

# Industry Development and Opportunity for Investment

## 1. Overview

### 1.1 Investment in the Mekong Region

### 1.2 Objectives:

The objectives of GMS industrial and investment policy are:

- (i) to maximize income and employment generation by taking advantage of comparative and competitive advantages among countries and sub-national regions in the region. That is, to reap the advantages of complementarity.
- (ii) To support sustainable development, in its economic, social, governance, and ecological dimensions.
- (iii) To build on the tourism and hospitality industry which is the common underlying economic strength of the GMS region.
- (iv) To improve cross-border infrastructure to facilitate the above, recognizing that software, e.g., tariffs, immigration regulations, etc., are as important as hardware.
- (v) To build on the existence of increasingly good infrastructure in the regions, essential corridor infrastructure will be in place within 7 years. Investment should focus on the corridors initially (over the next 15 years) to establish a developmental bridgehead in the Industry Development and Opportunity for Investment region.

### 1.3 INVESTMENT CONTEXT

- **Investment Situation:**
- **Investment Situation and Trends:** As indicated by Table x, investment in the GMS has fallen drastically from 10.3 billion U.S. in 1998 to 5,6 billion in 2001 and less than 3 billion in 2002. No jurisdiction in the region has escaped this decline, although the relative performance of Vietnam and Yunnan Province of China has been the best. This decrease in FDI was attributed to two major factors; (1) The global economic and political situation which saw a major shift in investment to coastal China, which became the factory of the world, and (2) the constraints and difficulties within the GMS countries themselves, particularly slowness in adopting AFTA principles which would have created a more conducive environment to FDI, and the investment and business climates in some GMS countries which were not especially friendly to FDI . To better attract investment, the GMS countries need to take immediate actions to solve their domestic problems and create sound investment and business climates.
- **Investment Promotion:** Tangible outcomes in terms of implementation of the GMS development strategy have been especially manifest in the

development of infrastructure linkages. Regional governments as well as the Asian Development Bank (ADB) have played a key role in supporting the scheme over the past decade. Apart from the hardware side, there have been improvements in laws and regulations related to investment and movement of goods and people. For example, Thailand is currently extending tax exemptions for foreign investments, targeting key clusters. Many of these clusters offer opportunities to other GMS countries through supply linkages. In addition, social and Human Resource Development investments have increased substantially in the GMS countries. Quantitative indicators look very good, the current challenge is to increase the quality and relevance of investment in human resource development to produce labor forces capable of competing in increasingly demanding global markets.

#### 1.4 Framework for industrial development in the GMS

- **Economic Corridor Development Strategy:** After the financial crisis in 1997, which started in Southeast Asia, the GMS countries adopted an Economic Corridor Strategy. The Economic Corridor strategy is based on the principle that investment should initially (for 10-20 years) be focused on specific corridors within the GMS. Implementing such a strategy will: (i) improve linkages and flows within the GMS thereby strengthening economic clusters in the various countries, and (ii) provide bridgeheads from which developmental benefits can diffuse over the region as a whole over time. Three Corridors are currently becoming a reality: the North-South, East-West, and Southern Economic Corridors (see Map 1). They will facilitate trade, investment, tourism, and production (manufacturing) opportunities in the GMS. Development of both hardware (transportation, telecommunications and energy) and software (facilitation of cross border movement of goods, services, investment, and people) are expected to be a key positive impact of corridor development.
- **Competitive Investment Location :** The heart of strategy is to integrate production more taking advantage of variation in labor, natural resource, technological, investment availability and costs throughout the GMS. Gateway nodes, such as Thailand's Eastern Seaboard, Danang, Kunming, and Sihanoukville will act as entering points. Border nodes such as Nong Kai and Aranya Prathet will facilitate rapid movement of goods and labor but can also serve as points of production combining, for example, natural resources and labor from one country and an advanced economic cluster's know how from another. Major nodes will be promoted, marketed world-wide, and developed as new regional production bases, based on the co-production concept noted above.

Co-production areas need to be carefully planned and implemented. . Prerequisites for their development include designation as special economic zones (with corresponding tax and tariff privileges), construction of industrial estates embodying the latest in logistics technology to minimize the disadvantages of land-locked conditions, etc., logistics centers rather than warehouses to minimize inventory costs, etc. Private investment is critical to the development of these co-production areas both because of capital requirements and because of the specialized knowledge of cluster dynamics, state-of-the-art logistics systems, etc., which only resides in the private sector.

Ultimately, each country will develop high profile clusters and participate in production processes depend upon its real comparative and competitive advantages.

▪ **Potential Industry for Development in the GMS:**

Each country has developed of high-profile industrial clusters, e.g., Thailand in automobiles, Cambodia in textiles, Yunnan in agro-products (including herbal medicines, tea and cut flowers for European markets), Laos in energy production and handicrafts, Vietnam in footwear, etc., which was to be distinguished from clusters in the other countries. The goal of GMS development should be to build on these strong clusters – bringing neighboring countries into the supply chain. Investment incentives, both to manufacturing and service industries should no longer be cross-board; rather they should be aimed at strengthening clusters in GMS countries or supply chain linkages to strong clusters in neighboring countries. Although it is impossible to pick industrial winners, often emerging clusters can be identified early in their life cycles. It is incumbent upon GMS countries, both their public and private sectors, to recognize the emergence of “winner” clusters and work closely with neighboring countries to realize their full potential. Potential industrial clusters that offer promise in the Economic Corridors described in Map 1 include the following:

- (i) Industry based on current comparative advantage in natural resources or cost effective labor: Agro-industry, light industry, footloose industries i.e. clothing, garments, accessories, consumer products, wood processing, construction materials and agricultural machinery.
- (ii) High potential industry based on emerging rapid demand (direct and indirect) : Logistics, Tourism, and Services
- (iii) High technology industry: For example, automotive parts to serve the highly successful vehicle cluster in Thailand or the rapidly growing motorcycle cluster in Viet Nam. In these industries, the structure of production has shifted from labor intensiveness, which accounts for less than 7% of total costs to technology oriented inputs, and logistics costs. Thus the growth of these industries will be closely related to improvements in the aligning of education to these clusters as well as improvement in education. In addition, logistics costs are too high, e.g., in the order of 15% of total costs, they need to be reduced closer to the United States standard of 9%.

## **2. Opportunities for Investment in the New Production Base along the Economic Corridors**

**2.1 Identify site and development pattern:** In general, there are various kinds of production bases such as bonded logistics centers, inland container depots (ICD), export processing zones (EPZ), general industrial zones (GIZ), free zones and special economic zones. Each one has different characteristics in terms of format, institutional support, and function in the overall cluster production. Different types of incentives will be needed to attract investment.

**2.2 Opportunities for Investment in each GMS Country:** The implementation of the economic corridor concept since 1997, which is now gaining momentum, is beginning to open up the Mekong region for investment outside major extended urban regions such as Bangkok and Ho Chi Minh City and coastal

industrial zones. The GMS countries, in turn, need to adjust their national strategies to better seize this opportunity by prioritizing and identifying target clusters and development nodes within the corridors. To spread investment among too many industries and over extended geographical areas is unlikely to result in rapid development based on past experience in ASEAN, and worldwide. The investment opportunities in each country can be summarized as follow;

- **Myanmar** The government supports the development of special border economic zone/industrial estates in Mawlamyine, Pa-an, and the border area between Myawaddy (Myanmar)-Mae Sod(Thailand) along the East West Economic Corridor (EWEC). To do so, Myanmar gives high priority to the development of transportation linkages as well as technical assistance to help develop the potentials of these new production bases.
- **Thailand** Along the North-South Economic Corridor, the government has accorded priority to the establishment of a special border economic zone in Chiang Rai province emphasizing Sino-Thai joint investment. Major development is underway in terms of infrastructure, and area development, and creation of a supportive business environment through changes to laws and regulations at both national and local levels. Major investment will occur in 2005. Along the East West Corridor, the Thai Government plans to establishment a border economic zone in Mae Sod province, and establish a logistics / of distribution center in Mukdahan province. These investments are planned for 2006.
- **LaoPDR.** The government places high priority on the East West Economic Corridor because the Lao PDR is landlocked. Development of this corridor, through Laos, would improve opportunities for manufacturing, tourism, etc. At present, manufacturing activity in Laos is negligible, to a considerable extent because of lack of access. Along this corridor, the government is in the process of establishing a special economic zone at Savannakhet, and recently approved incentives for investors in that zone. A major obstacle to development of manufacturing in Laos is the continued lack of “normal trade relations” (NTR) status with the United States which makes products from Laos prohibitively expensive in the world’s largest consumer market. However, prospects for Laos achieving NTR status are rapidly improving.
- **Viet Nam** Rapid progress has been made since 1997 in developing Vietnam’s production base. For example, it has shown the lowest rate of decline in FDI since the 1997 financial crisis, partly because of continued opening up of its economy. development in Viet Nam. Along the East West Economic Corridor, the Lao Bao special economic zone opened for investment in 2003. It will be one of the most important Border Nodes in the GMS. . The government is also promoting investment by developing new industrial zones, upgrading Danang deep-sea port (the eastern terminus of the East West Corridor) and marketing Hue as a world class heritage town. Industrial development in Vietnam has significant potential, however because Vietnam is not yet a member of the WTO it is subject to trading limitations. For example, its high potential high end garment industry is subject to quotas in the United States market. If Vietnam accedes to the WTO by mid-2006, this will change the dynamics of GMS development considerably, creating more of a bipolar industrial structured on the east-west corridor anchored by Thailand and Vietnam.

- **Cambodia** : The government of Cambodia is actively promoting Koh Kong Industrial Estate a Feasibility and design studies to establish Koh-Kong IE, identifying industries with high potential, infrastructure, appropriate development incentives, environmental protection measures, and supportive institutional arrangements, will be completed in October 2004. A major challenge facing Cambodia is the elimination of textile quotas in 2005, which, according to the WTO, will result in 50% of the world's textile production occurring in China, compared with 16% now. Cambodia will need to improve the productivity in this pillar industry, or suffer serious socio-economic implications.
- **Yunnan Province, PRC.** The Government of China has established a clear policy framework for the development of Yunnan Province based on its "Go West" policy introduced in 1999. This policy is urban-based and contains measures to attract investment into its southern and eastern region including Yunnan Province. In Yunnan Province, the "Go West" policy focuses on tourism, herbal pharmaceuticals, horticulture, energy, aviation, and the gateway function to western China, e.g., Tibet, and Southeast Asia.

### 3. Challenges

Key challenges related to accelerating development in the GMS are as follows: **(i) Support to investment** : Economic Disparities among the countries is still a critical issue. There is considerable variance in terms of the capacity to solve problems and attract and guide investment. Thus, countries must strengthen their own abilities and cooperate more to eliminate investment constraints. The more economically developed countries in the Region, such as Thailand, China, and Vietnam have a key role to play in this regard.

**3.1 Development of Targeted Investment Areas:** Investors generally prefer to locate in special economic zones, which are known by a variety of names, e.g., special economic zones, industrial estates, free zones, distribution centers, inland container depots, etc. GMS countries must clarify to investors procedures for investment, infrastructure availability, e.g., gas feeds, electricity costs, and details of incentives, e.g., tax and tariff, available. The management capability of facilities, e.g., industrial parks, and local governments should also be clarified. Investors should be able to take advantage of one-stop services as is already the norm in many Chinese and Thai jurisdictions. However, public resources are often not available to meet high investment costs necessary to provide infrastructure in economic zones. In this regard, public –private partnerships will be necessary. However, it will be difficult to attract private investment o locations along the economic corridors, however, investment is more likely if only a few nodes are developed, as advocated above. Private investors will be more comfortable if they can be assured that critical investment threshold can rapidly be realized in selected locations.

**3.2 Improvement of Regulatory frameworks:** One of the most important factors in building investors' confidence is the degree of transparency in national and local governance, consistency in investment policies, and their reliability. Investors monitor the track record of governments and do not like uncertainty. As noted earlier, investment incentives, infrastructure, etc., should be targeted to support the emergence of clusters with high potential, to both the countries involved, and the GMS as a whole.

**3.3 Skilled Human Resources:** Low cost labor is only important in very low end activities such as production of footwear and garments. The success of higher value activities such as electronics, automotives, tourism, etc., are dependent on the quality of labor and its cost effectiveness. GMS countries can potentially enjoy considerable comparative advantage by making high skilled labor available at competitive rates. As has been indicated, the key is relevant technical education. Such education would mean that students spend a high percentage of their time working in leading edge firms, that different countries in the region specialize in different types of technical education and then exchange students, etc. Unfortunately, at present, most of the labor force in the region is low-skilled and lacks expertise to attract high value investment and well-paying employment.

**Accessibility to information :** Investors need to receive clear and consistent information to make decisions regarding investment. Necessary information includes the existing economic situation, government policies and procedures, the legal framework and related regulations, availability of incentives, etc. This information needs to be included in targeted marketing efforts. For example, if the objective is to establish an automotive cluster, marketing (“advertising of place”) should focus on that cluster in automotive trade journals, etc. Investment information needs to be disseminated at the national level, but if GMS integration is to be realized, there is also a need for regional (cross-border) marketing and promotion.

#### **4. Enhance Opportunities for Investment in the Region by the Public Sector**

**4.1 Spatial Development Strategy and Infrastructure Development** GMS governments have already implemented initial phases of the GMS spatial development strategy by investing in major nodes, especially border areas and ports, bridges, etc. Other immediate actions that need to be taken in terms of public investment relate to improvements in public utilities, e.g., energy grids, environmental protection system, land development and urban planning systems, as well as improved delivery of other services particularly education, and public health. Private sector service delivery also needs to be improved in the region, e.g., banking systems. Public facilities such as ports, airports, transportation linkages need to be provided on a cost recovery basis. However, for the GMS to be competitive, fee structures need to be affordable in terms of the expected industries that will locate in the GMS.

#### **4.2 Clarifying Policy and regulatory frameworks**

- **Common investment related policies among the GMS countries** This concept is being developed through ongoing work by GMS working groups on (1) investment and (2) trade facilitation. The trade facilitation working group is committed to implementing single stop customs inspection at pilot border checkpoints to facilitate the movement of goods and people. The investment working group emphasizes building capacity of regional institutions concerned with investment, establishing a GMS investment data base web site, publishing investment information on the region for marketing and promotion purposes, as well as developing and distributing investment toolkits for interested potential investors and newcomers.
- **Improvement of Policy, Privileges and Incentives in each GMS country** : Although the GMS countries support the standardization of the incentives

to create a common investment promotion framework, they realize that this is unlikely to be achieved in the short run. Thus, the first step is to standardize and clarified investment promotion policies within each GMS country.

**Upgrade standard of national policy:** It is not enough to promulgate investment policies related to employment, investment, taxation, investment protection, rapid investment approval procedures, etc. Such policies must also be implemented and enforced consistently.

**Provide special privileges/incentives to specific clusters :** The GMS countries should promote the relocation, start-up or expansion of economic clusters in targeted areas that offer promise – especially for cross-border cooperation. these incentive packages would cover taxes including, income taxes, import/export duties, facilitation of investment approval procedure, transfer of foreign currency, employment privileges, e.g., no hassle issuance of work permits, access to land for factories, etc. However, targeting of clusters would also need to involve measures to support industry associations, align local technical education curricula to the clusters in question, etc.

**4.3 Supporting Plans :** Each GMS countries should give high priority to capacity building in development of human resources, databases, and applied targeted research and development. The GMS should become a learning region. National public sector resources are not sufficient to turn the GMS into an innovative learning region. Cooperation with multilateral and bilateral development agencies and the private sector is needed to realize this objective quickly.

## **5. Private Sector Participation**

Ten years of development in the GMS has resulted in considerable progress and significantly strengthened cooperation among the member countries. However, GMS countries still experience significant socio-economic disparities, which hinder the overall development of the region.

Partnerships with the private sector will strengthen GMS development and catalyze the development plan, turning a paper plan into on-the-ground reality. Participation from private sector will stimulate investment and promote development because of its catalytic nature, including in the following ways:

- Through Partnership in investment in basic infrastructure based on innovative financing modes, such as concessions.
- Through joint marketing and building awareness of potential for investment in the GMS, e.g., by participating with the public sector in road shows
- Through joint investment in targeted clusters, particularly those identified under the GMS Flagship programs
- By providing technical assistance (TA) to support programs and projects in both the private and public sectors, e.g., research, database development, and training and skill development
- By Supporting public and private institutional development, especially by agencies directly concerned with attracting investment from outside the region.

## **6. Conclusion**

The GMS is an emerging geo-strategic location for investment. The commitment from 6 governments to the Region's development has put in place region-wide transportation, telecommunications and energy grids, aligned along three strategic corridors over the past decade. Comparative advantage created by this development is creating an infrastructure platform and supportive investment and business climate attractive to a number of economic activities.

To ensure concrete results from investment in the GMS, the public and private sectors need to jointly engage in a strong partnership for development. The governments must strengthen investors' confidence by providing transparent, consistent, and efficiently administered laws and regulations, as well as developing appropriate infrastructure systems in support of investment. In parallel, the private sector should invest in and support the region's development by sharing technical know-how. To accomplish this, mechanisms to coordinate development between the public and private sectors need to be created and/or improved. Most important, governments need to develop a clearing house in each nation, to improve mutual understanding, share knowledge, negotiate misunderstandings, and guide future development to achieve maximum benefits.

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