banks which are at least majority-owned by Filipinos.	In banking, the Monetary Board shall ensure that at all times (60%) of the resources or assets of the Philippine banking system is held by domestic banks which are at least majority-owned by Filipinos. Forms of commercial presence: Only established, reputable and financially sound foreign banks that are widely-owned and publicly listed may operate in the Philippine banking system through any one of the following modes of entry, subject to relevant licensing and other requirements prior to actual entry. However, this shall not preclude secondary investment in the equity of a locally incorporated bank not exceeding 40% of voting stock. (a) Establishment of foreign bank branches with full banking authority [...] (b) Acquisition of up to 100% of the voting stock of an existing domestic bank. (c) Investing in up to 100% of the voting stock of a new locally incorporated banking subsidiary. [...] For foreign individuals or foreign non-bank corporations, aggregate share in the voting stock of a locally incorporated bank shall be limited to 40% in universal and commercial banks.
SGP	None	No commitment pertaining specifically to foreign equity limitations	No commitment pertaining specifically to foreign equity limitations
THA	Foreign ownership is limited to up to 25%.	Locally incorporated banks: Market access limited to the acquisition of shares of existing banks. Maximum foreign equity participation limited to	Locally incorporated banks: I. Market access limited to the acquisition of shares of existing banks. II. (i) The amount of shares held by persons of Thai nationality shall not

Country	Domestic legislation	AANZFTA	AFAS
		25% of paid-up registered capital.	be less than 75% of the total amount of voting shares sold. Combined shareholding of an individual and his/her related persons shall not exceed 10% of total number of shares sold, unless otherwise permitted by the Bank of Thailand; (ii) In the case where the Bank of Thailand deems appropriate, the Bank of Thailand may grant permission that persons of non-Thai nationality hold shares up to 49% of the total amount of voting shares sold.
VNM	Foreign ownership is limited to up to 30% in the acquisition of existing banks.	Foreign credit institutions are only permitted to establish commercial presence in Viet Nam in the following forms: (i) With respect to foreign commercial banks: [...] 100% foreign-owned banks are permitted. Equity participation: [...] For capital contribution in the form of buying shares, the total equity held by foreign institutions and individuals in each Viet Nam's joint-stock commercial bank may not exceed 30% of the bank's chartered capital, unless otherwise provided by Viet Nam's laws or authorised by a competent authority	Foreign credit institutions are only permitted to establish commercial presence in Viet Nam in the following forms: (i) With respect to foreign commercial banks: [...] 100% foreign-owned banks. Equity participation: [...] For capital contribution in the form of buying shares, the total equity held by foreign institutions and individuals in each Viet Nam's joint-stock commercial bank may not exceed 30% of the bank's chartered capital, unless otherwise provided by Viet Nam's laws or authorised by a competent authority.
Distribution			
BRD	None	Not covered	Not covered
KHM	None	None [albeit limited to a list of products]	None [albeit limited to a list of products]
IDN	Foreign shareholding is allowed between 49%-67%-100% depending on the distribution activity.	Not covered	Wholesale trade [in a limited list of products] and direct selling: Joint venture with foreign equity participation up to 51%. [Retail: not covered.]
LAO	Foreign shareholding is allowed between 50%-100% depending on the amount of registered capital.	Not covered	Commission agents' services & Franchising for textiles, clothing and footwear: None, except subject to economic needs test. Foreigners need to use a local agent for distribution. Wholesale trade services - Wholesale trade services on a fee or contract basis of textiles, clothing and footwear: Joint venture with Lao services providers is required. Foreign equity participation is limited to 49 %. Subject to meeting economic needs test.
MYS	Foreign investment in a limited range of wholesale and retail distribution activities is prohibited.	Not covered	Commission agents' services for textiles, clothing and footwear & Franchising: Foreign equity shall not exceed 51%. Wholesale and Retail Trade Businesses: Aggregate foreign equity is allowed up to 51%. Minimum foreign capital investment in respective formats of businesses is as per the Guidelines on Foreign Participation in Distributive Trade Services.
MMR	Foreign investment in convenience stores and mini-markets is not permitted and in the retail and wholesale distribution and exporting of a narrow range of products is permitted only through joint-venture with Myanmar citizen/enterprises.	Not covered	Commercial presence of foreign service suppliers are permitted in accordance with the Myanmar Companies Act 1914.[100% foreign equity allowed]
PHL	None [albeit for retail trade	Not covered	Commission Agents' Services, except rice and corn industry: The limits on foreign equity in

Country	Domestic legislation	AANZFTA	AFAS
	enterprises, full foreign ownership is allowed only for companies meeting discriminatory minimum capital requirements].		the Horizontal section does not apply. Wholesale trade services of fur articles // Retailing services of snowmobiles and related parts and accessories // Franchising Services: None, except that foreign equity participation is limited to a maximum of 70%. Petroleum product retail outlets: Up to 70% foreign equity is allowed in the operation of a petroleum product retail outlet provided it meets additional minimum capital conditions.
SGP	None	Unless otherwise specified, distribution services of any product subject to import prohibition or non-automatic import licensing shall be excluded from the scope of these commitments. Commission agents' services (except for pharmaceutical goods, medical goods and cosmetics) & wholesale trade services (except for pharmaceutical goods, medical goods, surgical and orthopaedic instruments): None.	None
THA	None	Commission Agents' Services: None [only horizontal measures, but this includes: Unless otherwise specified at the sector-specific level, commercial presence in sectors or sub-sectors in this schedule is permitted only through a limited liability company which is registered in Thailand and which meets the following conditions: (a) Foreign equity participation must not exceed 49% of registered capital; and (b) The number of foreign shareholders must be less than half of the total number of shareholders of the company concerned.]. Other distribution services are not covered.	Commission agents' services // Wholesale trade services of sports goods (incl. bicycles) // Franchising of other non-financial Intangible assets : as indicated in 3.3 of the horizontal section [3.3.(a) Foreign equity participation not to exceed 49% of the registered capital; (b) the number of foreign shareholders must be less than half of the total number of shareholders of the company concerned]. Commission agents' services - Sales, on a fee or contract basis, of medical goods // Wholesale trade services, on a fee or contract basis, of medical goods // Retailing services by foreign service supplier established in Thailand of the products manufactured locally under its own brand // Franchising for the right to franchises only for fast food business (excluding fast food restaurant): as indicated in 3.1 of the horizontal section [3.1 Foreign equity participation must not exceed 70% of the registered capital and shall only operate through joint-venture with a juridical person of Thai national].
VNM	Foreign investment above 51% in retail and wholesale business of a narrow range of products is not allowed.	A joint venture with a Vietnamese partner(s) is required. As of 1 January 2009 [or January 2010, depending on the distributed product]: None. Cigarettes and cigars, books, newspapers and magazines, video records on whatever medium, precious metals and stones, pharmaceutical products and drugs, explosives, processed oil and crude oil, rice, cane and beet sugar are excluded from the commitments. [Horizontal measure: foreign service suppliers are permitted to make capital contribution in the form of buying shares of Viet Nam's	Commission agents' services // wholesale trade services // Retailing services: None, since 11 January 2010, foreign-invested companies engaging in distribution services will be permitted to engage in the commission agents', wholesale and retail business of all legally imported and domestically produced products. Franchising services: None, and since 11 January 2010, branching is allowed. Measures applicable to all sub-sectors in Distribution Services: Cigarettes and cigars, books, newspapers and magazines, video records on whatever medium, precious metals and stones, pharmaceutical products and drugs, explosives, processed oil and crude oil, rice, cane and beet sugar are excluded from the commitments.

Country	Domestic legislation	AANZFTA	AFAS
		enterprises. In this case, the total equity held by foreign investors in each enterprise may not exceed 30% of the enterprise's chartered capital unless otherwise provided by Viet Nam's laws or authorised by Viet Nam's competent authority. Upon the entry into force of this Agreement, or any date or timeline otherwise specified in this Schedule, the 30% foreign equity limitation for acquisition of Vietnamese enterprises shall be eliminated (...)].	
Air Transport			
BRD	Notwithstanding any international agreement, no air transport enterprise shall apply for an operating licence pursuant to any regulations relating to the licensing of commercial flying, before an air operator's certificate is issued. Without prejudice to any international agreement to which Brunei is a party, no air transport enterprise shall be granted an operating licence unless it has its principal place of business in Brunei, and is owned and controlled by Brunei or by a citizen. Foreign shareholding in specialty air transport services (flight training) is limited to joint-ventures where foreign capital does not exceed 49%.	Rental of aircraft with crew: Unbound except: (a) Only through a representative office; or (b) Only by appointment of a General Sales Agent; who is a Bruneian Controlled Company.	AFAS: Aircraft repair and maintenance services / computer reservation system services / Rental of aircraft with or without crew: up to 80% foreign equity. Air freight forward services: up to 51% foreign equity. Selling and marketing of air transport services: unbound. MAAS, MAFLPAS, MAFLFAS: Each contracting party shall have the right to designate as many airlines as it wishes for the purpose of conducting international air freight/passenger services in according with the agreement [...] On the receipt of such designation, and of application from the designated airline [...] each contracting party shall grant the appropriate authorisation and technical permission with minimum procedural delay, provided that: [...] subject to the acceptance of the contracting party receiving the application of a designated airline, the designated airline is incorporated in and has its principal place of business in the territory of the contracting party, and is and remains substantially owned and effectively controlled by one or more ASEAN member state and/or its nationals, and the designating state has and maintains effective regulatory control [...]. [domestic air transport not covered]
KHM	None	None	AFAS: Aircraft repair and maitenance services / Rental of aircraft with or without crew / Air freight forward services / Aircraft catering services / refueling services / aircraft line maintenance: None. Selling and marketing of air transport services / computer reservation system services: unbound. MAAS, MAFLPAS, MAFLFAS: see Brunei.
IDN	Foreign equity participation is limited to 49% in air transport services, and limited to 67% in various services incidental to air transport.	Foreign services suppliers are permitted to establish joint venture enterprises in Indonesia, with maximum equity 49%.	AFAS: aircraft repair and maintenance services / Selling and marketing of air transport services / computer reservation system services / Air freight forward services: should be in the form of limited liability enterprise with maximum foreign equity 49%. Rental of aircraft without crew: commercial presence of foreign services supplier and/or provider is permitted up to 49%. MAAS, MAFLPAS, MAFLFAS: see Brunei.

Country	Domestic legislation	AANZFTA	AFAS
LAO	Foreign equity participation is limited to 49% in freight transport support activities, excepti airport services.	Not covered	AFAS: None. MAAS, MAFLPAS, MAFLFAS: see Brunei.
MYS	Investment in air transport and some incidental services, with the exception of airports, is allowed only by persons under the ownership Malaysian person or persons under the direct or indirect control of a Malaysian [assumes foreign shareholding limited to 49%].	Not covered	AFAS: Aircraft repair and maintenance services: unbound. Selling and marketing of air transport services / computer reservation system services: None. Rental of aircraft without crew / Aircraft line maintenance: foreign equity participation shall not exceed 49%. MAAS, MAFLPAS, MAFLFAS: see Brunei.
MMRr	None	None	AFAS: None. MAAS, MAFLPAS, MAFLFAS: see Brunei.
PHL	Foreign equity participation is limited to 40% for all sector-related activities.	None, except as indicated in the horizontal measure on transport: 3) No franchise, certificate, or any other form of authorisation for the operation of a public utility shall be granted except to Filipinos or to corporations or associations organised under the laws of the Philippines at least 60% of whose capital is owned by such citizens.	AFAS: Aircraft repair and maintenance services / Rental of aircraft with or without crew / airfreight forwarding services / cargo, baggage and passenger handling / catering services / aircraft line maintenance: None. Selling and marketing of air transport services / computer reservation system services: unbound. MAAS, MAFLPAS, MAFLFAS: see Brunei.
SGP	None	Not covered	AFAS: Aircraft repair and maintenance services: foreign equity participation of up to 70%. Selling and marketing of air transport services / Rental of aircraft with crew: foreign equity participation of up to 51%. Computer reservation system services / Rental of aircraft without crew / Aircraft line maintenance / Air freight forwarding services: none. Cargo handling: unbound. MAAS, MAFLPAS, MAFLFAS: see Brunei.
THA	Foreign equity participation is limited to 60%-75% in all transport and transport-related services.	Air Transport Services: Aircraft repair and maintenance services / Supporting services for air transport / Selling and marketing of air transport services: None [only horizontal measure: unless otherwise specified at the sector-specific level, commercial presence in sectors or sub-sectors in this schedule is permitted only through a limited liability company which is registered in Thailand and which meets the conditions: (a) foreign equity must not	AFAS: Aircraft repair and maintenance services / selling and marketing of air transport services / Computer reservation system services / Rental of aircraft with or without crew / Air freight forwarding services / passenger handling: as indicated in 3.3 of the horizontal section [3.3.(a) Foreign equity participation must not exceed 49% of the registered capital; (b) the number of foreign shareholders must be less than half of the total number of shareholders of the company concerned] MAAS, MAFLPAS, MAFLFAS: see Brunei.

Country	Domestic legislation	AANZFTA	AFAS
		exceed 49% of the registered capital; (b) The number of foreign shareholders must be less than half of the total number of shareholders of the company].	
VNM	Foreign ownership in air transport services is limited to 30%. Foreign ownership in airports and related airport services is limited to 49%.	For Air Transport Services: Sales and marketing air products services / Computer reservation services: None. Maintenance and repair of aircraft: As of 11 January 2012, 100% foreign invested enterprises shall be allowed.	AFAS: None, except for aircraft catering services: commercial presence of foreign supplier or providers is permitted up to 49%. MAAS, MAFLPAS, MAFLFAS: see Brunei.
Maritime & Inland Waterways Transport			
BRD	Foreign equity participation in maritime passenger and freight transport and auxiliary services is limited to 40%.	Maritime Transport Services - a) Freight Transport: i) The supply of international maritime transport, excluding vessels for the carriage and transport of energy goods, foreign equity participation shall not exceed 30%; ii) The supply of international maritime transport of energy goods: Unbound; b) Passenger Transport: Foreign equity participation shall not exceed 30%.	Maritime Transport Services & Waterways Transport Services - Passenger transport / Rental of Vessels with Crew / Maintenance and Repair of Vessels / Maritime Agency Services / Supporting Services for Internal Waterway Transport / Maritime Cargo Handling Services / Storage and warehousing services / Maritime Freight Forwarding Services: Foreign equity participation shall not exceed 51%. Maritime Transport Services & Waterways Transport Services – Freight transport: a) The supply of international maritime transport/internal waterways transport, excluding vessels for the carriage and transport of energy goods, foreign equity participation shall not exceed 51%; b) The supply of international maritime/IWT of energy goods: unbound.
KHM	None	Maritime Services - International transport (Freight and passengers), excluding cabotage: Unbound.	Maritime Services - International transport (Freight and passengers), excluding cabotage: None.
IDN	Foreign equity participation is limited to 49% in international and domestic maritime and inland water transport; limited to 67% in a range of related services and limited to 95% for terminals under PPPs.	Maritime Transport Services - international passenger and freight transport (excluding cabotage) and cargo handling services: Only through joint venture corporation: as specified in the Horizontal Section [3) Commercial Presence of the foreign service provider(s) may be in the form of joint venture and/or representative office, unless mentioned otherwise. Joint venture should meet the following requirements: a) Should be in the form of Limited Liability Enterprise (Perseroan Terbatas/PT), b) Not more than 49% of the capital share of the Limited Liability Enterprise (Perseroan Terbatas/PT), may be owned by foreign partner(s).]	Maritime Transport Services - International Passenger and Freight Transport (excluding cabotage) / Internal Waterways Transport Passenger and Freight Transport: Joint venture with foreign equity participation up to 60% or owner's representative. Maintenance and repair of Vessels (maritime and IWT): Joint venture with foreign equity participation up to 51%, for Eastern part of Java and eastern part of Indonesia, with vessels classification 500 DWT above. For other area and capacity, as indicated in the Horizontal Commitment. Pushing and towing Services (maritime and IWT) / Supporting services for internal Waterways Transport: Joint venture with foreign equity participation up to 51%. Vessel Salvage and Refloating Services / Maritime Freight Forwarding Services: Joint venture company with foreign equity participation up to 49%. Maritime cargo handling Services: Joint venture shipping company with foreign equity participation up to 70% is permitted only for port in Bitung, Kupang, Ambon, and Sorong. For other area, maximum foreign equity participation is 60%. Storage and warehousing services Outside Port Area and 1st Area for (a) Storage services of frozen or refrigerated goods and (b) Other storage or warehousing services: Commercial Presence is permitted in the form of a limited liability company with foreign equity

Country	Domestic legislation	AANZFTA	AFAS
			participation must not exceed 49% of the registered capital. Storage and warehousing services Outside Port Area and 1st Area for Storage services of frozen or refrigerated goods: JV with foreign equity participation up to 51 %.
LAO	Foreign equity participation is limited to 49% in freight support activities only.	Not covered	None, except for Maritime cargo handling and Other auxiliary services: unbound.
MYS	Foreign equity participation is limited to 49% in maritime cabotage and IWT and related services, except for containerised transhipment and passenger cruise services. No restriction on international transport.	Maritime Transport Services - International maritime transport services (excludes cabotage) / Maritime agency services covering marketing and sales of maritime transport and related services and acting on behalf of the companies organising the call of the ship or taking over cargoes when required / Vessel salvage and refloating services except on inland waters: Only through a representative office, regional office or locally incorporated joint-venture corporation with Malaysian individuals or Malaysian controlled corporations or both and aggregate foreign shareholding in the joint-venture corporation shall not exceed 30%.	Maritime Transport Services - International maritime transport services, excludes cabotage (Passenger transport) / Maintenance and repair vessels / Storage and warehousing services (covering private bonded warehousing services only): Only through a representative office, regional office or locally-incorporated joint-venture corporation with Malaysian individuals or Malaysian-controlled corporations or both and aggregate foreign shareholding in the joint-venture corporation shall not exceed 51%. International maritime transport services, excludes cabotage (Freight transport) / Maritime freight forwarding services: Only through a representative office, regional office or locally-incorporated joint-venture corporation with Malaysian individuals or Malaysian-controlled corporations or both and aggregate foreign shareholding in the joint-venture corporation shall not exceed 70%. Rental of cargo vessels with crew for international shipping / Rental and leasing services of all types of self-propelled seagoing vessels with operator, such as passenger vessels (except pleasure bath), tankers, bulk dry cargo vessels, cargo and freight vessels.) / Supporting services for maritime transport / Maritime agency services: None. Maritime Cargo Handling Services: Only through a representative office, regional office or locally incorporated joint venture corporation with Malaysian individuals or Malaysian controlled corporations or both. Aggregate foreign shareholding in the joint venture corporation shall not exceed 49%.
MMR	None	Maritime Transport Services - International Freight Transport (Excluding Cabotage), maritime cargo handling and wharehousing and storage services : 100% foreign investment allowed [None]; International Passenger Transport (Excluding Cabotage) and Maritime Freight Forwarding Services : unbound.	Maritime Transport Services (excludes cabotage): None, except for Pushing and towing services / Port and waterway operation services (excluding cargo Handling) / Navigation aid services: Joint Venture with a Myanmar Citizen or enterprise up to 70% equity is permitted. Maritime freight forwarding services: Joint Venture with a Myanmar Citizen or enterprise up to 80% equity is permitted.
PHL	Foreign equity participation is limited to 40%.	Maritime Transport Services - International Transport (passenger and freight), except a. cabotage transport, b. and government-owned cargoes / Cargo handling services / Storage and warehousing services / Container yard and depot services / Freight forwarding services: None, except as indicated in the horizontal section for transport services [3) No franchise, certificate, or any other form of authorisation for the operation of a public utility shall be granted	Maritime Transport Services - International Transport (passenger and freight), except a. cabotage transport, b. and government-owned cargoes / maintenance of vessels / supporting services for maritime transport / container yard and depot services / maritime agency services / cargo handling services / storage and warehouse services /: None [but horizontal section for transport services: No franchise, certificate, or any other form of authorisation for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organised under the laws

Country	Domestic legislation	AANZFTA	AFAS
		except to citizens of the Philippines or to corporations or associations organised under the laws of the Philippines at least 60% of whose capital is owned by such citizens]. Leasing/rental of vessels without crew / Maintenance and repair of vessels: None.	of the Philippines at least 60% of whose capital is owned by such citizens]. Maritime cargo freight services by foreign registered shipping companies / Repair of vessels / Vessel and salvage refloating services provided in oceans and seas / cargo handling services at the Subic Bay Freeport Zone / storage and warehouse services at the Subic Bay Freeport Zone: up to 70% foreign equity participation is allowed. Pushing and towing services / Port and waterway operation services / Other supporting services for water transport / Classification societies: Up to 40% foreign equity participation is allowed. Freight transport agency services / international freight forwarding by sea: Up to 100% foreign equity participation is allowed, provided that paid-in capital is not less than USD 200 000. Otherwise maximum foreign equity participation is 40%. Domestic freight forwarding by sea: Up to 40% foreign equity is allowed.
SGP	Ports: aggregate of foreign shareholdings in PSA Corporation (incumbent) is subject to a 49% limit.	Maritime Transport Services - International maritime transport (freight and passengers) excluding cabotage transport: None, except on the registration of Singapore flag ships as specified in the Merchant Ships Act [no foreign ownership limitation] / Maritime auxiliary services (Shipping agency services, Shipping brokerage Services and Classification societies, except for statutory services for Singapore flag ships): None.	Maritime Transport Services - International Maritime Passenger and Freight Transport excluding cabotage transport: None, except on the registration of Singapore flag ships as specified in the Merchant Shipping Act [no foreign ownership limitation]. Rental of vessels with crew / Maintenance and repair of vessels / Vessels salvage and re-floating services (not applicable in harbour): Foreign equity allowable up to a maximum of 70%. International Towage / Classification societies, except for statutory services for Singapore flag ships / Maritime auxiliary services (Shipping agency services and Shipping brokerage Services): None.
THA	Foreign equity participation is limited to 60%-75% in all transport and transport-related services.	Maritime Transport Services - Maritime passenger and freight transport (excluding cabotage) / international towing: i) Unbound for establishment of juristic person for the purpose of operating a fleet under the national flag of Thailand; ii) Other forms of commercial presence for the supply of international maritime transport/towing services (as defined below - 3.2) except branch office: as indicated in the horizontal section [horizontal measure: unless otherwise specified at the sector-specific level, commercial presence in sectors or sub-sectors in this schedule is permitted only through a limited liability company which is registered in Thailand and which meets the following conditions: (a) Foreign equity participation must not exceed 49% of the registered capital; and (b) The number of foreign shareholders must be less than half of the total number of shareholders of the company concerned.]. Supporting Services for maritime transport (Freight forwarding services / Marine surveys and classification societies / Port captain's services attached to specific foreign vessels / Shore reception facilities (collection of waste /oily water from ships)) / Storage and warehousing services: None [only horizontal measure above].	Maritime Transport Services - Passenger and freight transport, excluding cabotage / International towing / Supporting Services for maritime transport (Shore reception facilities (collection of waste/oily water from ships), Port captain's services attached to specific foreign vessels, Classification Societies, Vessels salvage and refloating services – not applicable in harbour) / Custom clearance services: As indicated in 3.3 of the horizontal section: a) Unbound for establishment of Juridical Person for the purpose of operating a fleet under the national flag of Thailand; b) Other forms of commercial presence for the supply of international maritime transport services except branch offices: As indicated in the horizontal section [3.3.(a) Foreign equity participation must not exceed 49% of the registered capital; (b) the number of foreign shareholders must be less than half of the total number of shareholders of the company concerned]. Passenger transport, excluding cabotage (International sea cruises (cruise carrier with more than 200,000 DWT capacity)) / Freight transport, excluding cabotage transport (Transoceanic water transport services of refrigerated freight by refrigerator vessels) / Rental of non-Thai flag vessels with crew / Maintenance and repair of vessels exceeding 100,000 DWT / Towing and pushing services on transoceanic waters / Vessels salvage and refloating services: As indicated in 3.1 of the horizontal section [3.1 Foreign equity participation must not exceed 70% of the registered capital and shall only operate through joint-venture with a juridical person of Thai national].

Country	Domestic legislation	AANZFTA	AFAS
VNM	Foreign equity participation is limited to 49% in cabotage and international passenger transport and related services. No restriction in international freight and a limited number of transport services.	Maritime Transport Services - 1) Passenger and freight transport (excluding cabotage): (a) Establishment of registered companies for the purpose of operating a fleet under the national flag of Viet Nam: As of 11 January 2009, foreign service suppliers are permitted to establish joint-ventures with foreign capital contribution not exceeding 49% of total legal capital; (b) Other forms of commercial presence for the supply of international maritime transport services: Upon entry into force of this Agreement, foreign shipping companies can establish joint ventures with 51% foreign ownership. As of 11 January 2012, foreign shipping companies can establish 100% foreign-invested enterprises. 2) Maritime Auxiliary Services (Container handling services): None, except that upon entry into force of this Agreement joint ventures with foreign capital contribution not exceeding 50% can be established. Other auxiliary services (Customs Clearance Services): [...] As of 11 January 2012, joint ventures can be established with no foreign ownership limitation. Other auxiliary services (Container Station and Depot Services): [...] As of 11 January 2014, None. 3) Internal Waterways Transport - passenger and freight transport: Upon entry into force of this Agreement, foreign service suppliers are permitted to provide services only through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 49% of total legal capital. Storage and warehouse services / Freight transport agency services / Other freight-related services: [...] As of 11 January 2014, none.	Maritime Transport Services - 1) Maritime Passenger Transport excluding cabotage: (a) Establishment of registered companies for the purpose of operating a fleet under the national flag of Viet Nam: foreign service suppliers are permitted to establish joint-ventures with foreign capital contribution not exceeding 49% of total legal capital [...]; Other forms of commercial presence for the supply of international maritime transport services: [...] Since 11 January 2012, foreign shipping companies can establish 100% foreign-invested enterprises. 2) Maritime Freight transport excluding cabotage: a) Establishment of registered companies for the purpose of operating a fleet under the national flag of Viet Nam: foreign service suppliers are permitted to establish joint-ventures with foreign capital contribution not exceeding 70% of total legal capital.[...]; Other forms of commercial presence for the supply of international maritime transport services: [...] Since 11 January 2012, foreign shipping companies can establish 100% foreign-invested enterprises. 3) Rental of vessels with crew / Maintenance and repair of vessels: None, except joint venture with the foreign capital contribution not exceeding 70% shall be permitted. 4) Supporting Services for Maritime Transport - Customs Clearance Services: After 5 years, joint ventures can be established with no foreign ownership limitation; Maritime Agency Services: Commercial presence may be in the form of joint venture. Maximum share of foreign equity in the joint venture company allowable up to 49%; Container Station and Depot Services: [...] Since 11 January 2014, none; Maritime cargo handling services: Commercial presence may be in the form of joint venture. Maximum share of foreign equity in the joint venture company allowable up to 49%; Container handling services, except services provided at airports: Foreign service suppliers are only permitted to provide services through the establishment of joint ventures with Vietnamese partners with the capital contribution of foreign side not exceeding 50%; Freight transport agency services / Storage and warehouse services / other services (bill auditing; freight brokerage services; freight inspection, weighing and sampling services; freight receiving and acceptance services; transport document preparation services): None; Ship broking services: unbound. Internal Waterways Transport - Passenger & Freight transport / Maintenance and repair of vessels: Foreign service suppliers are permitted to provide services only through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 51% of total legal capital.
Rail & Road Transport			
BRD	Foreign equity participation is limited to 49% in rail transport and related activities.	Not covered	Rail Transport Services: Passenger transport & Freight transport / Maintenance and repair of rail transport equipment / Pushing and towing services: Foreign equity participation should not exceed 51%. [Road Transport Services: not covered].

Country	Domestic legislation	AANZFTA	AFAS
KHM	None	Road Transport Services - passenger and freight transport / Rental of commercial vehicles with operator / Maintenance and repair of road transport equipment / Supporting services for road transport services: None. [Rail transport services: not covered].	Rail Transport Services: Passenger transport & Freight transport, excluding cabotage / Maintenance and repair of rail transport equipment / Pushing and towing services: / Supporting services for rail transport services: None. Road transport services: Passenger transport & Freight transport / rental of commercial vehicles with operator / maintenance and repair of road transport equipment / Supporting services for road transport services: None.
IDN	Foreign participation is limited to 95% in rail transport and limited to 49% in road transport and related services, except in the operation of toll roads which is limited to 95%.	Not covered	Rail Transport Services - Passenger and Freight Transport / Maintenance and repair of rail transport equipment: (a) Commercial presence is only possible by establishing joint venture company; b) Maximum share of foreign equity participation (FEP) in the joint venture railway company could be 49%. Rail Passenger Transport limited to Interurban Transport / Pushing and Towing Services / Supporting Services for Rail Transport Services: Joint venture company with foreign equity participation up to 51%. Rail Freight Transport limited to Transport of Frozen or Refrigerated Goods: Joint venture company with foreign equity participation up to 70%; Road Transport Services - Passenger and Freight transport by man-or animal-drawn vehicles / Parking services: Maximum share of foreign equity participation (FEP) in the joint venture company is 70 %. Road Freight Transport / Supporting Services for Road Transport Terminal / Maintenance and repair of road transport equipment: Joint venture company with foreign equity participation up to 49%.
LAO	Foreign participation is prohibited in domestic passenger urban transport and related services. It is limited to 49% in international road freight transport and in freight related services.	Not covered	Rail Transport Services - passenger and freight and rail transport-related services: None. Road Transport Services - Freight transport: Foreign equity participation is 100% for domestic transport. For cross-border road freight transport: joint venture with local service provider(s) is required, with foreign equity limited to 49%. Rental of commercial vehicles with operator / Supporting services for road transport services: Joint venture with Lao services providers is required. Foreign equity participation is limited to 70%. Maintenance and repair of road transport equipment: Unbound, except as indicated in the Horizontal Section [no foreign equity limitation]. [Road Passenger Transport Services: not covered].
MMR	Foreign participation in domestic road transport services remains mostly limited to 40%-49%. International logistics and some other transport-related services and rail transport are permitted without	Not covered	Rail Transport Services - Passenger and Freight transport / Pushing or towing services: Foreign equity shall not exceed 70%; Maintenance and repair of rail transport equipment: Aggregate foreign equity shall not exceed 51%. Road Transport Services - Freight transport / Covering private carriers: Foreign equity shall not exceed 70%; Maintenance and repair services not elsewhere classified of trailers and semi-trailers on a fee or contract basis / Private services provided by car parks, parking lots and parking garages, whether or not roofed: Foreign equity shall not exceed 51%. [Road Passenger

Country	Domestic legislation	AANZFTA	AFAS
	restriction.		Transport Services: not covered]
MMRr	None	Not covered	Road Transport Services - passenger and freight transport (excluding cabotage): None. [Rail Transport Services & Road and Rail Transport-Related Services: not covered].
PHL	Foreign equity participation is limited to 40%.	Rail Transport Services - Passenger and freight transport / Maintenance and repair of rail transport equipment: None, except as indicated in the horizontal section [3) No franchise, certificate, or any other form of authorisation for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organised under the laws of the Philippines at least 60% of whose capital is owned by such citizens]. Road Transport Services - Passenger and freight transport / Maintenance and repair of road vehicles: None [except as indicated in the horizontal section: see above].	Rail Transport Services - Passenger, Freight and Supporting Services (railroad, street railway, traction railway): Up to 40% foreign equity participation is allowed. Maintenance and repair of rail transport equipment: None. Road Transport Services - Passenger, Freight and Rental of commercial vehicles with operator: Up to 40% foreign equity participation is allowed. Maintenance and repair of road transport equipment: None. Routine cleaning and maintenance services limited to vehicle laundry and car-wash services / Parking services: Up to 70% foreign equity participation is allowed.
SGP	None	Not covered	Rail Transport Services - Pushing and towing services: unbound. Maintenance and repair of urban and suburban rail transport equipment: None. [Rail Passenger and Freight Transport Services: not covered] Road Transport Services - Rental services of cars with operators / Rental services of buses and coaches with operators / Rental services of commercial freight vehicles with operators / Freight (Road) transport of refrigerated goods, liquids or gases, containerised freight, furniture / Maintenance and repair services of motor vehicles / Maintenance and repair services of parts of motor vehicles / Parking services: None. [Road Passenger transport Services: not covered].
THL	Foreign equity participation is limited to 60%-75% in all transport and transport-related services;	Rail Transport Services - Maintenance and repair of rail transport equipment / Supporting Services for rail transport services (Passenger and freight car cleaning services / Security services at railway station): None [only horizontal measure: Unless otherwise specified at the sector-specific level, commercial presence in sectors or sub-sectors in this schedule is permitted only through a limited liability company which is registered in Thailand and which meets the following conditions: (a) Foreign equity participation must not exceed 49% of the registered capital; and (b) The number of foreign shareholders must be less than half of the total number of shareholders of the company concerned]. [Rail Passenger	Rail Transport Services - Maintenance and repair of rail transport equipment on a fee or contract basis / Railway car cleaning services under the service contract of railway authority: As indicated in 3.1 of the horizontal section [3.1. Foreign equity participation must not exceed 70% of the registered capital and shall only operate through joint-venture with a juridical person of Thai national]. Security services at railway station: As indicated in 3.3 of the horizontal section. [3.3a. Foreign equity participation must not exceed 49% of the registered capital; and b. The number of foreign shareholders must be less than half of the total number of shareholders of the company concerned]. [Rail Passenger and Freight Transport Services: not covered]. Road Transport Services - Other non-scheduled passenger transport - Rental services of passenger cars with operator / Rental services of buses and coaches with operator / Freight transport only for frozen or refrigerated goods, bulk liquids or gases and containerised freight /

Country	Domestic legislation	AANZFTA	AFAS
		and Freight Transport Services: not covered]. Road Transport Services - Other non-scheduled passenger transport - Freight transport only for frozen or refrigerated goods, bulk liquids or gases and containerised freight / Rental services of passenger cars with operator / Rental services of buses and coaches with operator: None [only horizontal measures: see above]. [Road Passenger Transport Services: not covered].	Automobile emergency road services / Parking services: As indicated in 3.3 of the horizontal section [see above]. Car valeting services / parking services for motor vehicles, motorcycles and bicycles provided by car parks, parking lots and parking garages, whether or not roofed: As indicated in 3.1 of the horizontal section [see above]. [Road Passenger Transport Services: not covered].
VNM	Foreign ownership in rail and road transport and related activities is limited to 49% and 51%, respectively. Majority ownership is allowed in railway terminals.	Rail Transport Services - passengers and freight transport: Unbound except: Foreign suppliers are permitted to provide freight transport services through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 49% of the total legal capital. Road Transport Services - passengers and freight transport: None, except:[...] As of 11 January 2010, subject to the needs of the market, joint-ventures with foreign capital contribution not exceeding 51% may be established to provide freight transport services.	Rail Transport Services - Passenger transport: Unbound, except: Foreign suppliers are permitted to provide freight transport services through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 51% of the total legal capital [...]. Freight transport: None. Pushing and towing services / Maintenance and repair of rail transport equipment / Supporting services for rail transport services: None, except that joint ventures with foreign capital contribution not exceeding 51% can be established. Rail handling services: None, except that joint ventures with foreign capital contribution not exceeding 70% can be established. Road Transport Services - Passenger transport: [...] Since 11 January 2014, subject to the needs of the market, joint-ventures with foreign capital contribution not exceeding 51% may be established to provide freight transport services [...]. Freight transport: Foreign service suppliers are permitted to provide freight transport services only through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 70% of total legal capital [...]. Maintenance and repair of road transport equipment: None, except that joint ventures with foreign capital contribution not exceeding 51% can be established. Freight Transport Agency Services (Excluding Road Transport): None.

Chapter 3.

Developing and liberalising services to boost productivity in Southeast Asia

The chapter illustrates the important role of services for inclusive growth and productivity in ASEAN. It provides an overview of the mechanisms through which services drive growth and productivity; generate well-paying jobs; enable access to goods and services for all parts of society as well as for SMEs; and foster upgrading of manufacturers in global value chains. The chapter raises the concern that services sectors in many ASEAN Member States are lagging behind those in peers elsewhere and argues that liberalising services, along with other reforms, can effectively support and accelerate the development of efficient services. Based on a multi-country econometric framework, the chapter demonstrates that opening services to greater foreign investment would help boost productivity and upgrading of downstream manufacturers, particularly SMEs.

Summary

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 (ICT) 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, ASEAN Member States (AMS) have not yet reaped the full potential from the development of services. Services 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. This underperformance in services in many AMS can be seen in terms of exports, productivity and, importantly, in terms the contribution of services to value added in manufacturing.

The implications of services liberalisation for inclusive growth and productivity

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, which is beyond the scope of this chapter. Market access barriers, on the other hand, share commonalities across service sectors and allow for a more general discussion within this chapter.

Services liberalisation remains an important challenge for achieving the ASEAN services integration agenda and its single production base aspirations (see Chapter 1). Entry restrictions in service sectors are still common across most ASEAN economies, usually in the form of foreign equity limitations. While Singapore has largely liberalised services and has a highly competitive services sector today, middle-income AMS still have highly restrictive services.[1] The analysis shows that liberalising and developing services could help AMS to foster inclusive growth and productivity as follows:

- FDI restrictions constrain competition and contestability in service sectors and act as a barrier to raising productivity levels in services. Further liberalisation could also help to raise efficiency in sectors still dominated by large state monopolies.
- Opening services would foster important domestic and foreign investment in telecommunications, logistics and financial infrastructure. While many of the 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).
- Foreign participation can help to improve services efficiency and availability. Stringent 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.

- Services liberalisation would increase the use of high quality services in production and thus raise manufacturing productivity in ASEAN. The analysis presented below reveals relatively low use of services in production and relatively low levels of productivity in manufacturing of middle-income AMS, compared to peers elsewhere. It has also been shown that both intensity of services use and productivity in manufacturing are negatively associated with services restrictions.
- The empirical analysis suggests that a productivity boost related to services liberalisation for ASEAN manufacturers may be particularly prominent for:
  - firms in countries with a more restrictive services regime (particularly Indonesia, Philippines, Viet Nam and Malaysia);
  - producers of e.g. machinery and automobiles relying extensively on services;
  - small and medium-sized enterprises (SMEs) as compared to large firms;
  - domestic firms as opposed to foreign-owned firms;
  - firms that do not export compared to exporters.

Services as a driver of inclusive growth and productivity

The role of services in the global economy is rising

Development involves a transition from an agricultural economy dominated by subsistence farming to an industrialised one dominated by manufacturing and subsequently by services. The share of services in GDP has increased globally, with the fastest rise in the middle-income group (OECD, 2017a). The average services share of low-income countries was below 50% in 2016, compared to almost 75% in high-income countries (World Bank, 2017).

The rising services share of global GDP is associated with a declining share of manufacturing and primary sectors, accelerated heavily by technological advances, particularly in ICT. The ICT revolution and digitalisation has made services tradable, transportable and storable, allowing for strong productivity gains in services. While modern services like telecommunications, financial services and business-related services such as data processing and the online distribution of electronic content have the greatest potential for productivity gains, digitalisation allows almost any type of more traditional services (e.g. retail, education and healthcare) to be traded and to experience enormous growth and productivity gains (OECD, 2014a). Productivity remains lower on average in services than in manufacturing, but the gap is rapidly shrinking. In recent years, productivity growth has often been higher in services than in manufacturing, in both advanced and emerging countries (OECD, 2017a and 2014a).

Along with structural shifts towards services and changes in the provision of services, the increasing services share of GDP is also related to demand-side factors. With a growing middle-class in developing countries (Brueckner et al., 2017), consumption and demand for a more diversified set of products and services increases (OECD, 2014a and 2010). Richer societies tend to spend proportionately more of their income on services (Flaaen et al., 2013). In this sense, economic development biases growth towards services which may be further accentuated with the digital revolution and other technological advances that allow consumers to acquire services instantaneously via online platforms (Low, 2016).

Access to services is enabled through advanced infrastructure

Improved access to a diversified set of services – including basic services such as health and education, as well as advanced digital services – requires investment in high-quality infrastructure and related services. Services are increasingly delivered online and may still involve the acquisition of physical goods, e.g. buying a book through an e-commerce platform. Fully delivering such an e-commerce service requires high quality telecommunications, advanced online banking, good logistic infrastructure and related services as well as stable and affordable access to electricity. These backbone services are integral to the provision of any service and to the functioning of GVCs, serving as the glue to connect consumers and producers across multiple countries.

The availability and quality of infrastructure is still much lower in many middle-income countries than in high-income ones (World Bank, 2017). While good infrastructure services may be available in some urban centres, access is often uncertain and expensive for large parts of society and SMEs, particularly in less developed sub-national regions.

Service sector development involves massive opportunities for job creation

Structural shifts in employment towards services follow a similar pattern as shifts in the composition of GDP. Over the past two decades, the share of services in total employment has increased both in high- and in middle-income countries. In an average high-income country, the employment share of services has increased from around 65% to 75%, while in middle-income countries it has increased from around 25% to almost 50% since the mid-1990s, along with urbanisation that enabled people to move from agriculture to urban jobs in industry and services (OECD, 2017a).

In the past, the rise of services raised worries of productivity slowdowns and fewer secure and well-paying jobs, compared to manufacturing employment (Flaan et al., 2013; OECD, 2014a; Low, 2016 and 2013). Such concerns have led some to call for a revival of traditional industrial policy to foster good manufacturing jobs for lower skilled workers, but productivity gains across service sectors and their rising role in manufacturing and consumption have, with some exceptions, tended to reduce these concerns. To enable inclusive development through services, significant investment in specialised human resources, along with the creation of an adequate business and investment climate (including for SMEs), are essential. SMEs are often responsible for the provision of dynamic services and create the most jobs (OECD, 2017a).

Services are increasingly used in manufacturing and integrated in GVCs

Technological advances in ICT and transport and, through them, facilitated trade and foreign investment opportunities, have driven the development of internationally fragmented production networks. In this process of proliferating GVCs, the share of services' value in production is often said to increase (Low, 2016 and 2013; Rentzhog and Anér, 2014). Newly available data on services value added in manufacturing production and exports illustrate the rising internationalisation of services, with an increase in the share of imported services value-added, along with a general increase in services inputs in manufacturing (Miroudot, 2017). Services value added embodied in manufacturing exports contributes positively to more resilient export relationships (Diaz-Mora et al., 2017) and makes manufacturing more productive (see below).

As the next industrial revolution unfolds, international production fragmentation may be slowing, and manufacturing activities might be re-shored to high-income countries and other advanced production hubs (De Backer, 2016). Manufacturing will be increasingly automated and make extensive use of advanced, digital technologies such as big data analytics, the internet of things and Blockchains – all enabled through advanced services (OECD, 2017a). Accordingly, the role of services for sustained manufacturing productivity will become even more indispensable, both in advanced and emerging country production hubs.

Lagging services development in ASEAN

ASEAN has less developed services than peers elsewhere

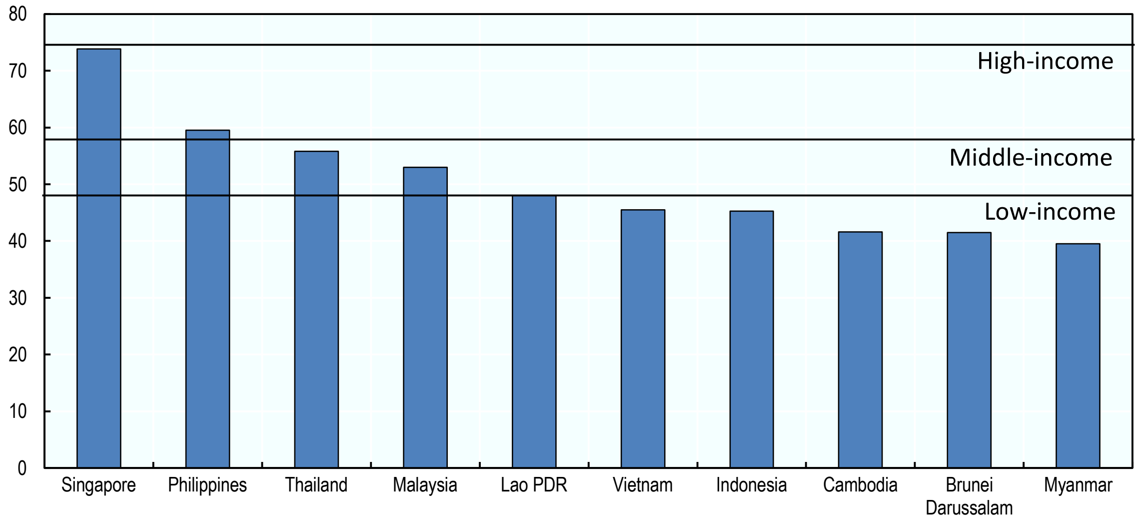
Despite the opportunities for inclusive growth and productivity, AMS have not yet reaped the full potential in services. As economic development involves shifts from agriculture and manufacturing towards services, it is useful to compare AMS with their peers in the same income group.

In many ways and in spite of wide diversity within the region, AMS remain trapped in traditional and low-productivity services (Noland et al., 2012). The average service sector share of GDP in ASEAN is approximately 50% which corresponds to the average contribution of services in low-income rather than middle income economies (Figure 3.1). Viet Nam, Indonesia, Cambodia, Brunei Darussalam and Myanmar have services shares of GDP considerably below 50%. Lao PDR’s share is approximately at the average low-income level. Thailand and Malaysia have shares at 55% and 53%, corresponding to shares below those of average middle-income countries. Thailand and Malaysia are at the upper middle-income level, where services would increasingly be needed to maintain growth and move up the value chain in production. Service sector development below potential is thus particularly worrisome in those two countries. The Philippines has reached the middle-income potential of services, with a services share of approximately 60%. Singapore, as a highly developed, services-based economy, has a services share of GDP at 74%, equivalent to the average share of high-income countries.

Although services are still underdeveloped in many AMS, important progress has been made over the past decade. Every country increased the services share of GDP between 2006 and 2016; in Brunei Darussalam and Lao PDR the shares increased by more than 10 percentage points, although both countries are natural resources-based economies and have suffered from a massive decrease in prices and demand of natural resources so the relative increase in services may not reflect a real shift in the economic structure. Singapore, the Philippines, Thailand, Malaysia, Viet Nam and Indonesia expanded services shares by 4-8 percentage points over 2006-16, while the two poorest countries, Cambodia and Myanmar, made the slowest progress. Both countries still have large agricultural sectors and will be shifting towards more industrial production before substantially expanding their services sectors.

Figure 3.1. Services are still underdeveloped in ASEAN

Services share as % of GDP (2016)



Source: Based on World Bank World Development Indicators.

With economic development, ICT-enabled, modern services are expected to gain in importance relative to other services (OECD, 2017a and 2014a). The share of business, financial, and telecommunications services in total services value added is higher in advanced countries than in any middle-income ASEAN Member. Business services – including professional services like legal, consulting, engineering and advertising, as well as R&D, computer and renting services – are important inputs into advanced manufacturing production. But, with the exception of Singapore, AMS have not yet developed strong business services.

Services exports are expanding but remain below potential

Trade in services has grown rapidly across the world, not least as a result of the geographic and organisational separation of production. With the emergence of GVCs, exports of modern services have grown most rapidly. Their share in world services exports has increased to more than 50%, while the share of transport, and travel and tourism services exports has declined (OECD, 2017a; ASEAN-World Bank, 2015).

ASEAN performs below other countries with similar income levels in terms of exports of services, with lower services exports as a share of GDP than in all other developing regions and with only slow growth in the share over time (ASEAN-World Bank, 2015). Services trade growth has been significant in recent years, but it has been clearly below growth in goods trade.

While some AMS have become established services exporters in particular sectors, sophisticated and modern services exports remain largely niche activities. AMS are mainly exporting ‘traditional services’ such as transport and travel and tourism services, with the notable exceptions of the Philippines and Singapore: the Philippines has become a regional hub for business process outsourcing and other ICT-enabled services exports; and Singapore’s exports of modern services, such as financial, professional and other business services have developed significantly over the past decades (ASEAN-World Bank, 2015).

Regional trade in services within ASEAN is also below the volumes predicted by standardised trade models (ASEAN-World Bank, 2015). All AMS export fewer services to Malaysia and Singapore than their economic fundamentals and geographic proximity would predict. Relatedly, the intensity of intra-regional services trade is lower than services trade between ASEAN countries and the rest of the world.

Although growing, labour productivity in services remains low

Technological advances have enabled productivity growth in services, as in manufacturing. Productivity growth in services in recent years has often been higher than in manufacturing in both advanced and emerging economies, but even in the former, services productivity remains below that in industrial sectors. In Singapore, for example, productivity in industry (including mining and manufacturing) is more than 50% above that in services, while services productivity levels in Singapore are among the highest globally. Productivity measures for services are widely used, but they come with significant challenges given that measuring appropriate output is often difficult in services (Box 3.1).

Labour productivity in middle-income AMS still lags far behind the levels in more advanced countries, with productivity levels in services and industry (including mining and manufacturing) below 40% of services productivity in Singapore (Figure 3.2). Malaysia performs best, followed by Thailand, Indonesia, Philippines, Viet Nam and Cambodia.[2] As in Singapore, all middle-income AMS have considerably lower productivity levels in services than in industry, although this difference is less pronounced in the least productive economies (Viet Nam and Cambodia). In Malaysia, services productivity is four times lower than in Singapore, while services productivity in Thailand corresponds to 15% of the levels in Singapore, and this ratio is below 10% for all other middle-income AMS.

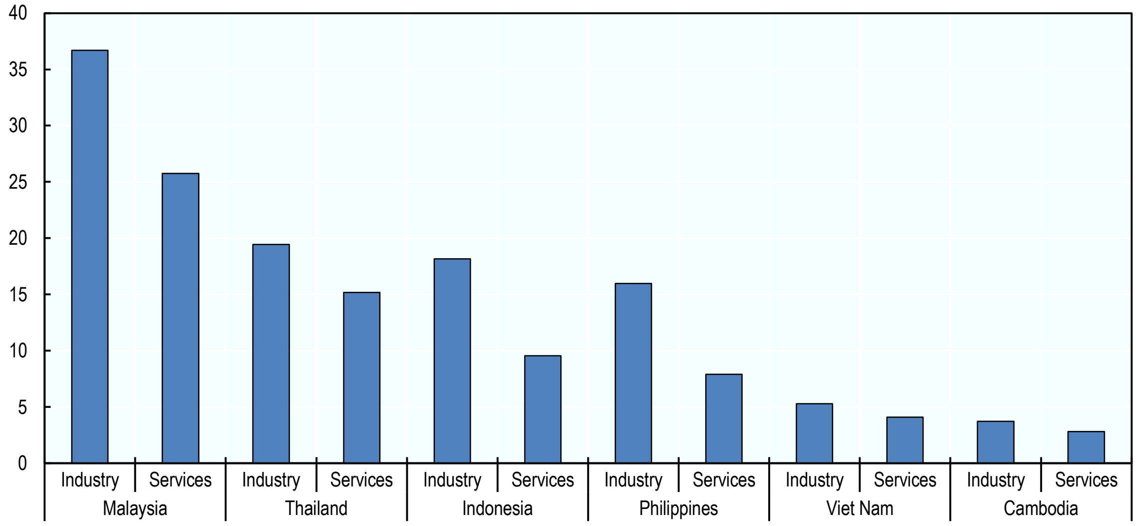
Box 3.1. The challenge of measuring productivity, efficiency and quality of services

A large service sector in an economy can be due to significant inefficiencies and a lack of competitive pressure, or on the contrary, to dynamic, productive services. Similarly, a high share of services inputs in total inputs in manufacturing output can be due to extensive use of productive services, which are likely to support upgrading and productivity, or the opposite – significant inefficiencies and high costs to access (potentially low quality) services. It is important to study the extent of competitive pressure, efficiency and productivity as well as the quality of services in order to evaluate the full potential services may have for inclusive growth in an economy.

Labour productivity, total factor productivity, efficiency scores based on data envelopment analysis or Roger's (1995) methods to estimate mark-ups (a measure of competitive pressure) can be used as proxies for competitiveness in services, but all these measures come with significant challenges given that measuring appropriate output is often difficult in services (OECD, 2014a). For example, services are generally not standardised and show a particularly high degree of product differentiation and hence service volumes and prices are difficult to calculate. Furthermore, service output is often measured by the costs of inputs (mainly wages) and thus comparing different countries or industries by proxies of competitiveness will be biased by national differences in input costs and input mixes (see Triplett and Bosworth, 2008, for example).

Figure 3.2. Labour productivity (industry and services) in selected AMS lags far behind services productivity in Singapore

Labour productivity in industry and services in % of Singapore's labour productivity in services (2016)



Note: Industry includes manufacturing, mining as well as construction and utilities. Services include all services except construction and utilities. Labour productivity is measured as value added per person employed, in constant USD prices.
Source: Based World Bank World Development Indicators.

Middle-income AMS have considerably improved services productivity over the past decade. Services productivity improved as much as 40% in Malaysia and Indonesia over 2006-16 and more than 20% in Thailand and the Philippines. Productivity growth in services in Viet Nam and Cambodia was considerably weaker. Despite strong growth, the productivity gap with advanced countries has only marginally been reduced.

Lagging productivity is particularly pronounced in backbone services

Broad access to, and availability of, backbone services is essential for inclusive growth and enhanced participation in GVCs, including by SMEs. The productivity gap between advanced countries and ASEAN middle-income countries is particularly marked in transport and telecommunications (ASEAN-World Bank, 2015). A simple proxy of competitive pressure (or inefficiency) in backbone services is the ratio of value added per unit of gross output – where value added includes labour costs and profits, and output also includes all input and external services costs. The comparison between AMS and selected comparator countries shows that this ratio is higher in all emerging countries in the ASEAN region compared to the same ratios in advanced countries. This finding could point to persistent high mark-ups and inefficiencies in backbone services in AMS that are still highly restricted for new foreign and domestic market entrants.

For transport and logistics services, the World Bank *Logistics Performance Index* provides a good measure of quality and efficiency (World Bank, 2017). While Singapore is among world's top five performers in this metric, and Malaysia and Thailand compete with peers in the middle-income group or above, logistics performance is still very weak in Lao PDR and Myanmar. It is a concern for all AMS that the relative logistics performance of AMS, compared to countries in similar income groups, has worsened over the past decade.

Telecommunications form the backbone on which increasingly modern, digital services are founded. Mobile-to-mobile connections are rapidly gaining ground in both consumer and business markets. The speed of general internet connection – and of mobile internet in particular – provides a good measure of telecommunications performance. Singapore has the fastest speeds not just among AMS but nearly across the entire world (Akamai, 2017; OpenSignal, 2017). Middle-income AMS have slow internet speeds, compared to peers elsewhere, particularly in the Philippines among the AMS covered. Mobile connection speed is six times faster in Singapore than in the Philippines.

Financial services also vary widely across ASEAN economies. At one end, Singapore has one of the most developed financial sectors in the world, with a sophisticated banking sector and developed capital markets. Malaysia and Thailand also have rather strong financial intermediation capabilities, but the other AMS have yet to develop their financial systems beyond banking activities, and financial intermediation through the banking system can still be relatively expensive. In the case of Indonesia, Cambodia, Lao PDR and the Philippines, bank net interest margins were 2 to 3.5 times higher than in Singapore over 2011-15 according to the World Bank's Global Financial Development data. Higher margins have been found to be associated with higher market concentration, a lower ratio of banking assets to GDP and lower penetration by foreign banks (Claessens and Van Horen, 2012; Demirguc-Kunt and Huizinga, 1999).

The use of services in manufacturing production and exports is relatively low

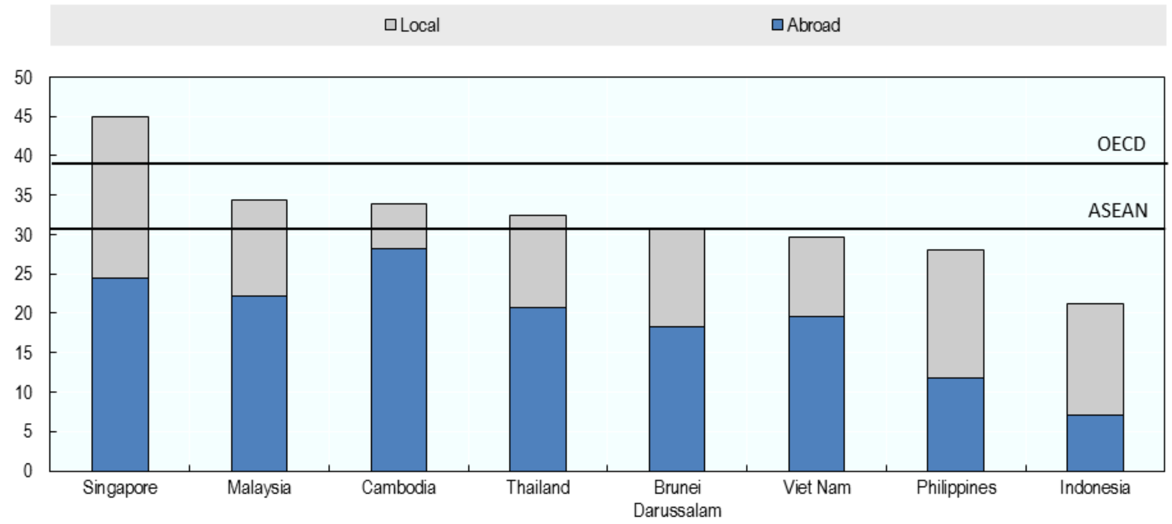
ASEAN growth over the past few decades has been strongly driven by manufacturing-led exports in GVCs. To ensure a continuation of this trend, ASEAN needs to upgrade within GVCs. This can be enabled through more intensive use of specialised services such as advanced ICTs (e.g. automated production and big data analytics) but also professional services such as engineering, design, and marketing services.

ASEAN has not yet matured in its participation in GVCs, at least vis-à-vis its use of services as an enabler of upgrading. While almost all AMS have increased services intensity over recent years, they still have a considerably lower average services value added share in manufacturing exports (30%), compared to the OECD average (almost 40%) (Figure 3.3). Viet Nam, the Philippines and Indonesia have services value added shares in manufacturing exports below the ASEAN average. Malaysia, Cambodia, Thailand and Brunei Darussalam have shares of 30-35%. Singapore is an outlier, reporting shares considerably above the OECD average at 45%. With respect to specialised business services, ASEAN countries are essentially not using them as inputs into production.[3]

GVCs allow the fragmentation of production and services inputs into production across different locations around the world. ASEAN strongly uses this opportunity: the share of imported services in total services value added in exports ranges from about 30% (Indonesia) to more than 80% (Cambodia) across ASEAN countries (Figure 3.3). Open markets for services imports can thus help to provide access to services even if they are not available locally.

Figure 3.3. AMS use services less intensively in production and exports than OECD countries

Services value added produced locally and abroad: share of gross manufacturing exports (in %) 2014



Source: Based on OECD Nowcast Estimates of Trade in Value Added.

Liberalising and developing services in ASEAN

Technological progress and knowledge-intensive services are massively transforming economies and industries. From the development of increasing customised services solutions and delivery channels to the 'servicification' of manufacturing products, services have revolutionised the way people and business interact, structure and organise themselves. Yet, in many ways their development is still largely hindered by internal and external policy distortions that stifle innovation and competition.

Service sectors differ greatly from one sub-sector to the next, raising diverse public policy concerns. They may have strong public good characteristics and be prone to important and idiosyncratic market failures, from natural monopoly characteristics and externalities in backbone services to moral hazard, asymmetric information and 'adequate quality' in financial and professional services. As such, services activities are typically subject to specific regulations either by government bodies or by self-regulating professional bodies.

Since many services were long considered as non-tradable, they often received less attention from public authorities concerning the potential development impact of greater external competition. As observed in Chapter 1, governments early on recognised the overall benefits of liberalising trade in goods – and the gains engendered from import competition – for the development of manufacturing industries, while the liberalisation of services sectors has typically lagged behind. The growing tradability of services, made possible with advances in technology and the increased demand for world-class services inputs within GVCs, has now put pressure on governments to find solutions that help to boost domestic services productivity levels.

Taken together, this requires service sector reforms to eliminate barriers to entry, allowing for greater competition and contestability pressures. This would stimulate innovation and technological diffusion within services industries. Reforms also need to promote the adoption of effective and compatible behind-the-border regulations to avoid inefficient regulatory divergence across countries. Regulatory heterogeneity may lead to market fragmentation and stall the scope for competition and contestability gains (Nordås and Rouzet, 2015; Fournier, 2016).

Without losing sight of the importance of a pro-competitive domestic regulatory environment, this section focuses on the role of liberalisation of FDI restrictions for developing efficient services. The heterogeneity of services implies the need for country- and industry-specific policy solutions to domestic regulations, which is beyond the scope of this chapter. Market access barriers, on the other hand, share commonalities across services sectors and allow for a more general policy discussion. Besides, as showed in Chapter 2, this remains an important challenge for achieving the ASEAN services integration agenda and its single production base aspirations. Entry restrictions in services sectors are still common across most ASEAN economies, most commonly in the form of foreign equity limitations.

Services FDI can foster modern services with higher productivity and better wages

Many services activities require a physical commercial presence by the provider. Foreign direct investment is, thus, arguably the most important mode for involving foreign services providers. For example, approximately 70% of all services provided by EU Member States outside the EU are provided through physical presence of EU service providers in foreign markets (Eurostat, 2016). It is also possibly the one offering the largest potential benefits to recipient economies. FDI firms are typically at the global or regional frontier in their respective areas and are usually larger, more innovative and more skill-intensive than domestic peers (OECD, 2015). Enabling foreign firms' establishment within host economies may have some disruptive effects, but offers an opportunity for local firms and people to tap into their pool of managerial competence, technical knowledge and know-how which may be valuable for sustaining productivity growth in the long-term.

Proximity to FDI firms may be particularly important for diffusing innovation and capabilities in knowledge-based services (Keller and Yeaple, 2013). The diffusion and mobilisation of know-how is largely determined by close interactions of people, customers and suppliers, as well as through observation, imitation and repetition (Hausmann et al., 2007). As such, services FDI may contribute to the discovery of innovative new services and products, not only within services sectors but also in manufacturing and other sectors as well (OECD, 2017a). In addition, the contestability of services sectors and the competitive pressure brought by service sector liberalisation may also help to make service sectors more efficient, reducing input costs to downstream businesses and to the population at large.

In ASEAN, service sectors account for two thirds of total inward FDI stocks, a level comparable to the OECD aggregate (see Chapter 1) – although the magnitude of cross-border investment in services may be overstated. Excluding Singapore, ASEAN received 40% of inward FDI in services in the last five years, compared to 70% if Singapore is included in the ASEAN aggregate. The services sectors of Cambodia, Lao PDR, Singapore, Thailand, and the Philippines attracted more than 50% of the total inward FDI over 2012-16. Indonesia and Viet Nam captured less than 30% of services FDI. By sector, financial services, wholesale and retail and real estate activities were the main recipients of recent inward FDI flows. Foreign investment in infrastructure services was also prevalent in some ASEAN Member States.

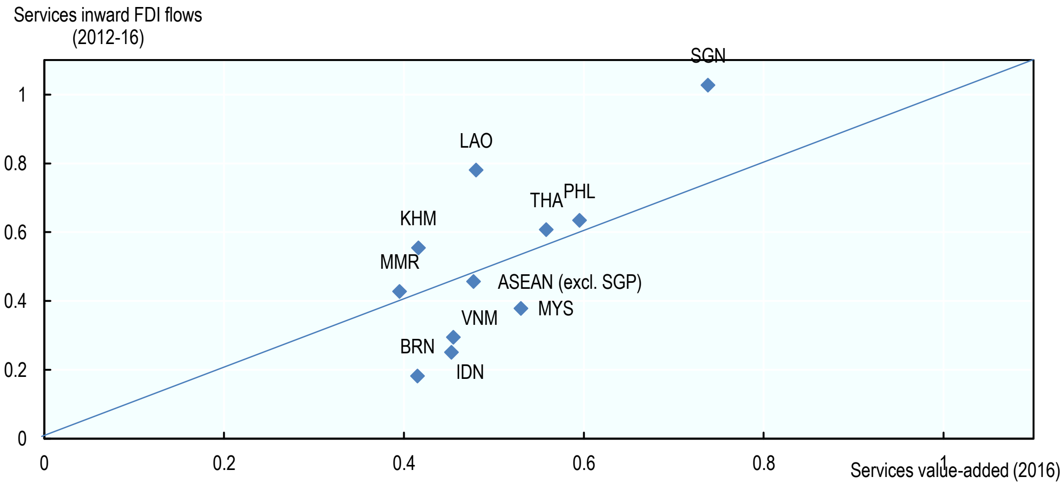
The differences across ASEAN economies partly reflect their diverse economic structure, including different structures within services. Not all types of services are equally attracting FDI. Singapore, Thailand, Philippines and Cambodia, for instance, received inward FDI in services equivalent or slightly higher than the weight of the sector in the economy. But this pattern does not hold across all member states (Figure 3.4). Despite an equal contribution of the sector to total value-added, Viet Nam's share of services FDI was considerably lower than in Cambodia. Malaysia has likewise received less FDI in services than the Philippines and Thailand, despite only a slightly lower sector weight in the economy. At the same time, Malaysia attracted relatively larger shares of FDI in more knowledge-intensive services, such as ICT, than other ASEAN countries. This is also the case for Indonesia, an economy where the share of services FDI is lower than what its economic structure would predict. Most of the FDI stock in Cambodia is in construction activities, a sector where the diffusion of know-how may be more limited.

Barriers to FDI depress investment and labour productivity in service sectors

The negative relationship between FDI restrictions and foreign investment entry is increasingly well-documented. Recent empirical studies using the OECD *FDI Regulatory Restrictiveness Index* (henceforth, the *FDI Index*) as well as other FDI restrictiveness measures suggest that FDI restrictions considerably depress FDI (Fournier, 2016; Ghosh et al., 2012; Nicoletti et al, 2003; Golub, 2003; Campos and Kinhosita, 2003). An OECD (2011) study analysed the effect of restrictions as captured by the *FDI Index* on bilateral FDI stocks in service sectors and found that across the sample of OECD countries a policy change from full restrictiveness to full liberalisation would increase FDI stocks in services by about 25%. A 50% improvement in the FDI Index score (FDI liberalisation) could cause as much as a 12% increase in FDI stocks for certain countries. More indirectly, existing studies on the impact of services liberalisation on manufacturing productivity identify FDI entry as a channel through which liberalisation affects downstream manufacturing sectors (e.g. Shepotylo and Vakhitov, 2015; Arnold et al., 2011 and 2012).

Figure 3.4. ASEAN receives less FDI in services than the sector weight in the economy

Services sector share (% of total)



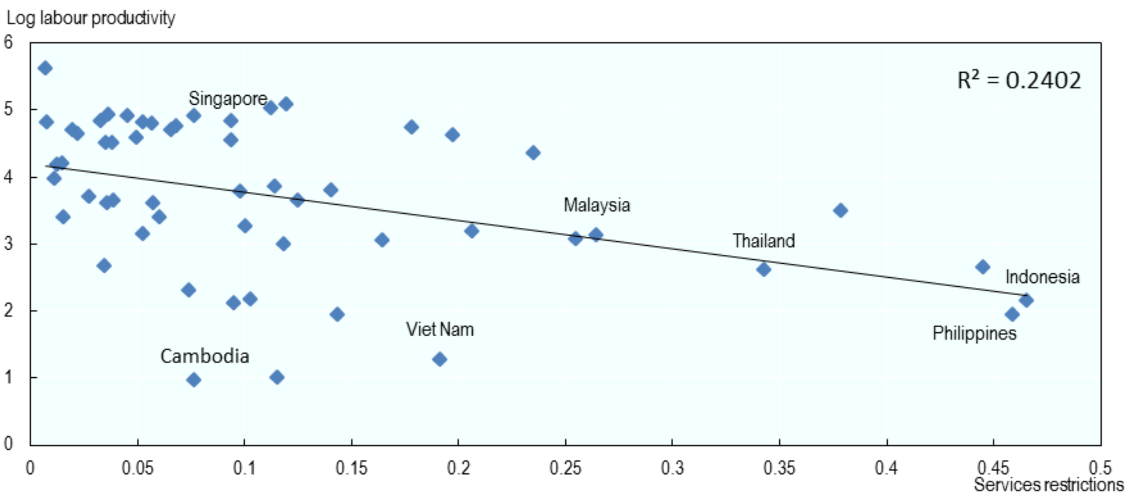
Note: The ASEAN aggregate represents an unweighted average.
Source: OECD based on ASEAN FDI Database and World Bank World Development Indicators.

Recent case study evidence for selected AMS also illustrates that liberalisation in services has led to new foreign market entrants (ASEAN, 2017). For example, in Viet Nam, strong improvements in business procedures and regulations as well as FDI liberalisation in business services are reported to be among the main drivers for a massive inflow of FDI across all sectors. Similarly, important banking sector reforms in Indonesia in the 1980s and early 1990s are reported to be associated with above average economic growth in Indonesia during the same period, although it is not clear whether growth in FDI was also triggered by these reforms. For the Philippines, a case study illustrates that reforms in the telecommunications sector are associated with lower costs, have led to new market entrants and enabled the development of a competitive business process outsourcing sector, which is now responsible for significant export revenues.

Conversely, limited competition from local affiliates of foreign MNEs may have impeded the development and upgrading of service sectors across ASEAN. An assessment of FDI in four key service sectors in AMS – finance, logistics, telecommunications and business services – and the corresponding level of FDI restrictions reveals a strong negative relationship.[4] In some cases, FDI may take off only after a critical mass of reforms has been implemented, suggesting that reform progress cannot stop short for it to trigger the desired effects.

In AMS and other selected countries, FDI restrictions are also directly associated with lower labour productivity in service sectors (Figure 3.5). Correlation does not prove causality but illustrates at a minimum that services reform could be accompanied by productivity growth in services in addition to greater investment levels. This finds support in the empirical literature (OECD, 2017a; Nordås and Rouzet, 2015; OECD, 2014a; Chanda and Gupta, 2011; WTO and UNCTAD, 2012). Comparing restrictions with FDI intensity in the four selected services sectors, reveals non-linearities with regards to labour productivity, corroborating the view that reforms may have to go deep, beyond a certain threshold level, for them to start translating into productivity growth.

Figure 3.5. 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.

Opening services to boost ASEAN productivity in manufacturing

Manufacturers rely heavily on service inputs in production. With increasingly digitalised GVCs, access to high quality services – particularly telecommunications, transport and specialised business services – is becoming all the more important. Liberalising market access in services would thus not only add competitive pressure in services, potentially spurring domestic and foreign services investment, but it would also likely benefit manufacturers through improved access to productive services. The recent empirical literature has identified a clear positive association between services reforms and productivity growth in manufacturing (Box 3.2).

Box 3.2. Services reforms raise manufacturing productivity

Recent empirical literature has identified a clear association between services reforms and productivity growth in the economy as a whole; as well as specifically in manufacturing (Low, 2016; OECD, 2013). A study of 15 OECD countries illustrates that anti-competitive upstream regulations in services and other non-manufacturing sectors curbed multi-factor productivity growth in downstream sectors between 1985 and 2007 (OECD, 2010). A recent study of Lao PDR confirms that services liberalisation benefits economic development across economic sectors, not just in services (Isono and Ishido, 2016).

Focusing on manufacturing, Duggan et al. (2013) employ the OECD *FDI Index* to assess the effects of FDI restrictions in services on the manufacturing productivity of Indonesian firms and find that service sector FDI liberalisation accounted for 8% of the observed increase in Indonesian manufacturers' total factor productivity (TFP) from 1997 to 2009. Shepotylo and Vakhitov (2015) analyse the impact of services liberalisation on manufacturing productivity in Ukraine over 2001-07 and find that a one standard deviation in liberalisation in services is associated with a 9% increase in the TFP of manufacturing firms. The authors also find that the effect of services liberalisation is stronger for domestic and small firms. Arnold et al. (2012) find that India's policy reforms in banking, telecommunications, insurance and transport services all had significant and positive effects on the productivity of Indian manufacturing firms from 1993 to 2005. Both foreign and domestic firms benefited from services reforms, but the effects were stronger for foreign-owned firms. A one standard deviation increase in services liberalisation resulted in a productivity increase of approximately 12% and 13% for domestic and foreign manufacturing firms, respectively. Relatedly, Berulava (2011) finds that liberalisation in telecommunications, electric power, transport, water distribution and banking stimulated the expansion of export activities of manufacturers in 29 transition economies from 2002 to 2009.

These findings are qualified by a recent study that argues that the effect of restrictions in upstream services is conditional on institutional quality (Beverelli, et al., 2015). Using sector-level data in a panel dataset of 58 countries spanning all stages of economic development, the study finds that countries with better economic governance benefit more from open services policies. That is, higher quality institutions attract more productive service providers and support higher levels of services performance, which then affect downstream manufacturing sectors.

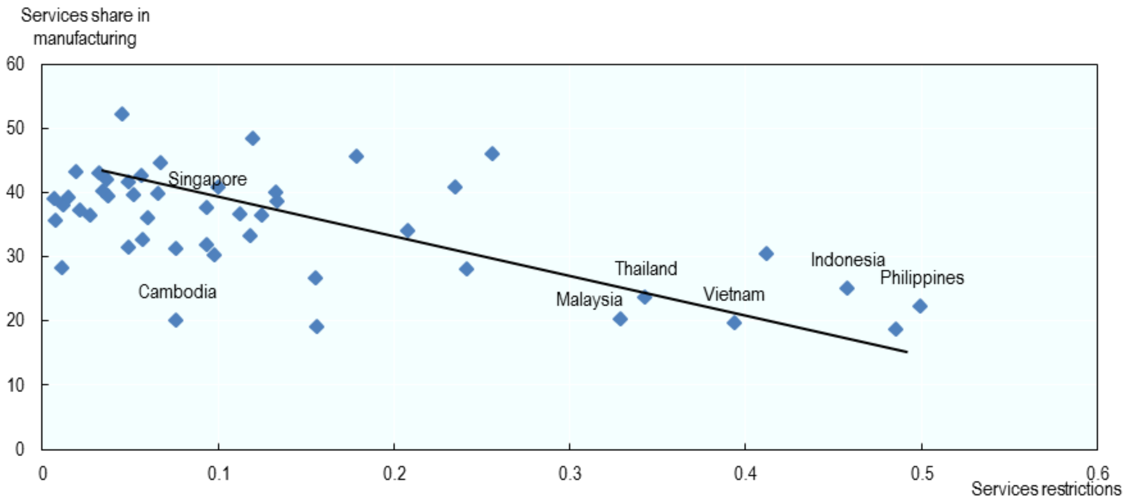
A number of studies also show a positive association between FDI in services and manufacturing productivity. Arnold et al. (2011) illustrate that increased foreign participation in services improved manufacturing productivity in the Czech Republic from 1998 to 2003. A one standard deviation in foreign presence in services is associated with an approximately 8% increase in the productivity of Czech manufacturing firms relying on services inputs. Fernandes and Paunov (2012) conduct a similar study on the effects of FDI in services sectors on the productivity of Chilean manufacturing firms between 1995 and 2004. A one standard deviation increase in service FDI would increase Chilean firms' TFP by 3%, and forward linkages from FDI in services explain 7% of the observed increase in the TFP of Chile's manufacturing firms during the period. Forlani (2011) finds that increased competition in network services in France improves the productivity of manufacturing firms.

Services liberalisation would increase the use of high quality services in production

To the extent that FDI liberalisation is associated with more intensive use of services in production and, importantly, with the use of more productive services, services liberalisation would raise productivity in downstream manufacturing industries. If services productivity increases with liberalisation of services, the unit costs for specific services would be expected to fall or, if costs are not falling, the same units of services would be delivered at higher quality levels. Relatedly, if the overall cost component of services inputs in manufacturing production increases when restrictions fall, it is likely that this increase is due to a more intensive use of productive services rather than the opposite scenario of more costly use of less productive services.

Comparing developing and developed countries, including seven AMS, FDI restrictions in services are negatively correlated with services' inputs shares in production (Figure 3.6). Except for Singapore and Cambodia, AMS have comparatively higher services restrictions than many of their peers in both developed and other emerging regions. They also fall behind in the use of services as inputs into manufacturing, compared to other countries. Cambodia has low levels of services restrictions but nonetheless does not intensively use services in production. All AMS have liberalised services over the past two decades and have also moved – albeit slowly – towards higher use of services in production.

Figure 3.6. More restrictions in ASEAN services are associated with comparatively lower use of services in manufacturing production



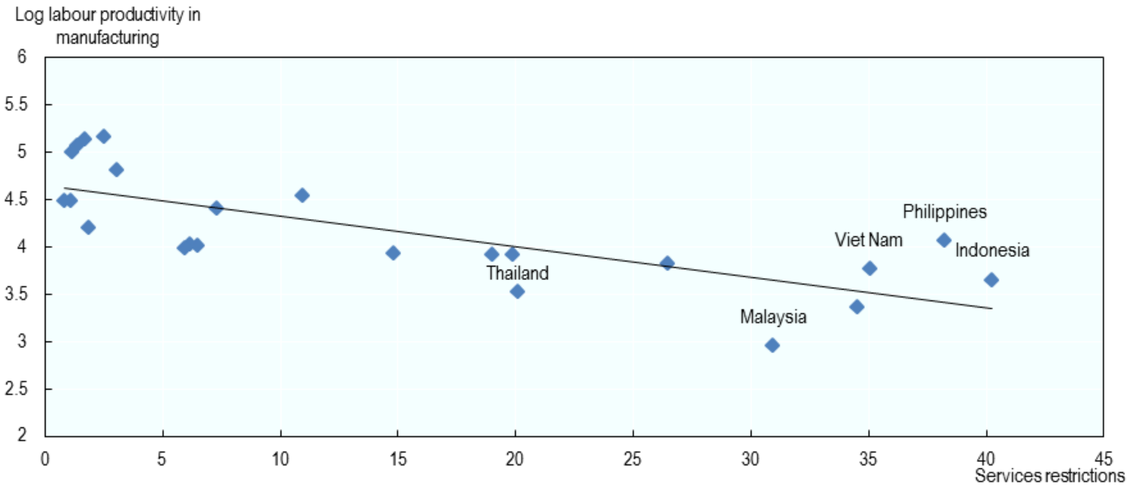
Note: Services restrictions correspond to the weighted restrictiveness of FDI in upstream services faced by downstream manufacturing sectors.
Source: Authors' calculations based on OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

As countries move up the value chain in manufacturing, they often use business services, like engineering, R&D and computer services, more intensively. The comparison between restrictions in business services and the share of these services in manufacturing production illustrates a non-linear, negative relationship. Although AMS have considerably liberalised business services, it has not yet led to an increased use of these services in production. This finding confirms that liberalising market access is just part of what is required to develop business service capabilities that can then be effectively installed in production processes. Skills development initiatives would be another important effort, for example.

More open services would raise manufacturing productivity

Middle-income AMS have high services restrictions and low levels of productivity compared to peers in other countries. Services restrictions faced by manufacturing producers across more than 20 middle-income countries, of which five are middle-income AMS, are negatively and linearly associated with average manufacturing productivity (in logarithmic terms) (Figure 3.7). The same relationship can be observed when decomposing the analysis into manufacturing sub-sectors, including lower technology sectors like food and garment production as well as higher technology sectors such as machinery or automobile production. This cross-country relationship is consistent with the growing body of econometric studies conducted almost exclusively for a single country (Box 3.2).

Figure 3.7. Services restrictions faced by downstream manufacturers are negatively associated with manufacturing labour productivity



Note: Labour productivity is defined as sales per person employed (in 1000s USD). Reported labour productivity figures correspond to simple averages of firms surveyed in World Bank Enterprise Surveys. Services restrictions correspond to FDI restrictions manufacturing firms face, based on their sourcing structure of services.
Source: Authors' calculations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

This section uses a multi-country empirical framework to further test the relationship of services liberalisation and manufacturing productivity and to identify whether restrictions in the ASEAN context are particularly detrimental for productivity, and whether SMEs, foreign-owned firms and exporters are relatively more or less affected by restrictions in services. The analysis uses firm-level data from more than 22 000 manufacturing firms across 21 developed and emerging economies, including Indonesia, Malaysia, the Philippines, Thailand and Viet Nam. Annex 3.A.1 provides a detailed description of data, methodology and results.

Manufacturers relying extensively on services face stronger productivity pressures in a restrictive services environment

In line with the stylised facts illustrated above and findings of previous studies, the econometric analysis shows that a marginal decrease in FDI restrictions (i.e. liberalisation) is associated with productivity improvements in downstream manufacturing sectors (see Annex 3.A.1). Statistically significant point estimates are identified in all model specifications and range between -0.2% and -5%, where these percentages mean that a one-unit increase in services restrictions is associated with a respective percentage drop in productivity (the restrictions variable ranges between 0-100). The data also suggest that manufacturers relying more extensively on services experience even stronger productivity pressures when they are exposed to a restrictive policy environment for FDI in services as compared to firms that use services less extensively. The combined effect of services share and restrictions is statistically significant and negative across model specifications, ranging from -0.2% to -0.4%.

Liberalising services in countries with relatively high restrictions – the case in most middle-income AMS – is particularly favourable for productivity

While firms in any country are likely to see a rise in productivity with lower services restrictions, the data suggest that this productivity rise is almost doubled for AMS. This result may help to explain part of the non-linearity observed in the descriptive analysis and may not be specific to AMS as such but rather to countries that are subject to higher average service restrictions more generally. That is, once restrictions fall below a certain threshold, expected average productivity increases sharply.

Restrictions in upstream services have a relatively stronger negative effect on SME manufacturers

SMEs rely proportionately more on high quality backbone and other services that are provided by upstream, external providers. Restrictions are likely to lower competitiveness and quality of service provision and may increase costs. With scale, firms are more likely to internalise certain services or source them from other markets and thus restrictions in upstream services could affect them less. Based on the analysis, productivity performance of SMEs (defined as firms with fewer than 200 employees) is more challenged by restrictions in upstream services than for larger firms. Independent of the model specification, the drop in productivity after a marginal increase in restrictions is consistently about 0.5% larger for SMEs compared to large firms.

Foreign-owned manufacturers may be less adversely affected by services restrictions than domestically owned firms

Affiliates of foreign manufacturers, just like larger domestic firms, are likely to internalise many of the upstream services or to source them directly from the head office or other affiliates abroad. Therefore, foreign-owned manufacturers are less likely to be adversely affected by FDI restrictions than domestically owned firms. The estimation results suggest that foreign-invested firms are either negatively affected by restrictions in services just like domestic firms or they can handle the burden of restrictions better than domestic firms.

Restrictions in upstream services may adversely affect exporters less than non-exporters

Existing theoretical and empirical literature on firm heterogeneity in export performance relies on the assumption that exporters are more productive and can therefore afford to invest into sunk costs enabling them to enter into exporting (see Melitz, 2003, for example). Accordingly, these structural differences between exporters and non-exporters may also mean that restrictions in upstream services affect exporters comparatively less, assuming that exporters have internalised some of the upstream services and thus rely less on outsourced services. The empirical findings illustrate that exporters cope with restrictions in services at least as well and sometimes better than non-exporters in terms of productivity.

Notes

1. Cambodia is somewhat an exception as it has considerably lower restrictions in services compared to other middle-income AMS. Albeit not a middle-income country, Brunei Darussalam also has highly restrictive services.
2. Data for Lao PDR and Myanmar were not available for this comparison.
3. Higher services cost shares may not always relate to more intensive use of efficient services in production but may to some extent also be explained by unobserved differences in efficiency, quality and affordability of services (Box 2.1).
4. FDI intensity measures correspond to the sum of all M&A inflows and separately to the sum of announced greenfield FDI inflows, divided/normalised by 1000 times each country's GDP in 2009 and 2016, respectively. FDI restrictions correspond to average scores of the OECD *FDI Regulatory Restrictiveness Index* over 2003-09 and 2010-16.

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Annex 3.A. Data, methodology and results of estimations

Data and descriptive statistics

The econometric work of this chapter makes use of four key sources of data: OECD *FDI Regulatory Restrictiveness Index* (Index); OECD Input-Output Tables (OIOT); World Bank Enterprise Surveys (WBES); and World Bank World Development Indicators (WDI). Specific variables constructed from these datasets are described below.

The analysis is conducted at the firm-level using data for more than 22 000 firms across 21 developing and emerging countries, including five ASEAN Member States: Indonesia, Malaysia, Philippines, Thailand and Viet Nam (Table 3.A.1). All firms are manufacturers and are identified at the two-digit level of the ISIC Rev. 3 classification (i.e. ISIC 15-37).[1] Firm-level data is taken from World Bank Enterprise Surveys. The sampling framework used in the collection of the data includes stratification by sector, firm size and region with varying degree of disaggregation depending on the country (World Bank, 2009). All other variables used in the estimations are constructed at the sectoral or country level.

[1] https://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=2

Annex Table 3.A.1. Number of firms surveyed per country and year

Country	2009	2010	2011	2012	2013	2014	2015	2016	**Total**
Argentina		720							**720**
Brazil	1339								**1339**
Chile		694							**694**
China				1652					**1652**
Czech Republic	83				98				**181**
Hungary	109				63				**172**
India						6844			**6844**
Indonesia	1008						1041		**2049**
Israel					179				**179**
Lithuania	89				91				**180**
Malaysia							538		**538**
Mexico		1085							**1085**
Philippines	835						923		**1758**
Poland	106				142				**248**
Russia	513			1080					**1593**
Slovak Republic	67								**67**
Sweden						317			**317**
Thailand								681	**681**
Tunisia					317				**317**
Turkey					670				**670**
Viet Nam	723						667		**1390**
Total	**4872**	**2499**	**0**	**2732**	**1560**	**7161**	**3169**	**681**	**22674**

Source: Authors' calculations based on World Bank Enterprise Surveys.

Dependent variable: Labour productivity

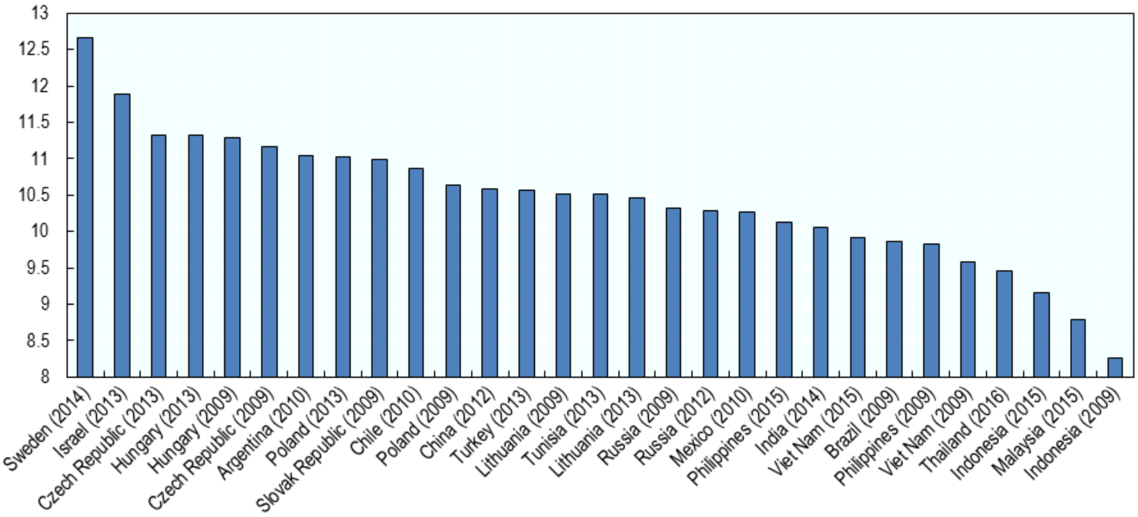
Labour productivity is used as the dependent variable in all estimation specifications. Labour productivity is measured at the firm level and defined by sales in USD over number of total full-time, permanent employees using WBES. Outliers in terms of extremely high or low productivity levels (the top and bottom 1%) are deleted from the dataset. In the estimations, the productivity variable is expressed in log terms. Figure 3.A1.1 shows a cross-country/survey comparison of average log productivity levels. Table 3.A1.2 provides more detailed statistics on variation in the productivity variable. As one would expect, it reveals that countries with more advanced manufacturing industries like Sweden or Israel have much higher productivity levels as compared to less developed countries. ASEAN countries in the dataset turn out to be among the least productive manufacturers.

Annex Table 3.A.2. Descriptive statistics on labour productivity in logs

Country	Year	Average	Std. Dev.	5% percentile	Median	95% percentile
Argentina	2010	11.0	0.8	9.7	11.0	12.5
Brazil	2009	9.9	1.9	5.7	10.2	12.2
Chile	2010	10.9	0.9	9.6	10.8	12.6
China	2012	10.6	0.9	9.1	10.6	12.2
Czech Republic	2009	11.2	0.9	9.9	11.1	12.6
Czech Republic	2013	11.3	1.0	10.0	11.3	13.4
Hungary	2009	11.3	1.1	9.6	11.1	13.2
Hungary	2013	11.3	1.1	9.6	11.2	13.2
India	2014	10.1	1.1	8.2	10.0	12.0
Indonesia	2009	8.3	1.7	5.7	8.1	11.2
Indonesia	2015	9.2	1.9	6.6	8.8	13.8
Israel	2013	11.9	0.7	10.6	11.9	13.0
Lithuania	2009	10.5	0.9	9.1	10.5	12.0
Lithuania	2013	10.5	0.9	9.0	10.4	12.2
Malaysia	2015	8.8	1.6	5.8	8.9	11.3
Mexico	2010	10.3	1.1	8.5	10.3	12.1
Philippines	2009	9.8	1.5	7.3	9.8	12.4
Philippines	2015	10.1	1.5	7.7	10.2	12.7
Poland	2009	10.6	0.9	9.0	10.7	12.1
Poland	2013	11.0	1.5	8.5	10.9	13.4
Russia	2009	10.3	1.0	8.5	10.3	12.1
Russia	2012	10.3	1.0	8.5	10.3	12.1
Slovak Republic	2009	11.0	0.8	9.8	10.8	12.6
Sweden	2014	12.7	0.6	11.8	12.6	13.9
Thailand	2016	9.5	1.4	7.2	9.4	11.9
Tunisia	2013	10.5	1.2	8.6	10.5	12.5
Turkey	2013	10.6	1.7	8.0	10.8	12.8
Viet Nam	2009	9.6	1.2	7.7	9.5	11.6
Viet Nam	2015	9.9	1.3	7.9	9.9	12.1
Total		10.1	1.5	7.6	10.2	12.4

Note: Labour productivity is calculated at the firm level and then aggregated to the country (survey) level. Labour productivity is defined by sales per full-time, permanent employee.
Source: Authors' calculations based on World Bank Enterprise Surveys.

Annex Figure 3.A.1. Labour productivity in logs

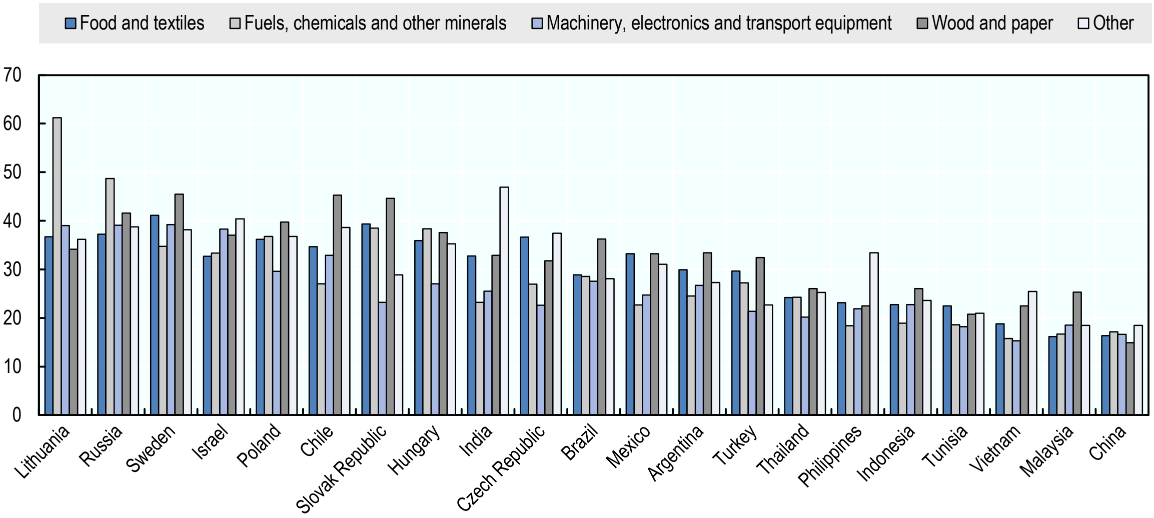


Note: Labour productivity is calculated at the firm level and then aggregated to the country (survey) level. Labour productivity is defined by sales per full-time, permanent employee.
Source: Authors' calculations based on World Bank Enterprise Surveys.

Independent variables

The ***services share*** in manufacturing production is measured at the sectoral level using OIOT and describes the cost share of services in total manufacturing production inputs (excluding in-house labour costs). The indicator is constructed for five separate manufacturing sectors. It is measured in the year 2008 which is prior to any observed labour productivity in this study. While this chapter discusses that services shares may vary over time (and restrictions could play a role), this variable does not vary over time in the econometric analysis for two reasons: firstly, OIOT data are not available after 2011 and accordingly, a time-varying variable would have involved significant extrapolation assumptions. Secondly, the core independent variable to investigate in this study is services FDI restrictiveness that varies over time and makes use of the input-output structure of the economy. The latter is kept constant over time to avoid changes in restrictions being driven by changes in the structure of the economy. Consistent with the construction of the restrictiveness variable, the services share variable is therefore kept constant over time. Figure 3.A1.2 presents the 2008 scores of services shares in total inputs across manufacturing sectors.

Annex Figure 3.A.2. Services share in manufacturing (in %): 2008



Source: Authors' calculations based on OECD Input-Output Tables.

As mentioned in the previous paragraph, the ***restrictions in services*** variable also makes use of OIOTs to identify the extent to which manufacturers use various services in production. The scores on restrictions in services are taken from the *Index* and are measured one year prior to the observation of labour productivity for a given firm. This approach helps to reduce potential endogeneity issues: the argument is that restrictions faced by services providers in t-1 will affect the quality of services provided in time t and will also affect the productivity of manufacturers using these services in time t. Services restrictions for nine different sectors are used to construct the variable; namely business services, financial services, logistics, telecommunications, utilities, construction, real estate services, wholesale and retail services as well as other services. The service restrictiveness that each of the five sectors in manufacturing faces is calculated as the weighted average of each service sector's score in the *Index*, where the weights are given by the share in the total input costs of a given manufacturing sector 's' accounted for the service 'j'.[2] The restrictions in services variable is constructed as indicated in (1).

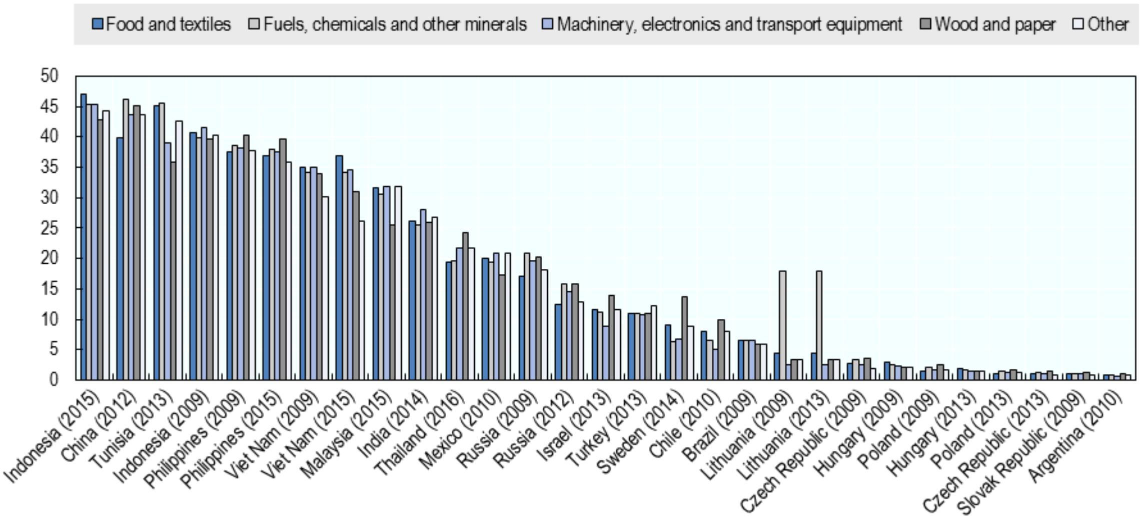
$$rest_{s,c,t} = \sum_{j}^{J}(w_{s,c,j} * Index_{j,c,t}), \qquad (1)$$

where *rest* is the weighted FDI restrictiveness index faced by manufacturing sector *s* at time *t* in country *c*; *w* is the share of service sector *j* in total inputs of manufacturing sector *s* in country *c;* and *Index* is the score of the OECD *FDI Regulatory Restrictiveness Index* of service sector *j* at time *t* in country *c*.

[2] Previous studies on the impact of services restrictions on manufacturing productivity have used time-varying weights (e.g. Duggan et al., 2013). As described above, the analysis in this study used time-constant weights to avoid changes in restrictions being driven by changes in the structure of the economy.

The average scores of FDI restrictions in upstream service sectors faced by manufacturing sub-sectors across countries/surveys are presented in Figure 3.A1.3. Manufacturers in ASEAN countries that are covered in the database face considerably higher restrictions in upstream service sectors compared to manufacturers in countries like Argentina, the Slovak Republic, the Czech Republic or Poland. Manufacturers in Israel and Sweden, the two most advanced countries in the database with the highest productivity levels, face relatively low but not the lowest restrictions in upstream services.

Annex Figure 3.A.3. Restrictiveness on FDI in upstream service sectors faced by manufacturing sub-sectors



Source: Authors' calculations based on OECD Input-Output Tables and OECD FDI Regulatory Restrictiveness Index.

The ***interaction*** variable is simply the product of the share in services variable and the variable on restrictions in services as described above. The interaction term is used in certain observations to study whether a parallel increase in restrictions and in the services share reveals an association with labour productivity outcomes, all else kept equal.

Furthermore, certain specifications make use of a set ***country-time varying variables*** from the WDIs. The variables are used to control for country-specific differences of the business environment and the level of development that may vary over time. They are used in specifications where no country-specific fixed effects are used. These variables include (where detailed descriptive statistics are reported in Table 3.A1.3):

- Log GDP per capita
- Constraints in customs clearance
- R&D as a share in GDP
- Constraints to start a business

Finally, a number of specifications additionally use ***firm-specific variables*** to control for factors internal to the firm that may relate to their productivity. Some variables are perception-based, others are factual. If the data at hand would be a panel, one could consider using firm-specific fixed effects. However, enterprise surveys do not include firm identifiers and thus even if more than one survey for a given country exists, firms cannot be identified over time (in case they were interviewed more than once). The variables used include (detailed descriptive statistics are reported in Tables 3.A1.3 and 3.A1.4):

- Constraints in terms of access to and availability and quality of finance
- Constraint in terms of access to and availability and quality of telecommunications
- Constraint in terms of access to and availability and quality of transport services
- Constraint in terms of access to and availability and quality of customs procedures
- Dummy on whether or not the firm is an SME, where SMEs are defined as firms with less than 200 employees for the purpose of this study
- Dummy on whether or not the firm is foreign owned, i.e. at least 10% of the equity stakes are foreign-owned
- Dummy on whether or not the firm is exporting goods

Annex Table 3.A.3. Descriptive statistics of other country and firm varying control variables

	Country-time varying variables						Firm varying variables									
	GDP per capita		Customs procedures		R&D share in GDP		Constraints to start a business		Finance constraints		Telecom constraints		Transport constraints		Customs constraints	
	Av.	Sd.	Av.	Sd.	Av.	Sd.	Av.	Sd.	Av.	Sd.	Av.	Sd.	Av.	Sd.	Av.	Sd.
Argentina	9.0	..	2.8	..	0.6	..	25.5	..	2.0	1.2	1.5	1.4	1.5	1.3	1.8	1.3
Brazil	9.1	..	2.5	..	1.1	..	147.0	..	2.4	1.3	2.4	1.6	1.7	1.3	1.7	1.4
Chile	9.2	..	5.8	..	0.4	..	40.0	..	1.4	1.3	1.6	1.5	1.5	1.3	0.8	1.1
China	8.6	..	4.4	..	1.8	..	38.0	..	0.8	0.9	0.3	0.6	0.5	0.8	0.3	0.6
Czech Republic	10.0	0.1	4.4	..	1.5	0.3	17.5	2.2	1.2	1.1	1.8	1.6	1.5	1.4	0.8	1.1
Hungary	9.6	0.1	4.4	0.2	1.1	0.1	6.4	0.5	0.7	1.1	0.6	1.1	0.7	1.2	0.4	0.8
India	7.3	..	3.8	..		..	31.2	..	1.2	1.1	0.4	0.8	1.1	1.0	0.9	1.1
Indonesia	7.9	0.2	3.6	0.4		..	67.5	15.3	1.2	1.2	0.8	1.2	0.9	1.2	0.8	1.1
Israel	10.4	..	4.5	..	4.2	..	20.0	..	0.5	0.9	0.1	0.5	0.4	0.8	0.4	0.8
Lithuania	9.6	..	4.5	..	0.8	0.1	22.7	3.3	1.4	1.4	1.1	1.4	0.9	1.3	0.5	1.0
Malaysia	9.3	..	5.2	..	1.3	..	7.5	..	1.4	0.9	1.4	1.0	1.5	1.0	1.5	1.0
Mexico	9.0	..	3.7	..	0.5	..	9.5	..	1.6	1.2	1.6	1.5	1.6	1.4	1.0	1.2
Philippines	7.8	0.2	3.2	0.3		..	37.3	3.5	0.9	1.1	1.2	1.2	1.1	1.2	0.9	1.2
Poland	9.5	..	4.1	0.3	0.8	0.1	41.5	3.0	1.3	1.3	0.7	1.2	1.1	1.3	0.9	1.1
Russia	9.5	0.1	2.8	0.1	1.0	..	29.0	..	1.6	1.4	1.1	1.4	1.3	1.4	0.9	1.3
Slovak Republic	9.8	..	4.8	..	0.5	..	17.5	..	1.7	1.1	..	..	1.4	1.4	0.9	1.1
Sweden	11.0	..	5.5	..	3.3	..	16.0	..	0.8	1.0	..	..	0.8	0.8	0.7	0.8
Thailand	8.7	..	3.7	..	0.6	..	27.5	..	0.6	0.9	0.9	1.2	0.6	0.8	0.3	0.7
Tunisia	8.3	..		..	0.7	..	11.0	..	1.1	1.4	0.4	0.8	0.5	0.9	0.6	0.9
Turkey	9.4	..	3.6	..	0.9	..	7.0	..	0.8	1.1	0.7	1.1	0.8	1.0	0.6	0.8
Vietnam	7.3	0.3	3.5	0.1		..	35.6	1.5	1.0	1.1	0.5	0.9	0.9	1.0	0.5	0.8

Notes: The firm varying variables are perception based, where 0 = service is perceived as not an obstacle in country; 1= service is a minor obstacle; 2= service is a moderate obstacle; 3 = service is a major obstacle; 4 = service is a very severe obstacle

Source: Authors' calculations based on World Bank Enterprise Surveys and World Development Indicators

Annex Table 3.A.4. Share of firms in each country/survey with specific characteristics

	Share of firms with/ that are:			
	Quality certificate	SMEs	Foreign-invested	Export
Argentina	39.3	80.8	14.9	49.0
Brazil	20.0	87.2	4.2	17.7
Bulgaria	35.6	88.9	8.9	37.9
Chile	37.0	84.5	13.0	31.3
China	72.0	75.7	7.4	21.0
Colombia	33.9	85.4	9.5	34.5
Czech Republic	60.9	85.4	18.9	64.3
Hungary	64.4	84.7	19.9	45.5
India	48.8	87.2	0.9	16.2
Indonesia	17.4	83.9	9.6	14.7
Israel	50.3	88.5	7.1	32.8
Lithuania	30.2	90.2	12.5	53.8
Malaysia	41.6	76.2	25.1	45.6
Mexico	24.6	81.2	9.3	25.2
Philippines	29.9	85.4	28.0	27.8
Poland	42.0	89.4	10.6	44.5
Russia	19.8	82.8	4.2	15.0
Slovak Republic	45.6	82.6	17.4	59.4
Sweden	74.0	87.7	28.0	76.9
Thailand	32.9	83.7	9.2	27.3
Tunisia	35.4	80.6	19.4	59.4
Turkey	52.3	86.0	5.8	47.8
Vietnam	25.7	77.4	13.9	31.1

Source: Authors' calculations based on World Bank Enterprise Surveys and World Development Indicators

Empirical strategy

The objective in this empirical exercise is to investigate econometrically the relationship between manufacturing productivity and FDI restrictions in services. Using the firm and sectoral level data described in the previous sub-section, the following baseline model (2) is estimates using different variants:

$$\ln LP_{f,s,c,t} = \propto_t + \propto_s + \beta_1 sshare_{s,c} + \beta_2 rest_{s,c,t-1} + \theta_1 X_f + \theta_2 Y_{c,t} + \varepsilon_{f,s,c,t}, \quad (2)$$

where ln *LP* is labour productivity as defined above of firm *f*, in sector *s*, country *c* and time *t*; $\propto_t$ and $\propto_s$ are time and sector fixed effects; *sshare* is the share of services in total inputs in manufacturing sector *s* and country *c*, reported in 2008 (prior to t_0, the first year in this dataset); *rest* are the weighted FDI restrictions faced by manufacturers in sector *s* in upstream services sectors, in country *c* and time *t-1*; X are firm-specific control variables and Y are country-time varying control variables; and *ε* is the error term.

Alternatively, a two-stage regression approach is applied, where ln *LP* is first regressed against country fixed effects. The predicted residuals of the first stage regression are then used as the dependent variable in the second stage regression, where the right hand side of the equation ensues just like equation (2). This second stage approach is used to address significant multi-collinearity between country fixed effects and our key variable of interest, namely the FDI restrictiveness variable *rest*. The high scores of the vector inflation factor (VIF) for the rest variable in regressions including country fixed effects indicates a severe multicollinearity problem (see Table 3.A1.5).[3]

Finally, an alternative set of models (using both the one stage and the two stage approach described above) tests the following three hypotheses:

- ***H1: Restrictions in upstream services adversely affect SME manufacturers more than larger firms:*** SMEs are expected to rely proportionately more on high quality backbone and other services that are provided by upstream, external providers. Restrictions are likely to lower competitiveness and quality of service provision and may increase costs. With scale, firms are more likely to internalise certain services and/or source them from other markets and thus restrictions in upstream services could affect them less.
- ***H2: Restrictions in upstream services affect foreign owned manufacturers less negatively than domestically owned firms:*** Affiliates of foreign manufacturers, just like larger domestic firms, are likely to internalise many of the upstream services and/or to source them directly from the head office abroad. Therefore, foreign owned manufacturers are less likely to be negatively affected by FDI restrictions as compared to domestically owned firms.
- ***H3: Restrictions in upstream services affect exporters less negatively than non-exporters:*** Existing theoretical and empirical literature on firm heterogeneity in export performance relies on the assumption that exporters are more productive and can therefore afford to invest into sunk costs enabling them to enter into exporting (see seminal paper of Melitz, 2003, for example). This hypothesis tests whether the structural differences between exporters and non-exporters may also mean that restrictions in upstream services affect exporters comparatively less, assuming that exporters have internalised some of the upstream services and thus rely less on outsourced services.

Estimation results

[3] VIF scores above 5 can indicate a multicollinearity problem.

Annex Table 3.A.5. Baseline regression results: Labour productivity on restrictions in services

		Ln LP								Resid
Country-sector varying	Services share	0.00394**	0.00628**	-0.00388**	0.00788***		-0.0106***	-0.000186	-0.00448**	
		(0.00163)	(0.00272)	(0.00167)	(0.00252)		(0.00177)	(0.00207)	(0.00203)	
Country-sector- time varying	Restrictions in services	-0.0226***	0.0219***	-0.00990***	-0.0492***	-0.0462***	-0.0241***	-0.0239***	-0.00813***	-0.00249***
		(0.00123)	(0.00632)	(0.00141)	(0.00270)	(0.00247)	(0.00154)	(0.00182)	(0.00158)	(0.000863)
Country-time-varying	Log GDP per capita			0.333***	-1.130***	-0.904***		-0.612***		
				(0.0201)	(0.102)	(0.0703)		(0.0477)		
	General constraints in customs clearance				0.256***	0.236***	0.179***			
					(0.0155)	(0.0136)	(0.0129)			
	R&D as share of GDP				0.712***	0.651***	0.425***			
					(0.0362)	(0.0292)	(0.0239)			
	General constraints to start a business				-0.00980***	-0.00946***	-0.00599***			
					(0.000610)	(0.000597)	(0.000509)			
Firm-specific	Constraint in terms of finance							-0.0924***	-0.0945***	
								(0.00869)	(0.00871)	
	Constraint in terms of telecom							0.00346	-0.00453	
								(0.0100)	(0.0101)	
	Constraint in terms of transport							0.0126	0.0118	
								(0.0101)	(0.0102)	
	Constraint in terms of customs							0.0567***	0.0533***	
								(0.00975)	(0.00984)	
	SME							-0.190***	-0.188***	
								(0.0292)	(0.0297)	
	Foreign-owned							0.352***	0.356***	
								(0.0470)	(0.0483)	
	Export							0.375***	0.379***	

	Ln LP								Resid
							(0.0253)	(0.0257)	
Constant	10.17***	8.759***	7.299***	20.32***	18.56***	10.42***	14.62***	9.334***	-0.0126
	(0.0783)	(0.204)	(0.187)	(0.886)	(0.673)	(0.114)	(0.411)	(0.127)	(0.0388)
Year effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country effects	No	Yes	No	No	No	No	No	No	No
VIF Restrictions in services	2.62	91.68	3.86	14.73	13.12	4.78	5.42	3.83	1.63
Observations	22,674	22,674	22,674	10,316	10,316	10,316	16,532	16,532	22,674
R-squared	0.155	0.252	0.166	0.275	0.275	0.269	0.225	0.213	0.043

Note: *Ln LP* is log labour productivity defined as sales per person employed. *Resid* is the residuals variable after a first stage regression of *Ln LP* on country fixed effects. VIF denotes vector inflation factor and is a measure to detect multicollinearity. Robust standard errors are in parentheses. Stars denote statistical significance levels: *** p<0.01, ** p<0.05, * p<0.1

Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, OECD Input-Output Tables, and World Development Indicators.

Annex Table 3.A.6. Baseline regression results: Labour productivity on restrictions in services and the interaction term

(services share * restrictions in services)

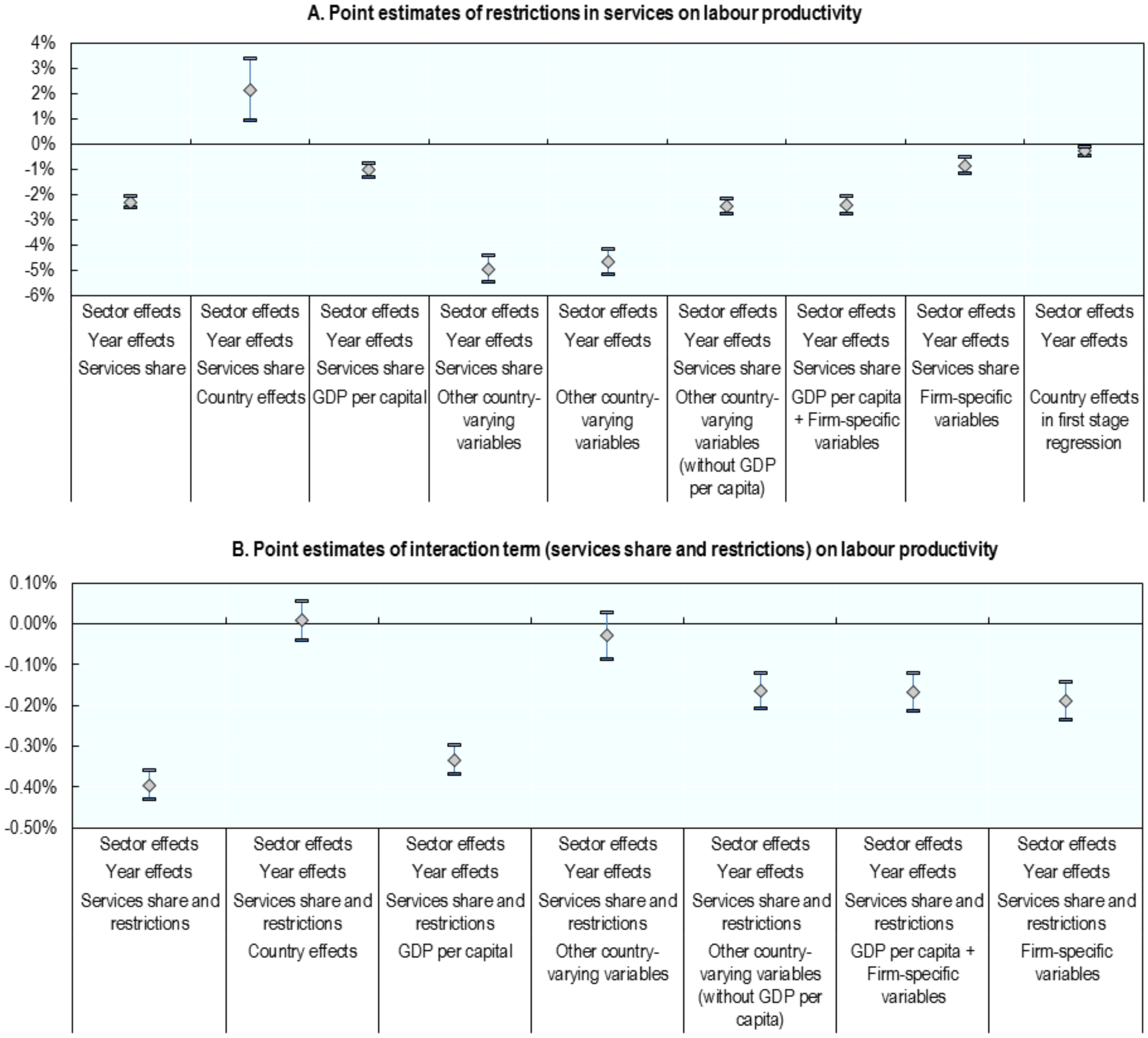
		Ln LP						
Country-sector varying	Services share	0.0921***	0.00423	0.0731***	0.0125**	0.0237***	0.0369***	0.0376***
		(0.00440)	(0.00585)	(0.00464)	(0.00542)	(0.00515)	(0.00577)	(0.00572)
Country-sector- time varying	Restrictions in services	0.0794***	0.0199**	0.0716***	-0.0401***	0.0183***	0.0179***	0.0388***
		(0.00486)	(0.00822)	(0.00472)	(0.00991)	(0.00601)	(0.00637)	(0.00615)
	Interaction (services share * restrictions in services)	-0.00395***	9.13e-05	-0.00333***	-0.000281	-0.00164***	-0.00166***	-0.00188***
		(0.000178)	(0.000243)	(0.000181)	(0.000293)	(0.000224)	(0.000241)	(0.000237)
Country-time-varying	Log GDP per capita			0.218***	-1.052***		-0.597***	
				(0.0200)	(0.134)		(0.0476)	
	General constraints in customs clearance				0.239***	0.109***		
					(0.0236)	(0.0150)		

		Ln LP						
	R&D as share of GDP				0.691***	0.417***		
					(0.0429)	(0.0238)		
	General constraints to start a business				-0.00954***	-0.00603***		
					(0.000686)	(0.000508)		
Firm-specific	Constraint in terms of finance						-0.0928***	-0.0948***
							(0.00867)	(0.00870)
	Constraint in terms of telecom						0.00657	-0.000793
							(0.0100)	(0.0101)
	Constraint in terms of transport						0.0132	0.0126
							(0.0101)	(0.0101)
	Constraint in terms of customs						0.0572***	0.0539***
							(0.00974)	(0.00983)
	SME						-0.188***	-0.186***
							(0.0291)	(0.0296)
	Foreign-owned						0.353***	0.356***
							(0.0470)	(0.0483)
	Export						0.381***	0.385***
							(0.0253)	(0.0256)
	Constant	7.588***	8.807***	6.119***	19.50***	9.985***	13.44***	8.152***
		(0.148)	(0.239)	(0.184)	(1.272)	(0.107)	(0.452)	(0.197)
	Year effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	Sector effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	Country effects	No	Yes	No	No	No	No	No
	Observations	22,674	22,674	22,674	10,316	10,316	16,532	16,532
	R-squared	0.173	0.252	0.177	0.275	0.272	0.227	0.215

Note: Ln LP is log labour productivity defined as sales per person employed. Robust standard errors are in parentheses. Stars denote statistical significance levels: *** p<0.01, ** p<0.05, * p<0.1

Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, OECD Input-Output Tables, and World Development Indicators.

Annex Figure 3.A.4. Services restrictions are negatively associated with firm productivity in downstream manufacturing sectors



Note: The point estimates indicate the % change of firm productivity in the manufacturing sector related to a one unit increase in services restrictions (Panel A) and a marginal increase in the value of the interaction term (services share and restrictions (Panel B). Restrictions range from 0-100. The different point estimates relate to different estimation specifications as indicated below each point estimate. Lower bounds (5% percentile) and upper bounds (95% percentile) of the confidence interval for each point estimate are also reported.
Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, OECD Input-Output Tables, and World Development Indicators.

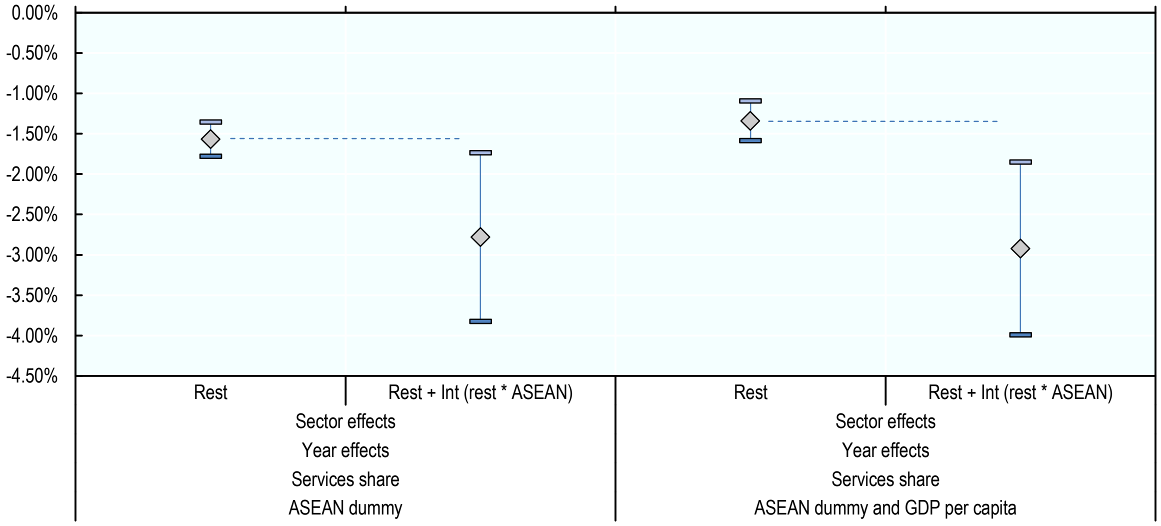
Annex Table 3.A.7. Regression result: Labour productivity on restrictions in services, interacted with ASEAN dummy

	1	2	3	4	5
	ln LP				
Services share	0.00524***	-0.00128	0.00862***	-0.0106***	-0.000313
	(0.00160)	(0.00162)	(0.00253)	(0.00177)	(0.00204)
Restrictions in services	-0.0134***	-0.00400***	-0.0503***	-0.0242***	-0.0239***
	(0.00126)	(0.00136)	(0.00269)	(0.00154)	(0.00179)
ASEAN dummy	0.0528	0.377*	-2.489***	-1.196*	-2.211***
	(0.207)	(0.219)	(0.669)	(0.661)	(0.394)
Interaction (restrictions in services * ASEAN dummy)	-0.0158***	-0.0193***	0.0565*	0.0139	0.00716
	(0.00546)	(0.00567)	(0.0330)	(0.0328)	(0.00601)
Log GDP per capita		0.308***	-1.174***		-0.645***
		(0.0230)	(0.102)		(0.0473)
General constraints in customs clearance			0.260***	0.179***	
			(0.0155)	(0.0129)	
R&D as share of GDP			0.726***	0.425***	
			(0.0362)	(0.0239)	
General constraints to start a business			-0.00995***	-0.00599***	
			(0.000609)	(0.000509)	
Constraint in terms of finance					-0.093***
					(0.00866)
Constraint in terms of telecom					0.000449
					(0.0100)
Constraint in terms of transport					0.0131
					(0.0101)
Constraint in terms of customs					0.0566***
					(0.00973)
SME					-0.191***
					(0.0290)
Foreign-owned					0.357***
					(0.0469)
Export					0.374***
					(0.0252)
Constant	10.20***	7.484***	20.71***	10.42***	16.71***
	(0.0815)	(0.222)	(0.884)	(0.114)	(0.549)
Year effects	Yes	Yes	Yes	Yes	Yes
Sector effects	Yes	Yes	Yes	Yes	Yes
Country effects	No	No	No	No	No
Observations	22,674	22,674	10,316	10,316	16,532
R-squared	0.160	0.168	0.275	0.269	0.228

Note: *Ln LP* is log labour productivity defined as sales per person employed. The following five ASEAN countries are included in the dataset: Indonesia, Malaysia, Philippines, Thailand and Viet Nam. Robust standard errors are in parentheses. Stars denote statistical significance levels: *** p<0.01, ** p<0.05, * p<0.1
Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

Annex Figure 3.A.5. Services restrictions in AMS may squeeze productivity more than in other emerging and developed regions

Point estimates and confidence interval: Estimated % change in labour productivity with a one-unit change in restrictions

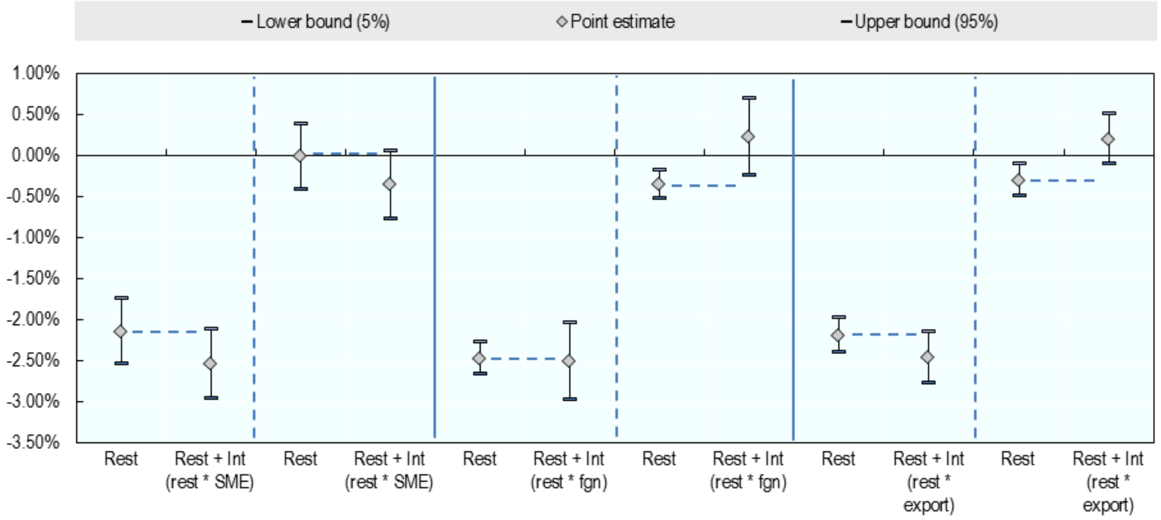


Note: *Rest* denotes restrictions in services. The *rest* variable ranges from 0-100. *Int* denotes the interaction term between the *rest* variable and the ASEAN country dummy. The following five ASEAN countries are included in the dataset: Indonesia, Malaysia, Philippines, Thailand and Viet Nam

Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

Annex Figure 3.A.6. Firm characteristics are associated with firms' exposure to FDI restrictions

Point estimates and confidence interval: Estimated % change in labour productivity with a one-unit change in restrictions



Note: *Rest* denotes restrictions in services. The *rest* variable ranges from 0-100. *Int* denotes the interaction term between the *rest* variable and the dummy for specific firm characteristics (including SME, foreign-owned, exporter).

Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

Annex Table 3.A.8. Regression result: Labour productivity on restrictions in services, interacted with firm characteristics

	1	2	3	4	5	6	7	8
	Ln LP	Resid	Ln LP	Resid	Ln LP	Resid	Ln LP	Resid
Restrictions in services	-0.0240***	-0.00225***	-0.0214***	-8.79e-05	-0.0247***	-0.00353***	-0.0218***	-0.00297***
	(0.000966)	(0.000873)	(0.00205)	(0.00201)	(0.000973)	(0.000885)	(0.00108)	(0.00100)
SME dummy			-0.335***	-0.310***				
			(0.0582)	(0.0549)				
Interaction (restrictions in services * SME dummy)			-0.00395*	-0.00347*				
			(0.00213)	(0.00209)				
Foreign-owned firm dummy					0.772***	0.375***		
					(0.0659)	(0.0605)		
Interaction (restrictions in services * foreign-owned firm dummy)					-0.000304	0.00583**		
					(0.00239)	(0.00237)		
Exporting firm dummy							0.714***	0.363***
							(0.0408)	(0.0380)
Interaction (restrictions in services * exporting firm dummy)							-0.00272*	0.00504***
							(0.00157)	(0.00152)
Constant	10.28***	-0.0441	10.60***	0.251***	10.25***	-0.0391	10.13***	-0.0926**
	(0.0416)	(0.0390)	(0.0648)	(0.0610)	(0.0413)	(0.0390)	(0.0429)	(0.0408)
Year effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country effects	No	No	No	No	No	No	No	No
VIF Restrictions in services	1.69	1.69	6.73	6.73	1.76	1.76	2.11	2.11
VIF Interaction term	5.58	5.58	9.67	9.67	4.57	4.57	4.29	4.29
Observations	22,674	22,674	22,674	22,674	22,674	22,674	22,674	22,674
R-squared	0.158	0.045	0.167	0.055	0.176	0.056	0.190	0.068

Note: *Ln LP* is log labour productivity defined as sales per person employed. *Resid* is the residuals variable after a first stage regression of *Ln LP* on country fixed effects. Robust standard errors are in parentheses. Stars denote statistical significance levels: *** p<0.01, ** p<0.05, * p<0.1

Source: Authors' estimations based on World Bank Enterprise Surveys, OECD FDI Regulatory Restrictiveness Index, and OECD Input-Output Tables.

Chapter 4.

Investment protection in Southeast Asia: Towards a more coherent and balanced regime

Regulatory predictability and certainty – through international treaties, domestic legislation and institutional quality – are essential to create sound and enabling investment environments. This chapter looks at how ASEAN Member States are progressively harmonising and streamlining their investment legislation towards a common set of standards of protection. At treaty level, the adoption of ACIA has also prompted a momentum to establish common rules for investment protection and liberalisation, although this may have resulted in temporarily creating an even more complex treaty network. This chapter also addresses the various options available to AMS to prevent the escalation of international investment disputes by establishing dispute prevention mechanisms, drawing on other countries' good practices.

Summary

The core goal of the ASEAN Economic Community (AEC) is to endow ASEAN Member States (AMS) with "more transparent, consistent and predictable investment rules, regulations, policies and procedures" (AEC Blueprint). AMS have, at different paces, embraced this objective in their respective regulatory-making processes, whether domestic laws or international treaties, or in establishing new institutional mechanisms.

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 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 there are still substantial discrepancies in regulatory environments governing the protection of investment across the region, AMS have made sustained efforts to move closer to achieving a more consistent and transparent legal landscape under the single ASEAN umbrella. Reform efforts that have been undertaken to varying degrees 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.

Lastly, 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.

Policy considerations

To achieve a more coherent and robust investment protection framework, it is important that ASEAN countries continue to sustain momentum and step up their reform efforts. The following set of policy considerations could serve as good practice guidance for reform implementation by ASEAN governments:

- *Bring more coherence to domestic legal frameworks for investment:* By progressively harmonising the content, scope and purpose of their investment legislation, AMS will improve the predictability and transparency of the regulatory regime governing investment in the region; The unification of investment laws is not the only way to achieve a more coherent regime: AMS will also need to *bring the future generation of investment agreements more in line with national investment policies***.**
- *Progressively streamline the network of investment treaties applicable in ASEAN***:** Driven by the ASEAN Comprehensive Investment Agreement (ACIA) and a wider regional move towards trade and investment agreements, AMS have engaged in a modernisation process of their treaty network, which will ultimately achieve greater harmonisation of treaty content across the region. To sustain this rationalisation effort, AMS could consider progressively terminating older generation bilateral investment treaties where the scope and provisions overlap with those of more recent treaties. A more regional approach to treaty-making offers an opportunity to create a more integrated investment area in ASEAN and to establish common rules on investment protection and liberalisation.
- *Establishing and institutionalising dispute prevention mechanisms***:** Dispute prevention policies and mechanisms are increasingly developed in many regions of the world, whether in the form of an Investment Ombudsman or an early alert mechanism. ASEAN countries are slightly lagging behind and would greatly benefit from the establishment of institutionalised mechanisms aimed at preventing disputes from escalating into costly international arbitration disputes.

Investment laws in AMS: towards harmonised and stronger provisions

Investment legislation can involve many layers of rules and regulations covering many different areas (Box 4.1). Many AMS have chosen to have a stand-alone investment law which, inter alia, grants property protection guarantees to investors and also establishes the degree of openness to investment and the rules for market entry. Often, investment laws and regulations include a list of sectors where investors face restrictions (Chapter 2) and set the conditions for receiving fiscal or non-fiscal investment incentives (Chapter 5). Regardless of its material scope, having clear investment legislation may serve as a signalling device and hence help to promote the country as an investment destination. AMS have embarked upon major investment climate reforms since the 1980s. They have progressively reinforced the protection standards of investment and have, more recently, included provisions aiming at striking a balance between investors' rights and obligations.

Investment-related laws in Southeast Asia

An investment law is not essential and many advanced economies make do without one, but over 100 developing and emerging economies have adopted this approach as part of their overall legal framework for investment. Even within this group, however, the scope of the investment law varies from one country to another but usually includes elements of investment protection, conditions for market access and eligibility for incentives. An investment law can also be a way for host governments to signal expectations concerning responsible conduct by imposing certain investor obligations. For these reasons, the investment law is often the first point of reference for a potential investor, and governments expend considerable resources and political capital to periodically revise and update their investment law.

Box 4.1. The overall legislative framework for investment

As reflected in the *Policy Framework for Investment*, the investment environment is the sum of many different policies, as well as of the interaction among them. It cannot be reduced to one specific variable, whether the World Bank's *Doing Business* indicator or the OECD's *FDI Regulatory Restrictiveness Index*. By the same token, the overall legislative framework for investment will depend on a broad panoply of legislation, often combined in idiosyncratic ways which differ widely across countries. One of the most important laws in this respect in many emerging and developing economies is the investment law. It can cover domestic and foreign investors in one law or in separate laws and set the conditions for market access for foreign firms and offer national treatment for established investors. It can also include the provision of incentives and offer guarantees of protection of the investor's assets. These conditions could be provided in other rules and regulations, but an investment law is nevertheless often used as a signalling device to investors, particularly foreign ones, that the economy is open and accommodating to foreign investment. For this reason, an investment law is often the first point of reference for a potential investor.

Incentives may be included in the investment law or they may appear in the general tax law, as is considered good practice. Similarly, the rules governing special economic zones are included in the *Investment Promotion Law* in Lao PDR but in a separate decree in Cambodia. The negative list of restricted sectors might be embedded in the investment law itself as in the *Foreign Investment Law* in the Philippines or may appear in a separate decree, as in Indonesia. Market access commitments for a specific set of investors may also be established in international agreements signed by the government.

Other relevant laws for investors include the enterprise law or companies act which establishes among other things the procedures for registering a business and the rules covering corporate governance, together with securities and accounting laws. Independently of any legislation, corporate practices can also shape entry conditions for both domestic and foreign investors, together with the presence of "golden shares" or residency or nationality requirements for the board of directors. Competition law, or its absence, also determines the potential contestability of markets. Other relevant regulations for potential investors may be contained in sectoral legislation, particularly in financial or natural resource sectors.

The protection of investors' property rights is often included in the investment law, if it exists, but more commonly in the constitution itself. An arbitration law can set out the procedures for settling disputes. In some countries, large investors in important sectors such as mining or infrastructure might sign individual contracts with the state which set out investor rights. To complement and strengthen this protective structure, governments often sign bilateral investment agreements or broader agreements which confer rights on investors from partner countries.

Going beyond this legislative and treaty structure, investors are also concerned about the issue of public governance: how these laws are actually implemented in practice and the general quality of the rule of law in the host country. Relevant legislation in this regard includes the civil code or what it referred to in Lao PDR as a law on laws which sets out the process for law-making, including public consultations and regulatory impact assessments.

Source: Based on *Policy Framework for Investment* (OECD, 2015)

Many governments use an investment law partly as a signalling device for investors and to promote transparency. The negative list of sectors where foreign investment is either restricted or prohibited is an important tool for transparency, allowing not only for investors to assess the scope for investment but also for policymakers and others to benchmark restrictiveness vis-à-vis other countries and over time. The negative list can also simplify the compiling of lists of non-conforming measures in investment agreements or free trade agreements with an investment chapter. A comparison of a country's negative list with actual commitments in agreements can also provide a measure of the "water" in such agreements (Chapter 2).

Southeast Asia is a diverse region, and the different legislative approaches framing investment policy reflect that diversity (Table 4.1). Neither Singapore nor Brunei Darussalam have a general investment law, while Malaysia, the Philippines and Thailand all have a version of an investment promotion law which stipulates incentives for foreign and domestic investors and sometimes offers certain protection guarantees for promoted investors. For the Philippines and Thailand, the condition for market access and operations of foreign enterprises is set out in a separate foreign investment law. This dual approach is covered within one unified investment law in CLMV countries, covering both foreign and domestic investors and usually providing certain guarantees and incentives, as well as the list of restricted sectors. Restrictions in Malaysia are covered in sectoral laws such as the *Financial Services Act* or the *Communications and Multimedia Act* and sometimes simply in guidelines, such as the Foreign Investment Committee Guidelines which required approval for foreign acquisitions of equity in Malaysian companies over a certain share.

There is no presumption that one legislative approach is better than all others for all economies at all levels of development. An advanced economy like Singapore with few restrictions would not be expected to need a dedicated investment law, just as most OECD countries regulate investment through a broad legislative framework. For many other AMS, the case is less clear-cut, as an investment law can add to transparency and predictability.

Table 4.1. Investment-related laws in ASEAN

	Investment Promotion Act, Omnibus Investment Code, etc.	Foreign Investment Law	Unified (foreign & domestic) Investment Law
Brunei Darussalam	No general law on investment or investment promotion		
Cambodia			1994, 2003, 2018 (expected)
Indonesia		1967	2007
Lao PDR		1986	2009, 2016
Malaysia	1986		
Myanmar		1988, 2012	2016
Philippines	1987	1991 (1996)	
Singapore	No general law on investment or investment promotion		
Thailand	1977, 1991	1972, 1999	
Viet Nam		1987 (1990, 1992), 1996 (2000)	2005, 2014

Note: Dates in parentheses refer to amendments to the law.
Source: Authors' compilation.

As can be seen in Table 4.1, CLMV countries have generally been active legislative reformers over time, compared to the rest of ASEAN. Each iteration of the investment law has been designed to address weaknesses in the existing one. The most recent laws in Viet Nam and Lao PDR aimed to streamline business registration while the current revision of the investment law in Cambodia is focused primarily on providing more targeted "smart" incentives. Other areas of reform include improved market access for foreign investors and aligning investment protection with the provisions in the ASEAN Comprehensive Investment Agreement. Even with these frequent improvements, certain lacunae exist and each new version is not always in all areas an improvement over the earlier version. Frequent changes also have the disadvantage of creating temporary uncertainty for investors prior to the issuance of implementing regulations.

Malaysia, the Philippines and Thailand have investment-related laws that date back decades. Another key piece of legislation in Malaysia is the *Industrial Coordination Act* from 1975 covering investment in manufacturing. The age of legislation is not necessarily a sufficient justification for reform, but a comprehensive reform of existing legislation can provide an opportunity to revisit certain longstanding policy approaches, such as on incentives or concerning discrimination against foreign investors. In the Philippines, many reforms of restrictions would also require amending the constitution which dates from 1987 at a time of strong nationalist sentiment following the ouster of the Marcos regime (OECD, 2016b).

Regional wave of legislative reforms

AMS – particularly CLMV countries – have in recent years accelerated the pace of reform of their domestic legislation toward higher standards of investment protection. Despite differences in their respective levels of economic development and openness to foreign investment, AMS policy approaches are converging towards an increasingly sound and consistent legal landscape for the protection of investment driven in part by a regional dynamic where a top-down approach to the construction of a regional economic entity can successfully spur its member states to enhance their domestic standards for investment protection.

AMS have all progressively amended their laws to create more coherent legal frameworks for investment. This unification process involves the creation of a single, non-discriminatory regime governing both domestic and foreign investment. A small majority of AMS have gradually unified their legal regime for investment by enacting a single omnibus investment law, under which all investors, regardless of their origin and nationality, benefit from the same core protection provisions.

While a consistent legal framework for protecting investments across the ASEAN region is still a work in progress, investment regulations of the least advanced AMS are being reformed and improved at a sustained pace. Individual countries have progressively brought their domestic legislation in line with common protection standards, drawing on the provisions of ASEAN Comprehensive Investment Agreement (ACIA), so as to maximise the benefits of building a regional entity as an attractive and dynamic investment destination. Implementing ACIA requires incorporating its provisions into domestic legislation in each AMS, a task which countries endowed with less robust regulatory frameworks have proactively undertaken in recent years. Some discrepancies still exist in the substance of protection provisions encountered in national legislation, however, as well as in the scope and purposes of such legislation.

While this section shows a sustained move towards regulatory convergence, the quality of investment laws should not be looked at in isolation from the broader regulatory framework. What matters most is the coherence of the wider legal environment, the application of the rule of law and the clarity of the wide range of legal instruments applying in a given jurisdiction. This includes, of course, the interplay between domestic legislation and international investment treaties, which play a major role in protecting foreign investments. The attention given to clarity and rationalisation should not be misconstrued, however, as investment laws have no vocation to align with treaty provisions. Their purpose and scope vary in many regards, and the content of some increasingly controversial treaty provisions, such as fair and equitable treatment (FET) and most-favoured nation treatment (MFN), is not meant to be replicated at legislative level. Moreover, while the main goal of investment treaties is to provide a high level of protection guarantees to foreign investors, the scope of investment laws is much wider, covering, for example, the regulation of the admission of investment and the provision of incentives.

The amendments of investment-related laws in AMS have evolved to reflect countries' stages of development. The pace of legal modernisation seems to have been greatly influenced by developments at a regional level, as illustrated by the evolution of core investment protection provisions, such as on expropriation and access to dispute settlement, in successive ASEAN agreements. ASEAN countries have opted for a top-down approach to the legal harmonisation process to achieve the ASEAN Economic Community.

In many AMS, domestic legislation has evolved to enshrine clearer legal guarantees for investment and the CLMV and some other countries have recently undertaken substantial reform efforts to further improve their investment legislation in order to comply with standards contained in ACIA. In this sense, the implementation of ACIA has prompted a drive for legislative reform throughout the region. Table 4.3 at the end of this section compares the main substantive differences in the treatment of investment across ASEAN and identifies regulatory issues where a certain level of legal consistency has been achieved across the region.

The ultimate goal of this convergence dynamic is the creation of a single regulatory block which would eventually reduce transaction costs of foreign investors operating in the region (Darsa, 2012; Wong, 2014). Despite evidence that countries reforming their investment laws and other related regulations are driven by a collective willingness to build an ASEAN-wide harmonised regulatory framework, the scope and purpose of investment legislation remains variable. This tends to show that there is no single formula for building an enabling domestic regulatory environment.

In **Indonesia**, the *Investment Law* 25/2007 provides national treatment for established enterprises, in contrast to the separate treatment for foreign and domestic firms in earlier laws. It also offers greater transparency in terms of the sectors covered, more extensive land use rights and a reduction in administrative burdens and longer work permits for key personnel (OECD, 2010). **Malaysia** has no comprehensive law governing FDI and containing general principles for foreign participation in local business. This policy choice has given the government maximum regulatory space to apply its affirmative action policy and to screen FDI to suit economic needs at a given time. In the absence of an all-encompassing foreign investment statute, FDI is regulated under sector-specific legislations. Protection of investors is granted in the Constitution and through the many bilateral investment treaties, which again shows that having a single investment law is not a universal panacea for creating a strong investment regulatory framework. The regulation of FDI includes the *Promotion of Investment Act* 1986, amended in 2007, which provides incentives.

In **Thailand**, the *Foreign Business Law* 1997 sets the conditions for market access, while the *Investment Promotion Act* 1977 contains provisions protecting domestic and foreign investors against adverse shifts in government policies, rules and regulations as well as from competition from SOEs. It also allows foreign and domestic investors can to apply for incentives. Likewise, the investment regime of the **Philippines** is governed by two separate laws, the *Omnibus Investment Code* (OIC) 1987 and the *Foreign Investment Act* (FIA) 1991 which provides for the general legal regime for foreign investment. The OIC, applicable to both domestic and foreign investment, is the main legislation governing investment, providing for the institutional framework for investment, setting rules for the registration of enterprises, offering incentives and guaranteeing standards of investment protection. Many other sectoral or general laws and regulations apply to investment activities.

Since the enactment of its first FDI law in 1986, **Lao PDR** has gradually reformed its investment legislation. With the 2009 *Law on Investment Promotion*, it adopted a single regulation governing both domestic and foreign investment under the same umbrella, thereby moving closer to ACIA standards. Building upon the 2009 reform, the government amended its investment law in 2016 to further align it with international good practices, ACIA and WTO commitments. Although the success of the reform will depend on the coherence of its provisions with other interacting laws and regulations, it showed a clear policy stance in favour of private sector development – creating the conditions for further transitioning towards a market-based economy. The new version of the law addresses some of the weaknesses of the earlier one but still does not provide enough legal predictability and security to investors or sufficiently strengthen the legal environment for investment, such as on dispute settlement and expropriation.

Myanmar has made substantial and rapid efforts to modernise its legal framework for investment. Starting in 2011, it initiated a broad reform process to improve its legal and regulatory framework for investment to create a more favourable investment climate by revising the investment regime put in place in 1988, when the country first opened to FDI. The *2012 Foreign Investment Law* and its accompanying implementing rules marked a milestone towards a more open and secure legal environment for investment but were only a first step. Their importance was partly symbolic, to show the government's desire to welcome responsible foreign investment after the disappointments following the first attempt at liberalisation after 1988, which offered few benefits in terms of inclusive and sustainable development. The 2012 *FIL* offered some improvements over the earlier 1988 law but left many questions unanswered, notably with respect to investor protection (OECD, 2014). The 2016 enactment of a new, all-encompassing investment law has closed the remaining gap, by introducing improved provisions on expropriation, non-discrimination and dispute settlement.

Viet Nam has aggressively pursued legislative reforms, with successive amendments to many of the core legislation covering investment (Table 4.2). From the 1987 *Law on Foreign Investment* to the laws on enterprises and investment enacted in 2015, Viet Nam has evolved towards modern, non-discriminatory legislation, closer to the level of the most advanced economies across Southeast Asia. The revisions were intended to progressively strengthen investor rights, create a more investor-friendly environment and narrow the policy gap between foreign and domestic investors. They have brought new waves of FDI into the country, while the investment environment has gradually been brought more in line with Viet Nam's international commitments (ASEAN in 1995, and WTO in 2007). Viet Nam has positioned itself as a model of a progressive strengthening and harmonisation of the investment regime and has provided a policy example to follow for less advanced countries in this process, such as Myanmar.

Table 4.2. Viet Nam has actively pursued sustained legislative reform

Investment	Adopted	Amended
Law on Foreign Investment	1987	1990, 1992
Law on Promotion of Domestic Investment	1994	1998
Law on Foreign Investment	1996	2000
Law on Investment	2005	
Law on Investment	2014	
Enterprises		
Law on State-Owned Enterprises	1995	
Law on State-Owned Enterprises	2003	
Law on Companies Law on Private Enterprises	1990	1994
Law on Enterprises	2005	2013
Law on Enterprises	2014	
Law on Laws		
Law on the Promulgation of Legal Normative Documents	1996	2002
Law on the Promulgation of Legal Normative Documents of People's Councils and People's Committees	2004	
Law on the Promulgation of Legal Normative Documents	2008	
Law on the Promulgation of Legal Documents	2015	

Source: OECD (2018, forthcoming).

The protection of property rights in domestic legislation of AMS

All AMS have progressively improved the treatment of investors by reinforcing core protection standards. The notion of protection of property rights embraces not only the guarantee against unlawful expropriation but also secure land rights, high standards of intellectual property rights, free repatriation of foreign investment, and promptly upholding contractual rights. This section focuses on the protection against expropriation, as it remains the cornerstone of any regulatory framework for protecting investment. It is a crucial right for investors and must be granted in the regulatory framework for investment through provisions for transparent and predictable procedures. AMS have achieved a fairly good level of consistency with respect to protecting investment in case of expropriation. Most AMS, including recently Myanmar and Lao PDR, have introduced strong guarantees against expropriation that are generally consistent with internationally recognised practices. But here again, it should be kept in mind that core protection guarantees are no better addressed in investment laws than in other laws of general application.

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

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

In **Viet Nam**, the unified 2005 *Investment Law* followed along the same lines for protecting against expropriation and the mechanisms for compensation as found in the 1998 *Domestic Investment Law* and in the *Foreign Investment Law*. It contained a provision against unlawful expropriation, as well as a general commitment to protect the right of ownership of assets. The 2014 amendment focused on the entry of investment rather than on the protection of property rights which might have led to a watering down of some core investment protection provisions that had previously been gradually improved throughout the successive investment laws.

In the **Philippines**, the protection against expropriation is not only provided in the OIC, but also in the Constitution and in other pieces of legislation, such as in the Civil Code. In line with the provisions of ACIA and with international good practice, the OIC provides that expropriation of private property is allowed for public use, against compensation at fair market value. The procedures for expropriation are set out in detail in the rules of civil procedure. The OIC also contains guarantees of legal stability for investment incentives and grants free repatriation of investment for foreign investors. Likewise, in **Thailand**, investments that are qualified to benefit from the protection guarantees of the 1977 *Investment Promotion Act* can benefit from the Act’s expropriation provision, as well as from other legal safeguards, such as in the 1999 *Foreign Business Act*.

Lao PDR protects against expropriation of the assets of both foreign and domestic investors by a Constitutional guarantee, as well as by a specific provision of the *Law on Investment Promotion*. In **Myanmar**, core investment protection provisions have been considerably improved through the new investment law which incorporates innovations that are likely to enhance the level of protection granted to investors. The provisions on expropriation, non-discrimination and dispute settlement have been clarified and better delineated to provide a more predictable scope and content to the protection guarantees.

Rebalancing investment laws by progressively introducing investor obligations

Governments in the region have progressively adopted legal obligations for investors to preserve the environment and other public policy objectives. While the increasing awareness of the need to promote and implement responsible business conduct is mirrored in national strategies that go well beyond the legislative framework, investment laws have a key role to play in introducing obligations binding upon investors. This evolution in rule-making is also reflected in many OECD member countries’ domestic laws, which increasingly often contain provisions to ensure that investors bind themselves to responsible business conduct (Chapter 6). This practice aims to strike a better balance between guarantees offered to investors and obligations that investors must respect in order to be eligible for these guarantees and for incentives. Cambodia, Lao PDR, Myanmar, Indonesia, the Philippines, Viet Nam and Thailand have incorporated general obligations binding upon investors through legal changes mainly introduced in the past decade.

Viet Nam was once a leader in this area: as of 1987, it provided a set of obligations for foreign investors, mainly relating to tax and social obligations. It subsequently provided a much wider range of binding obligations, although the 2015 *Investment Law* did not retain the article dedicated to investors' obligations provided in the 2005 law. Meanwhile, **Indonesia** introduced provisions on corporate social responsibility in the 2007 *Investment Law*. **Lao PDR** and **Myanmar**'s recent investment laws both contain an extensive section that imposes obligations upon investors, which is more detailed than what is commonly encountered in investment laws. In **Lao PDR**, alongside general obligations such as tax obligations and those relating to labour laws, a specific provision obliges investors to protect the environment. The *Investment Promotion Law* obliges investors to ensure that their business activities do not cause severe adverse impact on the people, national security, public order or health of workers. The incorporation of these investor obligations is likely to help less advanced ASEAN countries to strike a better balance between investors' rights and obligations and to bring their legislation closer to international standards for responsible business conduct, such as those contained in the OECD *Guidelines for Multinational Enterprises* (Chapter 6). However, as in all AMS' domestic laws and treaties, such obligations are always stated in very broad terms, with no specific requirements binding on investors. Investors nevertheless remain bound by other obligations, enshrined in other laws.

Table 4.3 compares AMS in where they stand in introducing what are considered to be the key pillars of a healthy investment regulatory climate. It looks at the successive legal amendments undertaken by ASEAN member states, identifies which countries have enacted a single law covering both domestic and foreign investment, compares the core protection provisions for investors and looks at whether countries have adopted a positive or a negative list approach to the entry of foreign investment. The availability of arbitration, as well as adherence to international investment treaties, are also included. This table gives a brief overview of the areas that need to be further improved to bring individual AMS closer to the standards set in ASEAN instruments.

Table 4.3. Comparative table of AMS' investment frameworks

	A single investment law covering domestic and foreign investments	Recent amendments of the Investment legislation	Provision on environmental impact, sustainable development, etc.	Non-discrimination (post-establishment) enshrined in domestic legislation	Negative list approach	Protection against expropriation	Guarantee of free transfer of funds provided by law	Possible recourse to investment arbitration provided by law	Adherence to international conventions on arbitration (ICSID Convention, & New York Convention)	Adherence to International Investment treaties (including BITs and FTAs)
Brunei Darussalam	No – 1 Investment Incentives Law (2001)		No	No	/	Yes, but not specific to investors	Yes	Yes	Yes	Yes
Cambodia	Yes	Ongoing	No	Yes, except for land	/	Yes, but incomplete	Yes	Yes	Yes	Yes
Lao PDR	Yes	2017	Yes	Yes	/	Yes	Yes	No	Not ICSID	Yes
Indonesia	Yes	2007	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Malaysia	No – several laws governing investment		No	No	/	Yes	Yes	Yes	Yes	Yes
Myanmar	Yes	2012, 2013, 2015, 2016	Yes	Yes, since 2017	Yes	Yes, but incomplete	Yes	Yes, but unclear	Not a member of ICSID; Adhered to NY Convention in 2013	Yes
Philippines	2 investment laws	1987, 1991, 1996		Yes	Yes	Yes	Yes	Yes	Yes	Yes
Singapore	No		No	Yes	/	Yes	Yes	Yes	Yes	Yes
Thailand	2 investment laws	1999		No	Yes	Yes, but incomplete	Yes	Yes	ICSID Convention signed not ratified	Yes
Vietnam	Yes	2005-14; ongoing		Yes	Yes	Yes	Yes	Yes	Not a member of ICSID	Yes

Source: Authors' compilation

Investment treaty policy developments in ASEAN

Alongside domestic legislation, the protection of international investment in Southeast Asia is governed by a two-tier regime made up of both ACIA and a broad network of international investment agreements (IIAs)[1] composed of stand-alone treaties signed by individual countries and of broader free trade agreements (FTAs) with investment chapters, either signed by individual AMS or concluded collectively.

IIAs typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to investor-state dispute settlement (ISDS) mechanisms to enforce those provisions (see Box 4.2 on common features of IIAs). Increasingly, treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment.

Box 4.2. Common features of international investment agreements

International investment agreements or IIAs, entered into between two or more countries, typically offer covered foreign investors substantive and procedural protection. They provide additional protection to covered foreign investors beyond that provided to all investors and or to foreign investors specifically in national legal frameworks.

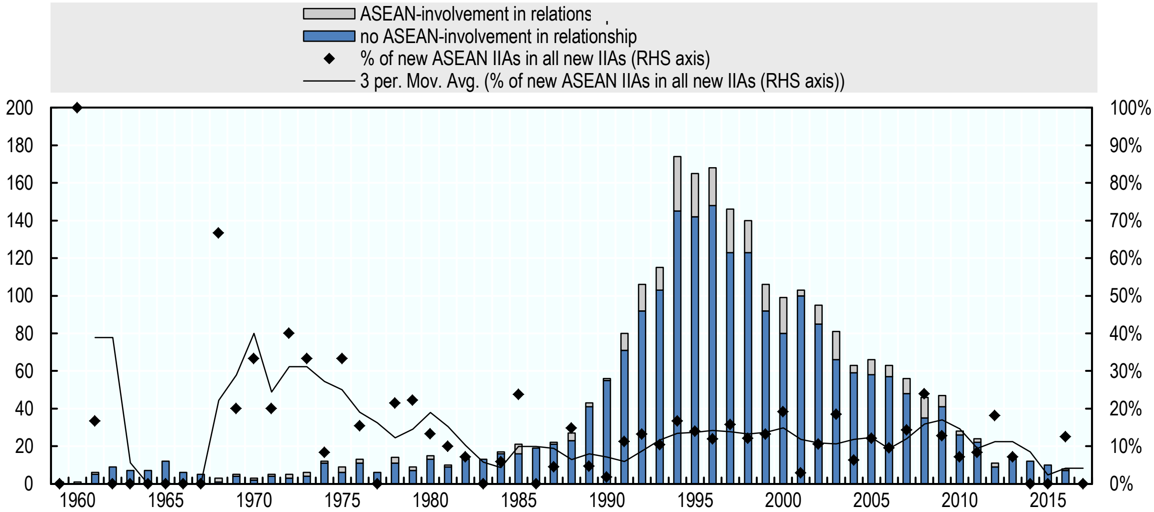
Substantive protections generally include protection against expropriation without compensation and against discrimination by, for example, guaranteeing that covered foreign investors will be treated no less favourably than investors from the host state (national treatment, or NT) or third states (most-favoured nation treatment, or MFN). Particularly important for policy considerations are guarantees of fair and equitable (FET) treatment or treatment, which can be equated (or not) with the international minimum standard of treatment of aliens under customary international law. The FET provision has been the one most frequently invoked by foreign investors in recent years. Additional clauses in IIAs can facilitate the transfer of profits, or limit or exclude certain performance requirements, such as local content rules.

IIAs can also foster liberalisation of investment by including commitments to open sectors to more foreign investment (market access) or by giving prospective covered foreign investors certain rights, typically by extending the NT and MFN standards to those seeking to make investments. IIAs usually provide for procedural venues to enforce the host state's obligations under the substantive standards. Today, most IIAs give investors the right to bring claims themselves against the host state before international arbitration tribunals for an alleged breach of the IIA – the so-called investor-state dispute settlement mechanism (ISDS) (Pohl et al., 2012; Gaukrodger and Gordon, 2012). The number of ISDS claims under IIAs has risen significantly in recent years to over 600 known claims currently (UNCTAD, 2015). Precise numbers of the cases are difficult to establish because of the confidentiality of certain arbitral proceedings (OECD, 2017).

ASEAN Member States have a long-standing tradition of concluding IIAs. Concomitantly with an early stance towards liberalisation and with the adoption of generous incentives, most developed ASEAN economies entered into investment treaties in the very early stages of the global development of investment treaty policy (Figure 4.1). Since that time, the network of treaties signed by AMS has expanded greatly. According to available information, around 270 IIAs are currently in force in Southeast Asia.

Figure 4.1. AMS were early movers in signing investment treaties

(number of agreements involving an ASEAN partner or not; share of total IIAs and 3-year moving average)



Note: ASEAN includes all treaties involving the original ASEAN6 plus treaties between OECD and CLMV countries.
Source: OECD treaty database.

How ACIA is influencing investment policy of ASEAN members

In the past decade, regional agreements – primarily ACIA – have been driving investment protection reforms. The agreement is the result of a merger of two earlier agreements, namely, the ASEAN Investment Guarantee Agreement and the Framework Agreement on ASEAN Investment Area, which respectively provided for investment protection guarantees and progressive investment liberalisation, into a single comprehensive investment agreement. ACIA hence simplifies and clarifies the ASEAN investment regime in that it provides for a clear interaction of liberalisation and protection provisions (OECD, 2014).

Among other objectives, ACIA aims to create a free and open investment regime by progressively liberalising intra-ASEAN investment and improving transparency and predictability of investment laws. It applies to the manufacturing, agriculture, fishery, forestry, mining and quarrying sectors, as well as to services incidental to manufacturing, but does not apply to other service sectors. The legal protection dimension is a building block of the collective effort towards the eventual creation of a single ASEAN Economic Community (Aldaba, 2013). ACIA provisions mostly draw on best practices encountered in bilateral investment treaties and in the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA). Through ACIA, ASEAN-based investors can now benefit from state-of-the-art provisions for the treatment of investment and investors, which are enforceable by an effective ISDS system. It incorporates the principles of national treatment and most-favoured-nation treatment and embeds recent innovative practices in international investment rule making.

ACIA also provides investors with guarantees of full protection and security, fair and equitable treatment, compensation in case of strife, protection against unlawful expropriation and the right to the free transfer of funds. Controversial provisions have been clarified and better detailed compared to the earlier Investment Guarantee Agreement. For example, the standards of fair and equitable treatment and full protection and security, which have raised considerable debate over the past decade and which have led to highly controversial arbitration awards, have been clarified to limit possible ambiguities. With more detailed provisions, ACIA grants more predictability to the treatment of investment. For example, it provides a definition of covered investment and explicitly covers portfolio investment. This has widely influenced domestic reforms in AMS.

The core underlying principle of ACIA is that of non-discrimination, comprised of the principles of national treatment and MFN treatment and the freedom to appoint senior management and boards of directors. In accordance with these principles, the Agreement contains no local content requirement and no condition on the entry of investment. ACIA also prohibits performance requirements, export requirements and trade balancing requirements. Through a set of general exceptions to the application of the protection provisions, it also incorporates a number of guarantees for host countries, such as the right to regulate, as well as environmental and social safeguards. ACIA therefore sets standards of protection and regulation that all AMS, at their own pace, have strived to achieve.

ASEAN-wide agreements and the increasingly complex treaty network

Recent investment treaty policy has in many cases been driven by a new regional dynamic: since the conclusion of ACIA in 2009, AMS have signed IIAs with Australia and New Zealand (2009), Korea (2009), China (2009), and India (2014)[2] (Table 4.4). ASEAN is currently also negotiating the inclusion of an investment chapter in the existing Economic Partnership Agreement with Japan. ASEAN is now negotiating the Regional Comprehensive Economic Partnership (RCEP) (Box 4.3)[3], and four AMS participated in the Trans-Pacific Partnership (TPP) negotiations (Box 4.4). In November 2017, ASEAN signed an investment treaty with Hong Kong, China. These treaties and negotiations place ASEAN at the cornerstone of the regional economic development and of the ongoing progressive harmonisation of treaty content across the region.

Table 4.4. ASEAN regional agreements with investment provisions

		Date signed
Hong Kong, China	ASEAN-Hong Kong Special Administrative Region (SAR) of China Investment Agreement	2017
India	ASEAN-India Investment Agreement	2014
Australia & New Zealand	AANZFTA (with investment provisions)	2009
China	ASEAN-China Investment Agreement	2009
South Korea	ASEAN-Korea Investment Agreement	2009
Japan	ASEAN-Japan CEPA (with investment provisions)	2008

Source: ASEAN.

Box 4.3. Towards a Regional Comprehensive Economic Partnership (RCEP)

The Regional Comprehensive Economic Partnership (RCEP) is a free trade agreement currently under negotiation between ASEAN and its six Dialogue Partners: Australia, China, India, Japan, South Korea and New Zealand. Negotiations formally started in November 2012 during the ASEAN Summit in Cambodia, with signature expected in 2018.[4] While negotiations were initially planned to be achieved by the end of 2015, the process was slowed due to divergences on the extent of trade and investment liberalisation commitments. RCEP will establish the most important trade area in the world with 3.4 billion inhabitants and 39% of the world's GDP.

RCEP aims to create a common trade and investment regulatory framework which will maximise economic interactions between AMS and their six Dialogue Partners and position ASEAN as a central cooperation platform for the development of regional economic policy (Yuzhu, 2013).[5] According to the "Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership", its objective is to "achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among the ASEAN Member States and ASEAN's FTA Partners." Harmonising the trade and investment regulatory framework should also relieve the "noodle bowl" effect generated by the coexistence of numerous multilateral and bilateral FTAs in the region.

The content and design of RCEP draw on the five ASEAN FTAs already signed with its six Dialogue Partners. It is expected to unify existing FTA provisions, which, in some areas, vary greatly, such as in the areas of tariff reductions and rules of origin (Yuzhu, 2013). RCEP aims to be comprehensive, covering a wide range of issues including trade in goods and services, investment, economic cooperation, intellectual property, competition and dispute settlement (Jose, 2017).[6] RCEP is often compared to the Trans-Pacific Partnership (TPP) as it also includes Asia-Pacific economies, although RCEP has been criticised for the probable lack of responsible business conduct provisions such as labour, human rights and environmental protection, unlike the TPP.[7]

Developing a regional approach towards the protection and liberalisation of investment in Southeast Asia brings opportunities to accelerate the harmonisation and modernisation of investment policies in individual member states. It also provides an opportunity for rationalising the IIA regime. Somewhat fewer IIAs have been signed by individual AMS since the signature of ACIA in 2009. This change reflects a stance towards more clarity in the regional investment policy, in accordance with ACIA's objective to *"create a free and open investment regime through (...) the improvement of transparency and predictability of investment rules, regulations and procedures conducive to increased investment among Member States."* (Art. 1 of ACIA). Nevertheless, ACIA has not yet prompted a rationalisation of the ASEAN "noodle bowl" of treaties, which remains one of the most complex in the world.

If AMS progressively replace their respective bilateral investment treaties (BITs) with an investment chapter of regional agreements, it would consolidate the global BIT network and thus ease the harmonisation between investment treaty policies and domestic investment regulations. But it also brings challenges as the current approach to regionalism, which consists in adding ASEAN treaties to the already existing network of bilateral treaties, leads to a multiplication of treaty layers. This may result, at least temporarily, in an even more complex network of international obligations, prone to overlap and inconsistency.

Box 4.4. The Trans-Pacific Partnership

The Trans-Pacific Partnership (TPP) is a free trade agreement signed on February 2016 between 12 economies (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam). It therefore covers four AMS, as well as three Dialogue Partners (Australia, New Zealand and Japan). Since the end of 2017, the TPP became the Comprehensive and Progressive Trans-Pacific Partnership.

The TPP is often considered as the heir of the Trans-Pacific Strategic Economic Partnership agreement (P4) signed in 2005 between New Zealand, Chile, Singapore and Brunei.[8] Discussions for a broader "Trans-Pacific" agreement started in 2007 and were concluded on October 2015.[9] [10] The agreement was renamed "Comprehensive and Progressive Agreement for Trans-Pacific Partnership" after the withdrawal of the United States from the Agreement on January 2017. Ministers of the 11 remaining economies declared in November 2017 that roughly 20 provisions in the original TPP will be suspended.[11] A final agreement is expected to be open for signatures in early 2018.[12]

The TPP's objective is to create a comprehensive trade and investment regulatory framework which facilitates market access among partner countries. It aims to go beyond traditional FTAs' provisions by addressing innovative issues including the development of digital economy and the role of both SOEs and SMEs in the global economy. The TPP includes 30 chapters covering, *inter alia*, trade in goods and services, electronic commerce, government procurement, intellectual property, labour, environment as well as dispute settlement.[13]

Following the US withdrawal, the four AMS party to the agreement committed to maintain the TPP. The Government of Brunei considered that its continuing participation would allow its economy to further diversify through inbound investments.[14] Malaysia, which like Viet Nam, had been particularly keen to gain privileged access to the US market[15], also reiterated its interest in concluding the TPP, as Malaysia currently has no FTA with Canada, Mexico and Peru.[16]

For example, in addition to the ASEAN-China Investment Agreement of 2009, eight AMS are parties to IIAs with China which also concluded with Singapore a bilateral FTA with an investment chapter in 2009, one year before the entry into force of the broader ASEAN Agreement.[17] Likewise, Australia and Malaysia concluded a FTA in 2012, subsequent to the entry into force of AANZFTA. In this context, with more bilateral FTAs in force, AMS could consider the termination of obsolete and redundant BITs.

According to available information, 13 BITs signed between AMS remain in force and therefore coexist with ACIA, while some were signed between AMS without having ever been ratified. While non-ratified treaties have, in principle, no impact on states' obligations, abrogating these treaties would provide further clarity in the ASEAN IIA network and would reduce legal uncertainty for investors and law practitioners.

AMS are, in parallel, continuously increasing their treaty network by entering into new agreements outside of the region. Some ASEAN Dialogue Partners are currently planning to enter into new BITs with AMS. India, for example, declared its intention to negotiate new BITs with Cambodia[18] and the Philippines[19] based on the new Indian BIT Model while investment guarantees are already provided by the ASEAN-India Investment Agreement.

The ASEAN IIA network has hence become increasingly broad and complex and AMS should be careful not to add opacity to the current ASEAN IIA network while entering into new BITs with ASEAN Dialogue Partners. While Article 44 of ACIA provides a safeguard against legal inconsistencies by stating that ACIA should not derogate from the existing rights and obligations of a Member State under other IIAs to which it is party, states should keep in mind that, by allowing BITs between AMS to coexist with ACIA, they provide two sources of protection to investors. In the event a dispute arises between an AMS and an investor, this situation would allow the investor to support its claim with the most favourable treaty in force. Hence, to reduce AMS exposure to ISDS, it would be preferable not to multiply sources of protection and rather maintain a clear, modern and coherent IIA network through the termination of BITs between AMS.

Steps have been taken towards rationalising the ASEAN investment treaty network and reducing the stock of BITs between AMS. In 2014, Indonesia announced the upcoming termination of its existing BITs, including those signed with AMS (Box 4.5). When developing a new model BIT and entering into new BITs within ASEAN, Indonesia will also need to consider ways to avoid creating further opacity and legal uncertainty to the existing IIA ASEAN network.

As for the content of treaties, the provisions of IIAs are often similar, although treaty design has evolved over time and there can be important differences in the details. In relation to their main design elements, treaties are often classified in generations. Not all countries have changed their treaty practice over time, and many countries, including AMS although to a lesser extent than in other parts of the world, still conclude what would be considered first-generation treaties today. First generation treaties typically offer similar or even broader rights and protections to investors than later treaty generations which typically refine, specify or limit the rights and protection they accord, and in most recent treaties, countries have started introducing better specified key treaty provisions to clarify government intent.

Regional and multilateral approaches offer an opportunity to create an integrated investment region in ASEAN and to establish common rules on investment protection and liberalisation. At the same time, additional commitments in agreements covering investment relations already subject to bilateral or other multilateral treaties may jeopardise the consistent implementation of AMS treaty policy: investors may circumvent new treaty policies by invoking the older investment treaty, which does not yet reflect these new policies. International practice shows that investment protection standards in older IIAs have often been relatively vague. Where they provide for arbitration, this gives investment arbitrators broad discretion to interpret and thereby determine the scope of protection they provide. While AMS investment treaty practice since 2009 reflects more specific treaty language, older treaties which are still in force, are often more vague.

Different levels of investment protection and liberalisation in various investment treaties raise policy issues. If and when they enter into force, new treaties such as the TPP will cover investment relations with numerous countries. For many of these countries, international investment is already covered by IIAs. Some investment relations might as a result be covered by more than one treaty. The investment relations between Singapore and Viet Nam provide an example: the bilateral investment treaty between the two countries entered into force in 1992; since 2012, investments between the two countries can also be covered by ACIA; TPP adds another layer of protection, which investors could invoke in their claims against the respective host government. The impact of treaty reforms and policy innovations can be negated because covered investors can circumvent them by choosing to bring a claim based on the bilateral, potentially more favourable, treaty. Multi-layering of investment provisions can be a burden on the effective implementation of new policies.

Some treaties, such as the EU-Viet Nam FTA, address this issue by providing for the replacement of existing bilateral treaties with EU member states, with only narrow exceptions.[20] It also clarifies that the "survival clauses", which typically extend certain treaty protections following termination of a treaty for already-made investments, cease to have effect. The FTA norms thus supersede the earlier norms immediately upon the entry in force of the FTA. Multiple layers of investment protection reflecting different treaty policies would also jeopardise the establishment of harmonised investment policy across ASEAN member states, a policy goal set forth in ACIA.

Box 4.5. Public scrutiny and reform of IIAs: the case of Indonesia

Bilateral investment treaties have been a source of political controversy in recent years, coming under increasing scrutiny by a variety of stakeholders, including civil society and academia, but also by contracting parties to IIAs themselves. Critics argue that IIAs unduly restrict governments' right to regulate and that arbitral proceedings are subject to important flaws. In this process, a number of core assumptions have been challenged. Econometric studies, for example, have failed to demonstrate conclusively that IIAs actually lead to increased FDI flows – a policy goal commonly associated with the investment protection regime (Sauvant and Sachs, 2009). Furthermore, while it has been contended that IIAs advance the international rule of law and good governance in host states by providing mechanisms to hold governments accountable, critics argue that opaque legal proceedings and potential conflicts of interest of arbitrators are contrary to rule of law standards (Van Harten, 2008). Moreover, the availability of international investment arbitration has been seen by some as an instrument that could circumvent, and thereby weaken, domestic legal and governance institutions (Ginsburg, 2005). Many governments are reviewing their investment treaty policy (OECD, 2017).

In March 2014, Indonesia announced its decision to terminate its BIT with the Netherlands (entered into force in 1995), which was to expire in July 2015. The government also declared its intention not to renew 67 other investment treaties, including the ones signed with Australia, China, Singapore and the United Kingdom (Matthews and Ponniya, 2017). The immediate impact of these terminations remains limited. Most of the BITs signed by Indonesia contain so-called sunset clauses, which guarantee the application of BIT provisions up to 10 years (on average) subsequent to the treaty termination. In practice, these clauses imply that companies that established their investments in Indonesia prior to the treaty termination will continue to benefit from BIT protection for a period of time as provided by the sunset clause. Meanwhile, investments initiated after the termination date will not be covered by these treaty provisions (Magiera, 2017). In the case of the Indonesia-Netherlands BIT, treaty provisions will remain applicable until July 2030, i.e. for a period of 15 years starting from the effective date of termination.

The decision of the Indonesian government[21] was driven by a growing concern over the lack of balance in the so-called "first generation" BITs, signed between the 1960s and 1990s, which were increasingly considered as reflecting an outdated state-of-play in the international investment landscape.[22] The new policy stance, adopted by Indonesia in the wake of South Africa's decision to terminate its own stock of BITs, was also justified by the necessity to increase the consistency between international investment treaties and recent national investment regulations (Bland and Donnan, 2014). A key issue, as stated by the Indonesian Investment Coordinating Board (BKPM), was the need to streamline old BITs with the 2007 *Investment Law*, which provide that international arbitration claims should be exclusively filed on the agreement of both parties (Amianti, 2015).[23]

Along with these considerations, the principal goal of this policy shift is to modernise Indonesia's treaties by introducing features that better reflect new practices as well as new economic realities.

Indonesia's new model BIT will aim at better balancing the interests of investors and host states, taking into greater consideration Indonesia's position both as a capital exporting and importing economy. The new treaties are also expected to give governments more leeway to regulate on matters of public interest such as health and the environment (Ewing-Chow and Losari, 2014). It is also likely that future Indonesian BITs will reduce the scope of ISDS provisions. There is indeed growing concern, as restated by Indonesia's then Coordinating Minister for Economic Affairs, Sofyan Djalil, that international arbitration disputes involving Indonesia had often been "unfair" and "contrary to Indonesia's interests" (Widuro, 2016).[24] According to many policy observers, this turnaround was largely prompted by the wide discontent over the number of ICSID cases filed against Indonesia. Indonesia is the ASEAN country that has been most affected by arbitration claims, some of which have given rise to high-cost damages, as with the *Churchill Mining and Planet Mining v. Indonesia* case (USD 1.4 billion).

The majority of treaty terminations undertaken by Indonesia were conducted unilaterally, which automatically triggered the sunset clauses. In some cases, mutual agreements on treaty termination were reached, allowing for the non-application of these clauses. In particular, Indonesia and the Republic of Argentina mutually agreed in October 2016 on terminating their BIT (signed in 1995) without applying the sunset clause. This agreement was supposed to take effect in 2017 by adopting an additional convention on the neutralisation of the sunset clause (Peterson, 2015).[25]

BKPM has reported that the government is currently drafting its new BIT model as well as renegotiating existing ones, but there is little information available regarding this draft model. According to the Board, the model will limit BIT terms to ten years and exclude the BIT automatic renewal provision.[26] Meanwhile, Indonesia remains bound by investment treaties signed under ASEAN, including ACIA as well as ASEAN FTAs negotiated with Australia, New Zealand, India, Japan, China and Korea. It is also still a party to other multilateral agreements including the Agreement of the Organisation of the Islamic Conference and the WTO Agreement on Trade-Related Investment Measures.

Investment disputes in AMS: the horizon of dispute prevention policies

Subsequent to the growing number of investor-state disputes worldwide, interest in dispute prevention policy (DPP) mechanisms as a means to prevent investor-state disputes from arising or from escalating into arbitration proceedings has increased. When disputes lead to formal proceedings, they are often costly, lengthy and unpredictable in their outcome. Regardless of whether or not host states lose their case, reputational costs can also be high, affecting in turn their image as a safe investment destination. DPPs, which can be defined as "any course of action adopted and pursued by one or more governments, specifically aimed at preventing investor-state conflicts arising under IIAs from escalating into full-blown disputes under those agreements."(Echandi, 2011), are increasingly regarded as an appropriate policy response to this threat. DPPs remain under-developed in Southeast Asia, and AMS should therefore consider introducing such policies into their investment regulatory and institutional infrastructures.

ISDS and dispute prevention policies in ASEAN

Since the 1990s, mechanisms for covered investors to bring claims directly against host governments – ISDS mechanisms – have become a frequent feature of investment treaties. OECD research shows that around 96% of the global IIA stock provides access to ISDS (Pohl et al., 2012), including all of the BITs signed by AMS, which testifies to the importance countries attach to dispute resolution mechanisms.

By virtue of ACIA, ASEAN investors can resolve their disputes with host states by using domestic courts or through international arbitration, including before ICSID tribunals or under UNCITRAL rules or any other ad hoc rules agreed upon by the disputing parties. The condition for investors to bring a claim under ACIA's ISDS provision is to prove that the dispute arose out of a breach of the host state's obligations under ACIA relating to the management, conduct, operation or sale of a covered investment. As for disputes between AMS relating to the interpretation of ACIA provisions, the disputing parties must use the ASEAN state-to-state dispute settlement mechanism under the ASEAN Protocol on Enhanced Dispute Settlement Mechanism.

Since investment claims are typically not brought before public courts but administered by arbitral tribunals, these proceedings need to be regulated and the decisions and awards enforced. The international community has developed specific institutions and rules to guarantee the effectiveness of arbitral justice. A majority of AMS have adhered to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention and to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) which has over 150 state parties.

Until recently, ISDS provisions in investment treaties provided for investor-state arbitration using ad hoc arbitration tribunals selected for each case in an approach derived from international commercial arbitration. Proponents of investor-state arbitration contend that it provides a forum to settle disputes that is independent from both the host state and the investor. This view has been increasingly challenged in recent years. Issues raised in the debate include among other things the characteristics of the pool of investment arbitrators, conflicts of interest, and lack of transparency (Gaukrodger and Gordon, 2012).

While ACIA does not explicitly refer to dispute prevention mechanisms per se, it provides for alternative dispute resolution (ADR) means: investment disputes can be settled by means of mediation, consultation, conciliation and negotiations. ACIA encourages investors to use ADR mechanisms prior to initiating ISDS proceedings. Yet, these ADR options are of limited impact to prevent disputes from escalating, as they prove to be efficient only when used at a very early stage of dispute. AANZFTA contains similar provisions on ADR, and provides for consultations and conciliation. It also establishes a Committee on Investment, albeit with only a limited role when it comes to dispute prevention.

Meanwhile, some jurisdictions have been actively developing different approaches to dispute settlement. In September 2015, the EU Commission announced a proposal to use a standing court of judges publicly appointed in advance by governments and an appellate tribunal for its on-going and future investment treaty negotiations. As agreed by the Parties, the EU-Viet Nam FTA was the first treaty to reflect this new approach with minor modifications.

Along the lines drawn in ACIA, there have been important reform efforts in many AMS to make arbitration available for the settlement of investor-state disputes. Singapore and Malaysia have become internationally recognised arbitration centres and have continuously promoted the use of arbitration for commercial and investment cases, but some of their ASEAN peers provide more uncertain access to arbitration mechanisms.

Following the path of Malaysia and Singapore, Indonesia introduced in 2007 a dispute settlement mechanism and provided that disputes between the government and foreign investors shall be settled through international arbitration. Likewise, in Viet Nam, important developments have been made over time with regard to ISDS. The 1995 legislation provided that international arbitration is available, among other dispute resolution bodies such as Vietnamese courts and arbitration bodies, to settle investment disputes. The 2015 law explicitly states that disputes arising from specific forms of contracts must be settled in accordance with the dispute resolution mechanisms agreed by the parties and stated in the contract.

In Myanmar, important ongoing amendments to the ISDS regime have been achieved in the past couple of years. The *Arbitration Act*, revised in 2016 and drawing on UNCITRAL *Model Law on International Commercial Arbitration*, brought Myanmar's jurisdiction in line with international standards on arbitral proceedings, and allowed the enactment by local courts of foreign arbitral awards and for accession in July 2013 to the 1958 New York Convention.

Meanwhile, Lao PDR, despite efforts to improve its ISDS provision in the 2016 *Investment Law*, does not yet provide a clear framework for the settlement and prevention of investment disputes, whether domestic or international. It has established a Committee for Economic Dispute Resolution, which provides an alternative to the court system and merely states that dispute resolution related to an investment can be carried out through amicable resolution, administrative resolution, dispute resolution by the Committee for Economic Dispute Resolution, or by filling a claim before domestic courts.

While it is difficult to establish a precise number and status of investment claims due to the confidentiality of certain ISDS proceedings, there have been relatively few cases involving AMS. Brunei Darussalam and Singapore have not had any known ISDS cases, while Cambodia, Myanmar and Thailand had to deal with only one public ISDS case. Indonesia has been the most affected country, with nine known cases; the Philippines has faced five public cases, Viet Nam four, and Lao PDR and Malaysia three cases each, which is relatively few compared to the average number of cases faced by emerging economies. Yet, a widespread feeling of discontent has grown over the existing architecture of investment dispute settlement. This has partly led Indonesia to discontinue the conclusion of investment treaties (Box 4.5). While redesigning their treaty and legislative policy in a more balanced way can be a valid answer to such concerns, AMS could also consider developing mechanisms to prevent disputes from arising. The use of dispute prevention mechanisms has not yet been adopted as a general practice by AMS, but there is a slowly emerging global trend that AMS could usefully follow in order to alleviate the potentially adverse effects of their adherence to ISDS mechanisms.

Options for developing innovative dispute prevention and avoidance mechanisms in AMS

To prevent the unnecessary escalation of investment disputes, some countries have implemented over the past decade new mechanisms to reduce the likelihood of investor-state disputes, but Southeast Asia does not seem to have followed this trend yet. Should they consider introducing such mechanisms, experience from other regions could usefully inform such a process. Latin America countries have been particularly innovative in setting up mechanisms for preventing disputes. Chile, Colombia, Costa Rica, the Dominican Republic, Mexico and Peru have all rapidly introduced measures to prevent and manage disputes. These policies can be divided into two groups: international and domestic DPPs. Domestic DPPs are policies that are unilaterally designed by a government to be implemented at a national level. These measures include early detection systems, training for public servants and the creation of dedicated institutions in charge of preventing, managing and monitoring disputes. While some countries, such as Colombia (Box 4.6), have instituted a comprehensive legislative and regulatory framework to prevent disputes, others such as Chile have opted for an informal prevention system where sectoral agencies directly manage disputes with investors (Joubin-Bret, 2015).

Governments have also adopted state-to-state DPPs through concerted approaches (Echandi, 2011). At treaty level, a new trend has been to introduce provisions that focus on managing conflicts between investors and states before they are raised as disputes in front of an arbitration panel, namely through increased transparency and dialogue. Transparency can help prevent disputes by ensuring better predictability of new regulations and by allowing for dialogue on the regulations before they enter into force – both between states and between states and individuals – thus favouring measures with fewer investment-hindering effects. This mirrors similar practice used in bilateral and regional trade agreements, as well as in the World Trade Organization (OECD, 2017).[27]

Brazil, for example, has decided not to include ISDS provisions in its new Agreements on Cooperation and Facilitation of Investment but instead provides for the creation of two institutional arrangements in order to prevent disputes: (i) a Focal Point or ombudsman within each government which addresses concerns of investors; and (ii) a Joint Committee, with representatives of the governments, responsible for the administration of the agreement. The Focal Point, called Ombudsman for Direct Investments (OID), was included in the structure of the Foreign Commerce Chamber (CAMEX), an inter-ministerial body in charge of the trade and investment policy in Brazil with a mandate to address foreign investors' concerns (Figure 4.2).

Alternatively, countries bound by more traditional types of IIAs have established mechanisms to identify treaties and investor-state contracts that contain an arbitration clause, so as to be able to monitor more closely contractual relationships out of which arbitration disputes can arise (UNCTAD, 2010a). For example, Peru adopted a law in 2006 establishing the "International Investment Disputes State Coordination and Response System", which aims, inter alia, to centralise information on agreements that provide for international ISDS (Box 4.7).

These institutional mechanisms which can be established at reasonable human and budgetary costs are likely, if coupled with streamlined policies and regulations, to substantially alleviate the risks of future investment disputes. ASEAN countries which have already implemented impressive policy reforms to rationalise, reinforce and harmonise their investment regulations might therefore consider it timely to adopt such approaches to allow for the construction of a safe, balanced and modern investment regulatory framework.

Box 4.6. The Columbian experience in establishing dispute prevention mechanisms

In 2010, the Colombian government raised concerns over a lack of capacity to face investment disputes should they arise. There was a poor understanding among public servants of IIA commitments and no identified lead agency to monitor arising disputes or defend the state. Funds and administrative procedures dedicated to managing disputes were unclear. To address these acknowledged institutional weaknesses, Colombia developed a legal and institutional framework to prevent potential litigation and to manage disputes.[28]

This policy has four objectives: strengthen the state's capacity in terms of dispute prevention and management; centralise decisions on ISDS and ensure effective inter-institutional coordination; ensure the availability of resources to defend the state; and establish administrative procedures and training programmes. A high-level commission in charge of establishing an investment dispute prevention and management strategy, and the Ministry of Trade acts as the Lead Agency responsible for coordinating the actions of government agencies. In parallel, training programmes are provided to sensitise officials at national and subnational levels to Colombia's international commitments.

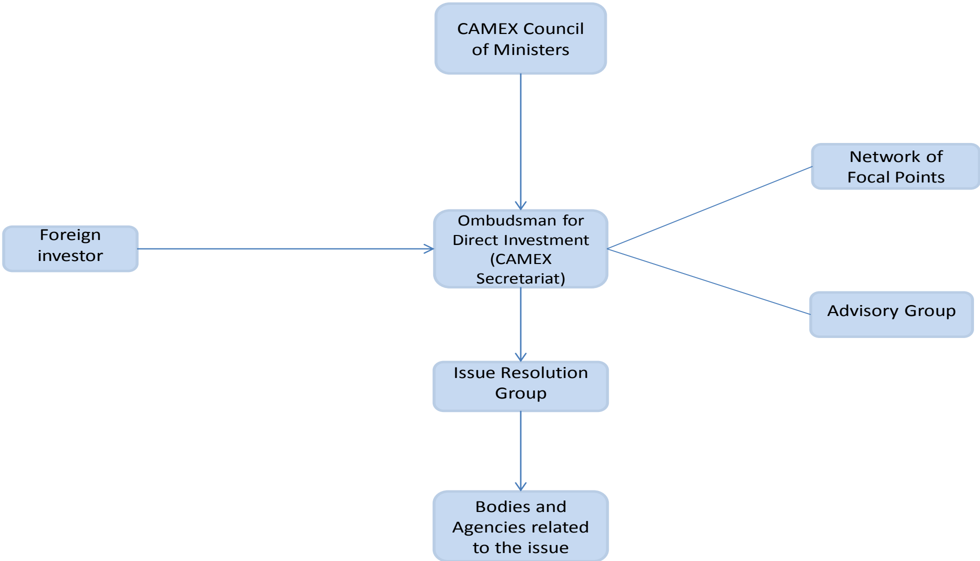
As for the institutional framework, a High-Level Government Body composed of ministers' representatives was established with the following six functions:

- Direct the national strategy in terms of dispute prevention and management;
- Promote the use of alternative disputes resolution;
- Recommend measures to prevent and settle disputes;
- Recommend measures to ensure a timely and constant defence;
- Hire an external counsel;
- Focus on specific sectors and entities.

For earlier detection of arising disputes, Colombia established SIFAI (the Investment Attraction Facilitation System), a public-private mechanism which identifies and centralises investors' issues in order to formulate solutions to improve the investment climate. SIFAI is managed by a technical committee in charge of coordinating and monitoring investment climate reforms, comprising the High Presidential Advisor for Public and Private Management, the Minister of Trade, the President of ProColombia – the investment promotion agency – and the president of the Private Council for Competitiveness.

Source: USAID-APEC, 2013

Figure 4.2. Institutional setting for dispute prevention in Brazil



Source: Kluwer Arbitration Blog, July 2017

Box 4.7. Monitoring treaties and preventing disputes: the case of Peru

In 2006, Peru implemented an ambitious policy to prevent investment disputes by creating the State Coordination and Response System for International Investment Disputes. This legislative and regulatory framework aims to improve the state's response to international investment disputes and to centralise all information regarding international commitments and investor-state contracts containing arbitration clauses. The framework also centralises information on arising investor-state disputes. Its goal is also to optimise the coordination of state agencies and to improve their accountability towards investment commitments. Lastly, it aims to standardise dispute settlement clauses included in IIAs and investor-state contracts.

A Special Commission, composed of the Ministry of Economy and Finance, the Ministry of Foreign Affairs, the Ministry of Justice and ProInversion (the investment promotion agency), is in charge of representing the state in international investment arbitration or alternative dispute resolution. The Ministry of Trade and the agency involved in a dispute can be invited to attend the Commission when necessary. The Commission addresses disputes and determines the possibility of amicable conciliation. It is also responsible for centralising information from involved agencies, appointing legal counsels and providing funds. Meanwhile, the Ministry of Economy and Finance centralises, through an online platform, information regarding investment disputes, reports to the Special Commission and delivers training to government agencies on Peru's IIAs commitments.

This system has prevented many conflicts from escalating into international arbitration. The intervention of the Special Commission has sometimes allowed contractual relationships to continue. In some cases, the conflict has not resulted in compensation but rather in a review of the regulation and its interpretation.

Source: UNCTAD, 2011.

Notes

1. The terms "investment treaties" and "IIAs" refer to both stand-alone investment treaties and investment provisions in broader free trade agreements.
2. The dates noted after the treaties indicate their year of signature.
3. The agreement is negotiated between the ASEAN member states and the countries of the ASEAN Plus agreements (Australia, China, India, Japan, Korea, and New Zealand).
4. http://news.abs-cbn.com/business/11/15/17/asean-aims-to-wrap-up-rcep-deal-in-2018
5. www.ciis.org.cn/english/2013-12/06/content_6518129.htm
6. http://dfat.gov.au/trade/agreements/rcep/documents/guiding-principles-rcep.pdf
7. www.straitstimes.com/asia/se-asia/asean-economic-ministers-set-to-push-for-rcep-trade-pact-involving-asean-and-six-other
8. https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/p4/
9. https://www.lexology.com/library/detail.aspx?g=b8d7f55d-9303-4ec2-84c5-acf2f9c40da1
10. http://dfat.gov.au/trade/agreements/tpp/pages/trans-pacific-partnership-agreement-tpp.aspx
11. www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/statement-declaration.aspx?lang=eng
12. www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_ATA%282017%29614602
13. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/summary-trans-pacific-partnership
14. http://mofat.gov.bn/Pages/TPP.aspx
15. https://www.cnbc.com/2017/07/13/vietnam-malaysia-stand-in-the-way-of-japans-trans-pacific-partnership-dream.html
16. https://www.nst.com.my/news/nation/2017/05/242531/trans-pacific-partnership-malaysia-must-not-quit
17. https://www.bilaterals.org/?-China-ASEAN-
18. https://economictimes.indiatimes.com/news/economy/policy/government-approves-signing-of-india-cambodia-investment-treaty/articleshow/53422434.cms
19. www.indembassymanila.in/eoi.php?id=Bilateral
20. EU-Viet Nam FTA, investment chapter, Art. 20.
21. Mahendra Siregar, chairman of Indonesia's investment co-ordination agency at the time, stated that the government's aim was not to weaken investor protection but to ensure there was consistency between local and international laws and regulations.
22. www.thejakartapost.com/news/2015/05/12/govt-revises-investment-treaties.html
23. www.thejakartapost.com/news/2015/05/12/govt-revises-investment-treaties.html
24. http://blog.ssek.com/index.php/2016/06/indonesian-legal-review-bilateral-investment-treaties/

25. https://www.bilaterals.org/?indonesia-ramps-up-termination-of
26. www.gbgindonesia.com/en/main/legal_updates/what_is_going_on_with_indonesia_s_bilateral_investment_treaties.php
27. www.oecd.org/gov/international-regulatory-co-operation-and-trade-9789264275942-en.htm
28. This policy was expressed in CONPES 3684 of 2010, a national policy document, and its implementing decree No. 1859 of 2012.

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Chapter 5.

Towards smarter use of tax incentives in Southeast Asia

This chapter provides a detailed mapping of investment incentives in ASEAN, using newly collected data from various online sources. It focuses on tax incentives and discusses the extent to which they are effective tools to increase investment, and to what extent they involve fiscal costs in ASEAN. The chapter identifies policy options for ASEAN to make incentive regimes more effective and efficient.

Summary

Fiscal and non-fiscal incentives are 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 significant 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 could also be politically easier to deliver than other types of subsidies as they do not require additional funds.

This chapter collects and consolidates available information on tax incentives in ASEAN and conducts a quantitative mapping of ASEAN with respect to the type of incentive instruments, the extent of their use, and the extent to which incentives promote or target specific activities.

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 number of years ranges from four (Viet Nam) to 20 years (Indonesia). Tax incentive schemes strongly reduce effective tax rates in all AMS; illustrating the magnitude of incentive competition. The wedge between the rate with and without incentives is above ten percentage points for each country.

Whether tax incentives are an effective tool to attract investment is unclear. Higher corporate tax rates are negatively associated with inward FDI in ASEAN, but existing studies suggest that tax incentives play a limited role in attracting investment at the aggregate level. Tax incentives may 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 – are 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.

ASEAN countries 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 countries 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 tax incentive 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.

International consensus also exists on the effectiveness of different incentive instruments. 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 spillover 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 (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. In Viet Nam and the Philippines, tax incentives are associated with a revenue loss of around 1% of GDP.

Policy considerations

Based on the analysis of ASEAN incentive regimes and international good practice, a set of policy considerations are derived for better governance and a smarter use of investment and tax incentives in ASEAN:

- *Tax incentives should be better coordinated within ASEAN countries.* It is important to appoint an overarching institution responsible for guaranteeing that tax incentives fulfil sometimes distinct objectives of various government authorities. The Ministry of Finance (i.e. 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.
- *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.

- *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.
- *Target tax incentives increasingly 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.

Corporate tax and incentive regimes in ASEAN

Statutory corporate income tax (CIT) rates are the first reference point for foreign and domestic investors when evaluating the tax competitiveness of a jurisdiction, but it is the entire tax regime – including various forms of tax incentives – which indicate a tax system’s burden on businesses or incentives to invest. The most common types of tax incentives are so-called tax holidays (periods during which an investment is fully exempt from taxation), reduced tax rates, tax credits and deductions (provisions to subtract certain expenses from taxable incomes or directly from taxes owed), and accelerated depreciation of assets. Beyond incentives directly affecting income taxes, exemptions from import and export taxation as well as from value added tax (VAT) are common measures to attract domestic and foreign investment in general, or in specific activities, sectors and regions.

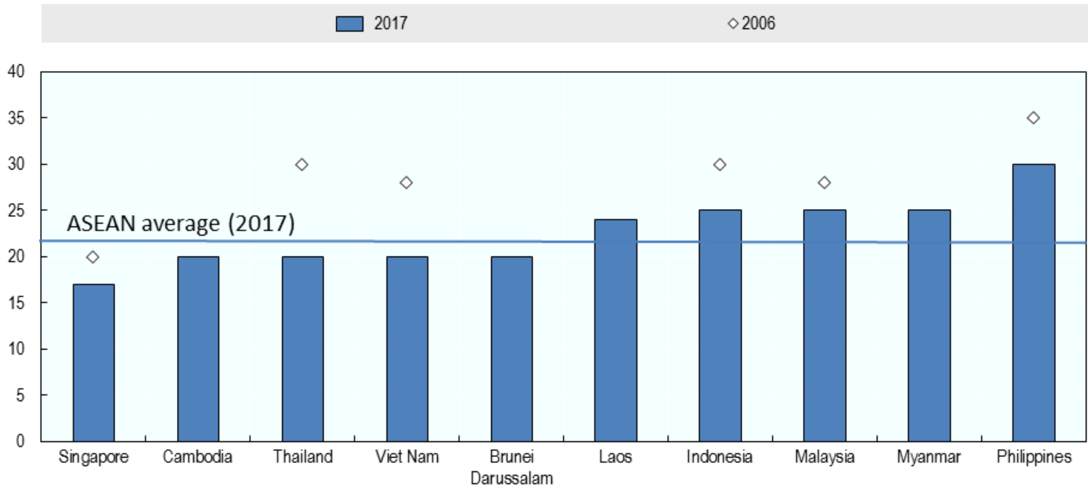
Rate-cutting tax reform in ASEAN

In ASEAN, the average CIT rate is currently 23%, down from around 26% a decade before (Figure 5.1). Singapore reports the lowest CIT rate at 17%, while Cambodia, Thailand and Viet Nam and Brunei Darussalam also tax returns of domestic and foreign investors below the average ASEAN rate. Lao PDR, Indonesia, Malaysia and Myanmar have rates at around 25%, while the Philippines stands out with an income tax rate significantly above the ASEAN average, at 30%.

Many ASEAN governments have adopted an expansionary tax policy: for example, Thailand and Viet Nam have reduced the CIT rate by 10 and 8 percentage points since 2006. The Philippines has reduced the CIT rate by 5 percentage points since 2009 but continues to have a comparatively high rate in the region. As a result of these reductions, average ASEAN corporate tax rates are on a par with rates within broader Asia and lower than the OECD average (25%).

Figure 5.1. Statutory corporate income tax rates in ASEAN have been lowered recently

Statutory corporate income tax rate (in %)



Source: Based on KPMG (2017), Tax Tools & Resources (*database*), www.kpmg.com/Global/en/services/Tax/tax-tools-and-resources/Pages/corporate-tax-rates-table.aspx and official national government websites.

Extensive use of tax incentives in ASEAN

Long history of tax incentives

All ASEAN Member States make extensive use of investment tax incentives and have done so for a long time. Singapore moved first in 1967 and was soon imitated by other countries: e.g. Philippines and Indonesia also in 1967, Malaysia in 1968, and Thailand 1972 (Thomsen, 2004). The sequencing of introducing tax incentives may have been associated with increasing competition for FDI in ASEAN. The apparently successful example of Singapore (and probably to a smaller extent Malaysia and Thailand) may have also led other ASEAN countries to implement tax incentive schemes (Chia and Whalley, 1995).

In the early phase, investment incentives often co-existed with FDI restrictions. Foreign companies were permitted to invest if complying with national government objectives of import substitution and export promotion, for example. ASEAN governments have gradually liberalised unilaterally, bilateral (free trade agreements), regionally (through ASEAN) and multilaterally (within the WTO), resulting in reduced FDI and trade restrictions (e.g. diminished negative list of sectors closed to FDI and phasing out of performance requirements). ASEAN Member States were left with tax incentives as one of the few remaining tools to influence domestic and foreign investment.

With gradual liberalisation, industrial policy in ASEAN countries shifted from protecting infant industries to supporting targeted industries (often called ‘strategic’ or ‘pioneer’ sectors) and specific activities (e.g. R&D, skills development or SME linkages). Increasingly, investment incentives were also used to increase investment in specific sub-national regions (particularly less developed regions). The result was and continues to be a complex system of tax incentives in all ASEAN countries which includes various types of tax incentive instruments, often targeted to specific sectors, activities and locations.

Generous and complex incentive systems in ASEAN

Information on tax incentives is generally available online, particularly through tax overviews published by global accounting firms as well as through national websites of investment promotion agencies (IPAs) and other government agencies. OECD *Investment Policy Reviews* of individual AMS also provide information on incentives. But existing data on incentives are often scattered across different sources and are mostly qualitative, making comparisons difficult.

This chapter collects and consolidates available information on tax incentives in ASEAN and conducts a quantitative mapping of ASEAN with respect to the type of incentive instruments, the extent of their use, and the extent to which incentives promote or target specific activities (Box 5.1). The mapping proxies the availability of different incentive instruments but does not weigh their relative generosity (see sub-section on effective tax rates below for a discussion on overall generosity of incentive schemes).

Criteria to qualify for incentives vary across countries, sectors and sub-national regional regions. ASEAN countries often provide incentives quite generically. The mapping exercise focuses predominantly on national level incentive regimes, per se available for almost any domestic and foreign investor.[1] The analysis focuses on four of the most prevalent tax incentive types: income tax holidays; income tax reductions; income tax deductions and credits (also including loss carry forward, reinvestment allowance and accelerated depreciation provisions); and trade tax and VAT exemptions.

All ASEAN Member States provide income tax holidays

A tax holiday is a complete exemption from taxation of corporate incomes, usually provided over a defined period of time, sometimes with the possibility of extension. A broad consensus agrees that tax holidays are the most distortive tax incentives (World Bank, 2017; OECD, 2015; IMF-OECD-UN-World Bank, 2015a). They apply to profits or income that are already secured and may therefore directly involve forgone government revenues – making profitable investment projects even more profitable (see below for a more detailed discussion).

All ten AMS provide income tax holidays for corporate investors, although respective generosity varies significantly (Figure 5.2, Panel A). Viet Nam, the Philippines and Cambodia are the least generous, providing a maximum number of four, six and six years of complete income tax exemption for qualifying investors. At the other end, Singapore, Brunei Darussalam and Indonesia have highly generous tax holiday schemes. Singapore provides a maximum of 15 years of tax holidays. Brunei Darussalam provides 5-8 years; with the possibility of extension for another 11 years. Indonesia allows for complete (or at the minimum 10%) income tax exemption for up to 15 years; with the possibility of a five-year extension. In the middle, Myanmar, Thailand, Lao PDR and Malaysia provide a maximum of 7-10 years of tax holidays.

Investors benefit from reduced tax rates after tax holiday periods in several AMS

Tax reduction schemes are preferential, non-zero tax rates below CIT rates and are used in six of the ten ASEAN countries (Figure 5.2, Panel B). They generally come into effect after the end of a tax holiday period, where the preferential tax rate is applied for either a certain period of time (in Singapore and Viet Nam) or in a specific location, mostly special economic zones (in Lao PDR, Myanmar and the Philippines). In Indonesia, the tax reduction and tax holiday schemes are integrated – i.e. investors either benefit from a reduced tax or from a full tax exemption from the start of the investment project (not illustrated in the figure).

Box 5.1. Database on ASEAN investment tax incentives

Data on tax incentives are often scattered across different sources and are not collected in a comparable and quantifiable format. A key challenge for the collection of incentives data is that several institutions (including at the sub-national level) are often responsible for providing tax incentives in a country. Moreover, the regimes often vary across specific geographic regions or other territorial areas (e.g. special economic zones) as well as across economic sectors and firm types (e.g. domestic versus foreign-owned, SME versus large firm). Incentives are often negotiated on an *ad hoc*, discretionary basis with investors, making the collection of data yet more difficult.

For the purpose of this report, detailed data on tax incentives are collected and summarised for each AMS (see Annex). The data are collected through desk research from online tax overviews of global accounting firms, national website of investment promotion agencies (IPAs) and other government agencies; as well as from national OECD *Investment Policy Reviews* of AMS. The following information is included:

- Standard corporate income tax (CIT) rate;
- Main government agencies involved in offering incentives; major laws regulating incentive provision;
- Qualifying firms for incentives; sectors/activities qualifying for incentives;
- Territorial differences in incentive provision (including with respect to SEZs);
- Availability and maximum length of tax holidays; availability of preferential CIT rates, and maximum reduction; availability of, and conditions attached to, tax deductions/allowances, as well as tax credits; availability of loss carry forward and reinvestment allowance schemes; availability of accelerated depreciation schemes; availability of import duty, export tax, and VAT exemptions; availability of other financial and non-financial incentives.

The collected data can be translated into simple quantitative indicators for benchmarking purposes (e.g. comparison of number of years of tax holidays) and can also be used in computations of effective tax rates taking account of incentive regimes. The data are comparable with the recently published *Developing Country Tax Incentives Database* by the World Bank (2017), which provides quantitative information on selected tax incentives for more than 100 countries, broken down by 22 economic sectors. Compared to the database presented in this chapter, the World Bank database is more selective in the type of incentives covered, provides less detailed information on what type of activities are targeted with incentives and does not discuss the extent of sub-national heterogeneity of incentive provision. Moreover, the Incentivesmonitor.com provides a comprehensive database of available fiscal and non-fiscal schemes around the world. It also reports all financial incentives awarded to US companies for foreign and domestic investment projects.

Tax deduction and credit schemes reduce investors' tax burden in ASEAN

Tax deductions or allowances allow certain expenses (e.g. on training programmes, R&D activities, capacity building of SMEs, and environmental protection) or revenues (e.g. export revenues) to be subtracted from taxable income. Tax credits are similar but enable investors to use such expenses directly to reduce the amount of taxes owed and are therefore more generous than deductions. Tax credits are often provided for taxes paid on foreign income of an internationally operating firm. Loss-carry-forward schemes (that allow deducting losses made in a previous year from income made in a given fiscal period) as well as accelerated depreciation of assets (ultimately lowering effective tax rates) are for simplicity also subsumed under the category of tax deductions and credits.

All AMS use tax deductions, credits or both (Figure 5.2, Panel C). Viet Nam has the most comprehensive regime under this category, in terms of the number of schemes implemented that allow for tax deductions and credits.[2] Tax credits are provided for CIT paid in foreign countries as well as for certain projects employing female workers or ethnic minorities. Investors can further deduct income in activities involving technology transfer and expenses on R&D from taxable income; carry forward loss from previous fiscal years and depreciate assets faster for taxable purposes. In contrast, Cambodia and Lao PDR make much less use of deduction and credit schemes. Cambodia provides accelerated depreciation as an alternative to tax holidays. Lao PDR provides a tax credit on reinvested profits, and losses may be carried forward fully and consecutively for a maximum of three years.

Beyond CIT incentives, a number of trade tax and VAT exemption are provided

Trade tax incentives include import duty exemptions on certain products (often raw materials and intermediates not available on the local market) as well as exemptions from duties for certain exported products and services. Moreover, countries may provide VAT exemptions for certain products. Even when VAT may be recovered, they still involve an administrative burden for firms, particularly in countries with lower administrative capabilities. Trade tax and VAT incentives do not directly affect CIT or CIT rates, but they affect costs of investments and therefore indirectly influence taxable incomes and thus investment decisions.

All AMS make use of trade or VAT exemptions to varying degrees (Figure 5.2, Panel D).[3] Counting the number of schemes available provides an indication of the extent these incentives are used in ASEAN: Myanmar and the Philippines have at least four different incentive schemes under this category; Cambodia has at least three schemes; while all other ASEAN countries have at least one or two trade tax or VAT exemption schemes.

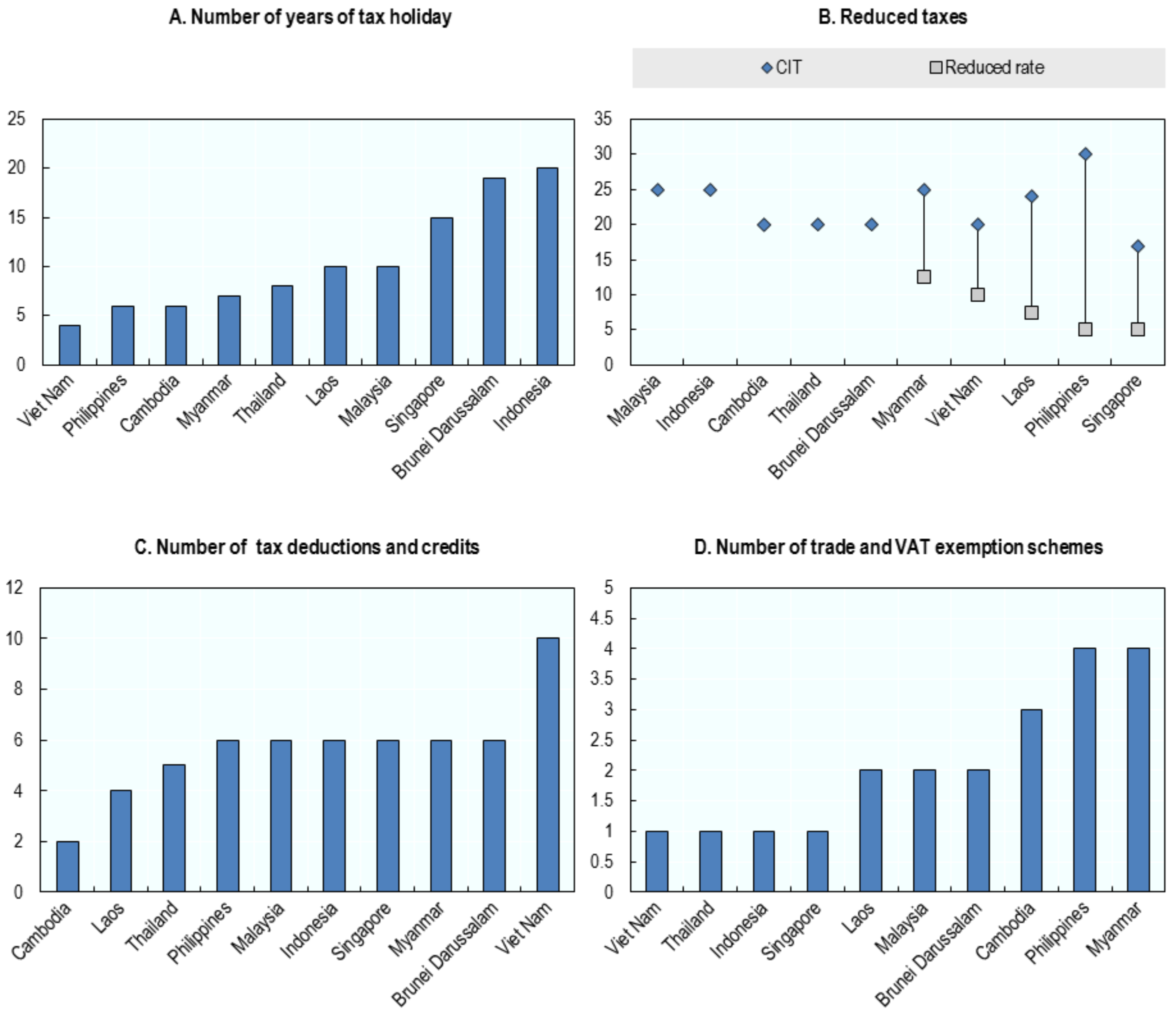
Incentives are often used to promote economic and social objectives

All ASEAN countries use targeted incentive schemes to promote and encourage economic and social spill-overs through investment. On the one hand, incentive schemes in ASEAN countries often include a positive list of targeted, strategic sectors which is often rather unspecific and broad, suggesting that incentives cover a wide range of sectors in all Member States. On the other hand, AMS report significant variety in the use of incentives to target and promote specific eligible activities, which may not (or only to a certain extent) be specific to the promoted industries. A non-exhaustive list of these activities includes:

- Enhance SME linkages
- Enhance employment in general or for specific groups such as women; provide training or enhance skills
- Invest in R&D and other strategic business services
- Invest in environmental protection
- Invest in high-tech activities (including automation and modernisation of equipment)

- Engage in exporting
- Import specific goods and services to promote local industries
- Relocate regional and international headquarters
- Promote less developed sub-national regions, including in SEZs
- Invest in infrastructure

Figure 5.2. Differential use of tax incentive instruments across ASEAN



Note: The underlying data used in these figures are based on newly collected data from various national and public online sources. The figures provide a proxy on the availability of different incentive instruments, but do not directly allow a weighing of generosity across types of incentive instruments. In panel C, tax deduction schemes (e.g. a reduction of export revenues or R&D expenses from taxable income) are counted once. Tax credits, loss carried forward and accelerated depreciation more strongly/directly lower the tax burden for firms and are therefore counted twice.
Source: Authors' calculations using various national and public sources (see Annex).

ASEAN countries have specific incentive provisions for six of the ten targeted activities on average (Table 5.1).[4] Malaysia most extensively targets specific activities through tax incentives, with specific tax incentive schemes for all ten activities listed above (see Box

5.3 on how Malaysia uses tax and other incentives in the area of linkage and skills promotion). Malaysia is followed by Thailand (7 targets), Philippines and Singapore (6 targets). Less developed economies within ASEAN – including Cambodia, Indonesia, Lao PDR and Myanmar – report less diversified incentive targeting compared to the rest of the region.

Table 5.1. Extent of tax incentive targeting across ASEAN

	Local sourcing, SME linkages	Employ-ment, training and skills	R&D and other strategic sectors	Green growth	High-tech	Export	Import	Head-quarter	Territorial, SEZs	Infra-structure
Brunei Darussalam		Deduction	Deduction	Deduction	Deduction		Trade tax exemption			
Cambodia						Trade tax exemption	Trade tax exemption		Trade tax exemption	
Indonesia					Tax Holiday		Trade tax exemption		Deduction, trade tax exemption	Tax Holiday
Laos						Trade tax exemption	Trade tax exemption		Tax Holiday	Tax Holiday
Malaysia	Tax holiday, reduction	Deduction	Tax holiday, reduction	Reduction	Tax holiday, reduction	Trade tax exemption	Trade tax exemption	Reduction, trade tax exemption	Reduction	Deduction
Myanmar		Deduction	Deduction			Trade tax exemption	Trade tax exemption		Reduction	
Philippines					Tax Holiday	Trade tax exemption	Trade tax exemption	Reduction	Reduction	Deduction
Singapore		Deduction	Deduction		Tax holiday, deduction		Trade tax exemption	Reduction	Trade tax exemption	
Thailand	Deduction	Deduction	Deduction				Trade tax exemption	Tax Holiday	Tax Holiday	Deduction
Viet Nam		Tax credit	Deduction		Deduction		Trade tax exemption		Tax holiday, reduction, trade tax exemption	Deduction, reduction

Note: *Tax holiday* = total income tax exemption over defined period; *reduction* = income tax rate reduction over defined period; *deduction* = deductions of certain expenses from taxable income; *tax credits* = deduction of certain expenses from payable taxes (loss carried forward and accelerated depreciation also fall under this category for simplicity); *trade tax exemption* = exemption from import duties, export taxes or VAT.
Source: Authors' calculations using various national and public sources (see Annex).

All countries except Brunei Darussalam have some regional targeting either via special incentive provisions for less developed regions or additional incentives in SEZs. For example in the Philippines, 'pioneer status' can be granted to enterprises located in less developed areas that are producing new products or using new methods, producing goods deemed highly essential to the country’s agricultural self-sufficiency programme, or goods utilising non-conventional fuel sources. Similarly in Lao PDR, incentives are differentiated according to geographic zones: zone 1 without infrastructure receiving most generous incentives, zone 2 with a moderate level of infrastructure receiving moderate priority for incentive provision, zone 3 with good infrastructure receiving low priority for investment promotion. Both countries provide additional incentives in SEZs.

All AMS provide duty exemptions for imports of certain goods (mostly raw materials and capital equipment that may not be available domestically). For example in Malaysia, for goods to be exported, full exemption is granted on components/raw materials, provided that local inputs are not available or not of sufficient quality. For goods for the local market, full exemption is possible if the component is not produced locally or if there is already no duty on imports of the final product. Services sectors such as tourism are also granted duty exemption under certain conditions.

If effectively implemented, targeted incentives – even if multi-layered – may be more likely to help achieve specific socio-economic development objectives. More advanced countries within ASEAN with advanced institutional capabilities have a more nuanced approach to tax incentive targeting (e.g. Singapore, Malaysia and Thailand). These countries tend to make use of specific tax incentives to promote SME linkages, skills, environmental protection, R&D, automation and high-tech activities, for example.

If institutional capacities and capabilities in a country are lagging, a simple and unspecific policy approach might be better, as it would increase certainty for potential investors. Less developed ASEAN countries could therefore consider less extensive tax incentive targeting (e.g. Cambodia, Indonesia, Lao PDR, and Myanmar), with incentives becoming more complex as the economy develops.

Incentives reduce effective tax rates in ASEAN

Effective tax rates are useful indicators to compare sometimes complex tax systems in a single number across countries. Effective tax rates can capture specific provisions of the tax legislation, including tax incentives. Average effective tax rates (AETRs) are the net average tax rates of a hypothetical investment project, corresponding to the present discounted value of taxes on returns on investment divided by the present discounted value of the before-tax income. AETRs are used to assess the predicted effect of taxes on discrete investment choices (IMF-OECD-UN-World Bank, 2015b).[5]

Wiedemann and Finke’s (2015) computations allow a comparison of AETRs with and without incentives across ASEAN countries (except Brunei Darussalam). The computations are based on a hypothetical investment project where a firm invests equally in five different assets (including intangibles, buildings, machinery, financial assets and inventory).[6] Reported AETR with incentives take into account all available incentives and thus correspond to the lowest possible effective tax rates investors’ may face.

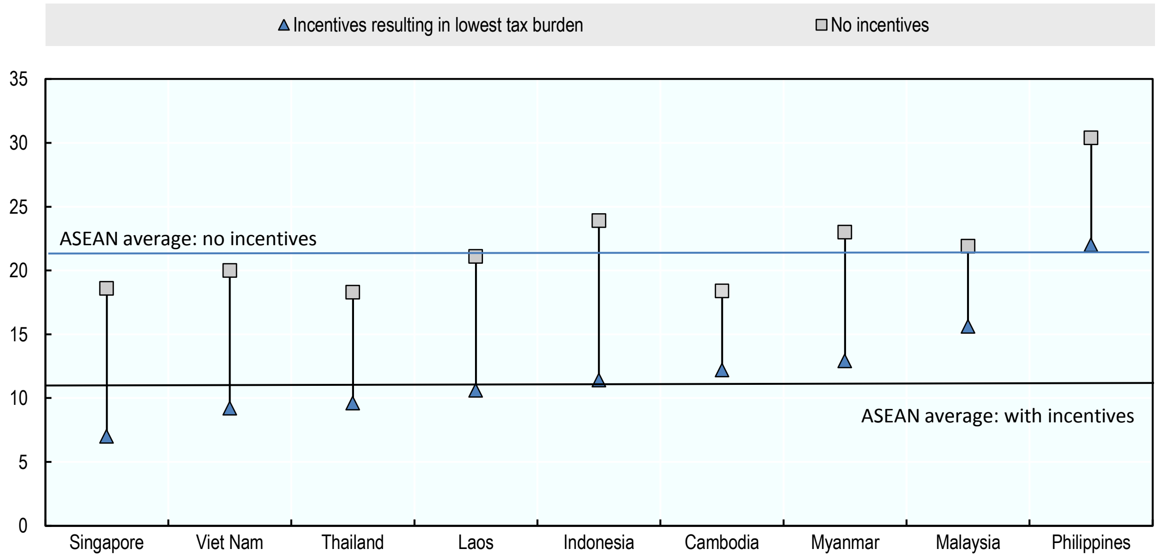
Incentive competition lowers corporate taxation in ASEAN

Tax incentives strongly reduce AETRs for domestic investors in ASEAN countries (Figure 5.3). The wedge between the AETR with and without incentives is above 10 percentage points for all countries. Cambodia reports the lowest wedge among ASEAN countries, pointing to a less extensive incentive system compared to its neighbours. This is consistent with a comparatively simple system of incentives in Cambodia, as illustrated in the previous sections. Malaysia also reports a relatively small wedge, despite extensive use of targeted tax incentives. Within ASEAN, Indonesia, Singapore, Viet Nam and Lao PDR have the highest tax rate wedge.

AETR levels with incentives are lowest in Singapore (7%), followed by Viet Nam and Thailand with highly competitive AETRs at below 10% after incentives. The Philippines has the highest after-incentive AETR among ASEAN countries. Given high statutory tax rates, the comparatively generous Philippine incentive system does not compensate enough to put the AETR with incentives below those of other ASEAN countries.

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

Average effective tax rates (AETRs) with and without incentives (in %)



Source: Based on Wiedemann, V. and Finke, K. (2015), Taxing investments in the Asia-Pacific Region: The importance of cross-border taxation and tax incentives, Discussion Paper No. 15-014.

An almost parallel downward shift of effective corporate tax rates without incentives to the equivalent rates with incentives suggests considerable incentive competition within ASEAN. If one assumes that AMS compete for investments predestined for the ASEAN region, partly supported by the fact that most sales of foreign affiliates go to the local and regional ASEAN market (Box 5.2), incentive competition could be detrimental from a fiscal resource mobilisation perspective. The relative competitive stance with and without incentives remains broadly the same when all AMS apply incentives vis-à-vis no AMS applies incentives (see section below). The implications on fiscal resources are very different however.

Benefits and costs of incentives in ASEAN

Tax and other incentives involve potential benefits as well as costs. The benefits may relate to the extent tax incentives increase investment – and particularly those investments that support national development goals and create positive spill-overs (e.g. job creation, skills development, SME linkages). The most important potential cost of tax incentives is the budgetary cost, i.e. the extent of forgone tax revenue due to tax incentives. Other costs may relate to distortions if incentives attract investments into sectors in which the country may not have a natural comparative advantage and thus the long-term effect of these investments could be negative (Zolt, 2013; Thomsen, 2004).[7]

Box 5.2. Sales patterns of US and Japanese investors in ASEAN

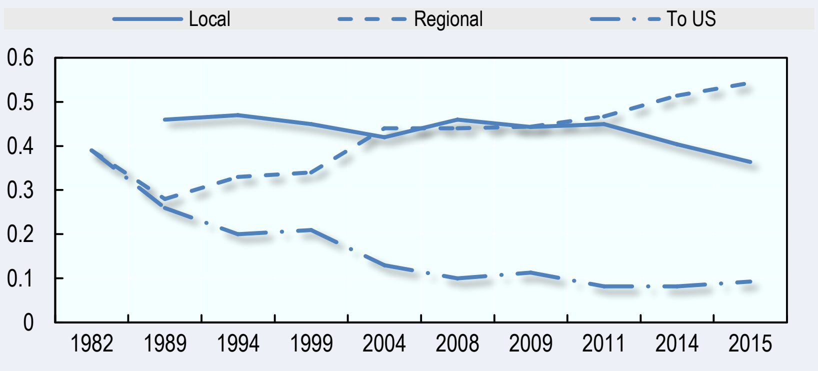
The sales patterns of foreign MNE affiliates operating in ASEAN give an idea of the main drivers of FDI in the region and hence the likely effectiveness of incentives. The evidence for Japanese and US investors in ASEAN suggests that, with some exceptions, investors are increasingly drawn to Southeast Asia by the attractiveness of the regional market and the high growth of individual economies within the region. They are investing to be closer to those markets and hence are less likely to consider locations elsewhere.

Japan – Sales of Japanese affiliates in ASEAN are roughly evenly divided between the local market and exports, principally to Japan and the rest of ASEAN. The Japan External Trade Organisation (JETRO) conducts an annual survey of Japanese firms in East and Southeast Asia. Excluding Brunei Darussalam, Lao PDR and Myanmar which have relatively small amounts of Japanese investment, the average proportion of exports to total sales of Japanese affiliates is 45%, meaning that over one half of sales are to the local market of the affiliate. Almost one third of affiliates in these countries do not export at all, or more than twice the number that export all of their output, implying that half of affiliates supply a mix of the local and export markets. Consistently across all AMS, including Lao PDR and Myanmar, the lion's share of exports go to either the ASEAN region or back to Japan. As one might expect, CLMV countries have the highest shares of exports to Japan, but overall, the Japanese and ASEAN markets take between 72% and 90% of exports for all AMS.

United States –US majority-owned affiliates in the region are less focused on supplying the home US market than are Japanese investors. While the US market took 39% of sales in 1982, this share has declined sharply over time and now represents only 8% of total sales, comprised mostly of computers and electronic products (Figure 4). The host country share of sales has also declined over time but still represents 36% of total sales – less than in the Japanese case but a significant share nonetheless. Exports to other destinations than the home market are now the largest share of total sales. Estimates based on a 2004 survey suggest that 80% of these exports went to the rest of Asia, including Southeast Asia. Such information is no longer provided, but given the growth in intra-regional trade since then, it is likely that the Asian/ASEAN share has remained the same or even increased.

Figure 5.4. US MNEs in ASEAN are mostly interested in local and regional markets

(affiliate sales to each destination as a percentage of total sales)



Note: The regional market includes all Asia. Data exclude KHM, LAO, MMR and BRD.
Source: US Bureau of Economic Analysis.

The benefits of incentives are uncertain

Evidence is inconclusive about whether tax incentives are an effective tool to attract investment. High corporate tax rates have been found to deter FDI entry (e.g. Andersen et al., 2017; De Mooij and Ederven, 2003; and Hassett and Hubbard, 2002), while existing studies suggest that tax incentives play a limited role in attracting investment at the aggregate level, particularly in developing and emerging countries (see James, 2014; James and Van Parys, 2009; Abbas and Klemm, 2013 for overviews of the literature). Consistent with existing evidence, higher corporate tax rates are associated with lower FDI intensities among ASEAN countries (Figure 5.5, Panel A). Effective tax rates faced by prospective investors in ASEAN are negatively correlated with inward FDI stocks (as % of GDP).[8] The Philippines, for example, has comparatively high AETRs and small FDI stocks relative to GDP. In Cambodia, Viet Nam and Thailand, investors face relatively low effective tax rates and aggregate investment intensities are high.[9]

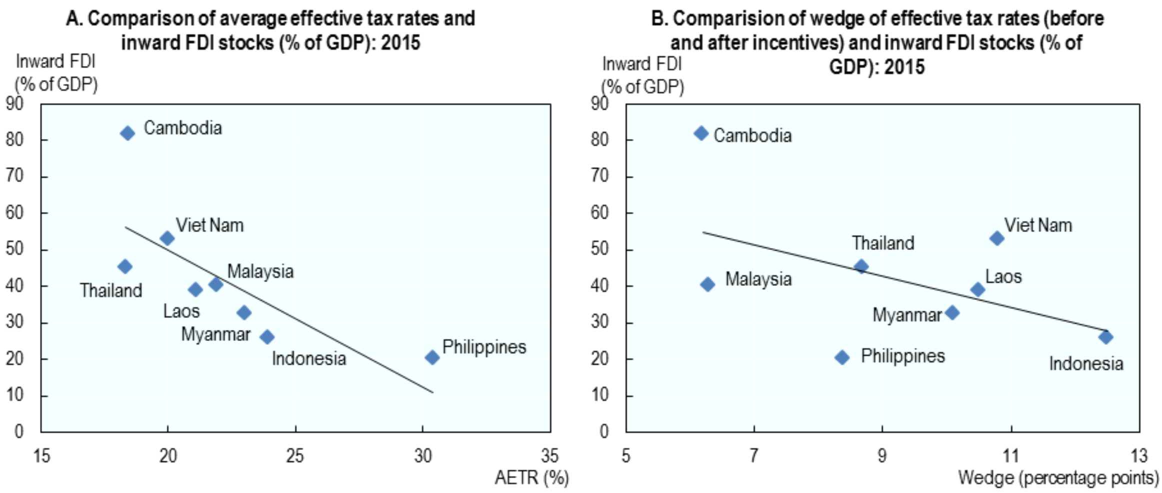
An equivalent negative relationship is observed when comparing FDI restrictions and FDI stocks (see Chapter 2). It thus appears that moderate corporate tax rates within ASEAN (and possibly elsewhere) are observed in countries that have considerably liberalised FDI. This finding underlines empirical studies that no single factor determines investment entry, but both market access and taxation are among important determinants (Andersen et al., 2017; van Dender, 2017; also see next sub-section). It also supports empirical evidence that corporate taxes tend to be lower when capital is more mobile, typically the case when economies are more open (Devereux, 2015).

The direct effect of incentives is difficult to disentangle, while a negative correlation would also be observed when plotting AETRs after incentives against FDI intensity. Existing empirical studies on the aggregate impact of tax incentives in Cambodia, Indonesia, Lao PDR, and Malaysia suggest that incentives schemes are less effective in increasing investment than a simple, uniform regime with moderate corporate tax rates (World Bank, 2017a). The wedge between effective tax rates with and without incentives illustrates the generosity of tax incentive use. The wedge is higher for countries with lower FDI intensities (e.g. Indonesia, Lao PDR and Myanmar); and it is lower for countries with higher FDI intensities (e.g. Cambodia and Thailand) (Figure 5.5, Panel B). This simple comparison is in line with other studies arguing for a simple, uniform incentive regime with moderate tax rates rather than tax incentives to attract investment. These conclusions need to be taken with a grain of salt, however. Many other factors – besides taxes and incentives – affect investment decisions.

Incentives can be used to promote specific development objectives and spillovers

Tax incentives can be used to promote and encourage economic and social spill-overs through investment. Developed and emerging countries, including in ASEAN, extensively engage in tax incentive targeting (see Table 5.1). International organisations and other institutions tend to argue for more targeted approaches, both in terms of sectors and activities (ASEAN, 2016; IISD, 2007 and 2014; IMF-OECD-UN-World Bank, 2015a; ESCAP, 2017; OECD, 2015; van Dender, 2017; and World Bank, 2017). From a policy coherence perspective, tax incentives that promote specific development objectives are more justifiable than regimes providing generous, unconditional incentives. As suggested in Chapter 6, tax and possibly non-tax incentives may be designed to foster responsible business conduct. Very little analysis currently exists on targeted tax incentives and their effectiveness, but some policy relevant evidence emerges.

Figure 5.5. Corporate tax rates are negatively associated with FDI intensity in ASEAN



Note: Singapore is not included in the figures as it is an outlier, with a share of FDI stocks in GDP of 370%. Singapore's AETR before incentives is 18.6% and the wedge is 7 percentage points. Including Singapore would make the negative slopes in the figures yet steeper, while the fit would be less good.
Source: Authors' illustration based on Wiedemann, V. and Finke, K. (2015) and UNCTAD (2017), UNCTADStat (database), http://unctadstat.unctad.org

Targeted tax incentives may support integration in GVCs and enhance exports

Investors optimise their supply chain and production strategies in GVCs by investing in cost-efficient locations (see Box 5.4 below). Tax incentives may be effective if investment projects support integration in regional and global value chains, i.e. production for further exporting. Such efficiency-seeking investments could be realised in any location with comparable investment conditions. Tax incentives can therefore be a decisive factor (Andersen et al., 2017).[10] Even for efficiency-seeking investments, however, incentives may only work if competing countries offer fewer incentives, which at least within ASEAN is not the case (Figure 5.3).

Tax incentives for investment projects involving other FDI motivations are less likely to be effective. These include projects to expand markets for selling (market-seeking) and investments in natural resource extraction (resource-seeking). Investments are location-specific in both cases and therefore likely to occur even without incentives. Investment projects are rarely just market- or efficiency seeking, but they often target increases in local sales as well as exports (see Chapter 1). This needs to be taken into account when providing targeted incentives.

Targeted tax incentives can promote and enable SME linkages and skills

Promoting SMEs and their integration in the global economy is a rising concern for developing and emerging economies, including in ASEAN. SMEs and micro enterprises make up for more than 60% of employment and above 98% of all established enterprises in ASEAN, but SMEs are responsible for less than 30% of value added and exports in most ASEAN countries (Lopez-Gonzalez, 2017; OECD-World Bank 2015). While ASEAN countries significantly promote SMEs through various platforms (ASEAN, 2015; OECD, 2018 forthcoming; OECD-ERIA, 2014), many of these efforts may remain ineffective, often due to a lack of coordination across agencies and lack of scale.

Leveraging significant recent FDI inflows to enhance linkages with local firms and SMEs can be an important opportunity for inclusive development. Malaysia and Thailand (and Singapore in the past) are providing investment tax incentives to foster linkages. These programmes have proven effective and illustrate the importance of involving investors in the promotion and upgrading of local firms (Box 5.3).

Box 5.3. Effective use of tax incentives to promote SME linkages and skills in Malaysia, Singapore and Thailand

Tax and other incentives to foster linkages with SMEs and their skills have proven effective in various countries around the world (Perera, 2012; UNCTAD, 2011; Christiansen and Thomsen, 2005). Malaysia, for instance, offers various incentives to encourage linkages between foreign investors and local SMEs. Under the Industrial Linkage Programme, investors can claim tax deductions for costs involved in providing support to local suppliers, including training, product development and testing, and factory auditing to ensure local supplier quality. A Global Supplier Programme offers financial and organisational support to MNEs, if specialists from their foreign affiliates are seconded to local firms (for up to two years) for the purposes of local upgrading.

Singapore's Local Industry Upgrading Programme had a similar design. The programme has now been replaced by the Pioneer Certificate Incentive and Development and Expansion Incentive. It encourages foreign MNEs to set up local upstream and downstream activities that are more typically conducted at companies' headquarters. The incentive provided is a corporate tax exemption or a reduced concessionary tax rate on eligible income. Companies that apply for this incentive must commit to upgrading their employment and business investments. The programme intends to foster technology transfers and the scale-up of the local economy. Similarly, Thailand moved from a system of location-based incentives (economic zones) to an activity- and merit-based one. These new incentives also include the promotion of SME linkages and skills.

These targeted tax incentive programmes reduce the perceived risk for foreign investors when engaging in capacity building of local suppliers. Studies have shown that these programmes have been effective in establishing linkages and boosting productivity in the SME sector in Malaysia and Singapore (UNCTAD, 2011). The programmes in Malaysia have influenced Intel in its decision to develop local SMEs as suppliers. Intel is reported to have developed a model for supporting supplier development and upgrading: potential suppliers are selected based on the quality of their management; human resources; technical, materials and process capabilities; and cost competitiveness. They are then provided with training and opportunities to supply the affiliate and ultimately, the global Intel network. Intel estimates benefits amounting to USD 50 million per year from participating in these programmes (Christiansen and Thomsen, 2005).

Home country tax regulation and international agreements may limit effectiveness of host country incentives

Multinational enterprises that are taxed on a 'territorial' basis in their home country are able to retain the benefits of host country tax incentives. These MNEs pay taxes on foreign income only in host economies, even if tax rates at home are higher. Conversely, investors from countries applying a global tax regime may be subject to home country taxes on foreign income, rendering the benefits of host country tax incentives largely ineffective, since taxes not paid abroad would be paid at home instead once repatriated (IMF-OECD-UN-World Bank, 2015a).

Effective tax rates can thus vary significantly between domestic and foreign investors, if investors are taxed at home. Germany, for example, has no tax treaty with Cambodia and therefore dividend payments are subject to taxation in Germany. The effective tax rate for German investors in Cambodia is therefore almost 30%, while that of a domestic Cambodian investor is below 20% (Wiedemann and Finke, 2015). Tax incentives in Cambodia that essentially reduce the effective tax rate for domestic investors to around 12% will not be relevant for German investors (Figure 5.3). Effective tax rates for German outbound investors in Viet Nam, in contrast, are comparable with those of a domestic investor, owing to a tax treaty between the two countries that exempts dividend payments received by the parent company from taxation in Germany and from withholding taxes in Viet Nam.

Limited effectiveness of tax incentives may also be expected for American, Chinese and Indian investors; for example. Foreign income of those investors are not exempted from taxation at home, but instead taxes paid abroad can be credited against claims at home (Wiedemann and Finke, 2015; IMF-OECD-UN-World Bank, 2015a).[11]

Cost-based instruments like tax deductions and credits are preferable to profit-based tax holidays and reductions

ASEAN Member States make use of a range of different tax incentives, such as tax holidays, tax reductions, tax deductions/allowances and tax credits, as well as incentives exempting firms from import and export taxation (see section above). A distinct economic analysis would be required for each of these instruments to evaluate their effectiveness vis-à-vis defined development objectives. Some instruments may indeed contribute to investment attraction, but they are very costly in terms of forgone revenue that the government could use to advance other development objectives such as infrastructure and skills development. Growing anecdotal evidence and widely agreed conceptual considerations suggest that tax incentives that lower the cost of investment should be preferred over profit-based tax incentives (ASEAN, 2016; ESCAP, 2017; IISD, 2007 and 2014; IMF-OECD-UN-World Bank, 2015a; van Dender, 2017; World Bank, 2017).

Cost-based tax incentives, such as tax deductions and credits, lower the cost of a specific input or production factor. In the case of deductions, a firm can remove a certain share of the investment value from its taxable income. In the case of tax credits, the firm can directly subtract expenses or revenues for certain activities from the amount of payable taxes. The benefit for the firm is independent of the profit-level and depends only on the size of the investment that is undertaken. Cost-based tax incentives make investment projects more profitable at the margin and are thus expected to attract new investment that would not otherwise have been made. They are often related to performance-based incentives that target certain activities (e.g. SME linkages, skills development etc.). These instruments can therefore support specific policy objectives. The downside of cost-based tax incentives is that they require higher tax administration capacities, which are often lacking in developing countries (Table 5.2). Developing countries therefore make less use of these advanced instruments, compared to emerging and advanced countries (Andersen et al., 2017; James, 2014). In ASEAN, the more developed countries like Malaysia, Thailand and Singapore are using cost-based incentives more extensively than their less developed peers like Cambodia, Myanmar and Lao PDR, for example.

Profit-based tax incentives, by contrast, reduce the rate applied to profits/income already secured. Tax holidays and preferential CIT rates fall into this category. They lower the tax rate (or eliminate taxation altogether) for any amount of profit earned by a firm. These incentives heavily favour firms with high profits – those that need the least support from government (Table 5.2).

Table 5.2. Global lessons on the advantages and disadvantages of income tax incentives

Type of tax incentive	Advantages	Disadvantages
Income tax holidays	Relatively low cost of compliance Low administrative costs	Costly and inefficient overall Create tax planning opportunities Attract short-run projects Only targeted to new investment Revenue costs are not transparent
Income tax reduction	Relatively simple to administer Revenue costs are relatively lower	Represent a windfall to existing investment Invite profit shifting through transfer pricing, domestic and/or international Discriminate against other businesses
Income tax deduction and credits	Flexible mechanism to target tax relief Limited revenue loss	Distort investor choice towards short-lived assets Invite abuse through assets-churning Greater administrative burden
Accelerated depreciation	Flexible mechanism to target tax relief Limited revenue loss Does not discriminate against long-lived assets	Some administrative burden Advantageous only with loss carry-forward provisions

Source: Adapted from OECD (2014a). See comparable table in ESCAP (2017) and World Bank (2017).

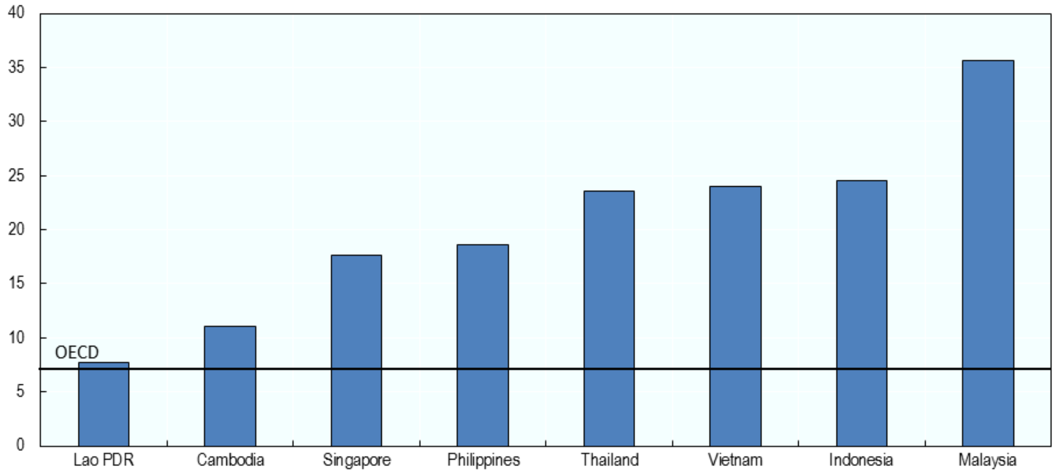
Investments benefiting most from profit-based incentives are likely to be undertaken even without incentives. Profit-based incentives are therefore likely to be redundant. Tax holidays tend to favour mobile activities rather than long-term investment. This introduces a bias towards short-term projects with low upfront investment costs and those least likely to generate spill-over effects on the wider economy. The risk of tax evasion through profit shifting is high for profit-based incentives, as firms can artificially allocate profits within the firm to plants or subsidiaries that benefit from these incentives (UNCTAD, 2015). In Cambodia, for example, firms can legally deregister and change names, allowing them to continue benefiting from tax exemptions as a 'new' company (OECD, 2018 forthcoming).

Tax incentives can involve significant fiscal losses

Corporate income tax revenues are an important and growing source of income for ASEAN governments. In Lao PDR and Cambodia, CIT revenue still accounts for a rather small share of total government revenues (8% and 11%, respectively), while the share is higher in Indonesia, Thailand, Viet Nam (around 25%) and Malaysia (35%) (Figure 5.6). All AMS for which data are available have higher contributions of corporate taxes to total government revenues, compared to average OECD countries (7%). This revenue has become comparatively more important with reductions of import duties over time, along with still very low revenues from personal income taxation in ASEAN. It is important to ensure that tax incentives and CIT policy in general are not contributing to a disproportionate or unplanned strain on these important fiscal resources.

Figure 5.6. Corporate income taxes are an important source of public revenue in ASEAN

Share of corporate income tax of total government revenue (in %)



Note: Data for Brunei Darussalam and Myanmar are not available for this analysis.
Source: Based on IMF (2017a), World Revenue Longitudinal Dataset (WoRLD), http://data.imf.org/revenues

Tax incentives can impose significant fiscal costs on countries using them. Tax holidays and preferential tax rates are often granted to firms that may have invested even without those incentives. And the non-collection of taxes from these firms means that governments have fewer resources to pursue important policy objectives such as infrastructure or skills development. Fiscal losses related to tax incentives may be particularly high in developing countries (Andersen et al., 2017; IMF-OECD-UN-World Bank, 2015a). In Cambodia, for example, the revenue loss corresponds to an estimated 6% of GDP (OECD, 2017a). In Viet Nam and the Philippines, tax incentives are associated with a revenue loss of around 1% of GDP (OECD, 2017b; Thomas, 2007).

A strong investment climate is important for location decisions of investors

Countries are most likely to benefit from tax incentives when combined with a strong investment climate, including good infrastructure, availability of skills, macroeconomic stability, market access and clear intellectual property rights (Andersen et al., 2017; Kinda, 2014; OECD, 2015; Thomsen, 2004). Incentives and the tax burden are just one of many factors considered by potential investors when weighing up investment decisions. Recent evidence from a series of investor motivation surveys shows that investment incentives and taxes are not among the top factors influencing firms' decision to invest (Kusek and Silva, 2017; James, 2014). The domestic market, political stability and security, as well as a skilled workforce are more often mentioned as key drivers for investment. Surveys in Thailand and Viet Nam found that more than 80% of the investors would have invested even without incentives (James, 2014). Moreover, evidence shows that a stable, predictable and efficient tax administration may be more important than low tax rates and incentives (IMF-OECD-UN-World Bank, 2015a).

Incentives may nevertheless play an important role in the later stage of negotiations between investors and governments of shortlisted investment locations (Freund and Moran, 2017). Incentives may not by themselves place countries on the shortlist, but they might make a difference for investors' final location decision, particularly if firms can choose among countries with otherwise similar investment conditions (see Box 5.4 for Viet Nam's experience in using tailored tax incentives to attract investments from Samsung).

Box 5.4. Role of tax incentives to attract Samsung investment in Viet Nam

Viet Nam has managed to attract a number of global lead firms and their strategic first-tier suppliers in the electronics sector. Foreign-invested firms are responsible for around 95% of electronics exports in Viet Nam, with Samsung alone exporting more than USD 50 million each year. It assembles approximately 200 million units of mobile phones per year in Viet Nam, corresponding to 50% of the total global supply of Samsung mobile phones. It first invested in Viet Nam in 2007 with a small project of USD 650 million in Hanoi and has now invested USD 17 billion and employs 120 000-150 000 workers. Samsung's direct and indirect suppliers operating in Viet Nam are responsible for another 250 000 jobs. Most of these suppliers are also global, foreign-owned firms. Among a total of approximately 200 Samsung suppliers in Viet Nam, 25-30 domestic firms are first-tier suppliers to Samsung.

Investments by Samsung have helped lead to the emergence and development of the electronics sector. Interviews with government and non-government stakeholders reveal a number of key determinants for Samsung's strategic location decision in Viet Nam. Firstly, Viet Nam stands out as a favourable investment location due to good connectivity infrastructure and ease of doing business in dedicated industrial hubs. Factories in Hanoi, for example, are located very close to the airport and thus daily shipments are possible. Secondly, it stands out with a growing and productive labour force ready to work for competitive wages. Thirdly, attractive complementary incentives such as good accommodation facilities and schools for workers and their families have been developed. Fourthly, and importantly, an attractive and tailored tax incentive package was mentioned by government officials as the critical factor for Samsung's decision to locate in Viet Nam and to expand rapidly. While pure tax holidays are included, tax credits and deductions for the support and promotion of specific activities (e.g. skills development, trade and infrastructure development) have made this package highly effective, both for Samsung and other stakeholders. The promotion of local sourcing and SME development through tax incentives has not been part of the Samsung tax incentives package, owing to a still weak local supplier base in electronics. Recent government efforts prioritise linkages, but poor coordination among government agencies makes implementation of these schemes difficult.

Source: Based on qualitative fact-finding and desk research in the context of an ongoing OECD-UNIDO project on MNE-SME linkages in ASEAN (OECD-UNIDO, 2017).

Policy considerations for a smarter use of tax incentives in ASEAN

International organisations and other entities have often advised countries to remove tax incentives or to improve their design, transparency and administration. Unilaterally removing tax incentives may be politically difficult due to vested interests of existing beneficiaries and significant tax competition among AMS. A smart use of incentives aligned with regional and national objectives is therefore increasingly recommended and could have a positive impact on social and economic development (ESCAP, 2017; OECD, 2015; IMF-OECD-UN-World Bank, 2015a; World Bank, 2017; van Dender, 2017). Based on the analysis in this chapter and international good practice, a set of policy considerations are derived.

Tax incentives should be better coordinated within and across ASEAN countries

From the perspective of investment promotion authorities (IPAs), a generous tax incentive policy is usually the preferred approach, as tax incentives lower the fiscal burden for firms and are thus expected to help increase investment. As illustrated above, taxation does affect location choices of investors – among many other factors such as market access – but it is uncertain to what extent incentives themselves have a distinct effect.

IPAs in ASEAN enjoy wide discretion over incentive policy to lower the tax burden for investors (e.g. OECD, 2018a, 2018b, 2017, 2016a, 2016b). They all extensively rely on tax incentives, resulting in heavy tax competition in ASEAN (see Figure 2.3). Significant incentive competition within ASEAN may result in limited effectiveness of tax incentives on investment however, particularly if AMS compete to a great extent for investment predestined for the ASEAN region (Box 5.2). If all AMS engage in incentive competition, the net effect on relative investment entry for each country (and the region as a whole) may be insignificant.

Generous incentives may not be optimal from the perspective of tax authorities, as they can involve significant revenue forgone and thus significantly limit government resources to pursue important development objectives (as shown above). Tax competition in ASEAN may not be associated with more investment for each country, but rather with a loss of non-collected government revenues.

Policy considerations:

- Tax incentive policy could be better coordinated across government ministries within AMS, fully aligned with national development objectives. An overarching institution could be appointed and would be responsible to guarantee that tax incentives fulfil sometimes distinct objectives of various government authorities. This body could be either at the presidential level, the Ministry of Economy or the Ministry of Finance. The Ministry of Finance as the tax authority is best placed to weigh different priorities while also keeping costs of incentives manageable (OECD, 2015a). In case IPAs are implementing tax incentives, these policies should be closely coordinated with and approved by tax authorities.
- Tax incentives including eligibility requirements may be prescribed in the law, preferably the tax law. AMS often have several laws prescribing tax incentives, including among others the law on investment (see Annex tables). Consolidating incentives in the tax law instead would reduce the likelihood of conflicting or overlapping provisions and reduce uncertainty and distortions, as well as unintended revenue losses. Moreover, regulating incentives under the tax law provides more flexibility for policymakers to revise incentives, as the tax law is regularly updated while the investment and other laws are not.
- Eligibility criteria of tax incentives should be clearly defined and readily verifiable to avoid discretionary and distortive decisions on incentives. Tax incentive regimes in most ASEAN countries allow significant discretion (see Box 5.1 for an example; and OECD, 2018a, 2018b, 2017, 2016a, 2016b). This creates unnecessary uncertainty for investors.
- The ASEAN Secretariat and its Member States could develop a regional policy forum to address potentially harmful tax competition. This forum could be informed by good practice examples from other regions, monitoring and analysis (Box 5.5). 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 (van Dender, 2017). This would help increase transparency and cost-awareness over tax policy and incentives. Policy considerations listed in this section may be a first input into these discussions.

Box 5.5. Managing incentive competition in a regional setting

Regional tax and incentive competition may reduce fiscal resources for all countries involved. The most comprehensive approach to address the issue is embodied in the EU regional aid policy, setting a maximum level of subsidy (including tax incentives) for every sub-national region in the European Union. Subsidies are allowed in the European Union's poorest regions, while many richer areas are banned from providing regional aid to any company. These maximum amounts are progressively reduced for investments over EUR 50 million. EU Member States have given much smaller subsidies on average than US state governments, where such rules do not exist.

Transparency on incentives offered is a prerequisite for regional coordination and reform. EU state aid rules require subsidies (tax incentives) to be notified in advance to the European Commission and provide the Commission wide discretion to approve, prohibit or modify a proposed subsidy. Outside the EU, several US states also make information on incentives publically available. Australia and Canada collect reports on incentives from their states and provinces but do not make this information public.

Source: IMF-OECD-UN-World Bank (2015a); Thomas (2014), and OECD (2014b).

Monitoring and re-evaluation of tax incentives is essential

Any tax or other incentive programme requires regular monitoring and assessment (ESCAP, 2017; OECD, 2015a).[12] Despite evidence on the benefits and costs of incentives in general and in ASEAN in particular, the net benefit of incentive programmes is context-specific and may change over time. Monitoring and re-evaluation of incentives is neglected in many countries (IMF-OECD-UN-World Bank, 2015a), or monitoring of eligibility requirements is relaxed over time as found in the case of Malaysia, for example (Christiansen and Thomsen, 2005). ASEAN countries often recognise the need for improved monitoring and evaluation mechanisms (see e.g. in Cambodia; Royal Government of Cambodia, 2015; OECD, 2018a, forthcoming). The OECD *Policy Framework for Investment* includes a number of international good practices regarding tax incentive monitoring summarised below (OECD, 2015).

Policy considerations:

- The tax authority should regularly prepare tax expenditure statements to measure and monitor the costs of tax incentives. These tax expenditure statements should be made public. It 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. Proposed conditions attached to incentives such as those that target a specific investor activity (e.g. SME linkages) require ongoing monitoring. Special tax returns for firms benefiting from incentives could be introduced.
- Incentive policies should be reviewed periodically to assess their effectiveness in helping meet desired goals. A natural way to introduce period assessments of incentive schemes is to make incentive policies temporary rather than permanent. Temporary schemes require reconsidering whether the incentive should be continued, reformed or repealed regularly. Additionally, it has been shown that temporary tax incentives can be used as a counter-cyclical policy: when foreseen to be phased out in the near future, the investment effects of an incentive tend to

be bigger than with permanent incentives (US Department of Treasury, 2010). Within ASEAN, Malaysia and Singapore have sunset clauses for some incentives.

Profit-based tax incentives should be phased out and cost-based schemes strengthened

ASEAN Member States make use of a variety of tax incentive instruments. All countries provide profit-based tax incentives, including tax holidays and preferential tax rates. Cost-based incentives – such as tax deductions, tax credits, accelerated depreciation and trade tax exemptions – are also used extensively. International organisations and other experts conceptually agree that tax incentives that lower the cost of investment should be preferred over profit-based tax incentives (ESCAP, 2017; IMF-OECD-UN-World Bank, 2015a; World Bank, 2017; van Dender, 2017). Anecdotal evidence, including from ASEAN countries, suggests that profit-based incentives may be redundant, while cost-based incentives support progress towards a specific development objective (see section above).[13]

Policy considerations:

- AMS could consider replacing their tax holiday schemes with cost-based tax deduction or credit schemes. Investors can deduct expenses on specific activities from their taxable income or directly from their taxes due. These schemes often relate to incentive targeting (see below). Other cost-based tax incentives may also be considered, such as accelerated depreciation of assets and loss-carried-forward schemes.
- Import duty exemptions on capital equipment and construction materials, as well as export tax exemptions may be retained if compatible with WTO, ASEAN and other commitments. An alternative would be to lower import and export duties across-the-board to encourage enhanced participation in GVCs.
- VAT exemptions provided in some ASEAN countries may be entirely redundant, since full operation of the tax means that VAT charged on inputs does not remain with the purchaser and can be fully recovered as a credit against VAT charged on sales. Exemptions should thus not have an effect on investment, if VAT refund procedures are effective.

Tax incentives may increasingly be targeted towards specific sectors and activities in line with broader development objectives

The incentive regimes of many AMS often lack specificity. Firms in almost any sector can typically benefit from tax incentives (see Annex). All countries have tax incentive policies to encourage certain activities such as exporting or investment in certain sub-national regions. More advanced countries within ASEAN use tax incentives to target specific activities more extensively, compared to less developed AMS.

The chapter illustrated that targeting of tax incentives and clearly defining eligibility criteria is important for an effective incentive regime. On the one hand, targeting will help avoid that tax incentives benefit projects that would take place even without incentives (e.g. natural resource extraction) and, on the other hand, it will enable the government to identify and attract those investment projects that are most likely to create social and economic spill-overs (e.g. skills and SME development, and GVC integration).

Policy considerations:

- AMS could consider enhancing sectoral targeting of tax incentives based on their respective objectives in development plans and strategies. Some countries aim to diversify their economy towards manufacturing and, within manufacturing, away from over-reliance on certain low value added and labour intensive sectors (e.g. garment production). Governments also aim to integrate their local firms in GVCs. AMS might consider removing incentives for sectors that are not a priority for diversification and local linkages as well as for sectors that are known to be location-specific and therefore less sensitive to tax incentives (e.g. mining).
- Providing targeted incentives for specific activities aligned with development objectives is useful. They are often provided via cost-based tax deductions or credits, making investment projects more profitable at the margin which is therefore likely to increase investment in such activities.
- Promoting specific sectors and activities through tax incentives can also have downsides. Sectoral targeting might put investments in other economic sectors at a competitive disadvantage and hence less likely to develop despite being more productive. Firm activities may be supported even if investors are likely to engage in them without incentives. The effectiveness of incentives should therefore be assessed regularly as argued in the section above.
- A simple and unspecific policy approach – less incentive targeting – might be better if institutional capacities and capabilities in a country are lagging and thus simplicity could create certainty for potential investors. Less developed ASEAN countries could therefore only sequentially engage in incentive targeting.

Notes

1. While incentives directed specifically at foreign investors are relatively rare, in practice, foreign firms are best-placed to take advantage of them as incentives are often found in strategic sectors like high-tech where local firms are often not competing; or they involve performance requirements for investors -- such as engage in exporting activities or R&D – with which local firms often do not comply. See Annex for country summaries with more granular information on possible nuances in the respective regimes.

2. In the analysis, each tax deduction scheme (e.g. a reduction of export revenues or R&D expenses from taxable income) is counted once. Tax credits, loss carried forward and accelerated depreciation more strongly/directly lower the tax burden for firms and are therefore counted twice.

3. VAT exemptions provided in some ASEAN countries may be entirely redundant, since full operation of the tax means that VAT charged on inputs does not stick with the purchaser and can be fully recovered as a credit against VAT charged on sales. Exemptions may thus not be viewed as an incentive or subsidy.

4. Targeted incentive provisions involve significant qualitative differences across countries: In some cases, targeted activities are actually promoted through a specific incentive instruments (e.g. tax deduction for R&D expenses). In other cases, targeted activities are only mentioned to be part of the incentive policy, but no specific incentive instrument is actually used to promote the activity. The analysis lists only activities that are actually targeted with an incentive instrument.

5. Similarly, marginal effective tax rates (METRs) summarise the effect of the legislative tax parameters on an incremental business activity and show how much to invest at the margin given a diminishing expected return on investment due to taxation. They are used to assess how taxes distort the level of investment (scale decisions).

6. Economic factors such as inflation and real economic depreciations are held constant, as the focus is to understand tax effects. The real rate of return on investment is estimated at 20%. The methodology applied is based on and further described in Devereux and Griffith (2003).

7. See ESCAP (2017) and World Bank (2017) for detailed overviews on the costs and benefits of tax incentives.

8. In this comparison, it is assumed that relative AETR differences across ASEAN countries remained constant over the past years when FDI stocks (as % of GDP) accumulated. FDI flows are not used in this comparison as FDI flows vary significantly year-on-year and therefore an association with tax rates may be less clear.

9. An equivalent negative relationship is observed when comparing FDI restrictions and FDI stocks (relative to the economic size) (see Chapter 2). It thus appears that moderate corporate tax rates within ASEAN and possibly elsewhere are observed in countries that have considerably liberalised FDI. This finding underlines empirical studies that no single factor determines investment entry, but both market access and taxation are among important determinants (Andersen et al., 2017; van Dender, 2017; also see next sub-section)

10. The 2017 Global Investment Competitiveness Survey finds that investors rely more heavily on incentives if they are exporting as compared to non-exporting investors. (Kusek and Silva, 2017). The survey is based on interviews with more than 750 executives of multinational enterprises with operations in developing and emerging countries. A recent study further shows that exporters in manufacturing are more likely to consider taxes as a business constraint, compared to non-exporters (Andersen et al., 2017). Tax incentives could therefore be a useful tool to reduce the burden of taxation for exporters.

11. The direction of current US tax reforms points towards 'territorial' taxation in the future. Tax incentives in host economies of American investors could thereby become more effective (Wolf, 2017)

12. Also see https://www.smartincentives.org/blogs/blog/144025031-how-to-collect-data-to-determine-if-incentives-are-working

13. Little evidence exists on the effects of different tax incentive instruments. Future research may focus on differential effects of incentive types.

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Annex 5.A. Detailed overview of investment incentives in ASEAN

Annex Table 5.A.1. Overview of tax incentives in Brunei Darussalam

Instrument	Description
Standard corporate income tax (CIT) rate	20% (2013)
Main government agencies involved in offering incentives	Ministry of Foreign Affairs and Trade
Major incentive laws	Investment Incentives Order 2001
Qualifying firms for incentives	Any (domestic or foreign) company which has been granted a pioneer certificate will be given the pioneer incentives. Exporters (under certain conditions) are also granted tax exemptions (similar to those outlined below), even if they do not have the pioneer status.
Activities/sectors qualifying for incentives (not exhaustive)	Conditions for a firm to receive the pioneer certificate include that the project is in the public interest, the industry is not yet adequately developed, the project may involve the development of a new pioneer industry. To date, pioneer status has been provided to firms in various low values added as well as high tech sectors (see link to MOFAT below). // Service providers may receive pioneer service certificates if the service is in the public interest and engages in engineering, financial, cultural, management, and other high-end business services.
Regional incentives (including SEZs)	NA
Income tax holiday	Tax holidays are provides for 5-8 years with the possibility of extension for another 11 years (3 years at once). In high tech parks, tax holidays are provided for 11 years with the possibility of extension for another 20 years (5 years at once). A company intending to incur new capital expenditure for the purpose of the manufacture or increased manufacture of an approved product may be provided for 3-5 years of tax relief on the expansion project with the possibility of extension for another 15 years (3 years at once).
Income tax reduction	NA
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Carry forward losses and allowances. // A 100% investment allowance (for up to 5 years) may also be applied in respect of the fixed capital expenditure of any of the following: for the manufacture or increased manufacture of any product; for the provision of specialised engineering or technical services; for research and development; for construction operation; for recycling of domestic industrial waste; in relation to any qualifying activity under pioneer services company; for promotion of the tourist industry (other than a hotel) in Brunei Darussalam. // A 100% allowance on the introduction of a new technology related to a product, process or services may be provided under certain conditions.
Accelerated depreciation	Accelerated depreciation allowance is provided.
Trade tax and VAT exemptions/deductions	Exemption from taxes on imported duties on machinery, equipment, component parts, accessories or building structures. // Exemption from taxes on imported raw materials. // A pioneer company is exempted from paying import duties on raw materials not available or produced in Brunei Darussalam intended for the production of the pioneer product.
Other incentives	Possibility for exemption of interest paid to non-resident lenders. // Basic right and guarantees to investors Repatriation of capital is not restricted. No restrictions are imposed on remittance of earning profits and dividends on investment.
Sources	MOFAT (2017)

Annex Table 5.A.2. Overview of tax incentives in Cambodia

Instrument	Description
Standard corporate income tax (CIT) rate	20% (2017); constant at least since 2010
Main government agencies involved in offering incentives	Council for the Development of Cambodia (CDC), being the highest decision-making body in defining the framework for investment strategies and accepting or rejecting investment proposals.
Major incentive laws	Amended Law on Investment (2003), law is currently under revision; Financial Management Law defines the specificities (sector, years) for the priority period; Law on Taxation, defines the CIT
Qualifying firms for incentives	The Qualified Investment Project (QIP) status can be granted to foreign and domestic firms. Firms with QIP status can benefit from investment incentives.
Activities/sectors qualifying for incentives (not exhaustive)	QIP status can be granted to most manufacturing projects and some high-value or large-scale service projects.
Regional incentives (including Special Economic Zones)	Cambodia offers almost equivalent treatment to companies inside and outside SEZs. A QIP located in a SEZ is entitled to the same incentives and privileges as other QIPs. However, firms in SEZs are eligible for additional incentives (such as further VAT exemptions and special customs procedures). Similarly, QIPs in the agricultural, agro-processing as well as garment and textiles sectors are entitled additional incentives similar to those in SEZs.
Income tax holiday	Up to 6 years: scheme composed of a trigger period, 3 years of tax holiday, and an additional priority period (up to 3 years). Length of the priority period depends on the type of project and the amount of invested capital.
Income tax reduction	NA
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	NA
Accelerated depreciation	As an alternative to the tax holiday, QIPs may opt for a 40% special depreciation allowance on the value of the new or used tangible properties employed in production or processing.
Trade tax and VAT exemptions/deductions	Duty-free import of production equipment and construction materials. Commodities to be imported free of duty vary according to the nature of the QIP: a distinction is made between domestically-oriented and export-oriented QIPs and those in supporting industries. // Agricultural materials used as inputs in export industries may be exempt from VAT. // QIPs are fully exempted from export taxes.
Other incentives	QIPs are not subject to any restriction on profit repatriation and reinvestment of earnings.
Sources	Council for the Development of Cambodia (2017); OECD (2017a, forthcoming)

Annex Table 5.A.3. Overview of tax incentives in Indonesia

Instrument	Description
Standard corporate income tax (CIT) rate	25% (2017), down from 30% in 2006
Main government agencies involved in offering incentives	Investment Coordinating Board; Director General of Taxation; Ministry of Finance
Major incentive laws	Investment Law; Law on Special Economic Zones; Income Tax Law
Qualifying firms for incentives	Domestic and foreign firms in so-called pioneer industries that have a wide range of connections, provide additional value and high externalities, introduce new technologies, and have strategic value for the national economy may benefit from tax incentives in Indonesia.
Activities/sectors qualifying for incentives (not exhaustive)	Firms operating in the following sector may qualify for tax incentives: Upstream metal; oil refinery industry and/or infrastructure, including those under the Public Private Partnership (PPP) scheme; base organic chemicals sourced from oil and gas; machinery; telecommunication and information; sea transportation; processing industry on agriculture, forestry, and fishery products; economic infrastructure other than those under the PPP scheme.
Regional incentives (including SEZ)	Tax incentives (in addition to those outlined below) may be granted in SEZs (e.g. additional CIT deductions, VAT exemptions, duty free importation)
Income tax holiday	CIT reduction of 10% to 100% of the CIT due for 5 to 15 years from the start of commercial production; with the possibility of extension to 20 years if of national interest. Income earned by venture capital companies in the form of profit sharing from their investments in Indonesia is permanently exempt from tax, provided that the following conditions are met
Income tax reduction	See income tax holiday
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Tax paid or payable in foreign countries upon income from abroad received or obtained by a resident taxpayer may be credited against tax payable in Indonesia in the same fiscal year. The amount of tax credit is the same amount as income tax paid or payable abroad, but shall not exceed tax payable calculated according to the Indonesian tax law. // A reduction of taxable income to 30% of profits and the option to carry forward losses for a maximum of 10 years may be granted under certain conditions (e.g. high investment value or export; high absorption of manpower; high local content). // Firms that reinvest their after-tax profits in Indonesia within the same year or no later than the following year are exempt from income taxes on these profits.
Accelerated depreciation	Accelerated depreciation and/or amortisation deductions may be provided under certain conditions (see income tax deductions and credits)
Trade tax and VAT exemptions/deductions	Applies only to firms in SEZs (see above)
Other incentives	Accelerated depreciation and/or amortisation deductions. // A reduction of the withholding rate on dividends paid to non-residents to 10%
Sources	EY (2014); OECD (2010); PWC (2017)

Annex Table 5.A.4. Overview of tax incentives in Lao PDR

Instrument	Description
Standard corporate income tax (CIT) rate	24% (2017), with the exception of companies listed on the stock market (19%) and those engaged in the manufacturing, import and sale of tobacco products (26%)
Main government agencies involved in offering incentives	The agency implementing investment incentives is the Investment Promotion Department (IPD) under the Ministry of Planning and Investment.
Major incentive laws	2009 Law on Investment Promotion and Decree on the Implementation of the Law on Investment Promotion
Qualifying firms for incentives	Tax incentives may be provides to domestic and foreign firms in specific sectors and geographic locations as outlined below. Investment projects in concessions receive additional discretionary treatment.
Activities/sectors qualifying for incentives (not exhaustive)	Firms operating in agriculture, industry, handicraft and services sectors may benefit from incentives. · Economic activities are categorised into three levels: activities under Level 1 are highly promoted; activities under Level 2 are moderately promoted; and activities under Level 3 are less promoted.
Regional incentives (including Special Economic Zones)	Firms operating in specific geographic locations may be granted incentives. Geographic locations are divided into zones, which are determined by geographic conditions and the availability of infrastructure: Zone 1 areas have very few or no infrastructure to support investment (mostly mountainous and remote areas) and is given a high investment promotion priority; Zone 2 has a moderate level of infrastructure to support investment and is given a moderate priority; and Zone 3 has good infrastructure to support investment and is given a low investment promotion priority. // In addition of a general allocation of incentives by geography, specially assigned SEZs may provide additional incentives.
Income tax holiday	Up to 10 years, depending on the economic activity and geographic location of the investment project.
Income tax reduction	Investments in concessions are subject to specific profit tax rates and incentives packages negotiated on a case-by-case basis between the government and the investor. They include mining, hydropower, telecommunications, transport, agriculture, forestry and certain tourism-related projects. Income taxes in a specific Zone (Zone 1-3) are lower than the statutory rate, between 7.5% and 20%.
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Tax credit on reinvested profits. // Losses may be carried forward fully and consecutively for a maximum of three years.
Accelerated depreciation	
Trade tax and VAT exemptions/deductions	Exemption from duties for the importation of raw material, equipment, spare parts and vehicles which are directly used for production. // Exemption from export duties for exportation of general goods and products.
Other incentives	Exemptions from land lease or concession fees for 3-15 years in special sectors, particularly education and healthcare.
Sources	Investment Promotion Department (2017); OECD (2017c, forthcoming)

Annex Table 5.A.5. Overview of tax incentives in Malaysia

Instrument	Description
Standard CIT rate	25% (2017), down from 28% (2006)
Main government agencies offering incentives	Malaysian Investment Development Authority; Ministry of International Trade & Industry; Ministry of Finance
Major incentive laws	Investment Incentives Act of 1968; Promotion of Investments Act 1986; Companies Act, 1965
Qualifying firms for incentives	Domestic and foreign-owned companies participating in a promoted activity or producing a promoted product may be eligible for either Priority Status (PS) or an Investment Tax Allowance (ITA) as well as other incentives (depending on the sector and region).
Activities/sectors qualifying for incentives (not exhaustive)	Firms operating in the manufacturing, agricultural, hotel, and tourism sectors, or any other industrial or commercial sector can get PS and ITA. Promoted activities include in particular: strategic projects, automation of production, high-technology industries, machinery, provision of technical and vocational training, strengthening industrial linkages, value creation from oil palm biomass, SMEs, hotel operators as well as outsourced and in-house R&D, and green technology, green services and green technology asset projects. // Firms in the transportation, communications, utilities sectors as well as in the petroleum sector can benefit from similar incentives.
Regional incentives (including Special Economic Zones)	Additional special incentives given by the Malaysian government are being customised for each economic region. To date, special legislation has been enacted only in respect of Iskandar Malaysia and East Coast Economic Region. Additional incentives include, for example, reduced personal income taxes for qualified knowledge workers working in Zones. Additional fiscal incentives are given to companies expanding to or establishing in less-developed areas. MSC Malaysia is Malaysia's initiative for the global information technology (IT) industry and is designed to be the R&D centre for industries based on IT. It is an ICT hub equipped with high-capacity global telecommunications and logistics networks, where registered companies benefit from extended fiscal and non-fiscal incentives (e.g. secure cyber and IPP laws, no internet censorship)
Income tax holiday	In general, pioneer status firms enjoy partial exemption (70%) from the payment of income tax for 5 years. In order to promote certain investment/activities (e.g. strategic projects, high-tech industries, R&D activities, strengthening industrial linkages, and hotel operators in the states of Sabah and Sarawak in East Malaysia), full income tax exemption for 10 years (instead of 5 years) can be considered. Newly established or existing companies undertaking specified management, upgrading and maintenance activities that comprise at least 70% of the annual income may benefit from 100% income tax exemption for 5 years.
Income tax reduction	A principal hub is a locally incorporated company that uses Malaysia as a base for conducting its regional and global businesses and operations through management, control, and support of key functions, such as management of risk, strategic decisions, finance, and human resources. CIT at tiered rates (0%, 5%, or 10%) is given for a period of up to 10 years along with other non-fiscal incentives (e.g. no equity restrictions, no expatriate conditions, import duty exemptions brought into free zones).
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	As an alternative to Pioneer Status, a company may apply for Investment Tax Allowance (60% in respect of qualifying capital expenditure incurred within five years, against 70% of the statutory income in the year of assessment. Unutilised allowance can be carried forward to subsequent years until the whole amount has been used up. To promote certain investment/activities (see above), a company may be given an allowance of 100% of capital expenditure against 100% of the statutory income and the period of tax relief may be extended from 5 to 10 years. // Under the Industrial Linkage Programme, MNEs can deduct from their income tax expenses incurred in developing SMEs through activities like training, product testing and development, auditing and other forms of technical assistance. // A resident company engaged in manufacturing or agriculture that exports manufactured products, agricultural produce, or services is entitled to allowances between 10% and 100% of increased exports (subject to satisfying prescribed conditions), which is deductible at up to 70% of statutory income. // Under certain conditions (e.g. 60% Malaysian ownership, use of local financial services and infrastructure), so-called international trading companies can be exempt

Instrument	Description
	for five years on income equivalent to 20% of increased export value, up to a maximum of 70% of statutory income.
Accelerated depreciation	Accelerated depreciation allowance is provided in certain sectors (e.g. petroleum, biotechnology industry) and for capital expenditure in automation equipment.
Trade tax and VAT exemptions/deductions	For goods to be exported, full exemption is normally granted on components/raw materials, provided local inputs are not available or of sufficient quality. // For goods for the local market, full exemption is possible if the component is not produced locally or if there is already no duty on imports of the final product. // Services sectors such as tourism are also granted duty exemption under certain conditions.
Other incentives	Malaysia provides additional tax incentives for Islamic financial services activities and a wide range of non-tax incentives to promote industrial linkages, SMEs, R&D among others.
Sources	EY (2014); MIDA (2017); OECD (2013); OECD (2016b); PWC (2017)

Annex Table 5.A.6. Overview of tax incentives in Myanmar

Instrument	Description
Standard CIT rate	25% (2017)
Main government agencies involved in offering incentives	Directorate of Investment and Company Administration (DICA); Myanmar Investment Commission (MIC); Central Body for the Myanmar Special Economic Zone; SEZ Management Committee
Major incentive laws	Myanmar Investment Law (MIL) 2016, a consolidation of the Myanmar Citizen Investment Law (2013) and the MFIL (2012); Myanmar Special Economic Zone Law of 2014 (Myanmar SEZ Law)
Qualifying firms for incentives	The MIC publishes a notification listing the sectors in which foreign or domestic firms may benefit from tax and other incentives. MIC may allow more favourable exemptions and reliefs for locations where Myanmar citizen-owned businesses are operated. The government may also provide subsidies, funding, capacity building, and training to Myanmar citizen investors and citizen-owned small and medium sized enterprises.
Activities/sectors qualifying for incentives (not exhaustive)	Based on information from the DICA website, current priority sectors include labour-intensive industries, agricultural-based industries, and infrastructure projects.
Regional incentives (including Special Economic Zones)	The MIC provides more generous tax incentives to underdeveloped and moderately developed regions/states. The designation of these zones is subject to change from time to time depending on the development in the respective regions. // The Myanmar SEZ Law 2014 provides similar incentives to investors and zone developers as the MIL 2016, with some additional and prolonged provisions (such as longer profits tax exemptions and possibility to carry forward loss as well as free land use for a defined period).
Income tax holiday	Exemption from corporate tax for 7, 5 or 3 years depending on whether the investment takes place in an under-, moderately or adequately developed region or state.
Income tax reduction	In SEZs, 50% income tax relief for the businesses operated in an exempted zone and a business promoted zone for the second five-year period. For the third five-year period, 50% income tax relief on the profits of the business if they are maintained for re-investment in a reserve fund and re-invested therein within one year after the reserve is made.
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Exemption or relief from income tax if the profits obtained from the investment business are reinvested in the same or similar type of business within one year. // Right to deduct expenses from assessable income incurred for R&D related to the investment activities/business required for the development of the country and carried out in the country. // In SEZs, carry forward of loss for five years from the year the loss is sustained.
Accelerated depreciation	Right to deduct depreciation for the purpose of income tax assessment, after computing such depreciation from the year of commencement of commercial operation based on an accelerated depreciation rate (which is less than the stipulated lifetime of the asset).
Trade tax and VAT exemptions/deductions	Exemption from customs duties or other internal taxes or both on machinery, equipment, machinery components, spare parts, construction materials not available locally, and materials used in the business that are imported as they are actually required, during the construction period, or during the preparatory period of the business. // Exemption or relief from customs duties or other domestic taxes on raw materials and semi-finished goods that are imported for producing export goods by wholly export investment businesses. // Right to obtain a refund (ex post tax credit), based on the amount of exported goods, of customs duties or other domestic taxes paid at the time of importation of raw materials and semi-finished goods that are used to manufacture the products in the country and re-export them. // If the volume of investment is increased and the original business is expanded during the period of investment, exemption or relief from customs duties or other internal taxes or both on machinery, equipment, instruments, machinery components, spare parts, materials used in the business, and construction materials not available locally, which are imported as they are actually required for use in the business that is being expanded.
Other incentives	Foreign investors will pay income tax at the rates applicable to Myanmar citizens.
Sources	EY (2014); OECD (2014); PWC (2017)

Annex Table 5.A.7. Overview of tax incentives in the Philippines

Instrument	Description
Standard CIT rate	30% (2017); from 35% (2006)
Main government agencies offering incentives	Board of Investments (BOI); Philippine Economic Zone Authority (PEZA); a set of other agencies for specific Special Economic Zones exist.
Major incentive laws	Omnibus Investments Code of 1987 administered by the BOI, providing comprehensive set of incentives for local and foreign enterprises engaged in activities considered by the government as high priority for national development, as set forth in a tri-annual Investment Priorities Plan (IPP). // Special Economic Zone Act of 1995,administered by PEZA; other laws provide incentives in specific sectors, for regional headquarters and in specific SEZs.
Qualifying firms for incentives	In general, domestic and foreign investors qualify for incentives under any of the afore cited laws for as long as the project is registered with the specific government agency. Domestic private investors enjoy lower threshold in terms of export commitment as follows: at least 50% of production is for export (for enterprises with Filipino ownership exceeding 60%); or at least 70% of production is for export (for more than 40% foreign-owned enterprises)
Activities/sectors qualifying for incentives (not exhaustive)	The BOI's Investment Priorities Plan (IPP) provides a list of priority areas of investments, broadly applying to all incentive providing agencies. The newly adopted 2017 IPP includes manufacturing (including agri-processing), agriculture, fishery and forestry, strategic services, infrastructure and logistics (including local government unit and public-private partnership), and health care services (including drug rehabilitation) as priority sectors. Investment in mass housing, inclusive business models, environment and climate change mitigation, innovation drivers, energy and export businesses are also priority areas.
Regional incentives (including Special Economic Zones)	Incentives are provided mostly to firms in underdeveloped locations (pioneer projects). The Philippines provides additional incentives to firms in SEZs (as outlined below, while most incentives provided outside Zones are also provided inside SEZs. // Pioneer status can be granted to enterprises in less developed areas that are producing new products or using new methods, producing goods deemed highly essential to the country's agricultural self-sufficiency program, or goods utilizing non-conventional fuel sources.
Income tax holiday	Pioneer projects for 6 years and non-pioneer projects for 4 years, with possible extension under certain conditions. Expansion projects: 3 years (limited to incremental sales revenue/volume). New or expansion projects in less developed regions (except mining and related products): 6 years. Modernisation projects: 3 years. Exporters may receive a tax holiday for exports of new products or to new markets.
Income tax reduction	Firms registered in SEZs benefit from a 5% tax on gross income after tax holidays have lapsed, and in lieu of all other taxes. // Reduced tax rates are provided for regional HQ.
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Tax credit equivalent to national internal revenue taxes and duties paid on raw materials, supplies and semi-manufacture of export products. // Tax credit on the purchase of domestic breeding stocks and genetic materials. // Deduction of 50% of wages for first 5 years, 100% of necessary and major infrastructure works from taxable income, 100% of wages in underdeveloped areas, all subject to certain conditions
Accelerated depreciation	
Trade tax and VAT exemptions/deductions	Duty free imports of capital equipment, spare parts and accessories, subject to conditions. // Zero-rated VAT on purchase of raw materials, supplies and services used for production of export products. // Exemption from wharfage dues and export tax, duty, impost, and fees. // Tax and duty-free imports of breeding stocks and genetic materials
Other incentives	Importation of consigned equipment for a period of 10 years from the date of registration, subject to posting of a re-export bond. // Simplification of customs procedures for importing equipment, spare parts, raw materials, and supplies and exports of processed products. // The privilege to operate a bonded manufacturing/trading warehouse subject to Customs rules and regulations. // Employment of Foreign Nationals. // Multiple-entry visas for expatriates, including spouse and unmarried children below 21 years old. // Firms registered in SEZs enjoy additional incentives, including e.g. special immigration/visa processing for foreign investors and after tax profit remittance without prior BSP (central bank) approval.
Sources	BOI (2013); EY (2014); OECD (2016a); PWC (2015), US (2015);

Annex Table 5.A.8. Overview of tax incentives in Singapore

Instrument	Description
Standard CIT rate	17% (2017), down from 20% in 2006
Main government agencies involved in offering incentives	EDB, Ministry of Finance
Major incentive laws	Singapore Commercial Code
Qualifying firms for incentives	Domestic and foreign applicants are expected to carry out substantive, high value activities in Singapore, and will be required to commit to certain levels of local business spending and skilled employment. Some factors that will be considered include the use of Singapore as a base from which to implement regional growth strategies; introduction and anchoring of leading-edge skills, technology, and activities in Singapore; contributions to the growth of R&D and innovation capabilities; and potential spin-off to the rest of the economy.
Activities/sectors qualifying for incentives (not exhaustive)	High technology production or services supporting high technology sectors
Regional incentives (including Special Economic Zones)	Additional incentives are provided in SEZs, in particular import duty exemptions on certain imports
Income tax holiday	Under the Pioneer Tax Incentives, a tax holiday of 5-15 years may be granted for each qualifying project.
Income tax reduction	Under the Development and Expansion Incentive, corporations engaging in new projects, expanding or upgrading their operations, or undertaking incremental activities after the tax holiday period may apply for their profits to be taxed at a reduced rate of not less than 5% for an initial period of up to ten years. The total tax relief period for each qualifying project or activity is subject to a maximum of 40 years. A new international growth scheme provides for a 10% concessionary tax rate on incremental income from qualifying activities for up to five years. The incentive is intended for larger domestic companies that anchor key functions in Singapore as they venture overseas.?
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Under the investment allowance, a tax exemption is granted on an amount of profits based on a specified percentage (of up to 100%) of the capital expenditure incurred for qualifying projects or activities within a period of up to five years. A 100% allowance may be granted for capital expenditure in automation. // The double tax deduction scheme for internationalisation allows companies expanding overseas to claim a double deduction for eligible expenses for specified market expansion and investment development activities. // The Productivity and Innovation Credit (PIC) scheme provides for an enhanced 400% deduction for qualifying expenditure incurred in respect of six qualifying activities during the accounting periods that end between 2010 and 2017 (i.e. years of assessment 2011 to 2018). The qualifying activities are: acquisition or leasing of prescribed IT and automation equipment; staff training; acquisition of IP; registration of IP rights; R&D; design. // Where income is earned from treaty countries, double taxation is avoided by means of foreign tax credit granted under those treaties. For non-treaty countries, unilateral tax credit is given in respect of foreign tax on all foreign-sourced income. These foreign tax credits may be pooled, subject to certain conditions
Accelerated depreciation	Accelerated depreciation is provided for certain qualified projects. // The M&A allowance allows to write-off 25% of the value of the acquisition executed between 1 April 2015 and 31 March 2020 under certain conditions.
Trade tax and VAT exemptions/deductions	Exemption from goods and services tax on imports under certain conditions.
Other incentives	Specific tax incentives are provided to regional and international headquarter operations. // Foreign dividends, foreign branch profits, and foreign service fee income remitted to Singapore may be exempt from tax if they fulfil certain conditions. // Non-fiscal investment incentives include grants for the development of research capabilities, training and productivity enhancing activities.
Sources	EY (2014); PWC (2017); EDB Singapore (2017)

Annex Table 5.A.9. Overview of tax incentives in Thailand

Instrument	Description
Standard corporate income tax (CIT) rate	20% (2017), down from 30% in 2006
Main government agencies involved in offering incentives	Board of Investment
Major incentive laws	Investment Promotion Act; 2015 BOI promotion scheme; Revenue Code
Qualifying firms for incentives	Domestic and foreign-owned firms may be eligible for incentives in Thailand.
Activities/sectors qualifying for incentives (not exhaustive)	Firms operating in the following sectors may qualify for fiscal incentives in Thailand: Agriculture and agricultural products; mining, ceramics, and basic metals; light industry; metal products, machinery, and transportation equipment; electronic industry and electrical appliances; chemicals, paper, and plastics; and services and public utilities. // Incentives depend on defined merits/activities undertaken by the promoted firms -- including R&D investment, decentralisation of activities, and operating in defined SEZs.?
Regional incentives (including Special Economic Zones)	One additional year of CIT exemption will be granted to projects located within an industrial estate or promoted industrial zone. However, the total period of CIT exemption cannot exceed eight years.
Income tax holiday	Exemption from CIT equal to or more than the amount of the investment, excluding the cost of land and working capital, for up to eight years, depending on the promoted activity (see income tax credit section).
Income tax reduction	NA
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	Tax deductions based on the value of a project (merit-based incentives) are provided in addition in order to motivate the investor to invest or spend on activities that will benefit the country or the industry as a whole. Merit-based tax deductions are provided in terms of additional CIT exemption depending on the type and size of merit-based activities. // Competitiveness enhancement-based incentives are provided for investment made or expenses incurred in R&D for their business, the provision of advance training to employees, or the development of local suppliers (e.g. corporate tax exemptions are granted to venture capital companies that invest in SMEs). // Decentralisation-based incentives are provided for operations in 20 poorer provinces in Thailand. The incentives include: up to 3 additional years of tax exemption, double deduction from taxable income of the costs of transportation, electricity, and water supply for ten years from the date on which revenue was first derived from the promoted activity; deduction from net profit of 25% of the project's infrastructure installation or construction costs in addition to normal depreciation. // Industrial area development incentives include one additional year of CIT exemption for projects located within an industrial estate or promoted industrial zone. However, the total period of CIT exemption will not exceed eight years. // A Thai company can use foreign tax paid on business income or dividends as a credit against its CIT liability. However, the credit cannot exceed the amount of Thai tax on the income.
Accelerated depreciation	NA
Trade tax and VAT exemptions/deductions	Exemption from import duties on imported machinery, raw and essential materials imported for manufacturing for export may be provided.
Other incentives	Exclusion of dividends derived from promoted enterprises from taxable income during the period of exemption from CIT. // Specific tax incentives are provided to regional and international headquarters operations as well as to international trading companies. // Non-fiscal incentives include: Permit for foreign nationals to enter the Kingdom for the purpose of studying investment opportunities; permit to bring into the Kingdom skilled workers and experts to work in investment promoted activities; permit to own land; permit to take out or remit money abroad in foreign currency
Sources	EY (2014); PWC (2017); Thailand Board of Investment (2017)

Annex Table 5.A.10. Overview of tax incentives in Viet Nam

Instrument	Description
Standard corporate income tax (CIT) rate	20% (2017), down from 28% (2006). Worldwide income by firms registered in Viet Nam is subject to CIT. // Enterprises operating in the oil and gas industry are subject to CIT rates ranging from 32% to 50%, depending on the location and specific project conditions.
Main government agencies involved in offering incentives	The Viet Nam Foreign Investment Agency under the Ministry of Planning and Investment is the main incentive implementing agency.
Major incentive laws	Tax incentives are regulated in the 2005 Investment Law. Other laws relevant for incentives include the Corporate Income Tax Law and the Law on Export and Import Taxation (for duty exemption) and the Land Law.
Qualifying firms for incentives	Tax incentives are granted based on regulated encouraged sectors, encouraged locations, and size of the projects to new investment projects of domestic and foreign-owned firms. Business expansion project may also benefit from incentives under certain conditions.
Activities/sectors qualifying for incentives (not exhaustive)	The sectors that are encouraged by the Vietnamese government include education, health care, sport/culture, high technology, environmental protection, scientific research, infrastructural development, and computer software manufacturing. Large manufacturing projects with investment capital of more than VND 6 trillion disbursed within three years of being licensed can also qualify for CIT incentives under certain conditions. Further, new investment projects engaging in manufacturing industrial products can benefit from incentives if the products support: the high technology sector, or the garment, textile, and footwear; information technology (IT); automobiles assembly; or mechanics sector and were not produced domestically as of 1 January 2015, or, if produced domestically, they meet the quality standards of the European Union (EU) or equivalent.
Regional incentives (including Special Economic Zones)	Viet Nam offers incentives exclusively to firms in special locations. The encouraged locations include qualifying economic and high-tech zones, certain industrial zones, and difficult socio-economic areas.
Income tax holiday	2-4 years with an additional 50% reduction of the rate for 4-9 years can be granted.
Income tax reduction	Two preferential CIT rates of 10% and 17% for 15 years and 10 years, respectively, are available. // Social sector (such as education, health) benefit from a 10% rate for the life of the project.
Income tax deductions and credits (including loss carry forward and reinvestment allowance)	CIT paid in foreign countries on income earned abroad can be creditable; the credit shall not exceed the CIT amount payable in Vietnam. // Tax credits may also be provided for projects engaging in manufacturing, construction, and transportation activities that employ several female staff and/or ethnic minorities. // Income from activities of technology transfer applicable to projects entitled to investment incentives shall be exempt from income tax. // Tax deductions can be provided on investment into an R&D fund; enterprises can appropriate up to 10% of annual profits before tax to the fund. // Losses may be carried forward fully and consecutively for a maximum of five years.
Accelerated depreciation	Investment may enjoy accelerated depreciation. The maximum rate of depreciation shall not be more than twice the level of depreciation as stipulated by regulations on depreciation of fixed assets.
Trade tax and VAT exemptions/deductions	Exemption of import duty on equipment, materials, means of transportation and other goods for implementation of investment projects in Viet Nam
Other incentives	Exemption or reduction of land use and land rental fees in addition to other preferential land lease terms. Exemption or reduction of infrastructure use fees. // To attract investment by its diaspora community, Viet Nam recognises dual citizenship for Vietnamese expatriates, who are allowed to choose their status as either domestic or foreign investors. // High-tech project may be eligible for funding from the National High Tech Development Program. // Assistance with recruitment and training of skilled labour as well as with immigration and residence procedures. // Reduced regulatory oversight in administrative and customs procedures.
Sources	EY (2014); OECD (2017b, forthcoming); FIA Vietnam (2016); PWC (2017); Nguyen (2016); Viet Nam Industrial Parks Investment Promotion (2017)

Chapter 6.

Promoting responsible business conduct as a strategic choice in Southeast Asia

Policymakers worldwide increasingly promote and enable responsible business conduct (RBC) in order to attract and retain quality investment and ensure that business activity contributes to broader value creation and sustainable development. This chapter looks at how a proactive and harmonised strategy on RBC among ASEAN members can help maximise the development impact of investment in the region, promote linkages with global value chains and create a level playing-field for businesses.

Summary

Societies can benefit from investment in many ways, but the relationship between the volume of investment and the benefit from that investment is not necessarily linear. More investment does not automatically lead to productivity growth, more competitive local firms or a more inclusive workforce. In certain cases, particularly when there are large-scale negative impacts associated with projects, investment can make host economies worse off. The need to balance economic growth objectives with environmental and social considerations becomes even more important in a context where policy and legal frameworks are still evolving.

This chapter examines how promoting and enabling responsible business conduct (RBC) is an increasingly important way through which policymakers can attract and retain quality investment and ensure that business activity contributes to broader value creation and sustainable development. Evidence shows that a proactive and strategic approach to RBC can enhance competitiveness for both individual businesses and the overall economy.

ASEAN policymakers, in the tradition of leadership as early movers in welcoming foreign direct investment (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.

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. As discussed in Chapter 1, while the export-oriented investment strategy implemented so far has made ASEAN one of the premier investment destinations in the world, it has not always led to lasting local capabilities. As ASEAN policymakers continue to build a more resilient, inclusive, people-oriented and people-centred community, one integrated with the global economy, RBC can play a role in increasing absorptive capacity and participation in global value chains (GVCs), while contributing to meeting the future competitiveness and skills challenges head on.

Policy considerations

- Develop an action plan for promoting and enabling RBC at an ASEAN level in the context of integration in global supply chains. 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*. Include RBC in investment incentives schemes.
- 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.
- Consider strengthening policy dialogue among AMS with a view to position ASEAN as a responsible investment region. Harmonise, clarify, and strengthen processes related to environmental and social impact assessments and encourage early participation by affected stakeholders.

- Promote National Action Plans on Business and Human Rights in all ASEAN members 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.

Scope and importance of responsible business conduct

RBC principles and standards set out an expectation that all businesses – regardless of their legal status, size, ownership structure or sector – avoid and address negative impacts of their operations, while contributing to the sustainable development where they operate. These expectations are prevalent throughout GVCs and are affirmed in the main international instruments on RBC – notably the OECD *Guidelines for Multinational Enterprises* (OECD *Guidelines*), the UN *Guiding Principles for Business and Human Rights* (UN *Guiding Principles*), and the fundamental International Labour Organization (ILO) Conventions – and increasingly in international trade and investment agreements and national development strategies, laws, and regulations worldwide.

RBC means integrating and considering environmental and social issues within core business activities, including throughout the supply chain and business relationships. The OECD *Guidelines*, for example, provide recommendations to businesses in the areas of disclosure; human rights; employment and industrial relations; environment; combatting bribery, bribe solicitation and extortion; consumer interests; science and technology; competition; and taxation. A key element of RBC is risk-based due diligence – a process through which businesses identify, prevent and mitigate their actual and potential negative impacts – including beyond the company itself – and account for how those impacts are addressed.

Many businesses also find that responsible business is good business, beyond ensuring that they respect human rights and comply with relevant laws and regulations. Understanding, addressing, and avoiding risks material to business operations in a more comprehensive way – beyond financial risks – often leads to a competitive advantage. A market in which internationally accepted environmental and social principles and standards are not respected faces an increased risk of being excluded from value chain activity.

Furthermore, a stronger role for the private sector in the development process was one of the key outcomes of the agreement on the 2030 Agenda for Sustainable Development. A number of Sustainable Development Goals (SDGs) refer to responsible production patterns, inclusive and sustainable economic growth, employment and decent work for all. The Paris Agreement on climate change also underlines the critical role of business in tackling climate change, including through reducing greenhouse gas emissions and improving environmental performance.

Importance of RBC is recognised in ASEAN

Strategic guidance

CSR is often used in a similar way as RBC, when defined beyond what has traditionally been considered CSR (mainly philanthropy). RBC is understood to be comprehensive and integral to core business. Many times both RBC and CSR (if used beyond philanthropy) aim to promote the same idea – that enterprises are expected to consider the impact of their activities beyond the impact on the company itself and positively contribute to sustainable development of the countries where they operate.

As a response to increasing demands by businesses, civil society and other stakeholders to take more strategic measures and emphasise company responsibility for economic, social and environmental impacts,[1] references to corporate social responsibility (CSR) and key RBC concepts have been included in the ASEAN Economic, Socio-Cultural, and Political-Security Community Blueprints 2025.

The Economic Blueprint specifies that enhanced stakeholder engagement is key to promoting transparency and making progress in ASEAN integration and identifies working closely with stakeholders to promote CSR activities as a strategic measure (ASEAN, 2016a). The Socio-Cultural Blueprint also reinforces the importance of multi-sectoral and multi-stakeholder engagement and calls for promoting and integrating a sustainable consumption and production strategy and best practices into national and regional policies or as part of CSR activities (ASEAN, 2016b). The Political-Security Blueprint calls on strengthening collaboration with the private sector and other relevant stakeholders to instil CSR (ASEAN, 2016c).

Focus on social and labour issues

Beyond this strategic guidance, specific action has also been taken on urgent social issues in the global supply chain. The legally binding 2015 ASEAN *Convention against Trafficking in Persons, Especially Women and Children* entered into force in March 2017. Modern slavery, forced labour, child labour, and human trafficking in the global supply chain are a serious and persistent problem worldwide. These crimes are not specific to one sector or one geographical region; they permeate the global supply chain in different forms. The ILO estimates 25 million people are victims of forced labour, with 16 million exploited in the private economy (ILO, 2017). These issues cannot be addressed by one stakeholder or one country; they require active and continuing engagement among all stakeholders. States have the primary obligation to protect against human rights abuses within their territory or jurisdiction, including against abuse by private actors, such as businesses. This includes taking steps to prevent, investigate, punish and redress abuses through effective policies, legislation, regulations and adjudication (e.g. as also set out in Principle 1 of the UN *Guiding Principles on Business and Human Rights*).

ASEAN has also taken steps to tackle a broader but related issue of migrant workers. In November 2017, ASEAN leaders adopted the *ASEAN Consensus on the Protection and the Promotion of the Rights of Migrant Workers* (ASEAN, 2017a). The consensus follows the 2007 ASEAN *Declaration on the Protection and the Promotion of the Rights of*

Migrant Workers and recognises the fundamental rights of migrant workers, tackles obligations of sending and receiving states, and sets out the commitments by ASEAN members, including for example, addressing recruitment malpractices that may lead to human rights abuses. The consensus envisions the elaboration of an action plan and a follow-up reporting mechanism on implementation.

Lastly, ASEAN Labour Ministers adopted the *Guidelines for Corporate Social Responsibility (CSR) on Labour* in 2016, providing broad guidance to governments, enterprises, establishments, employer and worker organisations on raising awareness, proactively encouraging engagement, and promoting social dialogue and compliance with core labour standards (ASEAN, 2016d). Ministers also adopted in 2016 the *Vientiane Declaration on Transition from Informal Employment to Formal Employment towards Decent Work Promotion in ASEAN* (ASEAN, 2016e).

Promoting National Action Plans

Recent action has also been taken to promote the implementation of the UN *Guiding Principles* in ASEAN. Five organisations (ASEAN Intergovernmental Commission on Human Rights (AICHR), Ministry of Justice of Thailand, UNDP, ASEAN CSR Network and UNESCAP) organised a *Regional Workshop on Business and Human Rights: Moving ahead with National Action Plans in ASEAN* in May 2017 to discuss developments on National Action Plans (NAPs) and a potential regional strategy for mainstreaming human rights practices in business operations (for more information, see UNDP, 2017). AICHR convened a four-day dedicated training programme in November 2017 on implementing the UN *Guiding Principles* (AICHR, 2017).

Action on NAPs in ASEAN follows the global trend to implement a recommendation by the UN develop NAPs as part of the state responsibility to disseminate and implement the UN *Guiding Principles*. As of December 2017, 19 countries worldwide had developed a NAP and 21 countries are in the process of developing or have committed to developing one (UN OHCHR, 2017). See Table 6.1 for the status of NAPs in ASEAN.

Governments are using NAPs to highlight their policies on RBC and signal the need for future action. As this review suggests, policy reforms needed to move up the value chain are cross-cutting by definition and, thus, policy coherence and effectiveness are important factors, but many silos still remain within governments (OECD, 2017a). NAPs are a useful tool to promote policy coherence and alignment on a number of topics related to implementing the SDGs and to the contribution of the private sector to development. The importance of policy coherence is explicitly recognised in the 2015 OECD *Policy Framework for Investment* (Box 6.1).

The scope and extent of development of NAPs varies by country.[2] Some go beyond the theme of business and human rights by including the environment, as in France and Italy, and RBC more generally, as in the United States. In other cases, NAPs complement existing laws, regulations and policy tools. For example, many EU members have adopted NAPs on CSR following the 2011 renewal of the EU CSR strategy. It is important that governments ensure that links between different but relevant action plans are made explicit. This is especially relevant as new national plans to implement the SDGs are being developed. Countries could, for example, as Japan has done, pledge that the development of NAPs on Business and Human Rights could function as an indicator for achieving the SDGs (Government of Japan, 2016).

Table 6.1. Status of development of National Action Plans in ASEAN Member States

Malaysia - in the process or committed to it
Myanmar - in the process or committed to it
Thailand - in the process or committed to it
Indonesia - promoted by the National Human Rights Institution or civil society
Philippines - promoted by the National Human Rights Institution or civil society
Viet Nam* - none
Lao PDR* - none
Cambodia* - none
Brunei Darussalam - none
Singapore - none

Note: * OECD recommendation to develop an NAP made in the context of an Investment Policy Review.
Source: UN OHCHR (2017).

Box 6.1. Role of governments in promoting and enabling responsible business

According to the OECD *Policy Framework for Investment*, which was designed by governments to support investment reform and most recently updated in 2015 to reflect experience of 25 countries and regional bodies that have applied it, governments can promote and enable RBC in several ways through:

- *Regulating* – establishing and enforcing an adequate legal framework that protects the public interest and underpins RBC, and monitoring business performance and compliance;
- *Facilitating* – clearly communicating expectations on what constitutes RBC, providing guidance on specific practices and enabling enterprises to meet those expectations;
- *Co-operating* – working with stakeholders in the business community, worker organisations, civil society, the general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC;
- *Promoting* – demonstrating support for best practices in RBC;
- *Exemplifying* – behaving responsibly in the government's role as an economic actor.

Source: OECD, 2015

The steps that AMS have taken on RBC are a signal that RBC issues are increasingly relevant for the region. As ASEAN members move toward a unified regional approach and in light of the ongoing policy dialogue on investment between the OECD and ASEAN, there is significant scope to increase dialogue and cooperation on RBC issues. Specific policy dialogue between ASEAN and the OECD Working Party on Responsible Business Conduct, the only inter-governmental policy body worldwide focusing exclusively on RBC issues, could be institutionalised and strengthened. Peer learning and experience sharing on lessons learned from recent policy innovations could be particularly useful. There is also an increased opportunity for collaboration on the application of a due diligence framework in the supply chain, particularly for example as related to migrant workers. A number of OECD countries have taken direct action to ensure good conditions in the supply chain (Box 6.2).

Box 6.2. Global policy developments and RBC

A number of countries are integrating RBC principles and standards in domestic regulations and initiatives. In March 2015, the **UK** enacted the *Modern Slavery Act*, mandating that commercial organisations prepare an annual statement on slavery and human trafficking and report on their due diligence processes to manage these risks within their operations and supply chains (UK, 2015). **France** mandates supply chain due diligence in accordance with the OECD *Guidelines* and requires all French companies with more than 5000 domestic employees or more than 10 000 international employees to publish a due diligence plan for human rights and environmental and social risks (France, 2016). **Canada** has enhanced its strategy *Doing Business the Canadian Way: A Strategy to Advance Corporate Social Responsibility in Canada's Extractive Sector Abroad* to allow for withdrawal of government support in foreign markets for companies that do not act responsibly or refuse to participate in the dispute resolution processes available through the Canadian government, including National Contact Points for the OECD *Guidelines*. The **United States** Federal Acquisition Regulation was revised in 2015, establishing a number of new safeguards to protect against trafficking in persons in federal contracts (Government of the United States, 2015). Additionally, the 2015 *Trade Facilitation and Trade Enforcement Act* eliminated the exceptions to the prohibition on import of goods into the United States - it is now illegal to import goods made, wholly or in part, with convict, forced and indentured labour under penal sanctions. In March 2016, US border agents withheld goods tied to forced labour on the basis of the new Act (US Customs and Border Protection, 2016). **China** is increasingly incorporating RBC into its national initiatives. In 2015, OECD and China signed a comprehensive programme of work, setting out the strategic vision and activities in a number of topics, including RBC. Several joint activities have been undertaken under the programme. Notably, on the basis of OECD RBC instruments, Chamber of Commerce Metals, Minerals & Chemicals Importers and Exporters adopted a *Chinese Due Diligence Guidelines for Responsible Minerals Supply Chains* in 2015.

RBC criteria have also been included in economic instruments. The OECD *Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence* was revised in April 2016 to strengthen RBC considerations in **export credits** and to promote policy coherence (OECD, 2016a). The OECD *Recommendation on Procurement* calls on adherents to use **public procurement** to support secondary policy objectives, including RBC standards set by the OECD *Guidelines*. The WTO *Revised Agreement on Government Procurement* of 2014 introduced new exceptions for environmental and social policy linkages in order to overcome some of the legal challenges associated with restricting procurement awards based on RBC principles (OECD, 2017e). These developments reflect international trends and are also contributing to joint action at the regional level. In 2014, the **European Union** passed a directive on promoting disclosure of non-financial and diversity information to promote more transparency on environmental and social issues across sectors and companies over a certain size incorporated in EU member states and listed on regulated EU exchanges (EC, 2014). First reports are expected in early 2018. Recently, an agreement on a framework to stop the financing of armed groups through trade in conflict minerals was reached at an EU level, with the aim that EU companies source tin, tantalum, tungsten and gold responsibly. These minerals are typically used in everyday products such as mobile phones, cars and jewellery (EC, 2016). Lastly, the new EU trade strategy *Trade for all: Towards a more responsible trade and investment policy* uses RBC as a pillar (EC, 2015).

ASEAN members are taking a varied approach to RBC

ASEAN Member States are also implementing concrete measures to promote and enable RBC domestically. The developments described below are not exhaustive since numerous materials document the extent of RBC or business and human rights initiatives in ASEAN;[3] rather, this section highlights innovative approaches on RBC/CSR.

Viet Nam has consistently stated the objective to deepen integration in the global economy and move up the value chain. These broad commitments have translated into several specific policies, laws and initiatives to promote better business practices and improve Viet Nam's overall business environment. Notably, the EU Free Trade Agreement (EU FTA) includes specific language on RBC, CSR and sustainable development, following dominant treaty practice globally in recent years. It refers to the promotion and co-operation on CSR in the Trade and Sustainable Development chapter (art. 9 and 14), with the OECD *Guidelines* specifically mentioned in art. 9 as the relevant international standard. Provisions related to RBC are also included in the chapter on state-owned enterprises (SOEs) (art. 5), which underlines co-operation efforts to ensure that SOEs observe internationally recognised standards of corporate governance (EU, 2016a). The EU published additional analysis of human rights and sustainable development considerations of the FTA in 2016 that elaborated on the implementation and monitoring of the relevant provisions, including as related to RBC (EU, 2016b). Similar types of references were also included in the Trans-Pacific Partnership (TPP). While TPP has not entered into force, these agreements demonstrate Viet Nam's commitments to more transparency and deep reforms. In the context of the TPP, Viet Nam had also committed to specific labour reforms in a separate but related bilateral agreement with the United States, *Plan for Enhancement of Trade and Labour Relations.* The forthcoming OECD *Investment Policy Review of Viet Nam* includes a more detailed chapter on RBC.

Myanmar included as the very first objective in the 2016 *Investment Law* an explicit reference to responsible investment. The Law's stated objective is to:

- develop responsible investment businesses which do not cause harm to the natural environment and the social environment for the interest of the Union and its citizens;
- protect the investors and their investment businesses in accordance with the law;
- create job opportunities for the people;
- develop human resources;
- develop high functioning production, service, and trading sectors
- develop technology, agriculture, livestock and industrial sectors;
- develop various professional fields including infrastructure around the Union;
- enable citizens to work alongside the international community;
- develop businesses and investment businesses that meet international standards.

Development of responsible and accountable businesses is also in the mandate of the Myanmar Investment Commission (Government of Myanmar, 2016). RBC is included in the 2017 implementation rules for the Law. A demonstrated commitment to RBC will be a part of the assessment criteria and the Commission may consider whether the investors or their associates have contravened the law, including in other jurisdictions and issues like environmental, labour, tax, anti-bribery and corruption or human rights law. An important set of transparency rules were also set out, asking investors to report on status of environmental and social impact assessments; compliance with environmental laws; employment performance; impacts on the environment and local community; land use;

how the commitments to develop investments in a responsible and sustainable manner is carried out; and other related provisions (Government of Myanmar, 2017).

Lao PDR is considering establishing a focal point on RBC within the government and is looking to improve its existing regulatory framework on RBC. The *Law on Investment Promotion* includes an extensive section that imposes obligations upon investors, which is more detailed than what is commonly encountered in investment laws. In addition to general obligations, art. 70 is fully dedicated to environmental obligations (Chapter 4). The 2017 OECD *Investment Policy Review of Lao PDR* includes a detailed chapter on RBC.

Cambodia's economic growth has its roots in RBC – improvements in labour conditions in the textiles and garment industry were directly linked with access to the US market under the 1999 US-Cambodia Trade Agreement on Textiles and Apparel. In light of changing market conditions and external factors that may limit the extent to which Cambodia can continue to rely on traditional sources of growth, the government is considering taking a broader and more strategic approach to promoting and enabling RBC. This includes mainstreaming RBC at a government level and clearly communicating RBC priorities and expectations, including to the private sector. The elaboration of the new investment law presents a unique opportunity to embed RBC in the smart incentives scheme the authorities are considering. The forthcoming OECD *Investment Policy Review of Cambodia* includes a more detailed chapter on RBC.

The Philippines has a long history of corporate philanthropy and community engagement rooted in the concept of *'bayanihan'*. While the Philippines has regulations in place for protecting public interest and underpinning RBC, certain challenges with regard to adverse impacts linked to business activities persist despite government efforts to address them – particularly concerning community displacement, labour and employment, environmental issues and corruption. While such issues are not unique to the Philippines, recent reports about increasing violence globally against land and human rights defenders, environmental activists, and trade unionists[4] warrant looking at how a shift from a focus on philanthropy to one emphasising company responsibility for economic, social and environmental impacts and the contribution towards sustainable development would strengthen RBC in the Philippines. The work of human rights defenders is critical in protecting the land and the environment, securing just and safe conditions of work, combating corruption, respecting indigenous cultures and rights and achieving sustainable development. The 2016 OECD *Investment Policy Review of the Philippines* includes a detailed chapter on RBC.

Indonesia was the first country in Asia to launch a National Action Plan on Business and Human Rights, launched in 2017 and spearheaded by the National Commission on Human Rights and the Institute for Policy Research and Advocacy. It includes recommendations to the government in different areas related to business and human rights (FIHRRST, 2017). Indonesia was also one of the first countries to integrate expectations on CSR (mainly philanthropy) within its legal framework during the previous decade. Recent analysis shows that CSR is still mainly viewed as philanthropy rather than an important component of core business operations.[5] Mainstreaming RBC as part of core business could bring significant benefits to addressing climate change risks as well as promoting better community engagement in the context of investments.[6]

Thailand announced in 2017 that it will develop a National Action Plan on Business and Human Rights based on internationally recognised responsible business principles and guidelines. Several initiatives on RBC are ongoing and domestic and foreign chambers of commerce are active. One area of reforms that the government has prioritised has been addressing human rights abuses in the fishing industry where it has taken steps to address forced labour and human trafficking in the industry, including by investigating, prosecuting and convicting traffickers. Nevertheless, implementation of the reform measures remains a challenge in practice.[7]

Malaysia has promoted CSR in different ways in the past two decades, including through CSR awards, reporting requirements for listed companies, and linking CSR with national development strategy plans. Awareness of the importance of RBC as a core business issue has increased in recent years. According to a November 2017 survey, 92% of Malaysian consumers believe that businesses have a responsibility to do social good and over half recognise business responsibility for impacts in its supply chain (Malek, 2018). Malaysia is also spearheading a new approach to dealing with cases of human trafficking. A special court for human trafficking cases has been announced as an attempt to fast-track and address trafficking crimes. A pilot project in Selangor is expected to be set up as early as May before gradual implementation throughout Malaysia (Yi, 2018).

Singapore has recently taken steps to address transboundary harm from environmental damage through the 2015 *Transboundary Haze Pollution Law*. The law is said to be inspired by the ASEAN Agreement on Transboundary Haze Pollution and as Mohan (2017) notes, it is a rare example in the environmental and human rights arena where extraterritorial jurisdiction is directly asserted over entities and activities not in a domestic jurisdiction. While implementation effectiveness and the political dimension of this approach are still debated, Singapore's experience, when considered with the experience of other ASEAN members on social issues discussed above, is a compelling argument for building a harmonised and regional approach to RBC.

RBC for quality growth

In light of varied approaches to RBC by ASEAN members, regional action on RBC may be warranted and particularly useful for addressing intra-regional imbalances and promoting investment in ASEAN. Clearly communicating RBC priorities and expectations, including directly to the private sector, would go a long way in setting up ASEAN businesses for next-generation GVCs. Regional action on promoting and enabling RBC may be particularly useful in the following policy areas.

Competitiveness and skills

One trend often mentioned in the context of raising productivity growth is the impact of technology on the future workforce. Liberalisation is not an end in itself – what matters most is how FDI inflows can be channelled in new sectors and competitive activity that can transform the economy, propelling productivity growth and creating the means for greater inclusiveness and sustainability. Fears about job displacement due to technology, particularly in the manufacturing sector, are not new. ILO estimates that in Cambodia, Indonesia, the Philippines, Thailand and Viet Nam – which account for approximately 80% of the entire ASEAN workforce – 56% of all employment is at high risk of displacement due to technology over the next decade or two (Chang et al., 2016a). Women, low skilled workers, and employees earning lower wages are most likely to be affected. The trend can already be seen in some sectors, particularly labour-intensive sectors. For example, as more automation is introduced in the garment and footwear sector, 9 million jobs in ASEAN are at risk, potentially leading to a reduction in exports if the effects are not offset (Chang et al., 2016b; Bissell-Linsk, 2017).

Productivity-enhancing technological trends are unlikely to be stopped, although the timing and severity of their impact on the workforce are unclear. UNCTAD (2017) cautions that the hype around negative impacts may not be fully warranted and that enough scope exists for policy acumen and targeted action not only to address potential displacement but also to intervene in a smart way in order to prepare the workforce for these changes. A proactive strategy to promote and enable RBC can play a role in such targeted action. Integrating RBC in business operations can positively support short-term productivity growth, as shown in the increasing empirical evidence globally as well as within ASEAN. Human capital development is a pillar of RBC, and targeted action to promote and enable RBC can help build the skills base for the future.

Box 6.3 summarises the empirical evidence showing that RBC has a positive impact on productivity and company performance; evidence from ASEAN businesses is also abundant. For example, the productivity of the garment and footwear sector has suffered in some ASEAN members due to issues with working conditions and wages (e.g. through lost working days at the factory level owing to strikes or limited investments in skills and chemicals, water consumption and pollution or high energy use). Most cases in ASEAN that have been considered by the National Contact Points (NCPs) for the OECD *Guidelines* – the state-based, non-judicial grievance mechanism available in case the *Guidelines* are not observed – have been related to employment and industrial relations in the manufacturing sector.

Equally, however, evidence from ASEAN firms suggests that improving working conditions and staying competitive are not two mutually exclusive goals. A 2015 World Bank assessment of the ILO/IFC Better Work Programme – which is implemented in seven countries, including Cambodia, Indonesia, and Viet Nam, and in 1 450 factories employing more than 1.9 million workers – concluded that participating factories in general do see a positive correlation between investing in better working conditions and profits, productivity and survival rates. At a country level, participation in the programme is associated with significant increases in apparel exports (BFC, 2016; World Bank, 2015). A more recent independent impact assessment of the programme in 2016 noted, however, that while more factories should be expected to pursue better conditions due to the link with better profits, demands and pressures in the supply chain make it unlikely that the problematic practices would be eliminated solely by market forces (Better Work, 2016).

Active promotion by governments of RBC can make a marked difference. Supply chain responsibility is one of the cornerstones of RBC as set out in the OECD *Guidelines* and the UN *Guiding Principles*. For example, purchasing practices in the garment sector can be an important factor for enabling or hindering improvements in working conditions. Poor purchasing practices – including rushed orders, changes to orders and delays in payments – can result in increased overtime and outsourcing to non-certified suppliers by factories. Suppliers also often assert that purchasing practices of buyers pose a challenge and a barrier for making financial investments in upgrading factories and acting responsibly. This has an effect also on skill upgrading.

All businesses – not just local factories – including retailers, brands, manufacturers, buying agents, exporters, and global commodities merchandisers, are expected to implement RBC principles and standards. The 2017 OECD *Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector* considers the impacts across the full length of the supply chain, not just in cut-make-trim. One of the due diligence points is that in instances in which the buyer changes the specifications of orders, it should also amend the lead time to reduce the risk of unauthorised subcontracting (OECD, 2017f). Additionally, the Guidance encourages companies to collaborate where appropriate in order to reduce duplication of efforts and to scale-up effective measures. The risk-based nature of due diligence means that companies are encouraged to prioritise the order in which they take action based on the likelihood and severity of the impact and that the extent of efforts should be proportionate to the risk.

Box 6.3 Responsible business is good business

RBC as part of core business decision making is not only socially desirable but also makes sense from a risk management point of view. Environmental and social issues are financially material. If these are not reflected in risk management practices, the company can be subject to losses. RBC can help with:

- *Reducing costs and avoiding legal liability*: In one study, nearly 20% of the 2 500 sampled companies were found to be subject to sanctions related to their social or environmental performance in 2012 and 2013, amounting to penalties of around EUR 96 billion (Vigeo, 2015). Likewise, a recent Harvard University study found that for a mining project with capital expenditure of USD 3-5 billion the costs attributed to delays from community conflicts can be on average USD 20 million per week due to lost productivity from temporary shutdowns or delays (Davis and Franks, 2014). Indeed, the 2017 *Risk Barometer* (Allianz, 2017), (and based on the insights of more than 1 200 experts from more than 50 countries) identifies business interruption (including supply chain disruption) as the number one business risk for the fifth successive year. Concern about interruptions in supply chains is seen to be shifting increasingly towards events that require better risk-management of societal and environmental factors.

- *Increasing returns, lowering cost of capital, and retaining employees*: One study found that better business practices have the potential to reduce the cost of debt for companies by 40% or more and increase revenue by up to 20% (Rochlin et al., 2015). More broadly, a cross-sector study tracking performance of companies over 18 years found that high sustainability companies – those with strong environmental, social, and governance (ESG) systems and practices in place – outperform low sustainability companies in stock performance and real accounting terms (Eccles et al, 2011). More recently, the OECD (2017d) examined the issue of RBC and the financial performance of companies (return on equity and return on assets) in a panel regression with over 6 500 observations. Controlling for value chain structure, economic and financial factors, the overwhelming finding is that the social score (a measure of a company's capacity to generate trust and loyalty with its workforce, customers and society) has a highly-significant positive effect on companies' return on equity and return on assets. These results lend support to the proposition that investing in and implementing RBC practices throughout the supply chain enhances financial performance in the long-run, on average, while supporting social goals.

- *Debunking the pollution haven hypothesis*: 2016 OECD report *Do environmental policies affect global value chains? A new perspective on the pollution haven hypothesis* examined the impact of environmental policies on global value chains and showed that countries that implement stringent environmental policies do not lose export competitiveness when compared to countries with more moderate regulations. The findings suggest that emerging economies with strong manufacturing sectors could strengthen and implement environmental laws without denting their overall share in export markets. High-pollution or energy-intensive industries would suffer a small disadvantage, but this would be compensated by growth in exports from less-polluting activities (Koźluk and Timiliotis, 2016).

It would be worthwhile to consider the advantages of ambitiously embracing the global push for RBC in supply chains and to support ASEAN firms that want to be leaders in RBC due diligence. ASEAN members could work toward branding ASEAN as the place to invest responsibly and could make concrete commitments to RBC by, for example, encouraging the implementation of the due diligence approach across different sectors. Suppliers of multinational enterprises (MNEs) may find that RBC gives them an advantage over businesses that do not, as they are able to respond to and address concerns that may come up in due diligence of the MNE when evaluating risks associated with its supply chain. For example, investors from the 48 countries that adhere to the OECD *Guidelines* are subject to them wherever they operate. This means that a large majority of the global supply chain is covered by the OECD *Guidelines* as these investors accounted for 75% global FDI outflows and 58% of global FDI inflows between 2010 and 2015, as well as 81% of global FDI outward stock in 2014 (OECD/IMF, 2016).

Box 6.4. A primary reference for responsible business - OECD *Guidelines for Multinational Enterprises*

The OECD Guidelines for Multinational Enterprises are the most comprehensive recommendations on what constitutes responsible business addressed by 46 adhering governments to businesses operating in or from their territories conduct on:

- disclosure
- human rights
- employment and industrial relations
- environment
- combating bribery, bribe solicitation and extortion
- consumer interests
- science and technology
- competition
- taxation

Their purpose is to ensure that business operations are in harmony with government policies; to strengthen the basis of mutual confidence between businesses and the societies in which they operate; to improve investment climate; and to enhance the contribution of the private sector to sustainable development. The Guidelines, together with the UN Guiding Principles on Business and Human Rights and core ILO Conventions, are the main international reference on RBC.

The Guidelines reflect good practice for all businesses and do not aim to introduce differences of treatment between multinational and domestic enterprises. The adhering governments wish to encourage their widest possible observance to the fullest extent possible, including among small- and medium-sized enterprises, even while acknowledging that these businesses may not have the same capacities as larger enterprises. Accordingly, multinational and domestic enterprises are subject to the same expectations wherever the Guidelines are relevant to both.

Each adhering country sets up a National Contact Point (NCP) tasked with promoting RBC and the Guidelines, as well as helping resolve issues in case the Guidelines are not observed. NCPs have considered over 400 such instances since 2000.

Furthermore, social and environmental challenges are not endemic to one particular sector or to low value-added industries. As ASEAN members promote higher value-added industries, it is important that better business practices are integrated in these efforts as well. For example, international organisations and academics have expressed concerns about the lack of understanding of potential environmental and occupational health and safety impacts associated with high-tech and electronics industries (Box 6.5). Concerns permeate the entire supply chain and include everything from worker exposure to hazardous and toxic chemicals during the production process to the associated risks with an ever-increasing volume of industrial and hazardous waste (such as electrical and electronic waste).

Lastly, beyond productivity gains, RBC can also lead to increasing worker capacities in the medium-term. Under the OECD *Guidelines* enterprises are expected to encourage local capacity building through close co-operation with the local community and human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees.

Box 6.5. RBC is also important for high-value industries

A recent epidemiologic review published in the *International Journal of Occupational and Environmental Health* looked at health impacts of semiconductor production. Most evidence suggests reproductive risks (*e.g*. congenital malformation and reduced fertility) from fabrication jobs, while noting that, although chemicals are suspected as causal agents, knowledge about the likely contributions from specific exposures is still limited. The study also looked at available studies of cancer risks and did not necessarily find a causal relationship, but nevertheless cautioned that available studies had serious limitations, such as information bias, that could be associated with underestimation of the risks (Kim *et al*, 2014). Similarly, a 2012 ILO study on e-waste raised serious concerns with the way that it is managed globally, noting that developing economies are disproportionately affected by the environmental and health risks linked to its recycling and disposal. The “hazardous, complex and expensive to treat in an environmentally sound manner” recycling and disposal process, combined with general lack of e-waste regulation, prevalence of informality in employment and manual disassembly and recovery of materials, has serious implications for the environment and the health of workers at this end of the value chain (ILO, 2012). A 2016 study by the United Nations University revealed that the average e-waste growth in East and Southeast Asia from 2010 to 2015 was 63%, with even Singapore, the leading economy in ASEAN, standing at 30% and having the most per-capita growth (20 kilograms waste) in ASEAN (Honda et al., 2016).

Integrating RBC in investment promotion and facilitation efforts

RBC expectations can be included in FDI attraction efforts and may help attract MNEs that are more inclined to source locally. The current *Invest in ASEAN* website does not mention environmental and social issues nor CSR. This is a missed opportunity to brand ASEAN as a responsible investment destination and to connect with investors that are keen on doing business responsibly. For example, companies from the European Union are important investors in ASEAN, and RBC is a pillar of the new EU trade strategy *Trade for all: Towards a more responsible trade and investment* (EC, 2015). Additionally, as Box 6.2 outlines, in some EU members, RBC expectations can be a legal requirement. Making an explicit link between RBC/investment promotion efforts can help fill the information gap for investors, particularly smaller businesses that may perceive the risk of operating in ASEAN to be higher than it is.

Furthermore, RBC could be included as an element of supplier databases and matchmaking. Governments could include RBC principles and standards in industry-specific training programmes as a way to build absorptive capacity of domestic companies and encourage business linkages with foreign investors. This could encompass everything from promotion to capacity building exercises to supporting cross-sectoral learning efforts (for example, supporting cost-sharing efforts within and among industries for specific due diligence tasks, participation in initiatives on responsible supply chain management and cooperation between industry members who share suppliers).

Additionally, training and awareness-raising with business leaders could also be useful in promoting a wider understanding and recognition of the importance of RBC. Educational institutions such as business schools can be important platforms. Lastly, the authorities could make educational and training programmes more market driven by increasingly involving the private sector in human resource development policies and encouraging internal and external training by employers.

Connecting environmental protection and social issues

Beyond forward-looking strategic actions, RBC could also be useful for ASEAN members as a way to address negative impacts of existing investments. ASEAN members are already dealing with high-profile disputes, including land disputes where several cases citing land rights and forced evictions, among other issues, are being considered by the Office of the Compliance Advisor/Ombudsman (CAO), the independent recourse mechanism for the IFC and MIGA, the private sector lending arms of the World Bank Group (CAO, 2017). The first ever climate change case submitted to the CAO in October 2017 questions whether IFC's portfolio of investments in a Philippine bank contributed to global climate change and caused other serious environmental and social harm (IDI, 2017).[8]

Environmental protection is also on the agenda of the International Criminal Court (ICC). A new policy paper issued in September 2016 by the ICC Office of the Prosecutor (2016) on case selection and prioritisation suggests an increasing space for prosecution of social and environmental issues, citing that particular consideration will be given to prosecuting "crimes that are committed by means of, or that result in, *inter alia*, the destruction of the environment, the illegal exploitation of natural resources or the illegal dispossession of land." A legal brief alleging that land rights violations in Cambodia amount to crimes against humanity was submitted to ICC in 2014 (Global Diligence, 2016; Guardian, 2016); issues related to land have also been raised in the context of several sectors in ASEAN.

ASEAN is highly vulnerable to climate change and improving the way that environmental and social impact assessments (ESIAs) are applied to investment projects would bring both immediate and long-term benefits. Requiring *ex ante* and *ex post* impact assessments is an important tool for examining, mitigating and preventing potential negative impacts of business activity.

Experience from Latin America underlines the importance of early and active engagement of affected stakeholders in investment projects. IADB (2017) analysis of 200 conflict-affected infrastructure projects in Latin America and the Caribbean shows that the lack of a multi-dimensional and balanced approach – namely the inclusion of environmental, social, and governance criteria, as well as economic ones – in project planning, design, and delivery is seriously detrimental for companies, investors, and national governments as conflicts can cause projects to fail. Thirty-six out of the 200 projects examined in the analysis were cancelled because of conflicts; 162 faced delays; and 116 faced cost overruns. Deficient planning, reduced access to resources, lack of community benefits, and lack of adequate consultation were cited as most prominent conflict drivers, with earliest phases of planning and design being particularly vulnerable to conflict.

Box 6.6. RBC in the global economic agenda

The G7 and G20 have committed to RBC. G7 Leaders pledged in 2015 to lead by example to promote international labour, social and environmental standards in global supply chains; to encourage enterprises active or headquartered in the G7 to implement due diligence and to strengthen access to remedy (G7, 2015). Specific encouragement was given to international efforts and promulgating industry-wide due diligence standards in the textile and ready-made garment sector. The need to help small and medium-size enterprises (SMEs) develop a common understanding of due diligence and responsible supply chain management was also highlighted. The G20 recognised in several statements the critical role of RBC in investment and global supply chains under the 2016 Chinese G20 Presidency. G20 Trade Ministers reinforced their determination to "promote inclusive, robust and sustainable trade and investment growth" and agreed on G20 Guiding Principles for Global Investment Policymaking. The Principles state that "investment policies should promote and facilitate the observance by investors of international best practices and applicable instruments of responsible business conduct and corporate governance" (G20, 2016a). G20 Leaders also acknowledged in their annual Communique "the important role of inclusive business in development" (G20, 2016b). This was followed by further commitments in 2017 under the German Presidency to foster "the implementation of labour, social and environmental standards and human rights in line with internationally recognised frameworks", including the OECD *Guidelines* (G20, 2017).

All ASEAN members require at least some elements of ESIAs, but regulatory systems for assessments seem to be complicated and face capacity constraints (see Sano et al., 2016 for an in-depth study of ESIAs in ASEAN). More clarity, better practices and better coordination between relevant ASEAN authorities could be prioritised. Negative environmental impacts are not bound by borders. ASEAN is already taking steps to address these issues. AICHR convened its third workshop on human rights, environment and climate change in Myanmar in October 2017 to discuss a rights-based approach to regional strategy management for an effective environmental impact assessment (ASEAN, 2017b). A workshop hosted by the Myanmar Ministry of Environment and Natural Resources Conservation, the Myanmar Centre for Responsible Business and the Vermont Law School was also organised in November 2017 with a focus on assessing social impacts and the value of public participation (Thompson, 2017) which revealed that significant issues still remain for successful ESIAs. Promoting transparency, as well as introducing capacity-building programmes to empower local communities, could help overcome some of these challenges (Box 6.7).

One additional way to promote transparency is through reporting and non-financial disclosure. Sustainability reporting is a growing trend in ASEAN. Disclosure is an important aspect of RBC. For example, all OECD industry-specific due diligence guidance9 recognise that businesses should report on their due diligence processes, meaning their RBC policies in general, as well as procedures and activities undertaken to identify, prevent and mitigate risks in their operations and throughout their business relationships. The guidance recognises that reporting should be done with due regard for commercial confidentiality and other competitive or security concerns. What this includes may be different according to the sector. For example, companies reporting on their mineral supply chains are asked to explain the management structure responsible for the company's due diligence and who in the company is directly responsible; describe the control systems over the mineral supply chain put in place by the company, explaining how this operates and what data it has yielded that has strengthened the company's due diligence efforts in the reporting period covered; describe the company's database and record-keeping system and explain the methods for disclosing all suppliers, down to the mine of origin, to downstream actors; disclose information on payments made to governments in line with Extractive Industry Transparency Initiative (EITI) criteria and principles.

Box 6.7. Transparency and meaningful stakeholder engagement – Example from extractives sector

Many companies operating in the extractives sector have found that involving stakeholders, such as local communities, in their planning and decision-making can not only help them to meet their responsibilities but also lower costs and risks associated with a project. In 2016, the OECD developed through a multi-stakeholder and inclusive process the *Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector* for practitioners in the mining, oil and gas industries. The guidance offers a practical framework for identifying and managing risks related to stakeholder engagement, provides an assessment framework to evaluate performance, as well as targeted guidance for specific stakeholder groups such as indigenous peoples, women, workers and artisanal and small scale miners. Main recommendations include:

- Integrating stakeholder engagement into project planning and regular business operations by sharing of decision-making power with interested and affected parties;
- Practising stakeholder engagement that is driven by stakeholders through ongoing consultation and follow-through;
- Developing a stakeholder engagement strategy which prioritises engagement with the most severely affected rather than the most influential stakeholders;
- Meaningful stakeholder engagement and due diligence are central components of RBC under the *Guidelines* and are critical for avoiding some of the potential adverse impacts of extractive operations as well as for optimising their potential positive contributions.

Governments could require that investors follow this international standard for stakeholder engagement. Similarly, ensuring that stakeholder rights are respected and that civil society organisations and local communities are supported and encouraged to engage without fear of reprisal or punishment is a pillar of government responsibilities around RBC (OECD, 2015).

Lastly, it should be noted that investment protection and promotion of RBC are not mutually exclusive goals. A new emphasis in recent investment treaty-making has been on sustainable development and RBC considerations. OECD research shows that three out of four international investment agreements concluded in 2008-13 include language on RBC (mainly free trade agreements with investment protection provisions) and virtually all of the investment treaties concluded in 2012-13 include such language (Gordon et al., 2014). The research shows that the major functions of such treaty language are, in the order of prevalence: (*i*) to establish the context and purpose of the treaty and set forth basic RBC principles through preamble language; (*ii*) to preserve policy space to enact public policies dealing with responsible business conduct concerns; and (*iii*) to avoid lowering standards, in particular relaxing environmental and labour standards for the purpose of attracting investment. Some of these innovations are also found in ASEAN (see Viet Nam and Lao PDR sections above).

Notes

1. A 2014 study on CSR and human rights commissioned by the ASEAN Intergovernmental Commission on Human Rights (Thomas & Chandra, 2014) found that RBC is a relatively new subject in ASEAN in general, with a low level of awareness among business leaders and policy makers. Most activities remain philanthropic, although awareness seems to be increasing.

2. The UN Working Group on Business and Human Rights has set up a dedicated webpage to provide easy access to existing plans, as well as key public information and analysis on the various stages of NAP development, implementation and follow up (UN OHCHR, 2017).

3. Notably Mohan and Morel (2015), BHHCR (2015) and OECD (2014; 2013).

4. The UN Special Rapporteur on the situation of human rights defenders raised an alarm in July 2017 that the number of attacks from States and business-related actors against human rights defenders when they seek to expose human rights abuses related to business activity is growing (UN, 2017). Some civil society organisations have warned that being a defender in Philippines is among the most dangerous places in the world (see for example Global Witness, 2014 as amended in 2016; FIDH-OMCT, 2017; HRW, 2017).

5. See for example MVO Nederland (2016) analysis commissioned by the Dutch embassy in Jakarta.

6. See for example Bacchi (2017) *Indonesia warned about price of palm oil on environment.*

7. See for example reports by the US Department of State (2017) and Human Rights Watch (2018).

8. Climate change financing is also being considered by NCPs for the OECD *Guidelines*. On 14 November 2017, the Dutch NCP accepted a case for further consideration related to climate change financing by ING Bank. The consortium of NGOs that submitted the case allege that ING is not meeting commitments to reduce greenhouse gas emissions as quickly as possible following the 2015 Paris climate change agreement and that it continues to finance companies and projects in industries which emit substantial levels of greenhouse gases. The NCP offered its good offices to the parties (Government of the Netherlands, 2017).

9. In addition to the garment and footwear and extractives guidances already mentioned, the OECD and FAO have developed *Guidance for Responsible Agricultural Supply Chains* and the OECD is currently working on a due diligence guidance for RBC that can be applied to all sectors. The OECD has also developed recommendations on RBC in the financial sector.

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