PITO

PRIVATE INVESTMENT AND TRADE OPPORTUNITIES

ECONOMIC BRIEF
NO. 8

THE LEGAL FRAMEWORK FOR INVESTMENT IN ASEAN: INVESTMENT REGULATIONS AND INCENTIVES

East-West Center

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I. INTRODUCTION

Direct foreign investment (DFI) is now recognized as a positive factor for enhancing a country's international competitiveness. Realizing this, the ASEAN nations have progressively liberalized their investment regimes. Like other developing countries in the Asia-Pacific region, the ASEAN nations seek foreign investment to acquire modern or high technology and know-how, expand employment, develop managerial and technical skills, increase exports, acquire capital, and increase foreign exchange receipts.

The ASEAN countries have been more successful in attracting direct foreign investment than most countries in Asia and the developing world. A large part of their success is attributable to their rapid economic growth and their emphasis on private sector–based, outward-looking development. The countries have relatively sound economic structures, stable political systems, developed entrepreneurial and technical capabilities, good legal and institutional structures, and ample resource endowments. Trade barriers are also relatively lower than in many other

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developing countries. In addition, their open approach to DFI has been a positive factor. All of the above combine to create a good investment environment. Indeed, foreign investors view the ASEAN countries as possessing among the most conducive environments for direct foreign investment in the developing world.

This Brief will look at the policies directly dealing with foreign investment, though the investment environment is clearly affected by other policies. While macroeconomic stability is essential, foreign investors facing the decision to invest in the ASEAN countries will also be influenced by microeconomic investment policies of these countries. For example, fiscal incentives, tax holidays, the right to remit profits overseas, and protection against nationalization of property significantly affect decisions of foreign investors.

In Section II, the directions and policies regarding foreign investment are examined for the individual ASEAN countries. Sectors that are open/closed to foreign ownership and the level of foreign equity participation permitted are discussed in Section III. Typically regulations over foreign equity participation stem from a country's concern over the economic, social, and cultural welfare of the domestic economy and people. Guarantees against non-nationalization are addressed in Section IV, though in the ASEAN countries, this issue has declined in importance due in part to the emergence of several national insurance schemes. In Section V, another factor that can be a major barrier to foreign investment is discussed—that is, the ability of the foreign firm to repatriate profits and dividends, interest and principal on loans, and royalties and fees. An investor's decision to invest abroad may also be affected by performance requirements (such as staffing and export requirements) and regulations on the minimum levels of investment, both of which are discussed in Section VI. This discussion is followed in Section VII by an analysis of the use of fiscal and non-fiscal incentives to attract DFI. The last section considers institutions designed to facilitate foreign investment inflows into their countries. Often called one-stop service centers, these agencies provide foreign investors with information and assistance in establishing a business in the country.

II. DIRECTION OF POLICIES

All of the ASEAN countries have been striving to increase private investment through more liberal economic policies, including an active program to attract DFI inflows. The rationale for and approach to economic policy change, however, differ across countries. For example, because of the low price of oil in the 1980s, Indonesia and, to a lesser degree, Malaysia have been attempting to diversify their economies away from the high dependence on oil as a source of income, foreign exchange, and government revenue.

The change has been most dramatic in Indonesia. Due to its previous focus on self-sufficiency, Indonesia's policies have generally promoted import-substitution manufacturing; a luxury it was able to afford at first because of its abundance of natural resources. Consequently, the country has typically followed a selective policy towards foreign investment. In 1986, however, when the price of oil fell to US$8 per barrel, Indonesia, which had committed 47 state projects at a cost of US$22 billion, was compelled to seek private and foreign sources to maintain investment in the manufacturing sector. As a result, restrictions and barriers to foreign investment were reduced or eliminated, and many sectors that were previously reserved for state enterprises are now open to private investment.

In Malaysia, the primary concern of the government in the 1970s was for a more balanced distribution of equity participation for indigenous Malaysians (*bumiputra*). The 1970 New Economic Policy (NEP) called for a redistribution of equity participation of 30 percent for foreign investors, 30 percent *bumiputra*, and 40 percent for others, and foreign investments were channeled only to the export processing zones in the country. However, as in Indonesia, the stance of the Malaysian government changed in the 1980s due to the decline in oil and commodity prices. To activate the sagging economy, a new law that provided fresh incentives aimed at accelerating private investment in manufacturing was promulgated in 1986. In June 1991, the Malaysian government unveiled the Second Outline Perspective Plan and the New Development Policy (NDP) which replaced the NEP. The NDP emphasizes private enterprise rather than government intervention to narrow the social and economic disparities among the different ethnic groups in the country.

The Philippines has a long history of legislation designed to encourage investment. However, the political crisis in 1983 and the ensuing instability in the country's political environment had an adverse impact on the economy, including DFI inflows. From US$344 million in 1982, DFI inflows declined to US$247 million in 1985 and bottomed out at US$72 million in 1988. In response to this declining trend in foreign investment, the Omnibus Investment Code of 1987 and, more recently, the Foreign Investment Act of 1991 were passed.[1] These two pieces of legislation represent the main set of rules and codes affecting foreign investment in the Philippines. The Omnibus Investment Code specifies numerous fiscal incentives and regulations regarding the employment of foreign nationals, customs procedures, and enterprises in export processing zones (EPZs). The Foreign Investment Act of 1991 was meant to increase foreign investments in the Philippines by liberalizing the rules and regulations regarding foreign ownership.

Singapore has especially welcomed foreign investment as a cornerstone of its economic development strategies. In the early years following the country's independence from the British, foreign investment was viewed as essential to Singapore's industrial development. At that time, the Singapore government believed that foreign investment, with its accompanying inflow of technology and managerial know-how, would allow Singapore to industrialize more quickly and efficiently than would be possible with only local capital and entrepreneurs. Because of the lack of natural resources in the country, the policies and legislation

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[1]See "Opening the Door: The Philippine Foreign Investment Act of 1991," *PITO Economic Brief*, No. 7, by Victor S. Licuanan and Cecilia C. Carlos.

focused on export expansion and employment creation. Incentives for firms producing labor-intensive manufactured exports, for example, were granted for up to 15 years and were aimed at extensive employment creation. However, in the 1980s, economic conditions in Singapore had changed considerably and the country's policies towards foreign investment changed accordingly. With the rising level of employment and the tightening of the labor market, incentives are now aimed at acquiring high-quality modern technology and at further development of the modern services sector, particularly the financial sector.

Unlike the other ASEAN countries, Thailand's basic legislative framework, which dates back to 1954, has remained virtually unchanged in terms of its legal framework. There has, nevertheless, been a deliberate shift in the attitudes and practices of the Thai government towards private sector development through DFI. Under its Sixth Economic Development Plan (1987–1991), annual growth of the private sector is targeted at 8.1 percent, while growth of the public sector is only 1 percent. That the plan is beginning to fulfill its goals is suggested by the fact that in 1990, the private sector already accounted for 65 percent of total domestic investment in this year and DFI inflows rose sharply. In addition, there has been a shift in emphasis away from foreign investment as a means of providing employment to its role in providing foreign exchange.

III. OWNERSHIP ISSUES AND SECTORAL PRIORITIES

Ownership issues are always controversial, particularly in developing countries. Investors argue that limiting equity participation distorts optimal investment decisions and puts foreign firms at a disadvantage vis-à-vis indigenous firms. The ASEAN countries, like developing countries elsewhere, have maintained that ownership issues are closely related to national security considerations. Nonetheless, the most important changes made in ASEAN countries to promote foreign investment concerns foreign ownership requirements.

Presently 100-percent foreign equity is permitted in most industries in most ASEAN countries. However, joint ventures are usually preferred, especially in industries that affect national security or that utilize domestic raw materials.

Singapore is very liberal among the ASEAN countries in terms of foreign ownership. There are no hard and fast rules on the permissible levels of foreign ownership, except for banks and brokerage firms, and projects are negotiated on a case-by-case basis. In addition, with the exception of telecommunications and public utilities, Singapore has virtually no restrictions on foreign participation in any sector. Thus, it is no surprise to find that this country has the highest incidence of wholly foreign-owned subsidiaries and majority-owned foreign joint ventures.

As a result of the Foreign Investment Act of 1991, 100-percent foreign equity in investments is permitted in the Philippines, except in sectors included in the negative list. No foreign participation is allowed in the mass media, professional services, small-scale mining, private security agencies, retail trade, cooperatives, the rice and corn industry (except when approved by the National Food Authority), and cockpit and cockfighting activities. Firms providing private recruitment services and construction/repair of locally funded public works are allowed to have up to 25-percent foreign equity, while firms in advertising are allowed a maximum of 30-percent foreign equity. Foreign ownership can be as high as 40 percent in public utility firms, firms involved with the development and utilization of natural resources, financing companies, manufacturers of firearms and dangerous drugs, gambling (except cockfighting), export enterprises, sauna and steam bathhouses, educational institutions, certain construction activities, and firms engaged in import and wholesale activities.

Equity participation requirements have also been eased recently in Malaysia with the passage of the NDP. Foreign investors are now permitted to hold up to 100-percent foreign equity if the company exports 80 percent or more of its production. The amount of ownership allowed decreases as the ratio of exports to total production declines. A 51-percent foreign share is allowed if the firm produces goods using high technology or if the good is a priority item for the domestic market. Most industries in Malaysia are nominally open to DFI, with the exception of the news media industry. As an indication of the results of the relaxation in regulations, as early as 1988, some 45 percent of total private sector investment came from foreign sources.

In Thailand, the Alien Business Law specifies those sectors and industries that are closed to foreign participation. In recent years, this law has been interpreted in a manner favorable to foreign investors. Sectors and industries that were once closed to foreigners are now partially open to foreign investors under certain conditions, with several professions such as accounting remaining closed. Under the Treaty of Amity and Economic Relations between the United States and Thailand, U.S. companies are generally not subject to the restrictions imposed by this Alien Business Law, except in the fields of communication, transport, fiduciary functions, banking, the exploitation of land or other natural resources, and domestic trade in indigenous agricultural commodities.

However, 100-percent foreign ownership is permitted in Thailand for promoted projects, which include those whose activities involve production for export, utilize agricultural or natural resources, or are deemed by the government as being beneficial to the country. Firms involved in production mainly for domestic distribution, agriculture, mineral exploration and mining, and the services sector must be majority-owned by Thai nationals, though this condition is relaxed for companies that export more than 50 percent of their production or when there are other justified reasons, as judged by the Board of Investment. Recently the Board of Investment has become more liberal in their interpretation of these regulations.

Indonesia is less permissive in terms of foreign ownership and equity. Almost all foreign investments in the country must be made through joint ventures with Indonesian partners, and in most cases, majority control must be held by the Indonesian firm within

15 years (with a possible extension for an additional five years). More specifically, a joint venture that is not on the negative list and which invests at least US$10 million, or has operations in specified locations, or exports at least 65 percent of total production, can be established with only 5 percent Indonesian ownership but this equity share must be increased to 20 percent in 10 years and 51 percent within 15 years. Exceptions to this include:

1. A joint venture which exports 100 percent of production and is located in a "bonded" zone may have as little as 5 percent Indonesian ownership and this share does not have to increase over time.
2. Corporations which sell 20 percent of their stock publicly to Indonesians must eventually reduce the foreign share to 55 percent.
3. Foreigners may have 100-percent equity in firms located in Bataam Island for the first five years of the operation. After this period, foreign investment must be reduced to be no more than 95 percent.

Note that "new" investments can be made into an existing firm where the new investment is made up of 80 percent foreign equity. In this way, majority ownership can be maintained indefinitely by the foreign partner.

In terms of sectors, Indonesia recently liberalized the limitations on foreign participation. With the replacement of the priority list with the negative list (DNI) in 1989, some manufacturing industries such as chemicals, metals, transportation, and broadcasting were opened to the private sector, and some of these, such as chemicals and metals, are open to foreign participation. The latest DNI list (June 1991) enumerates just sixty items, sixteen of which are completely closed to foreign investment (including six "non-traditional" sectors such as gambling and marijuana production which are closed to domestic and foreign investments). Of the ten sectors from which only foreign firms are excluded, the restrictions are most important in trade, advertising, entertainment, communications, and land, sea, and air transport. In the other forty-four sectors, exceptions are granted to foreign investors if certain export levels or other requirements regarding locating in remote areas or cooperating with state-owned firms are met by the joint-venture firm.

In terms of land and real estate ownership in the ASEAN countries, the rules vary fairly widely from country to country. In Indonesia, land can only be owned by Indonesian citizens while joint ventures can obtain a lease that gives them the right to construct and own buildings (the title is usually granted for 30 years and may be renewed at the discretion of the local government).

In Thailand, the Investment Promotion Act allows a promoted company with 50 percent or more of its shares held by foreigners to apply for land ownership. Private individuals are also allowed ownership in condominiums.

Restrictions on land ownership in the Philippines have been viewed as a problem by foreign investors. The government has recognized this problem and has implemented schemes by which these restrictions are relaxed through long-term lease arrangements. For example, a long-term lease arrangement has been extended to a large-scale agribusiness operation which requires large parcels of land for its activities. Similar arrangements are being explored by the government for other types of ventures.

In Malaysia, there are no restrictions on foreign land ownership in general, but it varies according to legislation enforced by individual states. Approval from the Foreign Investment Committee is required.

IV. GUARANTEES AGAINST NATIONALIZATION

All of the ASEAN countries have some form of guarantee to foreign investors against nationalization. In Indonesia, non-nationalization is provided in the Foreign Capital Investment Law of 1967. Moreover, nationalization in this country is defined to include the reduction of foreign ownership or control and management of an enterprise. No nationalization is allowed except in the public interest and through an enactment of law, and with arbitrated compensation.

The Malaysian constitution provides some measure of protection to foreign investors in terms of nationalization, and the country has signed bilateral guarantee treaties with its major investing partners, including the United States, Canada, Germany, and the United Kingdom.

In the Philippines, non-nationalization of foreign firms and assets is guaranteed by the country's constitution. Expropriation is only justified if the property is for public use or in the interest of national welfare and defense; in such a case, the foreign investor will be given just compensation and also has the right to remit the amount received in the currency in which the investment was originally made.

Thailand's guarantee against nationalization is contained in the Promotion of Investment Act of 1977. In addition, the law provides a guarantee against competition of new state enterprises, state monopolization of similar products, and price controls or tax-free imports of the good by government agencies or state enterprises.

Although Singapore does not guarantee against nationalization under any law, it has signed a number of bilateral guarantee treaties with several European countries, Canada, Sri Lanka, China, Taiwan, and the United States. In the event of nationalization due to non-commercial risks, foreign investors will be compensated and the compensation will be based on the market value of the property destroyed or confiscated.

In addition, investments in the ASEAN countries are covered by the Multilateral Investment Guarantee Agency (MIGA) which insures foreign investments in developing countries against non-commercial risks.[2] These include risks (1) resulting from restrictions against transfer and conversion; (2) from loss due to

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[2]As an institution affiliated with the World Bank, the objective of MIGA is to supplement the activities of the International Bank for Reconstruction and Development, the International Finance Corporation, and other international development financial institutions. The issuance of guarantees against non-commercial risks is the principal but not the sole function of MIGA.

legislative action, etc.; (3) arising from repudiation of contract; and (4) due to war and civil disturbance.

V. REPATRIATION OF PROFITS AND FOREIGN EXCHANGE RESTRICTIONS

Excessively severe restrictions on the transfer of funds to the home country can have a significant negative impact on DFI inflows. On this issue, the ASEAN countries are flexible. Although a simple form is required in Malaysia for export receipts above M$20,000 (which is equivalent to US$7,400), the primary reason for this regulation is to maintain an accurate record of transactions. All other payments—including repatriation of capital and remittance of profits, dividends, royalties, and commissions—are freely permitted.

The transfer of funds to and from Indonesia can also be done with little difficulty. The country has no foreign exchange controls and repatriation of profits, as well as remittances of expenses such as interest, royalties, and technical fees, is permitted without prior approval.

Singapore is equally liberal in their position towards repatriation of profits and fees. Approvals are needed only for transfers of funds in excess of S$5 million (US$2.76 million). Under these limits, foreign investors are free to transfer funds and remit profits, dividends, interest, and royalties.

In the Philippines, the country's Constitution and the Omnibus Investment Code guarantee the remittability of capital profits, royalties, and interest. However, all transfers of funds must be registered with the Central Bank or commercial banks, or in the case of royalties, with the Bureau of Patents, Trademarks, and Licenses. Moreover, unlike its ASEAN neighbors, the Philippines only allows repatriation of capital in fixed amounts annually over a period of years. In some instances, additional approvals from the Investment Coordination Committee of the National Economic Development Authority (NEDA) may be necessary.

With the recent adoption of IMF Article VIII,[3] the Thai government has deregulated the control of foreign currencies. Nevertheless, approval is required for all remittances of funds to and from Thailand. Firms that remit or retain funds abroad are subject to a 20-percent withholding tax in addition to payment of the corporate income tax (through other DFI incentives, however, an investor may get some relief). If payment is made to a company or partnership incorporated under foreign law or is made towards interest on loans, royalties, or management fees, then the withholding tax is 25 percent of gross remittances.

[3]According to IMF Article VIII, member countries (1) will not impose restrictions on the payment and transfer of funds for current international transactions; (2) will not engage in discriminatory currency arrangements or multiple currency practices; and (3) will ensure convertibility of foreign-held balances. Other conditions in this section include the furnishing of information and the commitment of each member to consult and collaborate with other IMF members.

VI. PERFORMANCE REQUIREMENTS AND MINIMUM LEVELS OF INVESTMENT

Performance requirements such as those restricting employment of foreign personnel, especially at the managerial level, and minimum levels of investment can be obstacles to DFI inflow. In addition, export requirements, local content requirements, technology transfer requirements, and so on will affect not only the decision of whether or not to invest in a country, but will also affect the scope and scale of the firm's operations.

Personnel Issues

With respect to personnel issues, local participation at the management and decision-making level is sought whenever possible in all of the countries with the exception of Singapore.

Singapore stands alone among the ASEAN nations as the only country that has no restrictions on foreign personnel, including personnel in top management positions. Although foreigners who are employed in Singapore and who earn more than S$1,500 (US$830) per month are required to procure employment passes, the passes are usually obtained with little difficulty. However, the restriction which does not allow foreigners to purchase property may act to deter foreigners from residing in the country for an extended period of time.

Although employment of foreigners is limited in the Philippines, the government has recently relaxed its guidelines for filling top-level posts by foreigners according to perceived needs in targeted industries such as tourism. Today the positions of president, treasurer, and general manager can be held by a foreign national with no time limit. However, foreign nationals in supervisory, technical, or advisory positions cannot be employed for more than five years from the date of registration of the firm with the Philippine government. In addition, foreign investors in the Philippines are permitted to take up permanent residence in the country, subject to certain conditions (the most important of which is the continued functioning of the business).

In Malaysia, the managing director and general manager positions may be held indefinitely by foreigners as long as justification for their continuing occupation of the position remains. Other top executive positions may only be occupied by foreigners if Malaysians are not available, but these positions must be filled by Malaysians after ten years. In joint ventures, the government suggests that the number of directors be prorated according to the distribution of equity ownership. Further, following the announcement of the 1992 Budget, employment of foreign workers and expatriates are subject to a levy ranging from M$360 to M$2,400 (US$130–US$890) depending on the level of skill.

The Alien Employment Act of 1978 requires that all foreigners obtain work permits prior to working in Thailand. At the same time, the foreigner must obtain a non-immigrant visa (applicants for work permits are not allowed to enter the country on a tourist or in-transit visa). The work permit is valid for the term of the foreigner's non-immigrant visa and is subject to renewal provided the visa is renewed or extended.

Indonesia's regulations appear to be the least open to foreign participation in the labor force, but current interpretations reflect the realities of an insufficient supply of skilled labor domestically. A list of professions that are open to expatriate personnel is provided by the government, and foreigners are permitted in key positions where Indonesians cannot be found. However, training is required to ensure the scheduled replacement of foreigners by Indonesian citizens. Although this ruling has been applied more liberally since 1987, lower positions remain closed to foreigners. In the mining and petroleum sectors, the requirements are even more restrictive.

Minimum Levels of Investment

In Indonesia, the minimum level of foreign investment permitted was recently scaled down from US$1 million to US$100,000–$250,000. In Malaysia, Singapore, and Thailand, there are no minimum capital requirements, but in Thailand the amount of the capital involved should reflect the nature of the business.

There are no minimum capital requirements in the Philippines. However, firms which export less than 60 percent of their output and with paid-in equity of less than US$500,000 are limited to a maximum of 40-percent foreign ownership unless they involve advanced technologies.

Other Performance Requirements

Regulations specifying a minimum level of local content, a minimum proportion of production that must be exported, and a minimum amount of technology transfer have largely been dismantled by the ASEAN countries. Rather than a restrictive attitude that attempts to control foreign investment, the emphasis has shifted to rules that promote a more orderly and balanced growth of foreign investment in terms of sectors and locations. Thus, instead of rules specifying minimum levels, incentives are granted to firms that produce goods with a certain local content ratio, firms that export a specific proportion of their output, and/or firms that transfer advanced technology.

VII. FISCAL AND NON-FISCAL INCENTIVES

Though the importance of fiscal incentives is debatable, they can influence a foreign investors' decision-making process at the margin and may alter the form of investment (e.g., the sector in which the investment is made, the production technique adopted, and whether the investment is in the form of a joint venture, licensing arrangement, or wholly owned subsidiary). The fiscal incentives can serve as a means of promoting investment in general, as a policy instrument for channeling investments into sectors or regions targeted by the government, or to remove or counteract disincentives.

Income Tax Exemptions

Several of the ASEAN countries employ a pioneer status scheme as a fiscal incentive to attract DFI, as pioneer firms are usually granted income tax holidays. Typically, pioneer status is granted to (1) firms in industries that have not yet been developed in the country on a commercial scale, (2) existing firms in industries that have good prospects for further development, (3) firms that bring in new technology, know-how, or skills into a new or existing industry, and (4) firms engaged in the production of exports.

In Brunei, corporations that qualify for pioneer status are granted income-tax exemptions of 100 percent for two to five years, where the term is based on the amount of capital the corporation brings into the country. In addition, Brunei allows losses incurred during the term of the tax holiday to be carried forward to post-tax holiday periods.

Full income-tax exemptions are also available in the Philippines to pioneer and non-pioneer firms for six and four years, respectively. Extension of the tax holiday is allowed for an additional two years provided that: (1) the project meets a prescribed capital equipment to worker ratio, (2) a specific utilization rate of indigenous raw materials is met, or (3) if the net foreign exchange earnings of the firm is at least US$500,000 each year for the first three years. Although the Philippines does not have a net loss carry forward provision, House Bill No. 30522 which proposes such a provision is one of the measures to be addressed in Congress in early February 1992.

In Thailand, 100-percent exemptions on corporate income taxes are given to pioneer enterprises for three to eight years. The length of the tax-free period depends on the enterprise's location, export earnings, employment, and other characteristics. In addition, losses incurred during the term of the tax holiday may be carried forward and deducted as expenses for up to five years.

The income-tax incentive in Malaysia is slightly different from that of Brunei, the Philippines, and Thailand. Rather than granting a full exemption from income taxes, a tax of only 10 percent is levied on the profits of the pioneer corporations. The duration of the tax holiday is five years. Malaysia also has a carry forward provision for losses incurred, with no time limit for using this provision unless the firm is closing down its operation.

Corporations that qualify for pioneer status in Singapore enjoy a 31-percent tax exemption on profits and the tax relief period is 5–10 years depending upon the amount of capital the corporation brings into the country. The manufacturing and services sectors have been targeted using this pioneer status scheme.

Indonesia stands alone as the only ASEAN country that does not grant tax holidays (tax incentives were abolished in 1984). However, the country does offer other fiscal incentives for foreign investors. The most important of these other incentives is the generous depreciation rates (50 and 25 percent declining-balance method for equipment with productive lives of less than 4 and 4–8 years, respectively) that are allowed to investors in this country. In addition, losses may be carried forward to the future for a period of 5 to 8 years. It should also be noted that the top tax bracket is just 35 percent, as Indonesia has opted for lower but more uniform personal and corporate taxation schemes.

Double Taxation Agreements

All of the ASEAN countries have agreements to avoid double taxation with a number of their major investing partners. In particular, each of the ASEAN nations provide double taxation relief to firms from its ASEAN neighbors. Presently, only Indonesia and the Philippines have an agreement with the United States, although negotiations on double taxation relief are presently underway between Thailand and the United States. According to the agreements, profits are taxable only if the taxpayer has a permanent establishment in the country. In addition, reduced rates of taxation are levied on certain dividends, interest, royalties, and other payments.

Exemptions on Taxes and Duties for Imported Capital, Equipment, and Machinery

Duty-free imports of machinery, equipment, and parts, as well as postponement or deferment of value added and other taxes on the importation of capital goods, is granted in many of the ASEAN nations. A 100-percent exemption from import duty on capital goods and machinery is also available in Indonesia. In Malaysia, duty on almost all machinery and equipment is exempt so long as (1) the machinery is not produced locally, and (2) the machinery is used for manufactured goods. In the Philippines, new and expanding enterprises that are registered with the Board of Investments can obtain a 100-percent exemption on duty on capital and machinery imports provided that the exemption is taken before August 14, 1992. In Thailand, imports of machinery and equipment are eligible for a 50-percent exemption of import duty (where the imported machinery is subject to a duty of 10 percent or more), and businesses may also obtain an exemption on their business taxes.

Exemptions on Taxes and Duty on Imported Raw Materials

In almost all of the ASEAN countries, imports of raw materials are exempted from paying import duty or taxes provided that the raw materials are not available domestically. In Brunei, the exemption is 100 percent and is given to companies that have been granted pioneer status. In Malaysia, up to 100 percent of import and excise duties for raw material imports is exempted if the raw materials are used in the production of manufactured goods, whether the goods are exported or are produced for domestic consumption (though there are some conditions in the latter case). Furthermore, firms using a minimum of 50 percent of raw materials and/or components manufactured in the country are eligible to receive a 20 percent investment tax allowance. In the Philippines, a 100-percent credit on taxes and duties for raw materials and semi-manufactured products is granted to registered firms as long as the materials are being used in the manufacture of export products. The exemption in Thailand is up to 90 percent of import duties and business taxes for imported raw materials and components. Indonesia exempts raw materials needed for the first two years of production for all foreign investment firms, and firms that export 65 percent or more of production continue to enjoy this exemption.

Other Tax Exemptions

Other tax exemptions are available in the ASEAN countries. In some cases, it is clear that the exemption is directed towards the promotion of a specific sector, group, or activity. For example, small-scale manufacturing firms in Malaysia are eligible for an abatement of 5 percent of adjusted income for up to five years.

Malaysia, the Philippines, and Singapore provide tax incentives for the establishment of regional headquarters in their respective countries. In Malaysia, the tax incentives for firms that establish their operational headquarters[4] in the country include a concessionary tax rate of 10 percent for management fees, interest on loans raised through financial institutions in Malaysia, and royalties arising from research and development work that was undertaken in the country (5–10 years). In the Philippines, regional headquarters of multinationals that only act as a supervisory, communications, and coordination center are not subject to

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[4]An operational headquarter refers to a foreign-owned multinational company which operates in Malaysia and carries out administrative, training, marketing, etc., for its subsidiaries or associated companies in the region. This concept does not include companies in the finance and services sectors. Other restrictions also apply.

income tax. Singapore is almost as liberal, and income arising from operational headquarters services in Singapore is taxed at only 10 percent for ten years, with the possibility of extension.

Still another example of tax incentive is the exemption of interest on approved foreign loans from taxes in Brunei.

Investment and Expansion Allowance

In all of the ASEAN countries save Indonesia, concessions are granted to firms in order to lower their initial capital expenditures or to firms that undertake investment to expand operations and/or infrastructure facilities. In Brunei, pioneer firms and firms that have undertaken capital expenditures that were approved by the government are eligible for tax exemptions for three to five years, depending upon the value of the new capital expenditure. Similarly, in the Philippines, a firm may obtain a tax credit for the purchase of domestically produced machinery, equipment, and parts. The credit is equivalent to 100 percent of the taxes and duties that would have been paid if the machinery, equipment, and parts had been imported. In Malaysia, up to 60 percent of qualifying capital expenditure may be deducted from taxes.

The allowance is slightly lower in Singapore where up to 50 percent of the value of the fixed investment is exempt from taxable income. However, the allowance, which is given for up to five years from the date on which the improvement is made, is only allowed for eligible manufacturing and service industries, for approved R&D activities, for approved construction projects, and approved water projects. Furthermore, manufacturing firms may take an exemption of 31 percent of profits for additional minimum investment of S$10 million (US$5.5 million) in new and productive equipment. The tax exemption is for profits in excess of the pre-expansion level and is for a period of up to five years.

In Thailand, enterprises in special investment promotion zones can take a deduction for installation of infrastructure facilities. This deduction is for a maximum of 25 percent of the investment costs and can be taken for 10 years from the date the income is earned.

Tax Incentives for Research and Development (R&D)

Of the ASEAN countries, Malaysia is perhaps the most generous in terms of tax incentives directed towards research and development. Not only can R&D expenses be deducted, but a double deduction is permitted for R&D activities that have been approved by the Minister of Finance. In addition, the Malaysian government grants an industrial building allowance for buildings used for research purposes—a 10-percent initial allowance and a 2-percent annual allowance thereafter. Plant and machinery used for approved research are also eligible for capital allowances.

The Philippines does not grant any tax deduction and/or exemption for firms incurring R&D expenses. However, the Department of Science and Technology grants incentives to firms engaged in R&D activities which have been identified as science and technology oriented.

In Thailand, tax privileges are only given to the importation of machinery which is to be used in R&D activities of the firm. No tax exemption or deduction is given for any other R&D expenses incurred.

Deductions for Labor Expenses

Because of the need to create employment and upgrade the labor force, several of the ASEAN countries have special fiscal incentives to promote employment expansion or improvement in the quality of the labor force. For example, Malaysia allows firms to take a double deduction for operational expenses incurred for approved training. An industrial building allowance for expenditure on buildings used for industrial training is also given (10 percent initial allowance and 2 percent annual allowance thereafter).

In the Philippines, one-half of the incremental labor expense of a registered firm that meets the prescribed ratio of capital to labor may be deducted. The deduction is double (i.e., 100 percent) if the firm is located in a less developed area.

Export Incentives

The importance placed on exports is clear in many of the ASEAN countries from the incentives that are offered to firms engaged in the manufacture of goods for the export market. Indonesia and the Philippines offer export credits at subsidized rates, while in Malaysia and the Philippines, firms can take advantage of export credit refinancing schemes. In addition, firms are eligible for restitution of the value added tax and the luxury tax paid by the producer on goods used in the manufacture of exports in Indonesia.

In Malaysia, firms which export their output are eligible for a number of other incentives. These include: (1) an abatement of adjusted income and export allowance, (2) an export allowance of 5 percent based on the FOB value of export sales for manufactured exports, (3) double deduction of export credit insurance premiums and of expenses incurred in the promotion of the exports, and (4) industrial building allowance for buildings and storage installations for exports.

In Thailand, export enterprises are eligible for (1) exemption of export duties and business taxes, (2) exemption of import duties and business taxes on imported raw materials, (3) allowance to deduct from taxable corporate income an amount equal to 5 percent of the increase in income from exports over the previous year. Indonesia opened certain business activities only to firms locating either outside Java or, in other cases, in specific locales in eastern Indonesia.

In the Philippines, a rediscounting facility is available to exporters for purchase orders, sales contracts, or export letters of credit at an annual rate of 15.5 percent. Firms that export their output may also obtain foreign currency deposit unit loans equivalent to as much as 70 percent of the value of the exports from commercial banks in the Philippines. Firms that produce non-traditional exports may also be exempt from payment of wharfage dues, export taxes, duties, impost and fees.

Incentives for Establishment of Enterprises in Target Locations

Several ASEAN nations offer special incentives to firms that locate their operations in designated, promoted areas. In Thailand, for example, firms that are located in zones furthest from Bangkok are granted a maximum 90 percent reduction in business taxes for up to 5 years, followed by a reduction of 50 percent of the corporate income tax for the next five years.[5] In addition, firms in promoted areas may deduct up to 200 percent of the cost of transportation and utilities expenses incurred from corporate income.

In Malaysia, the Promotion of Investments Act of 1986 provides an investment tax allowance of 5 percent to manufacturing firms located in promoted industrial areas. Larger investment allowances are given to hotels and other tourist projects outside of Kuala Lumpur and Penang.

VIII. INVESTMENT INFORMATION CENTERS

All of the ASEAN countries have a one-stop investment service center (see Appendix II). In Singapore, the Economic Development Board (EDB) is the one-stop investment service center that coordinates policies with government agencies, assists investors in a multitude of ways, and evaluates applications for tax and other investment incentives. Other institutions that foreign

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[5]In particular, the privileges described are granted to firms locating in the provinces of Samut Songkhram, Ratchaburi, Kanchanaburi, Suphanburi, Ang Thong, Ayutthaya, Saraburi, Nakhon Nayok, Chachoengsao, and Chon Buri.

investors often find useful as sources of information and as service centers are: (1) the Jurong Town Corporation, a statutory board that oversees development and management of industrial estates, assesses industrial land sites and factories in conjunction with new firms and existing firms seeking to upgrade their production facilities; (2) the Trade Development Board which assists domestic and foreign companies in using Singapore as a base of operations for various trading activities; and (3) the Singapore Institute of Standards and Industrial Research (SISIR) which assists domestic companies in using industrial technology.

The Malaysian Industrial Development Authority (MIDA) was established as a one-stop center. Most of the approvals required for manufacturing activities and tax incentives for foreign investors can be obtained at MIDA. The Ministry of International Trade and Industry, however, considers applications relating to the conditions pertaining to the government's policy on equity and employment.

The Investment Coordinating Board (BKPM) in Indonesia formulates policies on investment including the preparation of the list of sectors closed to investment. Since 1977, the BKPM is the only government agency responsible for investment applications, approvals, and investment facilities, with the exception of investments in energy and mining, which are handled by the Ministry of Energy and Mines. Foreign investment applications are submitted to the BKPM and to the affected Regional Investment Coordinating Board (BKPMD) which is located in every province. Approval of the foreign investment application is given by the President based on the recommendation of the Chairman of the BKPM, and the necessary regional permits for approved investment projects are provided by BKPMD. Investors in duty-free zones must apply directly to the authority of the particular zone and regional licenses are not required.

Like all of its ASEAN neighbors, the Philippine government has also established a one-stop investment center which is designed to facilitate foreign and local investment. The Investment One-stop Action Center provides prospective investors with all the information needed about investing in the Philippines under one roof and can assist investors with the processing of applications. In the Center there are representatives from various agencies (including the Central Bank, the Securities and Exchange Commission, the Commission on Immigration and Deportation, the Bureau of Customs, the Export Processing Zone Authority, the Department of Tourism, the Garments and Textile Export Board, the Department of Labor and Employment, and the Bonded Export Marketing Board), and these representatives have the authority to act on matters concerned with setting up a business or making investments in the Philippines. The Center is a relatively new service to investors, and thus far, the major users have been domestic small and medium-sized firms.

In Thailand, foreign investors can obtain information and services at two one-stop service centers. The Office of the Board of Investment houses one of these centers and provides services to BOI-promoted firms. Non-BOI promoted firms can go to the Industrial Work Department. In addition, firms located in an industrial estate can visit the Industrial Estate Authority of Thailand for information and applications.

IX. CONCLUSION

ASEAN countries have increasingly liberalized foreign investment policies in recent years. Indonesia, for example, selected to decrease the number of incentives to create a more neutral environment and attempted to streamline procedures and reduce disincentives. Other countries have streamlined approval processes and/or increased incentives. Clearly, however, sound policies affecting the overall macroeconomic conditions, wages, and trade barriers have also played a significant role in attracting investors. The low number of performance requirements and the relatively liberal regulations, etc., worked together with other policies to create a positive investment environment in ASEAN. Although some problems remain--infrastructural and other bottlenecks in some of the countries, shortages of skilled labor, and problems relating to intellectual property rights protection-- all ASEAN countries remain committed to the liberalization process and will continue to be a magnet for foreign investors.

APPENDIX I

	Indonesia	Malaysia	Philippines	Singapore	Thailand
Income tax exemption	No tax exemptions but generous depreciation rates such as the 50-25% declining-balance method for most equipment	Tax of only 10% of profit is levied on pioneer corporations for a period of 5 years	100% income tax exemption for pioneer and nonpioneer firms for 6 and 4 years, respectively, which is extendable for another 2 years if: (1) the project meets the prescribed ratio of capital equipment to number of workers; (2) a specific utilization rate of indigenous raw materials is met; (3) if the net foreign exchange earnings of the firm is at least $500,000 each year for the first three years	31% exemption on profits for firms granted pioneer status; tax relief period is 5-10 years	100% exemption of corporate income taxes for 3-8 years Exemption for up to 5 years on withholding tax on goodwill, royalties, and fees remitted abroad
Exemption of tax and duty on imported equipment and machinery	Up to 100% exemption on import duty of capital goods	Up to 100% exemption on duty for nearly all machinery if: (1) machinery is not produced locally; (2) machinery is used for manufactured goods	100% exemption of tax or duty of capital equipment or machinery imported by new or expanding registered enterprises before August 14, 1992		Exemption of business taxes on imported machinery; also 50% reduction in import duty on machinery which is subject to duty

Exemption of tax and duty on imported raw materials	Up to 100% exemption on import duty of raw materials	Up to 100% exemption on import duty and on excise duty for raw materials used in manufactured goods, exports, and domestic consumption with some conditions	100% tax credit for taxes/duties paid for raw materials and semi-manufactured products used in manufacture of export products		Exemption of up to 90% of import duties and business taxes for imported raw materials and components
Minimum level of investment	US$100,000-US$250,000	None	None	None	None
Double taxation agreements	Austria, Belgium, Canada, Denmark, France, Germany, Great Britain, India, Japan, Netherlands, New Zealand, Norway, Philippines, Singapore, Sweden, Switzerland, Thailand, and United States	Australia, Bangladesh, Belgium, Canada, China, Denmark, Finland, France, Germany, Hungary, India, Italy, Japan, Korea (South), Netherlands, New Zealand, Norway, Pakistan, Philippines, Poland, Romania, Singapore, Sri Lanka, Sweden, Switzerland, Thailand, United Kingdom, and USSR Negotiations underway with Brazil, Egypt, Indonesia, Kuwait, Malta, Turkey, and Yugoslavia	Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Indonesia, Italy, Japan, Korea, Malaysia, Netherlands, New Zealand, Pakistan, Singapore, Sweden, Thailand, United Kingdom, and United States	Australia, Bangladesh, Belgium, Canada, China, Denmark, Finland, France, Germany, India, Israel, Italy, Japan, Korea (South), Malaysia, Netherlands, New Zealand, Norway, Philippines, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, and United Kingdom	Austria, Belgium, Canada, Denmark, Finland, France, Germany, India, Indonesia, Italy, Japan, Korea (South), Malaysia, Netherlands, Norway, Pakistan, Philippines, Poland, Singapore, Sweden, and United Kingdom Negotiations underway with Australia, Romania, and the United States

Other tax exemptions		Abatement of 5% of adjusted income for small-scale manufacturing firms for 5 years Tax incentives for operational headquarters established in Malaysia include concessionary tax rate of 10% on management fees, interest on loans raised through financial institutions in Malaysia, and royalties arising from R&D work in Malaysia for 5-10 years Other fiscal and non-fiscal incentives are available to operational headquarters in the country	Regional headquarters of MNCs that establish themselves in the country are not subject to income tax provided that the regional headquarter only acts as a supervisory, communications, and coordinating center and does not earn income in the Philippines; also incentives for regional warehouses	Income arising from operational headquarters services emanating from Singapore is only taxed at 10% for 10 years with possibility of extension	

Investment allowance deductions		Up to 60% of qualifying capital expenditure may be deducted from taxes	Tax credit equivalent of 100% taxes and duties that would have been waived if the machinery, equipment, and parts had been imported	Up to 50% of value of fixed investment is exempt from taxable income for eligible manufacturing and service industries; approved R&D activities; approved construction; approved water projects Qualifying period is up to 5 years from date on which investment was made Also, exemption of 31% tax on profits for additional minimum investment of S$10 million in new and productive equipment in manufacturing, tax exemption is for profits in excess of preexpansion level and is for period of up to 5 years	Enterprises in special promotion zones may deduct up to 25% the cost of installation of infrastructural facilities; deduction can be taken for 10 years

Incentives for R&D		Deduction on R&D expenses allowed; double deduction for R&D approved by Minister of Finance Industrial building allowance for buildings used for research purposes-initial allowance of 10% and annual allowance of 2% thereafter Plant and machinery used for approved research are eligible for capital allowances	None, but incentives are granted to firms engaged in science and technology-oriented R&D activities by the Dept. of Science and Technology		None, but importation of machinery used in R&D activities of the firm may be eligible for tax privileges
Net loss carry forward provision	Losses may be carried forward within 5-8 years	Losses may be carried forward for an unlimited period provided the firm does not close down its operation	None, but a bill which proposes this provision is pending in the legislature		Losses may be carried forward and deducted as expenses for up to 5 years

Deductions for labor expenses		Double deduction on operational expenses for approved training Industrial building allowance for expenditure on buildings used for industrial training, initial allowance is 10% and 2% annual allowance thereafter	50% of the incremental labor expenses of a registered firm that meets the prescribed ratio of capital to labor, 100% deduction if firm is located in a less developed area		

Export incentives	Export credits at subsidized rates Restitution of value added tax paid by producer on purchase of goods and materials used in the manufacture of exports	Export credit refinancing scheme available Abatement of adjusted income and export allowance available to firms that export their output Export allowance of 5% based on FOB value of export sales for manufactured exports Double deduction of export credit insurance premiums, expenses incurred in the promotion of exports Industrial building allowance for buildings and storage installations for exports Abatement of 5% of adjusted income for 5 years for manufacturing firms in promoted areas	Rediscounting facility is available to exporters for purchase orders, sales contracts, or export letters of credit at 15.5% rate Exporting firms may also obtain foreign currency deposit unit loans equivalent to as much as 70% of exports from commercial banks Nontraditional exports are exempt from wharfage dues, export tax, duty, impost, and fee		Export enterprises are eligible for: (1) exemption of export duties and business taxes; (2) exemption of import duties and business taxes on imported raw materials; (3) allowance to deduct from taxable corporate income an amount equal to 5% of increase in income from exports over previous years

Incentives for promoted locations		Manufacturing firms locating in promoted industrial areas are granted a 5% investment tax allowance. Hotels and tourist projects are granted investment tax allowance of 25-75% depending on the project and the location.	Amount equivalent to 100% the value of necessary and major infrastructure works is deductible from taxable income		Maximum of 90% reduction of business tax for up to 5 years, then reduction of 50% of corporate income tax for 5 years thereafter Deduction from taxable 200% corporate income for cost of transport and utilities

APPENDIX II

APPENDIX II
One-Stop Investment Centers in ASEAN

Indonesia

Badan Koordinasi Penanaman Modal [Investment Coordinating Board]
Jl. Gatot Subroto No. 44
Jakarta

Telephone:	(021) 512008, or 514981, or 514984
Fax:	(021) 514945

Malaysia

Malaysian Industrial Development Authority
Gr, 3rd–6th Floor, Wisma Damansara
Jalan Semantan
P.O. Box 10618
50720 Kuala Lumpur

Telephone:	603-255-3633
Fax:	603-255-7970

The Philippines

One-Stop Action Center
Board of Investments Building
385 Sen Gil Puyat Avenue
Makati, Metro Manila

Telephone:	868-403, 818-1831
Fax:	63-2-819-1887

Singapore

Economic Development Board
250 North Bridge Road #24-00
Raffles City Tower
Singapore 0617

Telephone:	330-6723
Fax:	(65) 339-8310

Thailand

Investment Service Center
Office of the Board of Investment
555 Vipavadee-Rangsit Road
Bangkhen, Bangkok 10900

Telephone: 270-1400, 270-1410, 270-1420
Fax: 66-2-271-0777

Investment Services Subdivision
Industrial Development Division
Department of Industrial Promotion
Ministry of Industry
Rama 4, Prakhanong, Bangkok 10110

Telephone: 391-1669, 391-2809
Fax: 66-2-381-1601

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