2023 OECD Southeast Asia Ministerial Forum

Sustainable and Quality Investment: New Momentum for OECD-Southeast Asia Partnership

Background Note and Publications

Ha Noi, 26-27 October

OECD Southeast Asia
Regional Programme

Sustainable and Quality Investment: New Momentum for OECD-Southeast Asia Partnership

Over the past two decades, Southeast Asia has become a major engine of global economic growth. The economies of all ASEAN Member States (AMS) have more than doubled in size, and over 100 million people in the region have been lifted out of poverty. The region has also been among the biggest recipients of foreign direct investment (FDI) among emerging regions over this time period, with FDI flows to Southeast Asia increasing ninefold.

Under the right conditions, FDI can make an important contribution to sustainable development and the achievement of the Sustainable Development Goals (SDGs). OECD analysis indicates that foreign firms tend to contribute more than domestic firms when it comes to some elements of sustainable development. Significantly more foreign firms introduce new products and services than their domestic counterparts across most countries in the region, and this greater innovation capacity suggests that there is potential for knowledge and technology to spill over to domestic firms. Foreign firms are also more likely to provide training opportunities to their workforces, and by employing larger shares of women in their workforces in most AMS, can also help improve gender equality in the workplace.

Despite these indications, the contribution of FDI to sustainable development is not always clear-cut. In terms of carbon intensity (measured in emissions per unit of output), foreign firms perform better than their domestic counterparts in Viet Nam and the Philippines but less well in Indonesia and Thailand. The challenge for governments is therefore twofold: to attract foreign investors at a time of diminishing global FDI flows, but also to ensure that the investment confers sustainable benefits on the host economy.

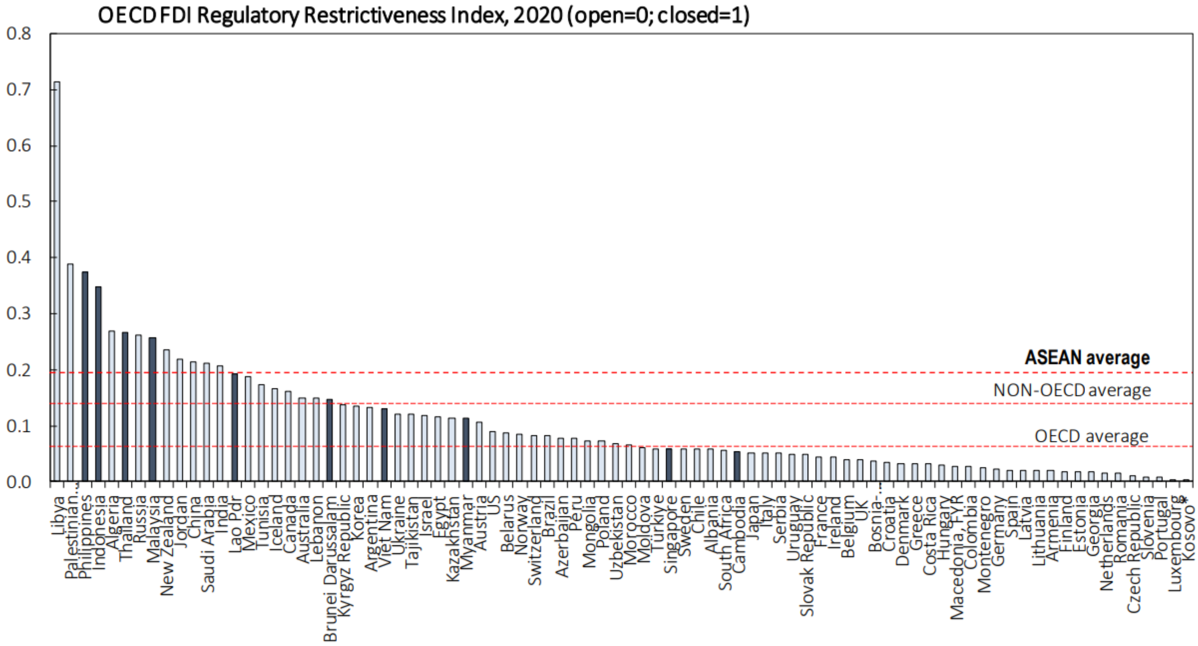
Too often the reason governments fail to attract sustainable investment is due to the lack of an enabling environment for investment. Green investors are no different than any others in requiring a stable, predictable, and transparent investment environment in which to identify bankable projects. Thus, efforts to mobilise green investment will fail to meet their intended target unless governments ensure a regulatory climate that provides investors with fair treatment and confidence in the rule of law. The widely accepted features of this enabling environment are detailed in the OECD Policy Framework for Investment (PFI).

At the same time, openness, stability, and fair treatment are not enough to channel private investment towards green growth and decarbonisation objectives. In other words, policies conducive to FDI will not automatically result in a substantial increase in green or climate-aligned FDI. Policymakers will also need to improve specific enabling conditions for green investment by developing policies and regulations that systematically internalise the cost of environmental externalities like carbon emissions. Targeted financial, technical and information support can also help address market failures that reduce the competitiveness of climate-aligned investments.

The next section examines efforts by AMS to address these dual objectives.

State of play

AMS individually and collectively have made substantial improvements over time in the climate for investment. OECD Investment Policy Reviews undertaken across the region have attested to this reform agenda. While all AMS have adopted a more open policy stance towards foreign investment over time, some have been much more ambitious reformers than others, and there is now substantial differentiation in levels of openness across the region. The table below, based on the OECD FDI Regulatory Restrictiveness Index, demonstrates this.



FDI restrictions as captured by the OECD FDI Index are strongly correlated with the stock of FDI, with OECD econometric analysis suggesting that a 10% improvement in the Index score will lead to a 2% increase in the stock of inward FDI. Additionally, discriminatory restrictions on the establishment and operations of foreign investors can diminish the potential contribution of FDI to decarbonisation. Some sectors that present significant opportunities for decarbonisation efforts remain partly off-limits to foreign investors in many countries – notably, transport, electricity transmission and distribution, and construction.

In their quest to leverage FDI as an engine of growth and development, AMS have not only gradually liberalised their economies to allow the entry of foreign investment, they have also designed investment promotion strategies to establish clear objectives, targets and means in their efforts to attract and facilitate FDI. Using FDI to meet the SDGs is high on the agenda of most ASEAN investment promotion agencies (IPAs), with over 56% considering the SDGs as a top factor influencing investment promotion priorities, compared with 44% in OECD countries.

As the broader objective of promoting sustainable and responsible investment is increasingly taken on board by ASEAN governments, IPAs need to rely on specific and consistent key performance indicators (KPIs) to ensure that: a) they attract the right investments, and b) the attracted FDI actually generates sustainability outcomes. However, IPAs across ASEAN differ significantly in the type of KPIs used for monitoring and evaluation (M&E). While all use the number of projects and the investment value (CAPEX) as M&E indicators, few had dedicated indicators to measure the sustainability outcomes of the attracted FDI as of January 2023.

Research by the OECD has uncovered an apparent disconnect between the overarching priority setting by IPAs and the KPIs used to prioritise investments and measure their outcomes. While most AMS base their investment promotion priorities on the SDGs (and have sometimes even readjusted them recently on the same basis), many have limited or no relevant KPI indicators to measure the sustainability performance of those investments. Conversely, some AMS have not set their investment promotion priorities based on the SDGs but use KPIs to measure the sustainability outcomes of their performance. Greater alignment of indicators at the prioritisation and M&E stages would promote stronger sustainability outcomes.

Many other policy settings affect the enabling environment for sustainable investment. Every ASEAN Member State has a environmental impact assessment (EIA) system applied to investment projects that may have a significant environmental or social impact.[1] With few exceptions, laws and policies of AMS provide for the three critical procedural rights of access to information, public participation, and access to remedies, including grievance redress mechanisms and other project-specific complaint processes. These procedural rights are necessary to ensure that EIAs can effectively identify community concerns about development projects and are critical for environmental governance.

EIA processes could be further strengthened to increase their effectiveness in promoting sustainable investment. As of January 2023, only Thailand, Lao PDR and Brunei Darussalam required the application of EIA principles to the assessment of the transboundary impacts of investment, while laws and policies unrelated to EIA partially require transboundary EIA in an additional four AMS. New tools such as strategic environmental assessments, which help address limitations of the EIA process in identifying cumulative environmental impacts across multiple projects, or those arising as a result of development planning at a regional level, have been adopted in some AMS and could be recognised at the ASEAN level to promote their further use across the region. Beginning EIA processes early enough to enable effective public comment and strengthening post-approval monitoring and enforcement processes would also improve the effectiveness of EIAs.

Incentives can also be used to encourage investment to be directed to sustainable purposes. Green sectors actively promoted in Southeast Asia include renewable energy, bioplastics, circular economy, electric vehicles and charging stations, re-forestation and biodiversity conservation. Examples of fiscal incentives used to promote these sectors typically include corporate income tax (CIT) holidays or reductions for a specified period and import duty and VAT exemptions on related machinery and equipment. Some AMS also provide investment incentives to improve the environmental performance of existing businesses and actively target specific business activities that advance green capabilities and support green growth, such as investment in green R&D, green jobs and skills or green suppliers. However, in some AMS, similar incentive packages are offered to 'green' and 'non-green' activities in targeted sectors, which raises questions about their overall effectiveness in reducing environmental impact.

Finally, while not solely applicable to FDI, fossil fuel subsidies can negatively impact sustainable investment by changing investment projects' incentives for energy use, often in environmentally harmful ways. The countries of Southeast Asia have made some progress in phasing out fossil fuels subsidies, but this process is far from complete and may be delayed by rising fuel prices. The structure of fossil fuel subsidies in Southeast Asia means that benefits accrue mainly to wealthier segments of the population (who use more of the subsidised fuel) rather than to the poorest. Phasing out subsidies could therefore free up public funds for targeted support to low-income groups, as well as boosting incentives for more sustainable investments.

Responsible business conduct and its impact on sustainable investment

Responsible business conduct (RBC) centres on an expectation that all businesses – regardless of their legal status, size, ownership structure or sector – avoid and address negative consequences of their operations, while contributing to sustainable development where they operate. This means integrating and considering environmental and social issues within core business activities, including throughout supply chains and business relationships. RBC is therefore of central interest to policymakers wishing to attract quality and sustainable investment.

At the policy maker level, there is growing consensus that a smart mix of policies, including regulation, market-based and voluntary initiatives, are appropriate to promote responsible

[1] Although Singapore lacks a legislative basis for EIA, it is carried out based on specific projects and broadly conforms to the requirements for EIA adopted by other countries in ASEAN. All other AMS have formal and legally binding systems for EIA.

business conduct. For example, Germany, Switzerland and Norway have introduced due diligence legislation (which reference or are aligned with the OECD RBC instruments) and discussions are also on-going at the EU level. There have also been thematic efforts, for example at the EU on updating the non-financial reporting directive and introducing reporting requirements in line with the RBC due diligence guidance.

Some AMS have started introducing regulations and policies which could support efforts to enhance due diligence. For example, Indonesia introduced requirements for corporate social responsibility in the Law on Limited Liability Companies in 2007. Moreover, Indonesia, Malaysia, Singapore, Thailand and Vietnam have introduced requirements and guidance on ESG reporting and trainings, as well as sustainability indices to measure and monitor commitments of listed companies.

At the regional level, ASEAN has already started reflecting RBC-related concepts across its frameworks and guidelines, and has also introduced a consultative body to promote and protect human rights in the region and the intergovernmental commission to provide a platform for engagement and exchange of RBC-related policies.

Recommendations for boosting quality and sustainable investment

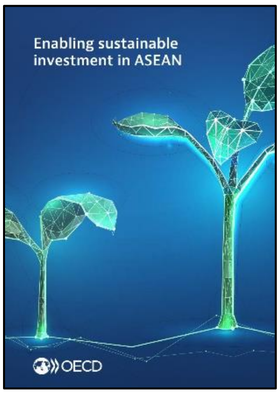
Taking the above issues into account, the OECD's *Enabling sustainable investment in ASEAN* report makes the following recommendations for promoting quality and sustainable investment:

- Consider further reducing FDI restrictions in broad sectors of the economy to support sustainability objectives.
- Further focus on the SDGs to design investment promotion strategies and set priorities.
- Improve the granularity of investment promotion indicators to select sustainable investors and measure their sustainability outcomes.
- Ensure and promote regional alignment and peer learning on RBC.
- Improve efforts to create an enabling environment for RBC within ASEAN Member States.
- Strengthen efforts to promote RBC due diligence.
- Ensure meaningful stakeholder engagement.
- Update Paris Agreement Nationally Determined Contributions (NDCs) with enhanced climate policy ambitions, including specific targets for emissions reductions in the transport sector.
- Use ASEAN as a platform to promote transboundary strategic environmental assessments (SEA) and environmental impact assessment (EIA)
- Consider phasing out fossil fuel subsidies and using freed up funds for targeted support to vulnerable low-income electricity users.
- Consider scaling down or phasing out investment incentives for non-green activities.

Adapted from OECD (2023), "Enabling sustainable investment in ASEAN", OECD Business and Finance Policy Papers, No. 23, OECD Publishing, Paris, https://doi.org/10.1787/eb34f287-en.

Want to know more?

Since 2014, the OECD's Southeast Asia Regional Programme (SEARP) has supported Southeast Asia in its domestic priorities, policy reforms and regional integration efforts. Investment policy has been a key pillar of SEARP since its inception, through the Regional Policy Network on Investment, the publication of Investment Policy Reviews covering eight ASEAN countries and the region as a whole, and close cooperation with the ASEAN Coordinating Committee on Investment. SEARP also publishes work on a wide range of issues relevant to the enabling environment for sustainable and quality investment, including macroeconomic developments, education and skills, clean energy and sustainable infrastructure, transport and much more. A selection of recent OECD work on these topics is available below.



[2023] Enabling Sustainable Investment in ASEAN

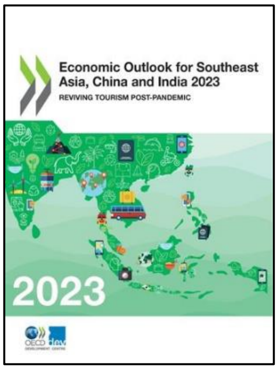
This paper analyses the efforts made by the governments of the Association of Southeast Asian Nations (ASEAN) to attract sustainable investment and how they can further promote investment benefits for social and environmental objectives. It uses the OECD's flagship tools on investment and responsible business conduct, and builds on the OECD's strong collaboration on investment with ASEAN. Aiming to help ASEAN Member States in their efforts to implement the sustainable investment component of the ASEAN Comprehensive Recovery Framework, this paper provides indicators to measure the sustainability impacts of foreign direct investment, benchmarks investment policy reforms and investment promotion priorities, and suggests ways to enable responsible business conduct and policy initiatives to foster green investment. DOI: https://doi.org/10.1787/eb34f287-en.

[2023] OECD Economic Surveys: Viet Nam 2023

Viet Nam has made remarkable economic progress over the past decades, sustaining high economic growth. The economy has also proven resilient to shocks, including the COVID-19 pandemic. Extensive and continued reforms since the late 1980s have been key to this economic success. Nevertheless, with significant challenges ahead, Viet Nam needs to make additional efforts to advance structural reforms that will further strengthen market forces. This report discusses numerous policy areas, including population, trade integration, worker skills, energy transition and fiscal policies by providing a comprehensive review of existing policies in Viet Nam and outlining specific policy recommendations for the selected policy areas mentioned in the report. DOI: https://doi.org/10.1787/8f2a6ecb-en

[2023] OECD Skills Strategy Southeast Asia: Skills for a Post-COVID Recovery and Growth

Skills are the key to shaping a better future, enabling countries and people to thrive in an increasingly interconnected and rapidly changing world. Megatrends such as globalisation, technological progress, demographic change, migration, and climate change, and recently COVID-19, are reshaping work and society, generating a growing demand for higher levels and new sets of skills This report, applies the OECD Skills Strategy framework to assess the performance of countries in SEA, identifies opportunities for improvement and provides recommendations based on in-depth desk analysis and consultations with stakeholder representatives. DOI: https://doi.org/10.1787/923bfd03-en



[2023] Economic Outlook for Southeast Asia, China and India 2023: Reviving Tourism Post-Pandemic

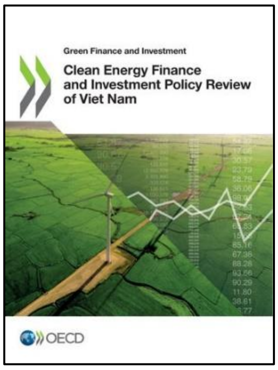
The 2023 edition of the OECD Economic Outlook for Southeast Asia, China and India discusses the region's economic outlook and macroeconomic challenges at a time of great uncertainty and a slowdown of the global economy, in particular owing to inflationary pressures, capital flow volatility and supply-side bottlenecks. The thematic chapters focus on reviving tourism after the pandemic. Tourism was among the sectors most affected by both the COVID-19 pandemic and responses to it. The report highlights the economic impact of tourism in the region and explores how the sector can be reshaped to regain its significant role in Emerging Asia. DOI: https://doi.org/10.1787/f677c529-en

[2022] Supporting Regulatory Reforms in Southeast Asia

Regulatory reforms have long been a focus for Southeast Asian nations, often as a way to improve the business climate and policy frameworks for trade and investment. The recent COVID-19 pandemic has spurred countries around the world to review and update their regulatory policies to respond to the current crisis and prepare for the next one. This publication presents a snapshot of the current state of regulatory reform across the region, with country profiles from all 10 Member States of the Association of Southeast Asian Nations (ASEAN) highlighting practices in three priority areas: whole-of-government initiatives, good regulatory practices, and use of digital technologies. It also offers an analysis of common themes identified across the profiles, including trends in regulatory reform, common challenges faced by countries, and future priorities in the region. DOI: https://doi.org/10.1787/aad87f86-en

[2022] ITF Southeast Asia Transport Outlook

This report provides scenarios for future transport demand and CO2 emissions in Southeast Asia up to 2050 to help decision-makers chart pathways to sustainable, resilient transport. The scenarios reflect existing policy initiatives and specific constraints in the region. They also examine the potential impact of policies addressing the challenges and opportunities for transport from Covid-19. ITF Transport Policy Papers assemble reports from case-specific policy analyses carried out by the ITF on request of member countries, thematic reviews carried out in agreement with local institutions, studies completed in the context of the ITF Corporate Partnership Board, and other work focused on supporting policy decisions. DOI: https://doi.org/10.1787/cce75f15-en

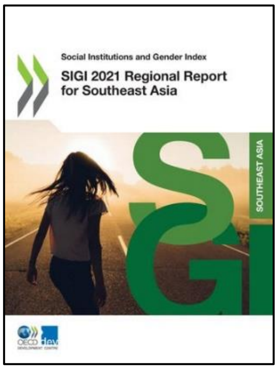


[2021] Clean Energy Finance and Investment Policy Review of Viet Nam

The Clean Energy Finance and Investment Policy Review of Viet Nam provides a comprehensive overview of the current policy framework, highlighting progress and identifying untapped opportunities for strengthening policy interventions that can help scale up clean energy finance and investment. It also provides a number of tailored recommendations for the Government of Viet Nam and development partners. The Review was undertaken within the OECD Clean Energy Finance and Investment Mobilisation (CEFIM) Programme, which supports governments in emerging economies to unlock finance and investment in clean energy. DOI: https://doi.org/10.1787/61c33f7f-en

[2021] Clean Energy Finance and Investment Policy Review of Indonesia

Thanks to renewable energy and energy efficiency potential and a dynamic economy, Indonesia has become a coveted destination for investors in the clean energy sector. Clean energy investment, however, remains far below the level needed to realise Indonesia's ambitious clean energy and sustainable finance goals.. This first Clean Energy Finance and Investment Policy Review of Indonesia supports efforts to reverse these trends and achieve a clean energy transition. The report provides a comprehensive overview of the current policy framework, highlighting progress and identifying untapped opportunities for strengthening policy interventions that can help scale up clean energy finance and investment. It also provides a number of tailored recommendations for the Government of Indonesia and development partners. The Review was undertaken within the OECD Clean Energy Finance and Investment Mobilisation (CEFIM) Programme, which supports governments in emerging economies to unlock finance and investment in clean energy. DOI: https://doi.org/10.1787/0007dd9d-en



[2021] SIGI 2021 Regional Report for Southeast Asia

Achieving gender equality and tackling discriminatory laws, social norms and practices set a direct path toward a more inclusive economy and society. The SIGI 2021 Regional Report for Southeast Asia provides new evidence-based analysis on the setbacks and progress in achieving gender equality between 2014 and 2019 in 11 countries. The report uncovers the discrimination women face within social institutions in various dimensions; in the family and household context, in relation to physical integrity and access to productive and financial resources, as well within the political and civil spheres. The SIGI 2021 Regional Report for Southeast Asia explores the interaction between women's empowerment and discriminatory social institutions by looking specifically at four core areas – health, education, the economic dimension and decision makingBuilding on the regional analysis of how discriminatory social institutions continue to hinder efforts toward SDG 5, the report provides a set of policy recommendations to enhance governments' efforts to deliver on their gender equality commitments by 2030. DOI: https://doi.org/10.1787/236f41d0-en

Forthcoming Publication

[2023] Extending Broadband Connectivity in Southeast Asia

Forthcoming (December 2023)

This report assesses the current state of connectivity in Southeast Asia and provides tailored recommendations for extending broadband access, focusing on five countries: Cambodia, Indonesia, Singapore, Thailand and Viet Nam. The analysis builds upon the OECD Recommendation on Broadband Connectivity, which provides a reference for policy makers and regulatory authorities within and outside of the OECD. Using the principles of the Recommendation as a roadmap, countries may be better able to unleash the full potential of connectivity for the digital transformation and to ensure equal access to connectivity for all users.