ERIA-DP-2015-32

ERIA Discussion Paper Series

AEC Blueprint Implementation Performance and Challenges: Investment Liberalization*

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April 2015

Abstract: *Investment liberalization is central for ASEAN to attract greater FDI inflows and intra-region direct investment flows. This paper focuses on measuring and examining the progress and challenges in the implementation of the investment liberalization initiatives in the AEC Blueprint 2009–2015. It also draws on country reports produced as part of the AEC Scorecard Project regarding other constraints on creating much better investment regimes in selected ASEAN countries. The result shows the foreign investment liberalization rate, based on the ASEAN Comprehensive Investment Agreement (ACIA), is high in manufacturing with the challenges to further liberalization to be found primarily in Indonesia and Viet Nam. The picture of liberalization in the agriculture–mining sector is much more mixed across ASEAN, with some ASEAN Member States very liberal in their foreign investment stance, while several others are more cautious, measured, and/or restrictive towards foreign equity participation. The main challenges of further investment liberalization in the region include complex cultural, political, and security sensitivities regarding foreign equity majority control in some sectors, especially in agricultural and natural resource–based industries. There may also be strategic industrial, nationalist, and/or developmental gap considerations working against foreign majority ownership in some manufacturing sectors in several ASEAN Member States. The paper ends with some recommendations for ASEAN investment liberalization initiatives post-2015.*

Keywords: ASEAN Economic Community, investment liberalization, ACIA.
JEL Classification: F13, F15, F36

* This paper benefited from significant inputs from the country reports under the ASEAN Economic Community (AEC) Scorecard Phase 4 project. The author thanks the country authors for their contribution and Rully Prassetya for his excellent research assistance.

As put strongly in the Roadmap for an ASEAN Community 2009–2015, a 'free and open investment regime is key to enhancing ASEAN's competitiveness in attracting foreign direct investment (FDI) as well as intra-ASEAN investment. Sustained inflows of new investments and reinvestments will promote and ensure dynamic development of ASEAN economies' (p.27). Investment liberalization is central to attaining a free and open investment regime in the region.

Foreign direct investment (FDI) is very important to the Association of Southeast Asian Nations (ASEAN). Indeed, ASEAN relies more on foreign investment for its capital formation than do China and India (see **Table 1**). As the table shows, all ASEAN Member States (AMSs), except for Indonesia and the Philippines, have ratios of FDI to capital formation significantly higher than China and (during 2008–2011) India. Moreover, in the context of the so-called second unbundling phenomenon of production networks and global value chains, FDI that is increasingly bundled with technology, management and quality control, and market linkages has been a critical factor in ASEAN's success of embedding itself firmly in East Asia's regional production and global value chains. ASEAN's industrial and technological upgrading imperatives are better served by new investments and reinvestments.

Table 1: Ratio of FDI Inward Flows to Gross Fixed Capital Formation (average %)

	1990–1995	1996–2001	2002–2007	2008–2011
Brunei Darussalam	6.20	53.62	86.32	30.91
Cambodia	23.97	42.04	26.34	39.59
Indonesia	4.95	-2.24	4.45	5.66
Lao PDR	13.89	24.47	8.37	11.83
Malaysia	16.73	12.48	14.32	13.50
Myanmar	23.27	48.87	20.54	17.81
Philippines	6.44	7.13	7.75	4.50
Singapore	32.06	46.56	82.57	65.45
Thailand	4.30	15.86	14.70	9.54
Viet Nam	33.52	23.08	13.70	23.65
ASEAN (Aggregate)	10.77	16.52	20.03	15.58
China	9.69	12.20	7.78	4.49
India	0.82	3.11	4.30	7.15

Source: UNCTAD Stat 2013.

Given the critical importance of a free and open investment regime for generating greater FDI flows and intra-ASEAN direct investment flows in the region, this paper focuses on measuring and examining the progress and challenges in the implementation of the investment liberalization measures contained in the ASEAN Economic Community (AEC) Blueprint. It also draws on country reports produced as part of the AEC Scorecard Project regarding other constraints on creating much better investment regimes in selected ASEAN countries. Section A presents the FDI flows into ASEAN and AMSs in recent years. Section B explains the scoring methodology on investment liberalization and discusses the scoring result. Section C discusses the progress and challenges of investment liberalization in selected AMSs. Section D concludes with a discussion of the way forward into 2015 and beyond.

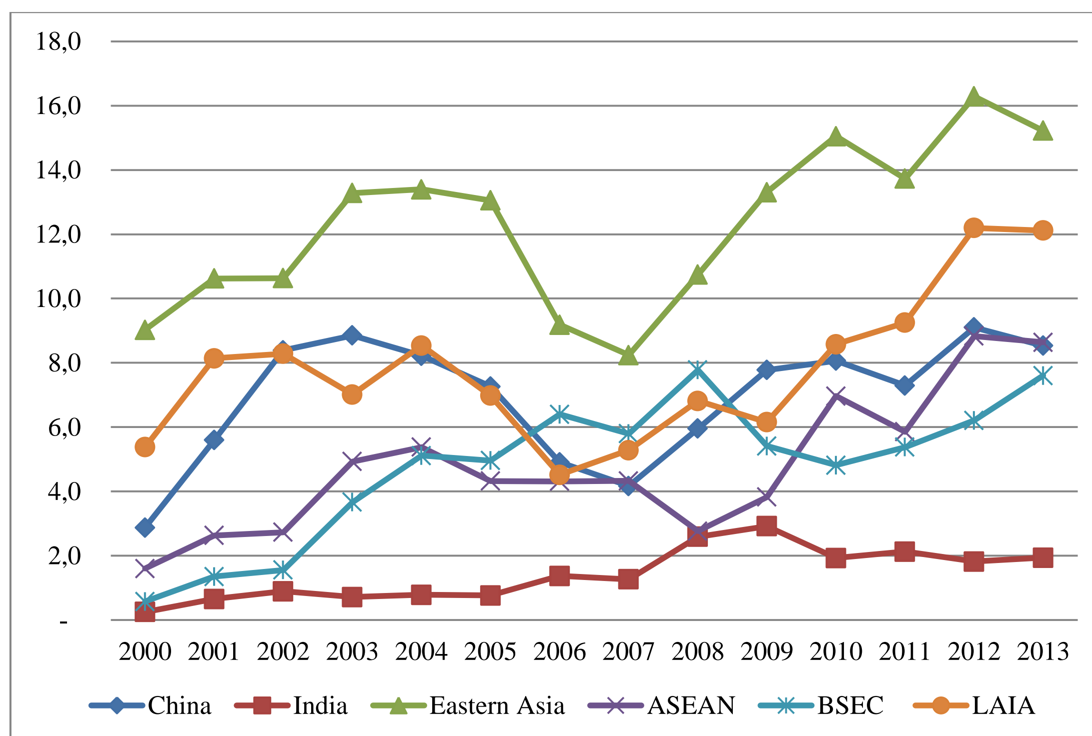
1. Foreign Direct Investment in ASEAN

ASEAN was the leading FDI destination among the major developing country regional groupings in the early 1990s. The rise of China in the 1990s and most of the 2000s and the recovery of the Latin American Integration Association (LAIA) area in the 2000s meant that ASEAN was effectively eclipsed. Indeed, China and LAIA, and to a lesser extent the Black Sea Economic Cooperation[2] area, were the leading investment destinations in the developing world in the first half of the 2000s, with China garnering an average of 8.7 percent of global FDI flows in 2002–2003, compared with ASEAN's global share of an average of 2.3 percent during this period. *It must be emphasized that the concern of FDI redirection from ASEAN to China was one of the major driving forces behind the ASEAN Leaders' decision to establish an ASEAN Economic Community during the ASEAN Summit meeting in Bali, Indonesia in 2003*. Interestingly, FDI inflows into ASEAN surged during 2003–2004, raising the region's global share to an average of 5.2 percent, right after the decision to establish the AEC. But 2004–2008

[2] The Black Sea Economic Cooperation consists of countries around the Black Sea, including the Russian Federation, Turkey, Georgia, and Ukraine.

saw a fall in ASEAN’s global share, similar to the experience of the developing world including China during that period. See **Figure 1**.

Figure 1: Inward FDI Flows, % of Total World Inflows



Note: Eastern Asia refers to the People’s Republic of China, Hong Kong Special Administrative Region, Macau Special Administrative Region, Republic of China (or Taiwan), Democratic People’s Republic of Korea (or North Korea), Republic of Korea (or South Korea), and Mongolia.
Source: UNCTAD Stat 2013.

However, as **Figure 1** shows, ASEAN saw a marked surge in FDI inflows from 2009 onward with its share of total global FDI inflows rising to an average of 8.7 percent in 2012–2013, from only 2.8 percent in 2008. It is worth noting that ASEAN’s share of 8.6 percent in 2013 equalled China’s share of 8.6 percent in the same year (and was marginally higher in total value than China’s), and was much higher than India’s 1.9 percent share. Note that China has been the leading investment destination country in the developing world since 1992; indeed, in 2013, China as a country ranked second to the United States globally. If ASEAN were viewed as a country, however, it would

be the second largest investment destination in the world after the United States in 2013.[3] **The upshot is that ASEAN is a growing investment hotspot.**

The experience in the European Union (EU) and the North American Free Trade Agreement (NAFTA) area shows that FDI inflows surged into these regions at the start of their formation. It is worth noting that the surges in FDI into ASEAN occurred during the period of the announcement of the formation of the AEC (2003–2004) and the years coinciding with the Roadmap for an ASEAN Community (2009–2015) going into AEC 2015. No comprehensive analysis of the link between FDI inflows into ASEAN and the impending establishment of the AEC has been undertaken, but recent surveys of multinational firms suggest that the formation of the AEC has been an increasingly important factor in their investment decisions in the region. Thus, there appear to be good indications that the AEC has already been delivering in one aspect; it has eased the concerns of the ASEAN leaders, expressed in the early 2000s, that AMSs were losing out to China in terms of FDI. With labour costs in China rising substantially, making the lower-wage AMSs in ASEAN increasingly attractive for more labour-intensive manufacturing companies, ASEAN has recently become a growing global investment hotspot. Firms from within and outside the ASEAN region appear to be increasingly taking note of the growing middle class in ASEAN, creating another source of impetus for FDI inflows into the region.

However, there is a major disparity in the country composition of FDI inflows into ASEAN, despite recent progress towards achieving greater balance. Singapore has been the dominant destination of FDI investment into ASEAN, which is illustrated by the fact that it accounts for just over half of ASEAN's total FDI stock (OECD, 2014, p.12) and per capita FDI inflows into the city-state and island country were nearly 59 times higher than the ASEAN average in 2012. In sharp contrast, per capita FDI inflows relative to average ASEAN per capita FDI inflows were less than one fifth for the Philippines; about a quarter for Lao PDR and Myanmar; about two-fifths for Indonesia; and about half to two-thirds for Viet Nam, Cambodia, and Thailand. Indeed, only Malaysia,

[3] **Figure 1** suggests that LAIA had a significantly higher share of global FDI inflows in 2013 than ASEAN and China. However, LAIA is much less a 'community' than ASEAN, and as such it may not be appropriate to look at it as a country.

Brunei Darussalam, and Thailand (until 2008) had been consistently above the ASEAN average since most of the past two decades.

Thus, one key challenge for ASEAN is how to significantly raise the current share of total FDI stock of AMSs other than Singapore by improving their investment attractiveness. As the Roadmap for an ASEAN Community 2009–2015 emphasizes, a free and open investment regime facilitated by investment liberalization nationally and within the whole ASEAN contributes to greater investment attractiveness in AMSs and ASEAN as a whole. The higher FDI inflows that should be the result would also likely reduce the existing disparities in FDI inflows between ASEAN countries.

2. Investment Liberalization in AEC Blueprint: Measurement and Results

***Measurement Methodology*.** The method of measuring the investment liberalization rate follows the method used in the AEC Scorecard Phase 2 Study of the Economic Research Institute for ASEAN and East Asia (ERIA) (See ERIA, 2012). Specifically, the overall foreign investment liberalization rate is equal to 60 percent of the foreign equity liberalization rate and 40 percent of the liberalization rate of other investment restrictions. The higher weight given to foreign equity liberalization is due to its critical importance for foreign investment decisions and its centrality in investment liberalization efforts.

$$FIL = 0.60\ (FEL) + 0.40\ (ORL)$$

where:

FIL = overall foreign investment liberalization rate

FEL = foreign equity liberalization rate

ORL = other restrictions liberalization rate

Similarly, ORL is the weighted average of the liberalization rate of other market access restrictions and the liberalization rate of national treatment restrictions or derogations. Specifically, the ORL rate is equal to 60 percent of the liberalization rate of national treatment restrictions and 40 percent of the liberalization rate of other market access restrictions:

$$ORL = 0.60\ (NT_ORL) + 0.40\ (MA_ORL)$$

where:

NT_ORL = liberalization rate of national treatment restrictions

MA_ORL = liberalization rate of other market access restrictions

The national treatment limitations or restrictions or impediments can be grouped into four types of measures:

1. Restrictions or discriminatory requirements on screening and approval of investment projects;
2. Restrictions on the composition of boards of directors and management;
3. Restrictions on movement of natural persons incidental to the operations of foreign invested firms; and
4. Input requirements, operational restrictions, and other restrictions.

The other market access restrictions or impediments can be grouped into six types of measures:

1. Limitations on the number of service suppliers;
2. Limitations on the total value of service transactions or assets;
3. Limitations on the number of service operations or on the total quantity of service output;
4. Limitations on the total number of service operations or on the total quantity of suppliers;
5. Limitations on the total number of natural persons that may be employed; and

6. Measures that restrict or require specific types of legal entity or joint venture.

Higher weight is given to the liberalization rate of national treatment restrictions because the national treatment restrictions have potentially more damaging effects on investment attractiveness of a country than the other market access restrictions. They tend to be more difficult to reduce or eliminate than the other market access limitations.

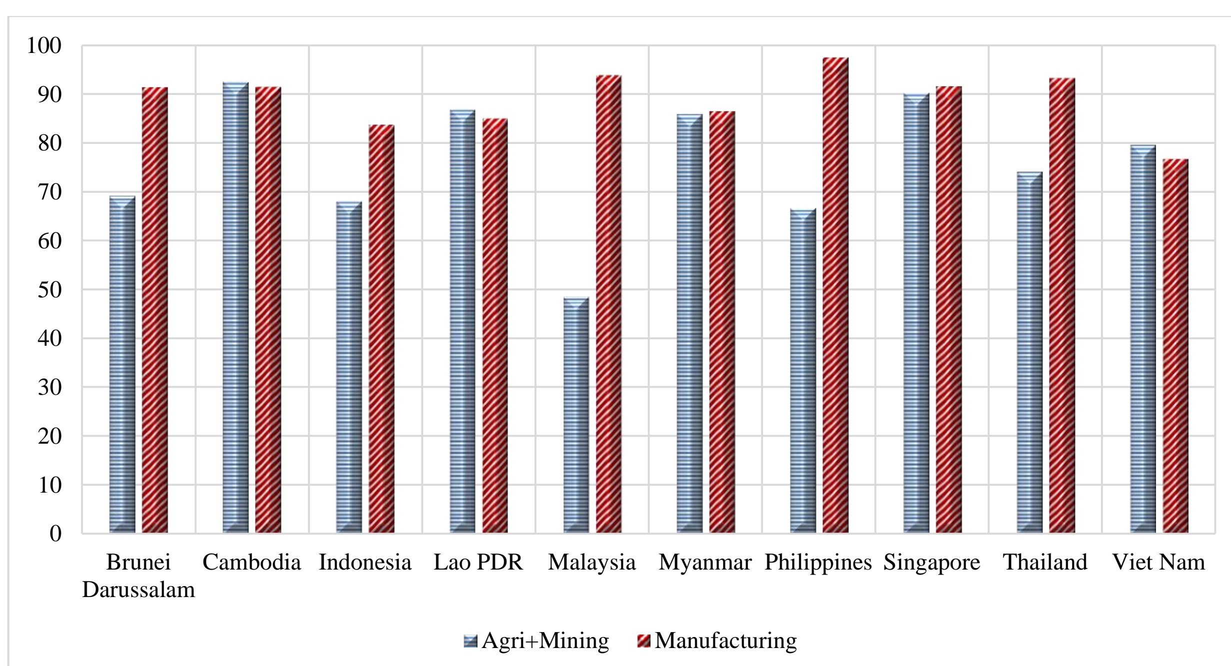
The **liberalization rate of other market access restrictions** (MA_ORL) is computed as equal to 100 minus the prevalence rate of other market restrictions. The **liberalization rate of other national market ORL** (ONT_ORL) is computed equal to 100 minus the prevalence rate of national treatment restrictions. Note that the method does not consider the degree of severity of national treatment derogations, only their incidence. Note also that higher liberalization rates for market access or for national treatment involve essentially the reduction or elimination of restrictions or impediments to foreign investment.

In the estimation of the foreign equity liberalization rate, we consider industries that allow at least 70 percent foreign equity (with or without conditions set for higher allowable foreign equity) to be liberalized (with or without conditions). Thus, the threshold for investment liberalization is less stringent than the usual reference point of 100 percent allowable foreign equity. The choice of at least 70 percent allowable foreign equity is based on the presumption that effective control of a corporation (that allows the change in the nature and organization of a corporation, for example) would generally require a two-thirds majority of the voting rights of the corporation. The implied assumption of the 70 percent threshold as 'liberalized' is that it is not very difficult to find local partners and that there may be positive societal benefits of such joint ventures through technology and managerial transfers as well as market linkage opportunities. Nonetheless, it is worth noting that countries that allow at least 51 percent foreign equity tend to allow 70 percent foreign equity and in most cases also up to 100 percent foreign equity, except in some cases of legal or constitutional constraints or due to socio-political objectives.

The estimation of the investment liberalization rate made use of the negative list approach and the Reservation List of the ASEAN Comprehensive Investment

Agreement (ACIA). **Figure 2** presents the investment liberalization rate for the case of 70 percent allowable foreign equity. The figure differentiates the investment liberalization rate for the combined agriculture and mining sectors from the liberalization rate for the manufacturing sector. **Many AMSs are more restrictive in the agriculture and natural resources sector than in the manufacturing sector**. Note that regional production networks are mainly in the manufacturing sector.

Figure 2: Foreign Investment Liberalization Rate (ACIA, 70% Foreign Equity)



Source: Author's estimates.

The following observations from **Figure 2** are worth pointing out**:**

1. Cambodia, Lao PDR, Myanmar, and Singapore have very high and nearly comparable levels of investment liberalization rates in the agriculture and natural resources sector and in the manufacturing sector. In fact, the agriculture and natural resources sector is more open than the manufacturing sector in Cambodia and Lao PDR. These four countries are the most open to foreign investment overall in ASEAN. Note that openness in agriculture is in

terms of use of land (usually through long-term leases), not in terms of ownership of land.

2. Cambodia, Lao PDR, and Myanmar—the three AMSs with the lowest per capita incomes in ASEAN—are land rich and resource rich. The implied development strategy is to leverage what they have in relative abundance (land and natural resources) to entice what they lack (capital and technical and managerial know-how) through large plantations (in Cambodia and Lao PDR) and capital-intensive energy and mining projects (Lao PDR and Myanmar).

3. Brunei Darussalam, Indonesia, Malaysia, Philippines, and Thailand take a more restrictive stance when it comes to land and natural resources, while being much more open in the manufacturing sector. The Philippines provides an example. The country has the most open manufacturing sector in ASEAN. However, constitutional provisions restrict foreigners to a minority position in the utilization of natural resources (including land), except in very special circumstances such as a foreign firm having a technical and financial agreement with the Philippine government in mining. Foreign ownership constraints in mining, especially in the oil and gas sector, explain in large part the low liberalization rate in the agriculture–mining sector in Brunei Darussalam, despite a very open agriculture sector, because the liberalization rate is a weighted average, the weights being the relative importance of the two sectors in national gross domestic product (GDP). Similarly, it is the mining sector, with its large relative share in national output, which greatly contributed to the relative low liberalization rate in the combined resources based sector of Malaysia.

4. Viet Nam has the lowest liberalization rate in manufacturing. In fact, the country has a higher liberalization rate in the agriculture–mining sector than in the manufacturing sector.

The list of manufacturing industries that do not meet the 70 percent threshold of allowable foreign equity by country is presented in **Table 2**. These industries can be considered 'sensitive industries' to some extent. As is implied by **Figure 2,** Indonesia and Viet Nam are the two countries with the largest number of industries that do not meet the 70 percent threshold in the manufacturing industry. At the other end, Lao PDR and Singapore have none. Some industries figure more often in the list—*food manufacturing, textiles and wearing apparel, basic metals, chemicals and chemical products, printing and reproduction of recorded media, beverages and tobacco, and non-metallic mineral products.* There are likely to be unique country-specific considerations for why some of these sectors are considered to be sensitive; for example, cultural considerations as reasons for restrictions on textiles and wearing apparel (e.g., batik in Indonesia and Malaysia, and silk in Thailand); food products (e.g., special local food products in Indonesia); and beverages and tobacco as controlled products (e.g., prohibitions of alcoholic beverages). At the same time, there may also be economic-strategic reasons for such more restrictive policy stances on FDI in the above-listed sectors—for example, the sectors are already well served by local producers (e.g., wearing apparel), the sectors are vital for the country's industrialization (e.g., basic metals, chemicals). The country reports under the AEC Scorecard project provide indications of challenges and progress of liberalization in the sectors listed in the ACIA Reservation List in a number of AMSs.

Table 2: Industries (Manufacturing) where some Component Sub-industries Do Not Meet the 70 percent Allowable Foreign Equity: 'Apparently Sensitive Industries'

Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Thailand	Viet Nam	Brunei Darussalam	Singapore
Manufacture of chemicals and chemical products	Manufacture of food products	Manufacture of food products	Manufacture of beverages	Manufacture of beverages	Printing and reproduction of recorded media	Manufacture of food products	Manufacture of food products	None	None
	Manufacture of beverages	Manufacture of textiles	Manufacture of tobacco products	Manufacture of tobacco products		Manufacture of textiles	Manufacture of beverages		
	Manufacture of textiles	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	Manufacture of textiles	Printing and reproduction of recorded media		Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	Manufacture of tobacco products		
	Manufacture of wearing apparel	Manufacture of chemicals and chemical products	Manufacture of wearing apparel	Manufacture of coke and refined petroleum products		Manufacture of other non-metallic mineral products	Printing and reproduction of recorded media		
	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	Other manufacturing	Printing and reproduction of recorded media	Manufacture of basic pharmaceutical products and pharmaceutical preparations		Manufacture of basic metals	Manufacture of coke and refined petroleum products		
	Manufacture of chemicals and chemical products		Manufacture of chemicals and chemical products	Manufacture of basic metals		Manufacture of fabricated metal products, except machinery and equipment	Manufacture of chemicals and chemical products		
	Manufacture of basic pharmaceutical products and pharmaceutical preparations		Manufacture of other non-metallic mineral products			Other manufacturing	Manufacture of other non-metallic mineral products		
	Manufacture of rubber and plastics products		Manufacture of basic metals				Manufacture of basic metals		

Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Thailand	Viet Nam	Brunei Darussalam	Singapore
	Manufacture of other non-metallic mineral products						Manufacture of fabricated metal products, except machinery and equipment		
	Manufacture of fabricated metal products, except machinery and equipment						Manufacture of electrical equipment		
	Manufacture of furniture						Manufacture of other transport equipment		
	Other manufacturing						Other manufacturing		
							Repair and installation of machinery and equipment		

Source: Author.

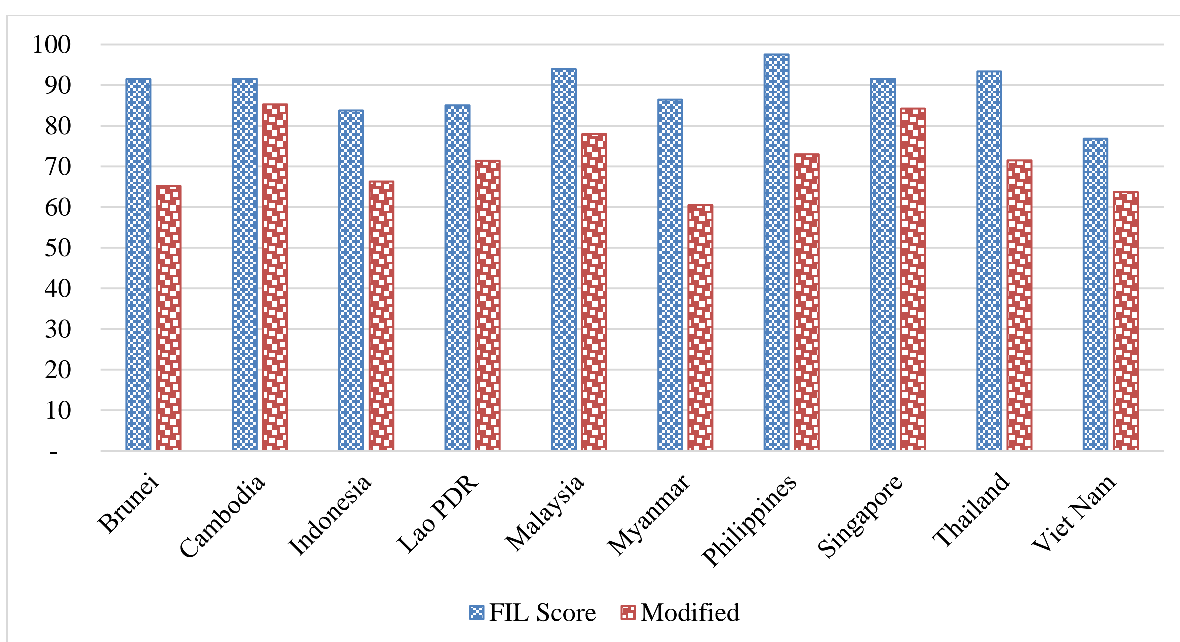
National Treatment Derogations. The scoring system used in **Figure 2** scored national treatment derogations in terms of incidence; i.e., the number of such limitations present in each AMS. However, there are various degrees of national treatment derogations, and a number of researchers consider such degrees of differences as significant in the degree of foreign investment liberalization of a country, or more usually termed 'FDI Restrictiveness Index' (see e.g., Thangavelu, 2014). The FDI Restrictiveness Index, which usually follows the approach and weights of the Organisation for Economic Co-operation and Development (OECD), differs in weights and references points from the scoring system used in the report. However, by tweaking somewhat the OECD weights and approach to bring these more closely in line with the report's scoring system, it is possible to get some *rough idea* of the impact on the liberalization rate of the degree of national treatment derogations.[4]

[4] The tweaking was done as follows: we raised the weights on foreign equity limitation from 0.4 to 0.6, similar to the report's scoring system; we transformed the 0.7 weight in foreign equity limitation into a 1.0 weight similar to that in the report's scoring, we deleted the 'national treatment' in the OECD scoring, and deleted the 'other market access' in the study's scoring. In effect, **the modified scoring system focuses only on foreign equity limitation and the national treatment derogations set out in the study's scoring system discussed earlier in the chapter.**

Figures 3 presents the rough approximation exercise between the modified report scoring system and a modified OECD system used by Thangavelu (2014) for the manufacturing sector. Taking into consideration that the approximation exercise is rough, the results are nevertheless worth noting. In addition, **Figure 3** indicates that all AMSs have a substantially lower overall foreign investment liberalization rate when scoring of national treatment derogations takes into consideration the degree of the derogations ('Modified') and not only the incidence of derogations ('FIL'), even for the AMSs where foreign equity liberalization rates are roughly the same (especially the Philippines, Thailand, and Brunei Darussalam). The only exception is Cambodia, where the gap is narrow and appears to be due mainly to foreign equity liberalization rate divergence.

The figure suggests that the national treatment derogations are relatively severe, and as such may act as disincentives to foreign investment inflows into the country. This implies a need to reduce the restrictiveness of the national treatment derogations over time, if not eliminate them altogether.

Figure 3: Comparison between Foreign Investment Liberalization Rates (FIL) and Modified OECD Foreign Investment Rate (Modified FIL): Manufacturing



Source: Author's estimates.

3. Investment Liberalization: Progress and Challenges in Selected ASEAN Member States

So far, the scoring and discussion on investment liberalization in AMSs has been based on the ACIA Reservation List, which is essentially on a commitment basis. The country reports under the AEC Scorecard project in a number of AMSs indicate that actual investment policies can differ from the commitments; they also highlight challenges in investment liberalization. The discussion below focuses on Indonesia, Malaysia, Myanmar, Philippines, Thailand, and Viet Nam, as they are indicative of both the progress and challenges of investment liberalization. Note that Cambodia, Lao PDR, and Singapore have economies relatively very open to FDI in both the manufacturing and non-manufacturing goods sectors.

Indonesia is a very good example of both the progress and challenges in investment liberalization. Indonesia's current regulation on allowable foreign equity in the country's economic sectors is Presidential Regulation No. 39/2014, promulgated in early 2014, which replaced the earlier Presidential Regulation No. 36/2010. Both presidential regulations provide the negative lists of sectors that are closed or open to foreign investment and the conditions for investment. Damuri *et al.* (2014) compared the negative list in Presidential Regulation No. 39/2014 with the Reservation List in ACIA. The results, shown in **Table 4**, indicate that more than half of the 72 manufacturing sectors in the ACIA Reservation List have become less restrictive under current investment regulations in Indonesia. Similarly, services incidental to manufacturing, agriculture, forestry, and fishery have become more liberalized than ACIA commitments. Some sectors in agriculture, forestry, fishery, and mining have also become more liberalized. Nonetheless, there are also a few sectors in manufacturing (9 out of 72), agriculture (2 out of 25), mining (2 out of 6), and services incidental to mining and quarrying (1 out of 4) that have become more restrictive than the ACIA commitments (see Damuri *et al.*, 2014).

Table 4: Indonesia's Negative Investment List Level of Restrictiveness in Comparison with ACIA Commitments

No.	Sectors	Less restrictive	Equal	More restrictive	Total number of subsectors
1	Manufacturing	35	28	9	72
2	Services Incidental to Manufacturing	22	3	0	25
3	Agriculture	7	16	2	25
4	Services Incidental to Agriculture	4	0	0	4
5	Forestry	3	8	0	11
6	Services Incidental to Forestry	1	0	0	1
7	Mining and Quarrying	2	2	2	6
8	Services Incidental to Mining and Quarrying	2	1	1	4
9	Fishery	2	2	0	4

Source: Damuri, *et al.*, 2014.

That there are sectors that have become more restrictive than the ACIA commitments suggests that the ACIA commitments are not binding enough for AMSs; indeed, as the interview of the Indonesia country study team '…with Indonesia Investment Coordinating Board (BKPM) revealed … there is no clear linkage between the two … (Presidential Regulations) …, and more specifically, the ACIA Reservation List did not influence the creation of the current Negative Investment List' (Ibid, p.46, paragraph provided). This suggests that investment liberalization in Indonesia is largely autonomous, and the progress in investment liberalization in the country is reflective of Indonesia's appreciation of the critical role of FDI for the total investment in and for the development of its economy.[5]

At the same time, that Indonesia restricted foreign equity in some sectors while liberalizing further foreign equity restrictions in many others indicates it does not favour wholesale liberalization of its investment regime and it provides an insight into Indonesia's current assessment of its national interest. For example, Indonesia allowed up to 100 percent foreign ownership during concession periods in some sectors like power generation of more than 10 megawatts or power plant transmission and

[5] Foreign investment accounted for two-thirds of the 'number of investments in Indonesia' in 2013 (Damuri *et al.*, 2014, p.42).

distribution in order to encourage foreign investors to participate in public–private partnership schemes. In contrast, Indonesia substantially lowered allowable foreign equity in sectors such as communications and information (e.g., call centres, data communication services, and telecommunication content services like ringtone or premium text) and the oil and gas drilling offshore sector, or effectively closed some sectors from foreign equity participation, such as drilling services and supporting oil and gas services (design and maintenance), which had previously been open up to 95 percent foreign equity. And some sectors are reserved for domestic micro, small, or medium enterprises, a regulation common to several AMSs (see Damuri *et al.*, 2014).

In Thailand, the reservation list in the actual investment regulations under Thailand's Foreign Business Act B.E. 2542 is virtually the same as in the ACIA Reservation List, with two of the three sectors committed to be liberalized up to 51 percent allowable foreign equity under ACIA already implemented; the remaining ACIA commitment not yet implemented is forestry from forest plantation (see TDRI, 2014). In contrast to Indonesia, it appears that in Thailand there is much greater concordance between the ACIA Reservation List and the actual reservation list except for one sector. It also appears that Thailand tends to hew its ACIA Reservation List to the actual reservation list, except for a very few ACIA commitments of marginally higher allowable foreign equity which the country is attempting to implement fully by 2015. That Thailand's Board of Investments has no plans to liberalize more than what had been committed to is due to the difficult process of investment liberalization in the country (see TDRI, 2014).

Like in Indonesia or other AMSs, Thailand allows at most minority foreign equity presence in some sectors or even forbids foreign equity participation in a few sectors, except with the express permission of the Thai government. Many of these are in the agriculture, fishery, and forestry sectors, agri-based manufacturing of sensitive products (e.g., sugar cane manufacturing, rice milling), or manufacture of culturally linked products (e.g., casting Buddha images, Thai silk yarn, weaving, or pattern printing). In view of the political or cultural sensitivity of those sectors, it is probably not surprising that Thailand's Ministry of Commerce is not keen to push for further liberalization, except for the remaining unimplemented ACIA commitment (i.e., forestry from forest plantation). Having said that, Thailand has a relatively liberal investment regime in

manufacturing, except for the sensitive sectors discussed above. Similarly, Thailand has a relatively liberal foreign equity environment in mining, allowing up to 60 percent foreign equity participation, thanks in part to the Thailand–Australia Free Trade Agreement (TAFTA), which allows up to 60 percent equity share in mining and quarrying and which also applies to investors from ASEAN (TDRI, 2014).

The Philippines has a liberal foreign investment regime in manufacturing similar to Thailand, as the scoring results of **Figure 2** show. Foreign equity is allowed up to 100 percent in manufacturing sectors, except for a very few that have national defense or security implications (e.g., nuclear, biological, chemical, or radiological weapons, and firecrackers) or domestic-oriented small firms with paid-in capital of less than USD200,000. However, the Philippines has severe constraints in the liberalization of the agriculture, fishery, forestry, and mining sectors because of constitutional prohibitions of foreign equity of more than 40 percent (see Llanto *et al.*, 2014). Efforts at easing the so-called economic provisions of the current Philippine Constitution have so far been stymied by the highly politically charged environment of constitutional reform, as such reform efforts and discussions have included the extremely politically sensitive and divisive issues of the structure of the national legislature, the tenure of legislators, the President of the country, and the organization of the national government (whether federal or central).[6]

Malaysia's ACIA Reservation List is fairly long, and there has barely been any improvement in terms of investment liberalization on the goods side, in sharp contrast to the noteworthy liberalization efforts in services. Interestingly, Malaysia eased up on foreign equity restrictions in key services sectors to attract FDI (even eliminating the 30 percent *bumiputera* share in a number of services industries), thereby encouraging the growth and development of the service and financial sectors to raise further the share of the services sector to the national economy from around 54 percent at present to a target

[6] At present, there is a move in the Philippine Congress (the lower house of the legislature; the upper house being the Senate) to modify the economic provisions of the Philippine Constitution by putting some legal course for flexibility (i.e., by leaving the specifications of the restriction to Congress, not explicitly stated in the Constitution). The leadership of the Philippine Congress appears aggressive and optimistic in pushing for the necessary constitutional modifications using this approach, in as much as it sidesteps and postpones the debates on the specific revisions of the laws concerned. So far, this approach has succeeded in delinking the discussion on the revision of the economic provisions of the Constitution from the political and institutional debates surrounding constitutional change in the country.

share of around 60 percent (MIER, 2014). What is striking is that Malaysia increasingly relies on more liberal foreign equity regulations to develop its services sector, but continues to pursue protectionist measures to develop and/or maintain a number of goods sectors. Among the apparently sensitive sectors that remain to be protected in Malaysia's Reservation List are wood-based industry, sugar refining, automotive industry, and oil and gas industry including petroleum refining. In addition, foreign equity participation is set at a ceiling of 25 percent in Malaysia's megaprojects and privatization projects and such foreign equity participation is allowed only if it is needed financially, technologically, and/or for international linkages and exports (MIER, 2014).

Malaysia has arguably been one of the most active AMSs in using trade protection for strategic industrial purposes, as best highlighted by the automotive industry, which historically has been shielded from foreign competition and which is a national project to develop local automotive design and engineering capabilities by providing preferential treatment for local brands Proton and Perodua (MIER, 2014). In addition, Malaysia's national automotive policy '…explicitly aims to use the automotive industry to enhance *bumiputera* participation' (Ibid.). Malaysia appears to be easing up in the automotive sector, especially in the development of energy efficient vehicles (EEV) where the government would like Malaysia to be the regional hub (MIER, 2014). Nonetheless, foreign cars are believed to be taxed '…several dozen percentage points higher (than Proton and Perodua cars)' (Takahashi, 2014).

The intermingling of economic-strategic and non-economic considerations is also apparent in the case of the oil and gas sector, shaped as it is by the special position of PETRONAS, considered to be the sole custodian of the petroleum industry (MIER, 2014) in Malaysia's economy and as source of government revenue. The case for protection of some industries like the wood-based industry (where the country has comparative advantage) and the sugar industry (where the country may not have comparative advantage) appears less compelling than those for the automotive and oil and gas industries, unless the protections are also probably shaped by the government's aim of supporting robust *bumiputera* participation in the economy.

Viet Nam does not appear to have such daunting constitutional constraint as the Philippines. Nonetheless, Viet Nam has the longest and widest ranging list of sectors in

the ACIA Reservation List among the AMSs. As Vo *et al.* (2014) pointed out, 'Viet Nam's commitments are mainly based on WTO commitments or equivalent to lowest commitment levels of other ASEAN member states', as the country emphasized the factor of development gap among AMSs. According to Vo *et al.* (2014), '…though the plan to reexamine and revise the Reservation List has been undertaken, it will take time to make any changes in the current List in the years to come' (p.41). In fact, given no changes in the Reservation List, recent stricter regulations under the new Labour Code shortening the allowable work permit period for intra-corporate transfers appears to have made the investment regime more restrictive (Vo *et al.*, 2014).

Viet Nam's more conservative investment liberalization stance, taking account of the development gap, contrasts sharply with the much more liberal investment regimes in Cambodia and Lao PDR, which have even lower per capita incomes and are at a lower stage of economic development. Viet Nam has been much more successful in attracting FDI than most AMSs during the past two decades, despite its less-than-welcoming foreign equity stance compared with many AMSs. This highlights the fact that investment liberalization—in terms of allowable foreign equity—is an important but not sufficient factor for successfully attracting FDI. Many factors determine inward FDI flows. In the case of Viet Nam, the more recent efforts to attract FDI involve improvements in the institutional setting of investment (e.g., greater protection of investors, elimination of unfair treatment of foreign investors regarding the right to establish their business and regarding investment activities in all sectors), document and process simplification in investment (e.g., elimination of investment certificates except for conditional investment projects, clarification of definition of prohibited and conditional business activities for foreigners, abolition of Harmonized System codes requirement for foreign enterprise registration certificates thereby allowing them to have as many business activities as they want, revision of government bidding rules shifting priority from low price to technical capacity and experience in the selection of bidders). Such institutional and procedural changes arguably also improve the regulatory regime governing direct investment in Viet Nam.

Myanmar has been opening up its economic sectors to FDI, which it considers to be critical for catching up with the rest of the AMSs economically. Thus, in comparison with its ACIA Reservation List, restrictions on foreign investment in wine production,

corrugated galvanized iron sheets, and bakery products have been removed. Similarly, 100 percent foreign ownership is allowed in petroleum refining and services related to petroleum refining and to recorded products (e.g., CDs). In addition, the Union of Myanmar Notification Nos. 49/2014 and 50/2014 list the sectors where joint venture with domestic partners is required; in gemstone and protected areas, foreign investment is not allowed. Foreign investors in virtually all areas have recognized that the country's investment regime in terms of foreign equity rules has improved. The complaints from foreign investors are more of investment facilitation issues like stay permit and length of time to get approvals, regulatory uncertainty (e.g., vagueness of profit-sharing arrangements in mining), and infrastructure bottlenecks (see YUE, 2014).

As the Myanmar country report (YUE, 2014) above indicates, a number of AEC Scorecard country reports also point out the importance of factors other than investment liberalization for improving the investment climate in their respective AMSs. For example, the Philippine country report brought out the importance of factors such as streamlining and simplifying business procedures, the overall business environment, corporate governance and labour laws, and the logistics infrastructure. The Philippine country report also emphasized that while '… ACIA by itself does not guarantee FDI inflows, it can be an important mechanism for vertical integration of multinational firms and (the) development of regional value chain. Hence, it would do well for member states like the Philippines to implement reforms in line with ACIA' (Llanto *et al.*, 2014, p.47). The Indonesia country report noted that Indonesia would do well to use its ACIA commitments as a benchmark for its investment policies. And interviews with the Malaysian private sector revealed concerns about the quality of human capital in the country (MIER *et al.*, 2014).

Several AMSs considered some sectors to be particularly sensitive in terms of allowing majority participation of foreign equity or any foreign equity participation at all. This is essentially the domain of component 1 of the ACIA framework, where no investment liberalization can be expected. The list under component 1 has yet to be finalized by each AMS, after which the rest of the sectors in the Reservation List would be considered part of component 2, which needs to be further liberalized or totally liberalized. Regarding the challenge of managing the liberalization process for the component 2 sectors, Damuri *et al.* (2014) emphasized the importance of 'ASEAN

need(ing) to conduct more socialization regarding the benefits and regulations of investment liberalization, and need(ing) to emphasize the cooperative aspect of these initiatives instead of merely describing the competitive side of liberalization within ASEAN countries' (p.47).

SME *development and investment openness.* Several AMSs carve out the small and medium enterprises (SMEs) sector, where foreign equity participation is highly restricted, if not banned outright. The implicit policy bias is the protection of SMEs from competition from foreign firms that are presumed to be more competitive. The restriction is considered to be particularly severe for domestic-oriented firms and in traditional industries. This policy bias in favour of domestic SMEs is a reflection of the major role of SMEs as employment generators, anchors for inclusive growth, and important test beds of domestic entrepreneurship. The scoring in the paper did not include any scoring with respect to foreign equity constraints on SMEs specifically, as SMEs are everywhere, but their incidence differs across industries. Despite the difficulty of including it in the scoring, the issue of foreign equity participation is worth exploring, and we use the experience of Singapore as a case for consideration.

Singapore, as one of the most open economies in ASEAN, provides an alternative perspective on the development of SMEs. Rather than shielding SMEs from competition from foreign-owned firms, the Singapore government appears to focus more on providing SMEs with support to enable them to better compete with foreign firms. Singapore's small domestic market and lack of natural resources have made it imperative for the city-state and island country to rely critically on attracting foreign investment, technology, and talent (Lim, Aw, and Loke, 2014). Given that fundamental policy imperative, how can one foster SMEs without protecting them? The answer, according to Lim, Aw, and Loke (p.91), is:

> Based on the Singapore experience, liberal investment regime must be complemented with effective and sustainable SMEs policy or other targeted sectoral policy. Initially, local SMEs were oriented toward supporting larger and more competitive foreign multinationals as sub-contractors. Over the years, due to successful and effective SME policies in nurturing and supporting vibrant and competitive SMEs and in fine-tuning liberal investment regime, these local firms have become more

> competitive in domestic economy and in venturing abroad to foreign markets. [The implication for other AMSs is that] in implementing ACIA, AMSs with large domestic market must also have robust and effective SMEs policies to nurture the development of local SMEs in supporting foreign firms and in exploiting non-tradable sectors which local SMEs normally have comparative advantage.
>
> Another important [area] which is critical to the implementation of ACIA for large AMSs is the existence and gradual implementation of competition regime and effective regulatory management. In the Singapore context, a liberal investment regime is strongly supplemented and reinforced with continuing improvement in the competition policy and regulatory regime with a view to strengthen competition and the development of competitive local SMEs. A liberal investment regime without concurrent policy measures to improve competitiveness and nurturing local SMEs would have much negative side-effects on local enterprises and SMEs.

Singapore's telecom industry provides a good example—it had been a monopoly until 1992, but now has more than 500 telecom providers and international call rates were slashed by 80 percent. According to Lim, Aw, and Loke (2014):

> The decision to introduce competition in the telecom sector was influenced by two factors. Firstly, rapid technological advancement reduced infrastructural costs. The natural monopoly argument thus is no longer valid. Secondly, a monopoly provider would not have the right incentives to satisfy the increasingly diverse and sophisticated demand for telecom services to support Singapore's development as a global business hub. As the telecom sector was the first monopolistic sector to liberalize in Singapore, no local templates for competition management could be adopted. Through gradual improvements in competition law and regulatory regime pertaining to the telecom sector, Singapore has been

able to liberal its telecom sector with maximal benefits to consumers and minimum injury to the dominant local telecom firm, that is SingTel.

4. Conclusion and Way Forward

The paper shows that the foreign investment liberalization rate, based on ACIA is high in manufacturing, with the challenges to further liberalization to be found primarily in Indonesia and Viet Nam. The major investment carve out that restricts substantially foreign equity participation in SMEs sector and manufacturing in a number of AMSs—in support of domestic micro and small enterprises (and cooperatives) where the paid-up capital ceiling is very low—is unlikely to be a significant barrier to FDI. With respect to the agriculture-mining sector, the picture is much more mixed across ASEAN; with some AMSs are very liberal in their foreign investment stance while several others are more cautious, measured, and/or restrictive towards foreign equity participation.

Several country reports under the AEC Scorecard project bring out the challenges of further investment liberalization. There are complex cultural, political, and security sensitivities regarding foreign equity majority control in some sectors, especially in agricultural and natural resource–based industries, in certain AMS. There may be strategic industrial, nationalist, and/or developmental gap considerations working against foreign majority ownership in some manufacturing sectors in several AMSs. It also emerges from some country reports that AMSs are currently emphasizing factors other than investment liberalization that are affecting their countries' attractiveness to foreign investors.

Given these findings, what is the way forward in terms of furthering investment liberalization in the ASEAN region in 2015 and beyond? The following are our key recommendations:

1. **First**, ***set a small number of sectors (following a commonly agreed level of disaggregation of sectors), with clear criteria, as ceiling for component 1 of the ACIA liberalization programme.*** Component 1 under ACIA consists of

sectors that are exempt from liberalization mandates on allowable foreign equity. This component addresses the current reality that several AMSs have cultural, political, security, or constitutional constraints concerning foreign equity control in certain sectors. It is useful to make the number of allowable sectors in component 1 very few to prevent it from being abused as a mechanism for thwarting further investment liberalization.

2. **Second**, ***with component 2 being effectively defined as the sectors in the AMSs' ACIA Reservation List less the sectors included in component 1, set agreed-upon timetable and possible formula for further investment liberalization of the sectors in component 2.*** This approach borrows from the AFAS formula approach to furthering services liberalization in ASEAN. The key difference is that, whereas AFAS aims for allowable foreign equity of at least 70 percent in all services sectors under AFAS, except for those under the 15 flexibility rule, sectors under ACIA's component 2 are expected to allow greater foreign equity participation, but not necessarily up to 100 percent participation.

   At present, AFAS has greater steering power than ACIA because the former has both a timetable and liberalization formula, whereas the latter lacks a time frame and clear formula for liberalization in component 2 under ACIA. It is apparent that for ACIA's liberalization programme to have more 'teeth', it would need to set an agreed-upon timetable, formula, and criteria for further investment liberalization in the region, similar to AFAS.

3. **Third,** national treatment derogations (e.g., regulations on the composition of boards of directors and intra-corporate transfers) can be a disincentive to FDI. It is important to ***consider reducing the severity of such national treatment derogations, if not eliminate them, as much as possible.***

4. **Fourth**, further investment liberalization in the region ultimately depends on the willingness of AMSs to pursue greater investment liberalization, especially in

the relatively sensitive sectors. Thus, as pointed out in the Indonesia country report (Damuri *et al.*, 2014), ***ASEAN and concerned AMSs would need to conduct more concerted socialization to concerned stakeholders on the benefits of investment liberalization.*** At the same time, given that further investment liberalization may give rise to adjustment costs, managing such liberalization may require a well-articulated and agreed-upon programme for improving the investment regime, consisting of initiatives in investment liberalization and other factors affecting AMSs' investment climates.

The investment attractiveness of a country is determined by many factors. They include broad economic factors such as market size, economic openness and stability of a country, quality of infrastructure, business environment including regulatory quality, labour cost, taxation and bureaucracy, and investment facilitation. A multitude of studies, indices, and indicators have tried to capture these various factors. Such indices have been applied to large sets of countries and in some cases Singapore leads globally (see e.g., Groh and Wich, 2012) or regionally in Asia (e.g., Vriens & Partners, 2013). This suggests that ***investment liberalization would need to be undertaken in tandem with a broader strategy of improving the overall business and investment climate.***

5. **Finally**, and related to the fourth recommendation***, a change in mindset or perspective may be needed to address national treatment derogations with respect to SMEs.*** Instead of continually protecting SMEs from foreign competition, it may be useful to consider the Singapore approach of focusing instead on SME development, with the objective of tempering the protection policies for SMEs over time in tandem with efforts to improve support structures and mechanisms for SME development.

In conclusion, it is worth noting that investment liberalization is only one of many factors that determine the investment attractiveness of a country, as we have seen. A number of them are also within the purview of the AEC. Thus, implementing those measures (e.g., regulatory improvement through the National Single Window) should

generate greater synergy between them and investment liberalization, which should result in an improved investment climate.

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