Policy Report

World Bank-Australia APEC Investment Policy Reform Workshop

June 18-19, 2019

Le Meridien Hotel

Kuala Lumpur, Malaysia

Summary

The World Bank Group Investment Policy and Promotion (IPP) Team, in partnership with the Australian Department of Foreign Affairs and Trade (DFAT) and APEC Investment Experts Group (IEG) held a workshop to share best practices and experiences on investment policy reform. The workshop helped to update the knowledge and skills of participants through the sharing of cutting-edge research and practical experience from the World Bank along with support from the OECD and peer-to-peer sharing from APEC Member economies. The workshop covered traditional investment policy issues such as investment promotion, retention, competitiveness and incentives, and went on to explore how investment can contribute to gender inclusion and sustainable development. The outcomes of this workshop will support the APEC Investment Expert's Group in its policy reform efforts.

The workshop brought together 77 participants (48% female) from across the Asia-Pacific region and 26 speakers (27% female) from the World Bank, OECD and investment agencies of selected economies. Participants and speakers were able to engage on substantive issues through eight panel sessions which included a mix of expert speakers and practical experience sharing from participants.

The workshop identified the following challenges requiring further reforms in APEC economies:

- Monitor the impact on investment from disruptive new technologies such as AI, 3D printing, IoT etc.
- Boost investment competitiveness by addressing constraints to investment attraction and implementation gaps.
- Make investment policy gender responsive by addressing barriers to women's participation in male-dominated sectors and using incentives and regulatory tools to drive reforms.
- Ensure that adequate after-care services are provided to enhance investment retention and prevent disputes from escalating.
- Investment incentive schemes must be carefully designed to ensure that they target the right investors in the right sectors, using the right instruments and ultimately deliver value for money.
- Continue to monitor the impact that FDI has on sustainable development indicators, conducting further in-depth reviews as required.
- Facilitate the creation of linkages between foreign investors and local firms by identifying gaps through consultations and working collaboratively to address them.

Welcome Remarks

The first set of welcoming remarks were delivered by **Mr. Michael Growder, Australia's Deputy High Commissioner to Malaysia**. Mr. Growder highlighted the importance of foreign investment citing the recent decision by Cochlear, an Australian manufacturer, to set up an overseas high-tech processing facility in Kuala Lumpur. Mr. Growder noted that in the current environment of rising protectionism, it becomes even more important to advocate for the benefits that investment can bring.

Mr. Firas Raad, Country Manager, World Bank Group, Malaysia, emphasized macroeconomic concerns of slowing global growth driven by weaker than expected trade and investment. He encouraged emerging market and developing economies to implement reforms that address domestic constraints to shore up growth.

Session 1. The Central Role of FDI in Development and Multidisciplinary Approaches to Reform.

This introductory session provided an overview of emerging trends in the global economy and their impact on investment policy. **Ivan Nimac, Global Lead on Investment Policy and Promotion at the World Bank**, reflected on the implications of 4^{th} Industrial Revolution technologies (AI, machine learning, 3D printing, IoT) on global value chains. The spread of GVCs has brought many benefits to developing countries enabling industrial upgrading and leapfrogging that was not possible before. Recent advances in smart factories, robotics and 3D printing has reduced the importance of low labour costs leading to the re-shoring of factories to advanced economies. Adidas' 'Speedfactories' in Ansbach, Germany and Atlanta, USA as well as Foxconn in Pennsylvania are some recent examples.

Policy makers must therefore keep a close watch on the impact of new technologies on GVCs and broader development outcomes. This will require new analytical tools as well as adapted legal and regulatory frameworks. Recent trends imply that there is increased competition for high-quality FDI with investors looking for the best conditions to deliver new, high-quality products not simply low-cost labour. Policy makers must therefore look at reforms across the investment lifecycle which covers – attraction, entry, protection, linkages and services.

The following 6 areas of reform are important in a changing global economy. Each of these are expanded on in subsequent sessions.

- Fine-tune investment competitiveness diagnostics for a changing global economy (Investment Reform Map 2.0)
- Make FDI gender responsive
- Address concerns around FDI entry, national security and economic interests
- Update investment promotion strategies to be aligned with FDI and GVC trends
- Improve the cost-effectiveness of incentives
- Promote productivity and value addition from FDI

Session 2. Measuring the Dimensions of Investment Competitiveness

This session provided a deep-dive into the analytical and diagnostic tools used to measure barriers to investment competitiveness. **Peter Kusek, Senior Economist, World Bank Group**, provided an overview of the *Investment Reform Map (IRM) Approach* and the *Analysing Barriers to Investment Competitiveness (ABIC)* assessment tools.

The IRM is a broad-based tool allowing governments to understand the investment landscape in their respective economies. It is comprised of 4 pillars.

Investment trends – provides an overview of investment patterns and how they differ by sectors and firms

FDI Analysis – examines the quantity, type and location of FDI to identify areas for promotion and reform

Institutional, Legal and Regulatory Assessment – examines the institutions, laws and regulations which may constrain investment along the investment lifecycle.

Investment Reform Agenda – defines the reform priorities and sets recommendations for the short and medium-term horizons.

The ABIC is an analytical tool comprised of an Investment & Competition Policy Review (ICPR) and a Foreign Investor Survey. The ICPR is designed to systematically identify barriers, explore megatrends and analyse differences between de jure and de facto conditions for FDI. While the Foreign Investor Survey assesses the effect of policies on investment behaviours of existing investors in target economies.

In the subsequent panel discussion, **Gerlin Catangui and Victor Steenbergen, of the World Bank Group**, provided an overview of the *FDI in Services- Reform Impact Simulation Tool* (FDI-RIST). This tool takes a particular focus on investment restrictions in services, given the importance of services embedded in modern manufacturing. The tool estimates the effects of services liberalisation using a gravity model framework. It allows users to simulate the effect of services liberalisation on investment, output and employment. An application of this tool was considered for the economy of Jordon. It was able to identify the 10 sub-sectors where Jordon faces significant services restrictions compared to its regional peers and that restrictions were mainly driven by equity restrictions for foreign firms and restrictions on key personnel providing professional services. This analysis was useful in designing a new negative list for Jordon which promotes jobs in various sectors.

In the subsequent question and answer session, participants asked about the model used, whether it was static or dynamic and whether its assumptions were realistic. The World Bank responded that though the model is static it is useful to illustrate the effects on different sectors. In the case of Jordon at least, they are verifying how the model works ex-post.

Box 1. Group exercise

Participants were asked to reflect on issues emanating from this session in small groups and then report back to the workshop.

On measuring competitiveness, participants said that they would benchmark against major competitors. One of the key factors identified was the need for stakeholder engagement across agencies, ministries and business associations. PNG, Chile and Brazil shared their experiences of ongoing reform.

On collecting FDI data, Indonesia shared its practice of requiring investors to submit reports to the Investment Board of Indonesia. However, problems of enforcing regular reporting and verifying data were identified.

In terms of policy issues over the next 10 years, the impact of technology on FDI was identified as a key issue of concern.

Session 3. How to Make Investment Policy Gender Responsive

This session discussed the role that FDI can play in promoting women's economic empowerment and considered policy levers that economies could use to maximise the benefits to women workers and entrepreneurs. The session included sharing of best-practices and explored analytical tools that economies can use to take a gender lens to developing investment promotion strategies.

Thomas Fuller, Assistant Director, Australia's Department of Foreign Affairs and Trade shared examples of Australia's policies and initiatives aimed at supporting gender equality. Australia has established institutional mechanisms in the form of a Discrimination Commissioner and a Minister for Women which aim to tackle cross-cutting issues that affect women. Women's labour force participation is encouraged through maternity leave provisions and subsidies for child care. Specific targeted actions include a gender equality fund to help make workplace more gender inclusive; supporting financial inclusion of women through Women's World Banking; and enabling women's access to markets through UN Women. Within APEC, Australia has supported the creation of the Women and Economy sub-fund and is developing a toolkit for trade promotion agencies to support women entrepreneurs[1].

Heba Mahmoud, Lead Private Sector Specialist, World Bank, provided an overview of differences in economic participation by gender. Women are found to be more dominant in certain sectors-healthcare, education, government, care services etc. While these sectors no doubt have high social value, they tend to be low productivity, low wage jobs thereby diminishing women's earning power. It was deemed important to analyse gender-based indicators at the country as well as sectoral levels when formulating policy.

[1] https://www.apec.org/Publications/2018/04/Supporting-Womens-Access-to-Global-Markets---A-Toolkit-for-Trade-Promotion-Organisers

The World Bank has recently developed a toolkit to help policymakers identify priority sectors, benchmark against peers and identify possible areas for intervention. The toolkit collects and presents gender-related data on three categories. The first measures the engagement of women in economic activities through labour force participation, access to finance, educational qualifications and representation in business. Second, women's participation rates and wages are disaggregated by sector allowing more careful targeting of policies. The third category is global gender indicators, allowing a comparison across countries on the labour participation rate, gender wage gap and skill levels.

Hania Kronfol, Private Sector Specialist, World Bank then provided examples of policy approaches that economies could use to address barriers to women's economic participation. These include incentives (eg. Tax subsidies); regulatory tools (eg. gender quotas, anti-discrimination rules); and information (certification, public information). Examples of incentive programs in 4 economies were discussed:

Jordon: Wage subsidy vouchers for female graduates give women more confidence to approach employers, but the long-term impact is less clear

Nigeria: targeted credit products, complemented by training, show success in growing women-owned businesses

Malaysia: Double tax deduction incentive provided on training expenditure incurred by companies re-employing women after a career break

United States: Federal agencies required to award a certain percentage of procurement contracts to small business, including women-owned businesses.

Ms. Kronfol concluded by calling for more research on the impact of incentive programs and their optimal design considerations.

In the Q&A session, participants from Malaysia highlighted the difficulty of increasing the number of women who re-join work after taking maternity leave. Despite a 1-year tax break offered to women returning to work, the impact on participation rates has been negligible. Participants called for more systemic reform such as subsidies for child care.

Session 4. Strengthening the Value Proposition for FDI: Practical Strategies for Upgrading Entry, Retention and Protection Frameworks

This session provided an overview of recent trends in investment attraction and protection. It provided a typology of investment restrictions and introduced participants to analysis and tools that can be used to identify areas for reform. In a panel discussion, participants from Myanmar, Brazil, Viet Nam and China shared examples of recent investment reforms in their economies (often undertaken in conjunction with the World Bank).

Xavier Forneris, Senior Private Sector Specialist, World Bank laid out the importance of investment policies that support entry, retention and protection – taking a lifecycle perspective. Investors face several types of restrictions on entry such as sectoral limitations, screening that is potentially discriminatory, limits to hiring foreign nationals, and performance requirements as a condition of entry. It is important to use data (such as investor surveys or OECD FDI Restrictiveness index) to make the case for reform that minimizes lost opportunities for jobs, technology and market access through GVCs. Investment protection reforms were also discussed including the core protection guarantees and examples of dispute prevention policies including South Korea's Ombudsman and the Strategic Investment Review Mechanism (SIRM) tool of the World Bank.

In the subsequent panel dialogue, **Myanmar** shared examples of its recent investment reforms, including abolishing minimum investment requirements; reducing the number of sectors requiring joint ventures from 92 to 22; limiting the extent of investment screening requirements; and the delegation of more authority to states (sub-national) and regional governments on investment decisions.

Brazil shared its recent experience of establishing an investment ombudsman to address investor grievances. The ombudsman works with state governments to ensure that enacted policies do not inadvertently trigger ISDS cases. Brazil has also established a new framework for investment which includes the creation of national investment committees.

Viet Nam is seeking to improve the quality of FDI it attracts. The current drawing cards of low-cost labour and cheap electricity have attracted firms specializing in low-tech assembly, high energy usage and environmentally damaging activities. Viet Nam is currently reviewing the list of conditions it imposes by sector and is developing mechanisms to attract new technology and quality investment.

China released a new negative list in 2017, reducing the areas in which FDI is not permitted. Special lists have been created for SEZ's to trial the opening of sectors to FDI. China has also established a timeline to liberalise restricted services sectors such as finance and automobiles. China also mentioned the release of its recently revised investment law.

In the Q&A session, participants inquired whether there were mechanisms to attract investment to small communities and second tier cities. The importance of incentives, such as as subsidies, and improving the general business climate were discussed in this regard.

Session 5. Trends in Institutional Arrangements and Solutions for Investment Policy and Promotion

This session explored in detail the issues facing Investment Promotion Agencies (IPAs) arising from changes in investment trends (south-south, south-north), new technologies (3D printing, Industry 4.0) and new modalities of entry (non-equity modes). Participants heard from experts on areas for reform of IPAs and also heard examples of best practice from IPAs in Malaysia and India.

Yago Larrey, World Bank cited the positive correlation between quality of investment promotion and FDI inflows as reason for IPAs to be given due consideration. The World Bank's *Investment Promotion Toolkit* provides a slew of evidenced based reforms that IPAs can consider. In particular it is important for IPAs to serve as a useful conduit between investors and governments, providing services to investors and feedback to policy makers. Ms. Larrey drew attention to the importance of high-level political support and the need for alignment between policy and implementation.

Muhammad Azmi bin Zulkifli, Director, Investor Relations, InvestKL, Malaysia provided an overview of their approach to investment promotion, highlighting examples of success and challenges being faced. A key concern is moving up the value chain by targeting firms in the digital, fintech and health sectors. InvestKL ensures that there is adequate co-ordination between the various Ministries, Agencies and businesses. It hosts Roundtables with business to identify issues of concern and then tries to address them. For example, after skilled labour shortages were identified as a pressing issue, a collaboration with academic institutions was initiated to help deliver the required skills.

Madhumitha Ramanathan, Vice President of Invest India highlighted the successful strategies that have enabled Invest India to support 2 million jobs and attract $135 billion in just 9 years of operation. Invest India customises its pitch to investors, identifying FDI origin countries and narrow sectors to focus on. Roadshows and roundtables spur the development of relationships and idea sharing on policy issues. Special desks have been created to address language barriers with investors from Japan, Korea and Russia – with services in those languages provided. They have been innovative with technology, creating an online platform – India Investment Grid- which provides investors with a menu of options and access to promoters as well as widely promoting investment reforms on social media. A key focus on engagement and aftercare ensures that current investors act as ambassadors that promote the investment environment. State (sub-national level government) capacity is also being improved through sharing of best practice between state IPAs and by creating a rating system to measure their performance. Finally, the IPA has a dynamic team with diversity across age, gender and global experience. Performance-based contracts are used to incentivise staff to deliver outcomes.

In the Q&A session participants discussed the difference between state (sub-national level government) and national IPAs. They were both deemed to be important in different ways. National branding brings investor attention to the country while state IPAs may target specific interests of companies. The issue of potential conflicts between multiple IPAs can be mitigated by creating a central unit with representatives from the state IPAs, along with banks and government officials.

Session 6. Improving the Cost-Effectiveness of Investment Incentives

This session explored approaches to help policy makers strike the right balance between offering investment incentives while ensuring that they do not reduce the tax base. It highlighted examples of broader institutional reforms that can attract FDI rather than relying simply on tax incentives. The session included sharing of examples from Malaysia, Viet Nam and Indonesia followed by a robust Q&A session.

Hania Kronfol and Victor Steenbergen, World Bank provided an introduction to the type of investment incentives (locational or behavioural) and modes (financial, fiscal, land) and cited their growing prevalence even though they are not rated highly in terms of investor concerns. Instead of merely using tax incentives which result in less revenue collection, they suggest various reforms to the design and implementation of incentive schemes. Firstly, it is important to identify the specific and measurable goals being incentivised. Increasing FDI is not an end it itself. Economies must select the appropriate incentive instrument. Tax holidays and concessionary rates tied to profit provide upfront benefits to companies but do not necessarily lead to desired outcomes. Performance based incentives such as R&D credits on the other hand are preferred as they are tied to desired activity. Economies must target marginal investors rather than those likely to invest anyway. Efficiency seeking investors are most responsive to incentives compared with natural resource and market seeking investors. Incentives should also have clear eligibility criteria and must not be ad-hoc. Finally, monitoring and evaluation is important to understand whether incentives are working.

Malaysia shared examples of tax incentives it offers to MNCs to setup factories. These include tax holidays, double/single deductions; RnD credits etc. More than 100 tax incentives are given to industries.

Viet Nam has active industrial policies in priority sectors such as IT and electronics. Incentives are targeted at capital intensive high-tech projects, projects worth more than $270 million and companies employing more than 500 people. Also specialised support is given to SMEs, education and cultural programs. In terms of reforms, Viet Nam is currently reconciling inconsistencies between the investment law and tax law for new projects or new enterprises.

Indonesia is targeting incentives at upstream industries using a mix of income and performance-based incentives. Tax holidays are offered for up to 20 years for investments over a certain threshold. A tax holiday on certain capital investments and accelerated depreciation are also offered.

In the Q&A session participants discussed the challenges faced in measuring the costs and benefits or incentives and examples of reforms that delivered value for money. Malaysia informed participants that incentives are approved by a national committee. In 2019 the government has initiated a review into whether there exist redundancies in existing tax incentive schemes. Viet Nam cited a recent report showing that the incentive system was not effective. Ongoing reforms are moving incentives from income-based towards performance-based.

Participants then questioned how tax competition could be avoided. Several economies responded that tax incentives are not the top priority for investors, that competition is instead based on quality of infrastructure, simplified administrative procedures and good governance. The World Bank warned of several negative consequences of current incentive schemes including a reduced revenue base, complicated tax code which may enable tax evasion, lack of support for SMEs and of concern for broader social impact.

Session 7. FDI Qualities: How investment supports sustainable development?

This session introduced participants to the OECD approach to investment policy reform through the Policy Framework for Investment as well as various analytical tools. The focus of this presentation was to discuss recently developed indicators that track the extent to which FDI is associated with Sustainable Development Goal (SDG) outcomes.

Martin Wermelinger, OECD, provided an overview of the FDI Qualities Initiative which aims to better align foreign investment with sustainable development outcomes. The indicators are composed of 5 clusters- productivity/innovation, skills, job quality, gender and carbon footprint. These indicators compiled at the country, regional and global level can be useful in determining policy priorities. For example, the indicators revealed that in Thailand, FDI contributes to competitiveness with higher

R&D and foreign technology compared to domestic firms but unclear or negative impact on inclusive and green growth. While in Malaysia, there was no discernible difference between foreign and domestic firms in terms of sustainable outcomes.

Examining whether FDI contributes to the greening of economies in APEC, the indicators reveal that FDI in renewables is increasing rapidly in APEC relative to fossil fuels though the stock of FDI in fossil fuels remains large. FDI tends to be prevalent in industries with lower levels of carbon emissions though foreign firms tend to also be less energy efficient than their domestic counterparts. In some economies, FDI is found to be concentrated in more productive and R&D intensive sectors (Thailand, Mexico and Chile) while this is not necessarily the case in other economies.

While the indicators are useful to provide a snapshot at the country level and benchmark against regional peers, further in-depth analysis through Investment Policy Reviews may be required.

In the Q&A session, participants shared concerns they had about linking investment directly through SDGs. There was also a discussion on the selection process for the 5 clusters which was driven largely by data availability. Participants also questioned the policy implications arising from these results, cautioning that it may lead to increased screening based on SDG requirements rather than facilitation.

Session 8. Promoting Productivity and Domestic Value Addition from FDI

This session highlighted the importance of linkages between FDI and domestic firms and discussed policies that seek to maximise the benefits of FDI for host economies. Participants heard from Malaysia and Viet Nam on their practical experience in establishing strong linkages and generating knowledge spillovers.

Wim Douw and Ulla Heher, Pirvate Sector specialists, World Bank described the importance of FDI linkages in terms of raising productivity and access to technology. FDI is found to promote competition, introduce new technologies and business models, provide training to staff and bring local suppliers up to meet international standards. It was noted that these benefits are not guaranteed as they may be inhibited by lack of information on the capabilities of local suppliers or their understanding of MNC requirements, lack of skills or capacity of local firms to deliver requirements. The use of business surveys to obtain quantitative information on sourcing requirements and local capabilities was recommended.

Malaysia presented its ecosystem approach to promoting investment linkages. The Malaysian Investment Development Authority typically collects a list of products that MNCs want to source locally. Next they identify domestic companies with those capabilities as well as opportunities for training and R&D. An example of the MIADA-Turkish Aerospace linkage program was presented where a consortium was created to provide end-to-end product delivery from a mix of Turkish and Malaysian companies.

Viet Nam presented its supplier development program created to meet the needs of MNCs. Moving away from imposing local content requirements, Viet Nam works with MNCs to create partnerships that deliver value to local firms (training), MNCs (lower costs, risks) and to the public (attract FDI). An

Advisory Board comprised of stakeholders from the MNC, industry associations and other partner organisations helps to identify gaps and then workshops are organised to support local firms. Competitiveness reviews are also conducted where firms conduct a self-assessment and develop a plan to improve over six months. Key challenges identified were maintaining local commitment, reducing reliance on international experts and government capacity for the intensive co-ordination required.

Conclusion

Closing remarks were delivered by **Mr. Ivan Nimac, World Bank** and **Mr. Thomas Fuller, Australia**. Mr. Nimac noted that the purpose of this workshop was to combine a theoretical framework with practical examples, allowing policy makers to more nimbly adapt to a rapidly changing world. Mr. Fuller noted that the Australian government remains committed to promoting open trade and investment policies that will create a safer, more prosperous region. He cited Australia's Foreign Policy Whitepaper which stressed the importance of bringing countries closer together and establishing strong people-to-people links. He thanked participants for their contribution to the workshop and the World Bank and OECD for bringing their expertise to APEC.