

# Chapter 7

## **Investment Liberalization and Facilitation: Contribution to the ASEAN Economic Community Blueprint**

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### **INTRODUCTION**

Investment liberalization and facilitation are integral part of regional economic integration. Investment is instrumental to structural adjustment of the relevant economies and realization of the benefits of dynamic effect of the regional economic integration. Investment is needed to facilitate structural adjustment as well as exploitation of the opportunities emerging from liberalization of trade in goods and services. The structural adjustment and exploitation of the new opportunities may call for industrial relocation from the disadvantage location to a more competitive location, changing and up-grading production technology, enlarging production capacity, provision of supporting services and industries, and new investment. Investment liberalization and facilitation would make capital resource readily available at lower cost and hence enable fuller adjustment and exploitation.

Therefore, to deepen economic integration in ASEAN and East Asia, investment liberalization and facilitation is very vital. This paper reviews and discusses some important features of investment liberalization and facilitation agreement and vision of ASEAN and offers some recommendation on making investment liberalization and facilitation more effective in deepening of ASEAN and East Asian economic integration.

## **2. ASEAN INVESTMENT AREA<sup>1</sup>**

At the fifth ASEAN Summit in Bangkok in December 1995, the ASEAN Leaders decided to establish the ASEAN Investment Area (AIA) to attract FDI from outside as well as within ASEAN region. A Task Force was set up to draft the Framework Agreement on the ASEAN Investment Area. The Framework Agreement was then signed by the ASEAN Economic Ministers on October 7, 1998 and entered into force since April 7, 1999. Cambodia, then joined the accession to the AIA Agreement on April 30, 1999, about 3 weeks after the date of enter into force, so that the AIA extends across all 10 ASEAN countries.

The objectives of the Framework Agreement on AIA are : a) to establish a competitive ASEAN Investment Area with a more liberal and transparent investment environment amongst Member States in order to increase FDI inflows from both ASEAN and Non-ASEAN sources into ASEAN, jointly promote ASEAN as the most attractive investment area, strengthen and increase the competitiveness of ASEAN's economic sectors, and reduce or eliminate regulations and conditions which impede investment flows and the operation of investment projects in ASEAN; and b) to contribute towards free flow of investments by 2020.

Member states are obliged to undertake co-operation and facilitation programme (Schedule I), promotion and awareness programme (Schedule II), and liberalization programme (Schedule III). Under Schedule I, Member States are required to take 1) individual initiatives to increase transparency of its investment rules, regulations, policies and procedures, simplify and expedite procedures for applications and approvals of investment projects, and expand the number of bilateral Double Taxation Avoidance Agreements among ASEAN Member States, and 2) collective initiatives to establish a Database for ASEAN Supporting Industries and ASEAN Technology Supplies and ASEAN database on ASEAN investment and opportunities, promote public-private sector linkages through regular dialogues with the ASEAN business community and other international organizations to identify investment impediments within and outside ASEAN and propose ways to improve the ASEAN investment environment, identify target areas for technical co-operation such as HRD,

infrastructure, supporting industries, SMEs, IT, R&D, etc., review and improve the ASEAN Agreement for the Promotion and Protection of Investment, and examine the possibility of an ASEAN Double Taxation Agreement.

Under Schedule II, Member States agreed to organize joint investment promotion activities, conduct regular consultation among investment agencies of ASEAN on investment promotion matters, organize investment related training programmes for officials of investment agencies of ASEAN, exchange lists of promoted sectors/industries where investment from other Member States could be encouraged and initiate promotional activities, and examine ways to support promotion efforts of other Member States.

Under Schedule III, Member States are required to 1) unilaterally reduce and eliminate restrictive investment measures and liberalize rules, regulations and policies relating to investment, rules on licensing conditions, rules relating to access to domestic finance, and rules to facilitate payment, receipts and repatriation of profits by investors; 2) undertake individual action plans to open up all industries for investment to ASEAN investors by 2010 and to all investors by 2020 and to extend national treatment to all ASEAN investors by 2010 and to all investors by 2020; and 3) promote freer flow of capital, skilled labour, professionals and technology among ASEAN Member States.

Note, however, that Article 7 of the Agreement stipulates that Member States immediately open all their industries for investment and accord national treatment to ASEAN investors subject to exceptions under Temporary Exclusion List (TEL) and Sensitive List (SL). TEL will be reviewed every 2 years and will be progressively phased out by 2010 by all Member States except Vietnam, Lao, and Myanmar. Vietnam will phase out its TEL by 2013 and Lao and Myanmar by 2015. SL would be reviewed by January 1, 2003 and periodically thereafter as decided by the AIA Council.

A Member State is required to extend any preferential treatment under any existing or future agreements to which it is a party to all other Member States on the Most Favoured Nation (MFN) basis.

The Agreement also calls for transparency in the Member State's relevant measures, laws, regulations, and administrative guidelines pertaining to or affecting this agreement and including international agreements pertaining to or affecting investment to which the Member States are also signatory (Article II).

Certain exceptions are provided in the interest of national security and public morals, human, animal or plant life or health, prevention of deceptive and fraudulent practices, protection of privacy of individuals and safety, and equitable or effective imposition or collection of direct taxes in respect of investments or investors of Member States.

In addition, emergency safeguard measures and measures to safeguard the balance of payments are allowed for Member States to prevent or to remedy any serious injury and threat resulting from implementation of the liberalization programme or in the event of serious balance of payments and external financial difficulties or threat.

It could be observed that under the Agreement, Member States unilaterally draw up and implement their own liberalization plans in accordance with the Agreement. The preferential treatment is then extended to other Member States on MFN basis amongst those that meet the requirements in the Agreement. The Member State that is not ready to make the required concessions would have to waive its right to such concessions extended by other Member States unless the counterpart Member State is willing to forego the waiver. This mechanism is the well known ASEAN-X which was employed in AFTA.

Of noteworthy feature of the Agreement is the provision of preferential differential treatment for less developed new members of ASEAN to take 3-5 years longer to achieve the liberalization target but yet might get access to other Member States' MFN concessions.

In order to revive the ASEAN economies from the economic and financial crisis, the ASEAN Leaders agreed at the Sixth ASEAN Summit on December 16, 1998 to adopt Bold Measures whereby TEL for the manufacturing sector would be phased out by all Member States by 2003 except for Cambodia, Lao and Vietnam which would do so no later than 2010. In addition the First AIA Council Meeting on March 5, 1999 agreed to widen and elaborate AIA coverage to include manufacturing, agriculture, fishery, forestry, mining and quarrying and services incidental to these sectors. These were then undertaken by the Protocol to Amend the Framework Agreement on the ASEAN Investment Area agreed in September 2001.

Subsequently, it was reported that the AIA process has made good progress. At the Sixth AIA Ministerial Council Meeting in September 2003, it was reported that Member

States had opened up more industries to foreign investment by phasing in the list of sectors and investment measures in the TEL. Significant achievements had also been made in transferring sectors and measures in the SL to the TEL. Member States also, on individual basis, introduced more favourable measures to improve their investment regime. Several projects on investment promotion and facilitation aiming at strengthening capacity building, improving transparency, and harmonization and improvement of FDI data quality were implemented successfully with support from Dialogue Partners and international organizations such as UNCTAD. To enhance transparency and promote greater awareness of ASEAN investment environment, the Council agreed to publish an update Compendium of Investment Policy Measures and the FDI data set. The Council also agreed to have regular dialogue with ASEAN dialogue partners to spearhead investment cooperation as well as to have more active dialogue with ASEAN and Non-ASEAN business representatives. Recognizing the growing importance of the services sector, the Council agreed to work out the scope of expanding the AIA to include services such as education services, health care, telecommunication, tourism, banking and finance, insurance, trading, e-commerce, distribution and logistics, transportation and warehousing, professional services such as accounting, engineering, and advertising.

In the following year, progress was made in the area of promotion of awareness of development in ASEAN's supporting industries and understanding of transnational corporations' strategies. Some Member Countries have reviewed The TEL and The SL and submitted the revised version. The ASEAN Business Advisory Council (ABAC) in cooperation with the Coordinating Committee on Investments (CCI) successfully organized and concluded the First ASEAN Business and Investment Summit in October 2003 in Bali. The first CCI-Japan Investment Consultation was held in May 2004. Continued progress in the AIA process would be made through enhancing external linkages with Dialogue Partners and joint consultations with private sectors. It was also agreed that ASEAN's investment and trade policies should work in tandem to ensure ASEAN's competitiveness.

Another big step in ASEAN's initiatives in investment cooperation was taken when ASEAN Framework Agreement for the Integration of Priority Sectors was signed on November 29, 2004, to accelerate the integration of priority sectors to realize the end

goal of ASEAN Economic Community that ASEAN Leaders agreed to establish by 2020. The Agreement identified 11 sectors namely agro-based products, air transport, automotives, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparels, tourism, and wood-based products, as the priority sectors. The Agreement provides for liberalization of trade in goods, trade in services, and investment; trade and investment facilitation; and promotion and monitoring in the priority sectors. The Agreement also includes other areas for integration such as intellectual property rights cooperation, industrial complementation promotion, and human resource development among ASEAN Member States.

On liberalization of trade in goods, all CEPT-AFTA tariffs on priority sector products would be eliminated by January 1, 2007 for ASEAN-6 and January 2012 for CLMV (with certain exception). Member States would establish the database of ASEAN NTMs by June 30, 2004, establish criteria to identify NTMs that are barriers to trade by June 30, 2005 and establish a definitive work programme for the removal of NTMs that are trade barriers by December 31, 2005, and adopt the WTO Agreement on Import Licensing Procedures and develop common implementation guidelines appropriate for ASEAN by December 31, 2004. Member States would also endeavour to expand the coverage of the ASEAN Integration System of Preferences (AISP) Scheme by including products in the priority sectors.

As for trade in services, Member States would set clear targets and schedules for progressive liberalization for each round of negotiations toward achieving freer flow of trade in services earlier than 2020, accelerate the service liberalization for the priority sectors by 2010, accelerate the development of Mutual Recognition Arrangements (MRAs) by January 1, 2008 and promote joint ventures and cooperation including third country markets, based on ASEAN-X mechanism.

On investment, Member States would accelerate the opening up of sectors currently in the SL by transferring them to the TEL under the AIA, using ASEAN-X formula and beginning 2004, reduce restrictive investment measures in the SL beginning 2004 and complete the elimination of restrictive investment measures in the TEL by December 31, 2010 for ASEAN-6, 2013 for Vietnam and 2015 for Cambodia, Lao, and Myanmar, identify programme and activities to promote investment in ASEAN by December 31, 2005, promote manufacturing processes in ASEAN to take advantage of their

comparative strengths through establishment of a network of ASEAN free trade zones to facilitate outsourcing beginning 2005 and undertake more efficient joint ASEAN facilitation and promotion measures to promote FDI on ongoing basis, and promote and facilitate joint/cross border investments in manufacturing activities through special incentive where appropriate by CLMV for FDI from ASEAN and special measures by ASEAN-6 to promote and facilitate relocation of investment to CLMV especially for labour intensive manufacturing activities.

Regarding trade and investment facilitation, Member States would improve the CEPT Rules of Origin by making them more transparent, predictable and standardized and adopting substantial transformation as an alternative criteria for origin status; apply the ASEAN Harmonized Tariff Nomenclature (AHTN) for extra-ASEAN trade on an on-going basis; simplify, improve and harmonize custom declaration forms by December 31, 2005; ensure the Green Lane System for CEPT products by December 31, 2004; develop the Single Window approach including the electronic processing of trade documents at national and regional level by December 31, 2005; develop common implementation guidelines by December 2004 to fulfill the obligations of the WTO Agreement on Customs Valuation; take certain steps to accelerate the development of MRAs and harmonize product standards and technical regulations; expedite the development of integrated transport logistics services within ASEAN; and develop ASEAN Agreement and accelerate completion of MRAs to facilitate the movement of business persons, experts, professionals, skilled labour and talents.

On trade and investment promotion, Member States would intensify joint intra-ASEAN and extra-ASEAN trade promotion efforts, assist CLMV in organizing promotional activities, undertake more effective joint ASEAN facilitation and promotion measures, and develop new sources of inward FDI such as China, India and Korea.

The Agreement also provides that Member States expand the scope of ASEAN intellectual property rights cooperation to include cooperation in copyright information exchanges and enforcement; promote industrial complementation among ASEAN manufacturers through identification and development of specialization of production processes, R&D, and testing facilities based on comparative advantage of individual Member States; and development of guidelines on promoting outsourcing arrangements



among Member States, and cooperate to develop and upgrade skills and capacity building.

### **3. ASEAN Comprehensive Investment Agreement (ACIA)**

Subsequent ASEAN Summits accelerated ASEAN economic integration deeper and faster. The Summit in Kuala Lumpur in December 1997 decided to transform ASEAN into a stable, prosperous, and highly competitive region with equitable economic development, and reduced poverty and socio-economic disparities (ASEAN Vision 2020). The Bali Summit in October 2003 declared the goal of ASEAN Community by 2020 including ASEAN Economic Community (AEC), ASEAN Socio-Cultural Community, and ASEAN Security Community. The 12th ASEAN Summit in January 2007 then signed the Cebu Declaration on Acceleration of the Establishment of an ASEAN Community by 2015. Particularly, the ASEAN Leaders agreed to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital.

The AEC Blueprint envisaged 4 key characteristics: a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy.

In the AEC Blueprint, free flow of investment and freer flow of capital are two major integral parts. A free and open investment regime is considered to be key to enhancing ASEAN's competitiveness in attracting foreign direct investment (FDI) and intra-ASEAN investment to ensure dynamic development of ASEAN economies. The AEC Blueprint calls for a review of the Framework Agreement on the AIA 1988 and the ASEAN Agreement for the Promotion and Protection of Investment, 1987 or commonly referred to as ASEAN Investment Guarantee Agreement (IGA) with the objective to realize an ASEAN Comprehensive Investment Agreement (ACIA) which would be forward looking, with improved features, provisions and obligations. The ACIA will cover investment protection, facilitation and cooperation, promotion and awareness, and liberalization.

With respect to investment protection, the ACIA will strengthen the provisions on investor-state dispute settlement mechanism, transfer and repatriation of capital, profits, dividends, etc., transparent coverage on the expropriation and compensation, full protection and security, and treatment of compensation for losses resulting from strife.

On facilitation and cooperation, the ACIA will provide for a more transparent, consistent and predictable investment rules, regulations, policies and procedures including harmonizing investment policies; streamlining and simplifying procedures for investment applications and approvals; promoting dissemination of investment information, rules, regulations, policies and procedures; strengthening databases on all forms of investments to facilitate policy formulation; strengthening coordination among government ministries and agencies; consulting with private sectors to facilitate investment; and identifying and working towards ASEAN-wide complementation.

The ACIA will also promote ASEAN as an integrated investment area and production network. The ACIA intends to create the necessary environment to promote all forms of investment and new growth areas into ASEAN; promote intra-ASEAN investments, particularly investments from ASEAN-6 to CLMV; promote the growth and development of SMEs and MNEs; promote industrial complementation and production networks among MNCs in ASEAN; promote joint investment mission focusing on regional clusters and production networks; extend the benefits of ASEAN industrial cooperation initiatives in addition to the AICO Scheme to encourage regional clusters and production networks; and work towards establishing an effective network of bilateral agreements on avoidance of double taxation among ASEAN countries.

Most importantly the ACIA will progressively liberalize ASEAN Member Countries investment regime to achieve free and open investment by 2015. Specifically, the ACIA will extend non-discriminatory treatment, including national treatment and most-favoured nation treatment, to investors in ASEAN with limited exceptions; reduce and where possible, eliminate restrictions to entry for investments in the Priority Integration Sectors covering goods; and reduce and where possible, eliminate restrictive investment measures and other impediments, including performance requirements.

With regard to freer flow of capital, the AEC will strengthen ASEAN capital market development and integration and will allow greater capital mobility. To strengthen ASEAN capital market development and integration, the AEC calls for

greater harmonization in capital market standards in ASEAN in the areas of offering rules for debt securities, disclosure requirements and distribution rules; mutual recognition arrangement or agreement for cross recognition of qualification, education and experience of market professionals; greater flexibility in language and governing law requirements for securities issuance; enhancement of withholding tax structure to promote the broadening of investor base in ASEAN debt issuance; and facilitation of market driven efforts to establish exchange and debt market linkages including cross-border capital raising activities.

In allowing greater capital mobility, the AEC will remove or relax restrictions to facilitate the flows of payments and transfers for current account transactions and remove or relax restrictions on capital flows to support foreign direct investment and initiatives to promote capital market development, while ensuring that the liberalization is consistent with member countries' national agenda and readiness of the economy and the benefits of liberalization is to be shared by all ASEAN countries as well as allowing adequate safeguard against potential macroeconomic instability and systemic risk that may arise from the liberalization process including the right to adopt necessary measures to ensure macroeconomic stability.

#### **4. POLICY ISSUES IN ASEAN INVESTMENT LIBERALIZATION AND FACILITATION**

The AIA and the ACIA are some big steps in the right direction of deepening ASEAN economic integration. Considering the ongoing development of international trade and investment globally as well as regionally, however, there are still several points of consideration in ASEAN investment liberalization and facilitation.

First, under the AIA, the accession to other ASEAN member countries' investment liberalization is conditional on ASEAN-X basis, and remain so under the ACIA. This mechanism serves to encourage voluntary reciprocal liberalization and discourage free riding. However, it allows X countries to fall behind in the liberalization process and thus will weaken the regional force of attracting investment as well as reduce the

potential benefits of the induced investment as the sources of inputs and the markets for the output will be rather limited. It would be desirable for ASEAN to have a concerted collective investment liberalization commitment of all ASEAN member countries in stead of allowing for –X during a given time frame of investment liberalization.

Second, the time frame of investment liberalization by 2015 is rather long, considering rapid pace of globalization, private sector dynamism, and strong competition for FDI. Investors will not wait that long for the investment opportunity. To shorten the time frame of investment liberalization, ASEAN member countries might review impediments to inward FDI which could be classified into a) administrative impediments, b) market access and national treatment standards, c) incentives, and d) operational restrictions (Pangestu and Bora, 1995) and consider the causes or rationale of those impediments (or restrictions) with the aim to remove them as many and soon as possible. Among other things, it was found that regulations on several stages of business undertaking, from starting a business to closing it were significant impediments to FDI inflows to developed and developing countries (Sudsawasd, 2008). Hence administrative impediments should be targeted for removal through investment facilitation program of action, most of which could be dealt without reservation and delay.

Furthermore, Sudsawasd (2008) also found that distance which reflects transaction cost of trade and investment had significant negative effect on FDI flows from OECD countries to East Asian countries while the size (GDP), labor costs and corporate income tax rates in the home countries had significant positive effects. On the other hand, corporate income tax rates in host countries had no significant effect on FDI flows to East Asian countries implying that tax incentive was not effective in attracting FDI. However, in the case of ASEAN-5, bilateral income tax treaties was found to affect FDI inflows positively.

Focusing on intra-developing Asian FDI flows, Rajan (2008) found also that distance significantly deterred bilateral FDI flows while depreciated host country currency, lower political risk and presence of FTA between host and home countries stimulated bilateral FDI flows.

Based on these findings, investment facilitation through logistics and communication improvement to reduce the transaction cost of distance will be a priority

while tax incentive competition will be futile. ASEAN countries would be better off with harmonized tax incentive and even better, tax incentive removal, the sooner the better.

Third, it is observed that the AIA offers preferential treatment to only ASEAN investors for a certain period of time and extend to all investors in later years. Given the fact that FDI in ASEAN has been and will continue to be largely from non-ASEAN, the impact of investment liberalization in favour of ASEAN investors will be rather limited and not conducive to achieving ASEAN's competitiveness in attracting FDI and competitive production base. To achieve competitiveness in attracting FDI and competitive product base, ASEAN investment liberalization needs to be unconditional MFN. Therefore, it would be a significant improvement of the ACIA if the national treatment and most favored nation treatment to "investors in ASEAN" refers to ASEAN as well as non-ASEAN investors.

Fourth, trade liberalization and investment liberalization have to progress in tandem to reinforce each other's impact and generate the greatest benefits. Therefore The TEL and The SL in trade in goods and services will limit the investment opportunities and benefits and vice versa. It is, therefore, of utmost important to minimize The TEL and The SL in both trade and investment liberalization and eliminate them as soon as possible.

Fifth, trade and investment liberalization needs to be accompanied by structural adjustment. There will be losers who resist and protest liberalization. To realize the benefits of liberalization, there must be structural adjustment. Without structural adjustment assistance measures and facilities, restructuring is difficult to realize. On the contrary, a well designed program of restructuring assistance may help accelerate the pace of liberalization. Therefore, ASEAN member countries need to unilaterally and, if possible, collectively come up with restructuring assistance and capacity building for those adversely affected by trade and investment liberalization to move ahead with and reap the benefits from trade and investment liberalization (Pupphavesa, 1993).

## **5. POLICY RECOMMENDATIONS ON INVESTMENT LIBERALIZATION AND FACILITATION**

ASEAN has made a courageous commitment to achieve an ASEAN Economic Community. Investment liberalization and facilitation is instrumental to such achievement. After reviewing the AIA and the ACIA, it is viewed that the AEC could be of greater success through the following commitment and actions:

1. ASEAN member countries make stronger commitment to collective approach and common time frame of trade and investment liberalization;
2. ASEAN member countries commit to faster acceleration and harmonization of trade and investment liberalization and facilitation;
3. ASEAN trade and investment liberalization should be multilateralized rather than preferential to ASEAN member countries;
4. ASEAN member countries should pursue coherent and broader coverage of trade and investment liberalization and facilitation;
5. ASEAN member countries unilaterally and collectively set up and implement structural adjustment and reform assistance and capacity building measures and facilities to ease the adversely affected parties.

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## NOTE

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1. Based on Pupphavesa, Wisarn and Sasatra Sudsawasdi, "Progress of ASEAN Initiatives for Investment and Services Cooperation and Its Implications for Wider Regional Economic Integration in Asia," prepared for Workshop on Preferential Trading Agreements in Asia: Towards an Asian Economic Community, organized by Indian Council for Research on International Economic Relations, India Habitat Centre, March 30, 2006.