THE MEKONG REGION

Foreign Direct Investment

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ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
AIA	ASEAN Investment Area
BCC	business corporation contract
CDRI	Cambodia Development Resource Institute
CIB	Cambodia Investment Board
CLMV	Cambodia, Lao PDR, Myanmar, Viet Nam
CLV	Cambodia, Lao PDR, and Viet Nam
EdL	Electricité du Laos
EPZ	export processing zone
EU	European Union
FDI	foreign direct investment
FIE	foreign-invested enterprise
FIMC	Foreign Investment Management Committee
FTA	free trade area
GDCF	gross domestic capital formation
GDP	gross domestic product
GMS	Greater Mekong subregion
GSO	General Statistics Office
Guangxi Zhuang AR	Guangxi Zhuang Autonomous Region
HCMC	Ho Chi Minh City
KPRP	Kampuchea People's Revolutionary Party
Lao PDR	Lao People's Democratic Republic
LPG	labor productivity growth
M&A	merger and acquisition
MFA	Multifibre Arrangement
MFN	most-favored nation
MNE	multinational enterprise
MPI	Ministry of Planning and Investment
NIE	newly-industrializing economy
OECD	Organisation for Economic Co-operation and Development
PRC	People's Republic of China
SARS	severe acute respiratory syndrome
SEZ	special economic zone
SOE	state-owned enterprise
TFPG	total factor productivity growth
UN	United Nations
US	United States
WTO	World Trade Organization

NOTES

In this report, "$" refers to US dollars.

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EXECUTIVE SUMMARY

The economies of the Greater Mekong subregion (GMS)[1] have collectively grown at one of the fastest rates in the world since the early 1990s as many of them started the transition from central planning to a market-based system and became more closely integrated with the region and the world. In the 10 years to 2004, gross domestic product (GDP) in the subregion grew at an average annual rate of over 6%,[2] in spite of a number of adverse shocks. These included the 1997 financial crisis, the slowdown in the global and regional economies in 2001, the onset of the severe acute respiratory syndrome (SARS) in 2003, and more recently, the ongoing threat from avian flu and the persistent rise in oil prices.

Average economic growth in the subregion remained strong at 7.9% in 2005, although it was lower than in the previous year, primarily reflecting slower growth in Thailand, the subregion's largest economy. Growth in most other economies continued its upward trend. Inflationary pressures have increased in some countries with the persistent rise in world oil prices and higher food prices. But inflation rates remain within single digits as monetary policy has become more restrictive and the fiscal stance has been stable. The current account reverted to a deficit in Thailand for the first time since the 1997 crisis, reflecting higher oil imports, subdued tourism revenues, and strong (import-intensive) investment growth. In Viet Nam, the deficit narrowed for the second year helped by higher revenues from oil exports. Over the past few years, trade has expanded rapidly and the share of trade within the GMS has increased relative to that with the rest of the world. Net capital inflows, with a significant contribution from foreign direct investment (FDI), were sufficient to finance the current account deficits and foreign exchange reserves remain at comfortable levels.

In this report, we discuss in some detail the significance of FDI especially in the three transitional economies in the GMS—Cambodia, Lao People's Democratic Republic (Lao PDR), and Viet Nam (CLV). Attracting FDI has been a key focus of market-oriented policy reforms in these countries. As transitional economies, these countries require substantial amounts of investment to transform their economies and meet the economic, social, and other developmental goals that they have set themselves. The levels of domestic savings in these countries are far from adequate to meet these investment requirements, as reflected in their current account deficits. Support from bilateral and multilateral development agencies in the form of grants, loans (both soft and market-based) and technical assistance have an important role to play in this process, but the magnitude of the development challenges that these countries face is so great that much more will be needed. Furthermore, external debt levels are already quite high especially in Cambodia and the Lao PDR, so borrowings alone cannot be relied upon to fill resource gaps. This is where FDI comes in.

FDI can provide the resources to increase investment beyond domestic savings levels without adding to the external debt burden. But it can do much more than this. FDI can bring with it firm-specific knowledge in the form of technology, managerial expertise, marketing know-how, and other things such as these that cannot easily be leased or purchased on the market by the host country. Indeed this may well be the key advantage provided by FDI.

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[1] The GMS comprises Cambodia, People's Republic of China (PRC), Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam. Because of lack of data, we are unable to provide a detailed assessment of Myanmar, as well as Yunnan Province and the Guangxi Zhuang Autonomous Region of the PRC.

[2] This figure includes the Guangxi Zhuang Autonomous Region of the PRC, which was included in the GMS Economic Cooperation program in December 2004.

Combining the direct contribution to growth through investment with the various indirect spillover effects suggests that FDI has the potential to play an important catalytic role in countries in the process of transition from command to market economies.

The experience of all three countries confirms this. FDI has played an important role in promoting GDP growth, export expansion, and employment generation in the CLV countries. There is empirical evidence that FDI has contributed to productivity growth in Viet Nam, and a host of anecdotal evidence that it has done the same in Cambodia and in the Lao PDR.

In Cambodia, the rapid expansion of FDI-driven clothing exports has become a major source of employment and income for women, reducing poverty and helping narrow the urban-rural income gap. Recently, FDI has also begun expanding into other labor-intensive export industries, such as shoes, toys, and wood products, which is further contributing to employment generation.

In the Lao PDR, foreign investment in the hydroelectric power and mining sectors are boosting GDP growth and creating substantial employment opportunities in this landlocked country. Furthermore, through taxes, royalties and dividends, the citizens of the Lao PDR stand to be significant beneficiaries of such FDI projects, as long as these revenue streams are well managed. FDI is also behind the rapid increase in mining-related exports, and there appears to be significant untapped potential in this area.

FDI has played an important role in transforming the economy of Viet Nam. There is a substantial amount of evidence that highlights the role of FDI in driving growth in GDP, exports and employment, as well as positive spillover effects in the economy through enhanced productivity. As long as the investment climate remains open and receptive, Viet Nam has the potential to further diversify FDI inflows, shifting it from the light-manufacturing sector to assembly and related activities in the electronics industry. If this happens, Viet Nam looks well placed to emulate the developmental achievements of its more advanced ASEAN neighbors.

To a large extent, the role that FDI can play in assisting in the transformation of these countries is limited by inherent deficiencies in the investment environment─poor physical infrastructure, limited domestic capacity in the form of human capital and entrepreneurial skills, and weaknesses in legal, judicial, and administrative structures. Strengthening of the financial and banking sectors and addressing vulnerabilities in the corporate sector are also important in improving the investment climate in the CLV countries. To varying degrees, policy uncertainty and perceived political interference or instability has affected perceptions of risk and hindered investment inflows as well. These are long-term developmental challenges that the CLV countries need to address, and significant progress has been made since the reform process began around the mid-1980s. Much more remains to be done in the future, however, if these countries are to attract the amounts of FDI that their more advanced ASEAN neighbors had done in transforming and modernizing their economies.

In short, the most significant constraint on FDI flows to the CLV countries is the perceived risk associated with investing there. In such an environment, investors will require a higher minimum return on their investment to compensate for the higher level of perceived risk. This has implications not only for the volume of FDI flowing to these countries, but also the quality of FDI that they receive. The higher rates of return required usually results in a large share of investments that are short-term in nature. These investments are sometimes described as being ”footloose”; firms operating "with their bags packed" in readiness to flee the scene as

soon as wages begin to rise and tax incentives begin to expire. This can cause disruption to labor markets and result in other forms of adjustment costs in the domestic economy.

The longer-term investments tend to be made only under certain preconditions. First, the investments tend to focus on resource-based activities. The expected returns also need to be sufficiently high, which usually translates into the host countries receiving a lower share of direct rents (royalties, taxes, dividends, etc.) that they would otherwise be able to negotiate. Second, the involvement of a third party, in the form of an honest broker, may be required in such projects so that they can be successfully concluded. Often this role is played by a multilateral development agency that can provide various forms of implicit and explicit guarantees. When the involvement of such a third party is either infeasible or unsolicited, then foreign investors may try to protect their investments through ad-hoc arrangements with local officials and partners. Corruption in this instance occurs not as a means to bypass government regulations, as is commonly the case, but rather to substitute for a lack of them. Such rent seeking activities impose costs on the domestic economy and distort the local investment climate. Most rent seeking activities also run counter to national interests.

There are a number of other less challenging and more immediate policy issues that can be addressed in order to improve the investment climate in these countries. These are policy changes that could be introduced almost immediately if the political will to do so exists. The first of these relate to investment incentives. There is a need to increase neutrality and reduce distortions that currently exist in the structure of investment incentives in these countries. Policies that encourage investments in a discriminatory manner, for example based on export requirements or by sector, distort prices and decision making and result in less than optimal outcomes that are welfare-reducing on the whole. Furthermore, a harmonized reduction in incentives offered, perhaps within the GMS or ASEAN framework, could allow governments to use the revenue savings to improve the overall fiscal environment, as well as the physical and social infrastructure of the country. If they can do this, then it could be more effective in attracting FDI than the incentives themselves.

There is also a need to ensure that so-called “one-stop shops” for foreign investors operate as such and are effective in practice. In the Lao PDR for instance, the Foreign Investment Management Committee is supposed to play this role but because the process has not been integrated and coordinated across government departments, the Committee has become a “one-*more*-stop shop,” and this serves to delay applications to the point where a significant amount of FDI is being denied the country.

Addressing these short-term policy and procedural issues is likely to produce immediate results in terms of the volume of FDI. Addressing the longer-term challenges particularly in relation to infrastructure, human capital, and legal, judicial, and administrative structures will affect not only the volume, but also the quality and industrial composition of FDI. Longer-term investments in a more diversified array of sectors can be expected, as well as greater productivity and other spillovers to the domestic economy. Through the direct involvement of multilateral development agencies such as ADB and the World Bank or through public-private partnerships that they facilitate, FDI may also be able to play an important role in addressing these challenges. This is already happening today in the region, with road, energy, and telecommunications infrastructure through the GMS program of ADB, for instance, but the role that FDI can play in this process has yet to be fully tapped.

I. INTRODUCTION

The inaugural issue of *The Mekong Region: An Economic Overview* was published in 2004 and included analysis of external debt sustainability in the less developed countries of the Greater Mekong subregion (GMS) (ADB 2004). The 2005 issue dealt with economic impacts of infrastructure projects in the GMS (ADB 2005). In this third issue, we look at the trends, patterns, and economic impacts of foreign direct investment (FDI) as well as implications for policies to promote FDI and enhance its benefits.

The remainder of this report is organized in three parts:

(i) First, we provide a brief overview of the recent economic performance in the GMS economies. We review trends in gross domestic product (GDP) growth, inflation, fiscal and monetary variables, intra-regional trade, and external balance of payments accounts.

(ii) The second part discusses in detail the trends and patterns of foreign direct investment in the sub-region, especially in Cambodia, Lao PDR, and Viet Nam (CLV), where the literature on this topic is sparse. It looks at the policies implemented to foster FDI and the impact of FDI on the economies' growth, employment and productivity.

(iii) The final part of the report provides a summary of the main points, including policy implications for the transition economies in the Mekong as they attempt to attract FDI and take full advantage of the benefits that it has to offer.

II. RECENT ECONOMIC PERFORMANCE

A. Overview

Economic growth in the GMS remained strong at close to 8% in 2005 although it was lower than in the previous year, primarily reflecting lower growth in Thailand, its largest economy. Growth in most other economies continued its upward trend. Inflationary pressures have increased in some countries with the persistent rise in world oil prices and higher food prices. But inflation rates remain well within single digits as monetary policy has become more restrictive and the fiscal stance is stable. The current account reverted to a deficit in Thailand for the first time since the 1997 financial crisis, partly reflecting higher oil imports and subdued tourism revenues, and partly imports required for the strong growth in investment in the past several years as the economy recovered from the crisis. In Viet Nam, the deficit narrowed for the second year helped by higher revenues from oil exports. Over the past few years, trade has expanded rapidly and the share of trade within the GMS has increased relative to that with the rest of the world. Net capital inflows were more than sufficient to finance the current account deficits and foreign exchange reserves remain at comfortable levels.

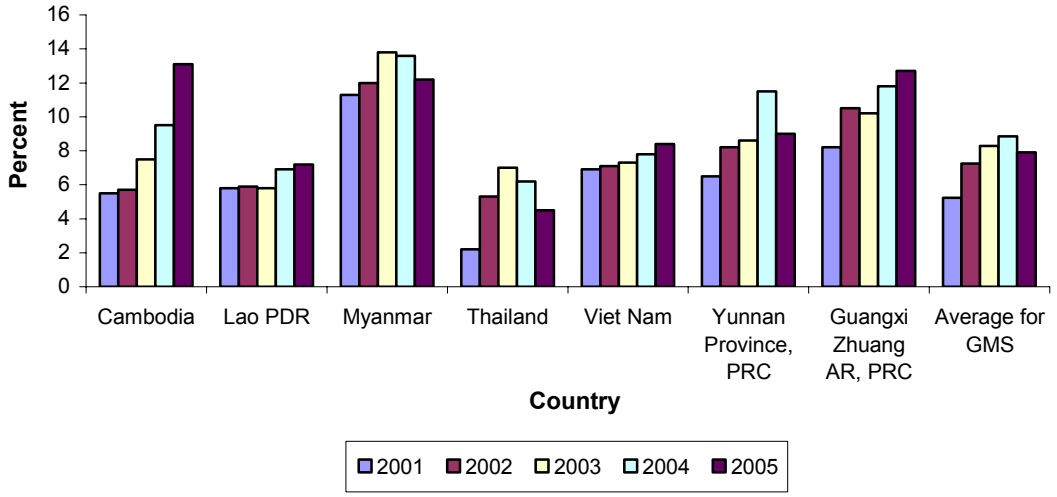
B. GDP Growth

The GMS is one of the fastest growing subregions in the world. In the 10 years to 2004, GDP in the subregion grew at an average annual rate of over 6%, in spite of a number of adverse shocks including the 1997 financial crisis, the slowdown in the global and regional economies in 2001, the onset of the severe acute respiratory syndrome (SARS) in 2003, and more recently, the ongoing threat from avian flu and the persistent rise in oil prices.

Economic growth in the subregion accelerated in the past few years to 8.8% in 2004 (Figure 1). Growth moderated to 7.9% in 2005, primarily reflecting a slowdown in Thailand, the largest economy within the GMS with a 41% weight. Thailand's economy was buffeted by a number of shocks, including a prolonged drought, the decline in tourism following the tsunami at end-2004, and higher oil prices. As the weather normalized and the effects of the tsunami moderated over the course of the year, growth picked up to 5.1% in the second half from 3.9% in the first.

Most of the other economies recorded stronger growth in 2005 than in previous years. Cambodia's growth in particular surged to 13.1% last year as the agriculture sector rebounded with the alleviation of drought that had led to stagnant agricultural output in 2004. The tourism and construction sectors continued to perform well. The garment industry expanded by 12%, reflecting strong exports to the United States (US), its largest market.

Figure 1: GDP Growth (%)



GDP = gross domestic growth, GMS = Greater Mekong Subregion, Guangxi Zhuang AR = Guangxi Zhuang autonomous region, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

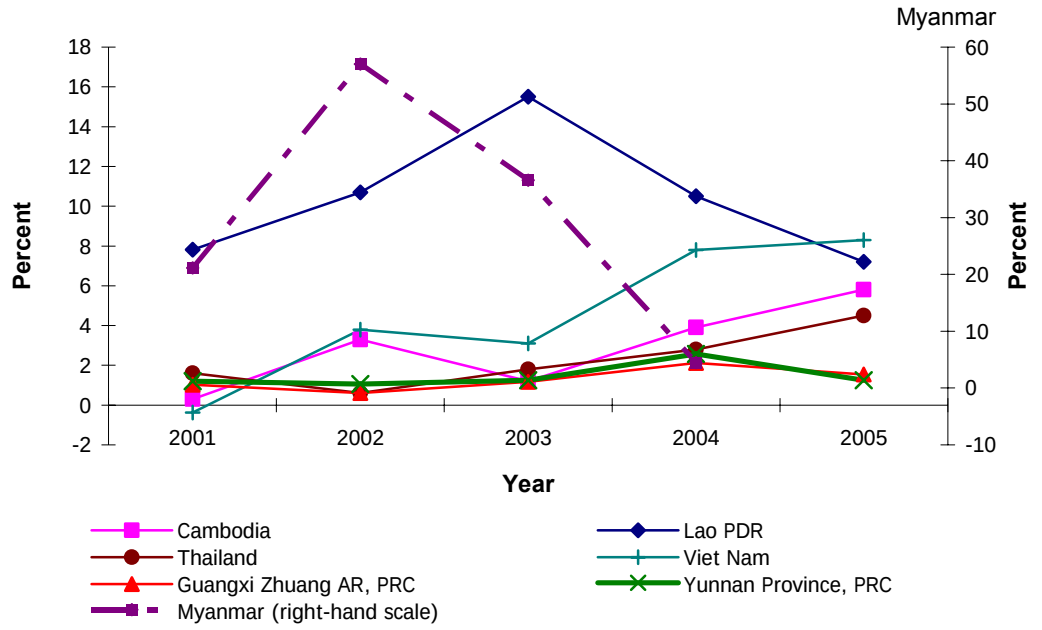
Sources: Asian Development Bank. *Asian Development Outlook 2006,* Manila; International Monetary Fund. *Statement by IMF Staff Mission to Cambodia* . Press Release No. 06/96. May 11, 2006; *An Introduction to China's Provinces, Municipalities and Autonomous Regions* . Available: http://www.china.org/english/features/ProvinceView/167754.htm; *China Statistical Yearbook 2005* , compiled by the China National Bureau of Statistics. China Statistics Press; Foreign Affairs Office, The People's Government of Yunnan Province; Guangxi Statistics Network. Available: http://www.gxtj.gov.ch.

C. Inflation

The inflation rate increased over the past couple of years in Cambodia, Thailand, and Viet Nam (Figure 2), although it remains within single digits. A large part of the increase can be attributed to the direct and indirect effects of the rise in world oil prices and the countries' efforts to align domestic with international prices to reduce the cost of fuel subsidies and to promote energy efficiency.

Another prominent reason for the increase in inflation rates was higher food prices, partly reflecting the trend in world food prices and partly abnormal weather patterns that affected domestic agricultural output as in Thailand. In Cambodia, although the agricultural output rebounded in 2005, higher prices in Thailand and Viet Nam led to increased exports of fish and rice to these markets as a result of which domestic prices remained at elevated levels. In Viet Nam, apart from the effects of higher prices for food and fuel, the 30% increase in public sector salaries in October 2004 is also likely to have contributed to higher inflation in 2005.

Figure 2: Inflation Rate, %



Guangxi Zhuang AR = Guangxi Zhuang autonomous region, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.
Sources: Asian Development Bank. *Asian Development Outlook 2006,* Manila; Asia Regional Information Center, ADB; IMF International Financial Statistics Online, downloaded 30 May 2006.

The Lao PDR's inflation rate moderated from a recent peak of 15.5% reached in 2003 to 7.2% in 2005. The authorities have taken steps to restrain credit in the past couple of years so that broad money supply (M2) growth slowed to 8.1% in 2005 from 23% in 2004 and the kip's nominal exchange rate against the US dollar and the Thai baht remained broadly stable.

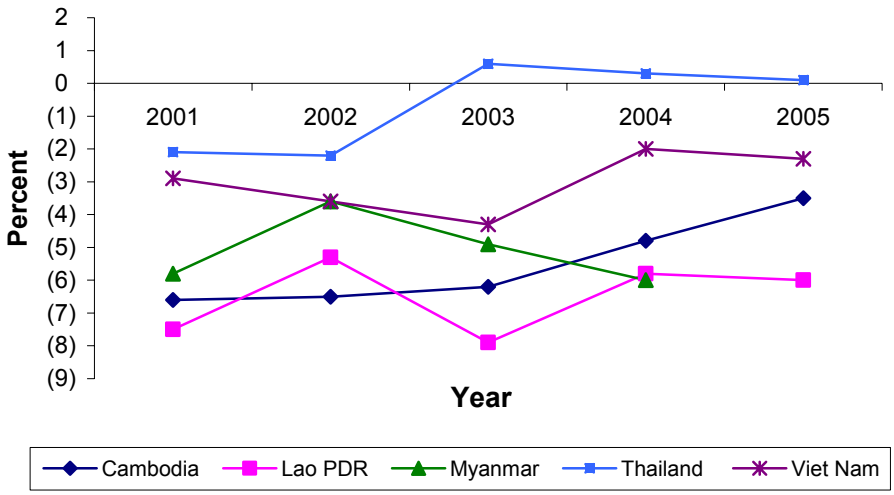
Monetary policy was more restrictive in the subregion in general in order to stem inflationary pressure and in response to rising global interest rates. Cambodia, along with the Lao PDR, has relatively little flexibility in independently adjusting its monetary policy considering the high degree of dollarization of its economy. In Thailand as well, the 14-day repo rate (policy interest rate) was raised successively to 4.75% in April in line with the increase in the US Federal Funds target rate. Viet Nam raised key interest rates in 2005, following an increase in the required reserve ratio for banks in the previous year, as authorities attempted to curb credit growth to dampen inflationary pressure. Credit growth is estimated to have slowed from nearly 42% in 2004 to 32% in 2005.

Myanmar's data for 2005 are not available, but the data for 2004 show a sharp deceleration in inflation to single digits, probably reflecting the lagged effect of a deceleration in broad money supply growth in the previous year. M2 rose only 1.4% in 2003 compared with 35% in 2002 as credit to nonfinancial public enterprises was cut back drastically. However, money supply growth was back up to around 30% in 2004-2005. Coupled with the eightfold increase in domestic fuel prices in October 2005, this suggests that inflation probably rose significantly over the past year.

D. Fiscal Balance

The fiscal performance of the GMS economies remained broadly stable in 2005 (Figure 3). Thailand continued to post a surplus for the third consecutive year, albeit of a smaller magnitude. Revenues grew strongly while expenditures were contained within the original budget target in spite of a mid-year supplementary budget of 50 billion baht (about 0.7% of GDP).

Figure 3: Fiscal Balance, % of GDP



GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.

- Excluding grants for Cambodia, Lao PDR, Thailand, and Viet Nam.
- For Myanmar, fiscal year data (April–March).
- For Thailand, data refers to cash balance composed of the budgetary balance and nonbudgetary balance.

Sources: Asian Development Bank. *Asian Development Outlook 2006,* Manila; IMF.

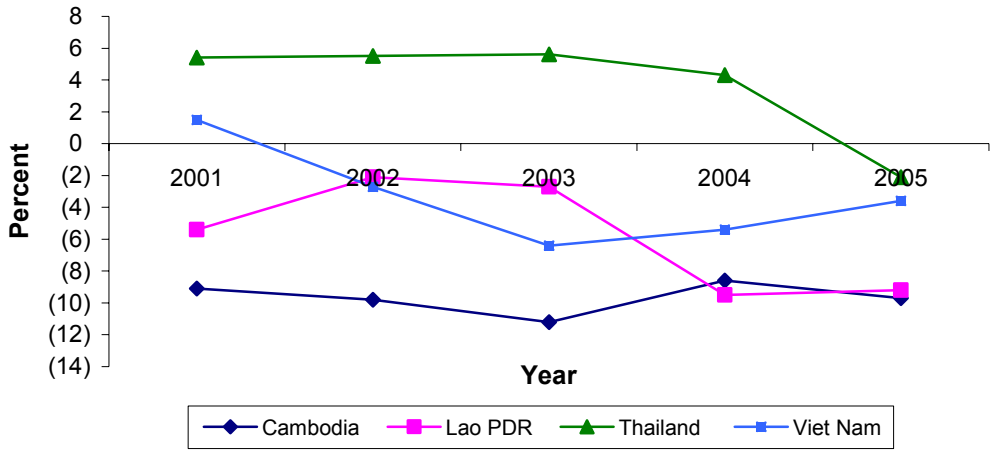
In Viet Nam, the fiscal deficit narrowed to just above 2% of GDP in the past 2 years from 4.3% of GDP in 2003. Revenues remained buoyant at around 22% of GDP, the highest in the subregion, supported by a 46% rise in oil receipts in 2005 to 4.6% of GDP.

The fiscal deficit fell significantly as well in Cambodia and, to a lesser extent, in the Lao PDR over the last 2 years. In both countries, however, revenues amount to a relatively low 11% of GDP, constraining the Government's ability to increase development and other expenditures.

E. Current Account Balance

The current account reverted to a deficit in Thailand last year for the first time since the 1997 crisis (Figure 4). Total export growth slowed from 22% in 2004, but was still significant at 15% as manufactured exports, particularly of high-tech products, increased 17%. However, strong import growth, partly reflecting a 58% increase in oil imports and continued strength in investment, and a decline in tourism receipts as a result of the effects in the first half of the December 2004 tsunami resulted in a deficit for the full year.

Figure 4: Current Account Balance, % of GDP



GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
* Excluding official transfers for Cambodia, Lao PDR and Viet Nam.
Sources: Asian Development Bank. *Asian Development Outlook 2006,* Manila; Bank of the Lao PDR.

In Viet Nam, the deficit narrowed for the second consecutive year, reflecting strong exports and buoyant revenues from tourism and workers abroad. Exports increased 20% in 2005, driven by sales of fuel, wood products, and electronic goods. Net fuel exports have risen from 3.5% of GDP in 2003 to 4.8% in 2005. Textile and garment exports rose by about 10%. The country is not yet a member of the World Trade Organization (WTO) and is still subject to quotas on textiles and garments in the US. Its impending accession to WTO membership would allow quota-free access and should benefit this sector. With imports expanding at a slower pace than exports, and the strong growth in remittances from workers abroad and in tourism receipts, the current account deficit fell for the second year to 3.6% of GDP in 2005.

The current account deficit narrowed somewhat in Cambodia over the past two years. Garment exports, which account for 80% of total receipts, rose about 12% in 2005. Although this was half the rate in 2004, it alleviated previous concerns of a slump in garment exports following the expiration at the end of 2004 of the global quota system under the WTO Agreement on Textiles and Clothing. Re-imposition of restrictions by the US and the European Union (EU) on clothing imports from the PRC in the second half of the year helped support the increase in garment exports from Cambodia. Imports increased 17% on the back of higher oil prices. However, strong performance of the tourism sector helped hold the current account deficit to about 10% of GDP, similar to that in the previous two years.

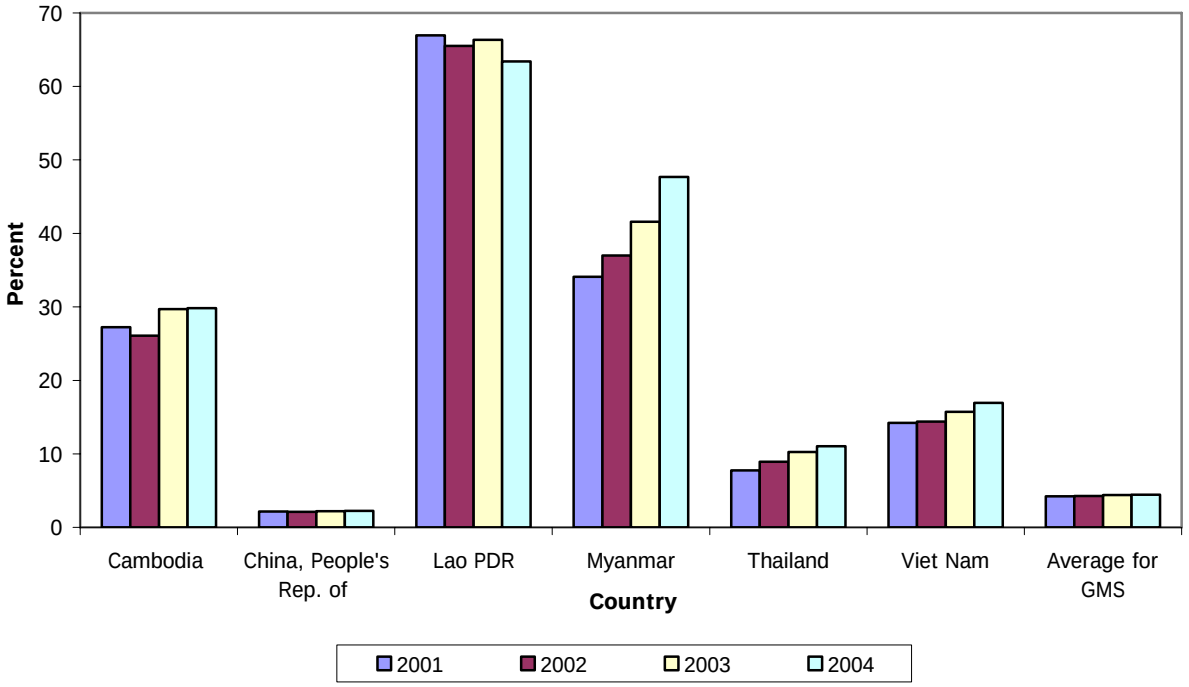
In the Lao PDR, with the opening up and expansion of gold and copper mines over the past two years, the surge in mining exports led to an estimated 50% growth in total exports in 2005. Coupled with strong tourism revenues, the expansion in exports contributed to a marginal decrease in the current account deficit from the 2004 level, in spite of a continued increase in import requirements for the mining and the hydropower projects, as well as for fuel.

F. Direction of Trade

The direction of trade over the past few years suggests a rapid expansion of GMS economies' trade both among themselves and with the rest of the world. Over the 2000-2004 period, the recorded trade with the world rose at a rapid compound annual average rate of 22%, but trade flows within the GMS increased even faster at a rate of 25%.

There is considerable variation among countries in their direction of trade (Figure 5). As would be expected, the share of intra-GMS trade in total trade is higher for the smaller economies than for the larger ones. But the larger countries, especially Thailand and Viet Nam, show notable increases in the past few years. Among the countries, the Lao PDR's share is the highest, probably reflecting its landlocked geography. Recorded trade flows from the Lao PDR to other GMS countries declined during 2001-2004 to a still-high share of 63%. The decline reflected lower trade with Cambodia and Viet Nam. Trade with the PRC and Thailand continued to increase at an average annual rate of 29% and 11%, respectively, during the period. For the subregion as a whole, intra-trade increased to 4.4% in 2004 from 4% in 2000.

Figure 5: Share of Intraregional Trade to Total Trade [a], %



GMS = Greater Mekong subregion, Lao PDR = Lao People's Democratic Republic.
[a] Ratio of total trade (exports+imports) with GMS countries to total trade with the world.
Source: Compiled from International Monetary Fund. Direction of Trade Statistics. April 2006 CD-ROM.

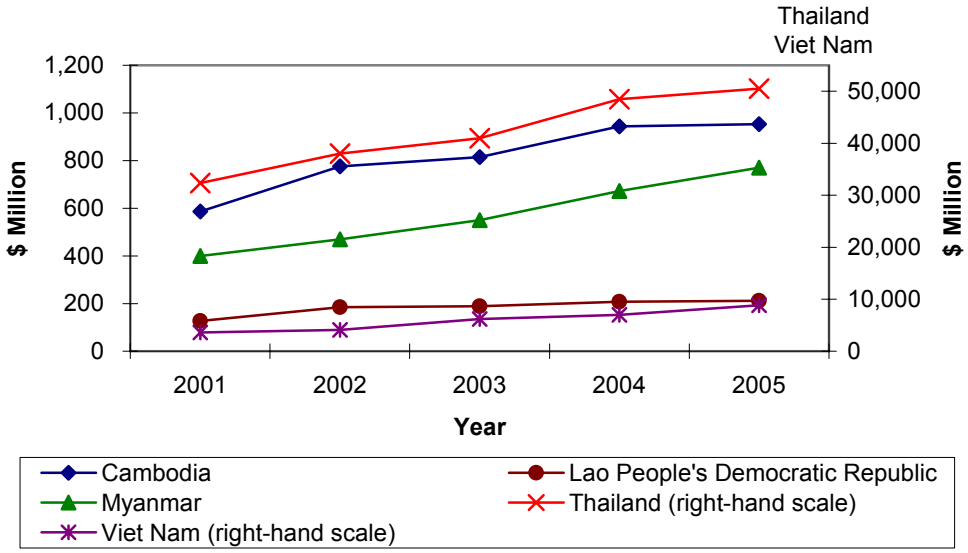
Some of the potentially important factors contributing to this increase in intra-GMS trade are proximity of the countries to each other, better physical connectivity through cross-border infrastructure, tariff reductions under the ASEAN Common Effective Preferential Tariff (CEPT) framework, and other measures to facilitate trade. Cross-border linkages are likely to improve further and compliance with the ASEAN CEPT commitments is also likely to continue.

Combined with Viet Nam's impending accession to WTO, and the start of negotiations for the Lao PDR's accession, this should enhance prospects for further integration of GMS economies with the global markets and among themselves.

G. External Financing and Foreign Exchange Reserves

Net capital inflows to the GMS countries were more than sufficient to finance the current account deficits in 2005. Foreign exchange reserves, in US dollar terms, rose in all the countries (Figure 6). Reserves were sufficient to cover about 3 months of merchandise imports in Cambodia, Lao PDR, Myanmar, and Viet Nam and 5 months in Thailand.

Figure 6: Foreign Exchange Reserves [a]
(in $ million)



[a] For Lao PDR and Viet Nam, data available as of November 2005.
Source: International Financial Statistics Online, downloaded 30 May 2006.

In Thailand, net capital inflows turned positive for the first time since the 1997 crisis, mirroring the trend in the current account deficit. The private and state enterprise sector recorded capital inflows of $11 billion, compared with an outflow of $3.8 billion in 2004. Part of these inflows included a tripling in net foreign direct investment to $3.4 billion. The government and the banking sectors showed net capital outflows, partly reflecting continued net repayments on their debt. For the economy as a whole external debt declined further to 32% of GDP from 36% in 2004.

Foreign direct investment inflows into Viet Nam increased in 2005 to above $2 billion, equivalent to 4% of GDP. Coupled with disbursements of about $1.5 billion from official development assistance (ODA), this was more than sufficient to fund the current account deficit. External debt has fallen steadily as a share of GDP to 33% in 2005 and debt service payments are a modest 5.2% of exports of goods and services.

Cambodia and the Lao PDR are more reliant on ODA to finance their current account deficits. However, FDI inflows are assuming greater importance in these countries as well, especially as debt levels are high. Total external public debt in Cambodia amounted to an estimated $3.2 billion (52% of GDP), nearly two thirds of which is owed to the Russian Federation and the US and is not being serviced while they are under renegotiation. In the Lao PDR, external public debt in 2005 was an estimated $2.4 billion (78% of GDP), of which about $390 million is owed to the Russian Federation and is under renegotiation. Most of the external debt is on concessional terms so that the debt service payments are modest in terms of exports, although they are significant in terms of government revenues, reflecting low revenue mobilization.

In the remainder of this economic overview of the Mekong region, we discuss the increasing importance of FDI in Cambodia, Lao PDR, and Viet Nam as an additional source of funds to fill the savings-investment gap as reflected in their current account deficit, and, perhaps more significantly, to boost overall economic productivity.

III. FOREIGN DIRECT INVESTMENT IN THE TRANSITION ECONOMIES

Attracting foreign direct investment (FDI) has been a key focus of market-oriented policy reforms in the three transitional economies in the GMS─Cambodia, Lao PDR, and Viet Nam (CLV). The thrust to encourage FDI is rooted in the belief that it can play a catalytic role in supporting the process of economic transition in these countries, and act as a conduit for revitalizing the private sector. Although much has been written on the role and impacts of FDI in Thailand and the PRC, there is a dearth of systematic comparative analysis of FDI flows to these transitional countries and their developmental impacts.

For this reason, we focus on the CLV countries.[3] For completeness, we summarize later in Box 3 and Box 4, respectively, the PRC's FDI experience, focusing on what impact it has had on FDI flows in the broader region, and Thailand's experience with an emphasis on the post-crisis period. The analysis of the FDI experience in the CLV countries is conducted by: (i) surveying the evolution of FDI policy in these countries in the context of overall policy reforms and the current state of the investment climate; (ii) examining the experience with attracting FDI from a comparative regional and global perspective, with a view to informing the debate on how to reform the policy regimes; and (iii) assessing the development impacts of FDI in the economy, focusing on the impact on GDP and its domestic components, employment, exports and productivity growth.

The analysis is organized in four sections. Section A provides an analytical account of the nature, developmental implications, and typology of FDI in order to place the ensuing discussion in context. Section B reviews the FDI policy and investment environment in the three countries with emphasis on key policy shifts and similarities and difference in the current policy regimes. Section C examines trends and patterns of FDI, focusing in turn on trends in total inflows against the backdrop of regional and global trends, source-country and sectoral/industry composition, and emerging patterns of intra-regional flows. Section D examines the developmental impacts of FDI. Emphasis is placed on the roles that the reform agenda and policy changes have had in determining outcomes.

A. Analytical Context

1. What is FDI?

Foreign direct investment originates from the decision of a resident entity to obtain a *lasting interest* in an enterprise in another country. The entity is usually a multinational enterprise (MNE) and the investment is generally associated with relocating part of its production activities to the host country. In other words, FDI is a flow of long-term capital based on long-term profit considerations and is associated with a significant degree of influence or control by the investor in the management of the enterprise. It is this element of "influence and control" that distinguishes FDI from portfolio investment and other forms of international capital flows.

[3] The other transitional economy in the GMS is Myanmar but we are unable to include it in the analysis because of incomplete information and deficiencies in the quality of reported data. The official data on FDI flows is included in Table 5 however.

2. What can FDI Offer?

The most obvious contribution of FDI and other forms of international private capital flows to the capital receiving country is to increase domestic investment beyond the level permitted by domestic savings. This in turn enables the country to grow with less sacrifice to current consumption, or without increasing its stock of external debt. FDI, however, is unique among capital flows because its role is not limited to adding to investment in the host country.

FDI can bring with it firm-specific knowledge in the form of technology, managerial expertise, marketing know-how, and other things such as these that cannot easily be leased or purchased on the market by the host country. Affiliates of MNEs, as part of the parent company's global network, often have marketing channels in place, possess experience and expertise in the many complex facets of product development, and are well placed to take advantage of inter-country differences in costs of production. When foreign firms employ domestic labor, various forms of formal and informal training that is generally unavailable in local firms is usually provided. On these grounds, FDI enables managers and workers in the host country to acquire and spread knowledge and technology faster than would otherwise be possible. It may also allow local entrepreneurs to learn about export markets and stimulate competition with local firms.

These various favorable indirect effects arising from the presence of foreign-affiliated firms in an economy are generally referred to as “spillover effects” of FDI. Indeed these spillover effects may well be the key advantage provided by FDI. Ideas can be as important as physical inputs, and an economy can grow just because new ideas beget more new ideas, as postulated by the endogenous growth theory (Romer 1992). This aspect of the role of FDI is both more subtle and substantive because knowledge spillover is an economy-wide phenomenon, and is by no means limited to the particular industry in which the foreign firm is located. The introduction of new ideas of efficient management, inventory systems, worker training, or incentive systems may result in application in other industries as well (Athukorala and Menon 1995).

However, the developmental impact of FDI tends to vary across countries depending on a number of factors. The extent of spillover effects depends on the nature of the domestic policy regime and various resource-endowment related factors such as domestic capacity in the form of human capital and entrepreneurial skills. In relation to the policy regime, a country with an outward-oriented approach has the potential to reap greater benefits from FDI than a country whose policy regime is biased in favor of import substituting production. This is because, in contrast to an import-substitution program, an export-oriented regime tends to encourage FDI in activities where the host country enjoys natural comparative advantage in international production. As regards domestic resource endowment, a country at an advanced stage of human capital and entrepreneurial development is better placed to reap technological spillovers from the presence of foreign-affiliated companies than a country that is poor in terms of this condition.

3. Determinants of FDI

A country’s attractiveness as a site for foreign investment is determined by a combination of its comparative advantage in international production and the domestic investment climate. The term “investment climate” covers the foreign investment regime (rules governing foreign investment and specific incentives for investors such as tax holidays and repatriation of profits) and the general investment environment, which refers to a variety of

factors including political stability, macroeconomic environment, adequacy of social and physical infrastructure, level of institutional development, and the attitude of host countries towards foreign enterprise participation.

The CLV countries are rich in terms of their endowments of natural resources, and possess a competitive edge when it comes to the cost of labor. If there is a constraint on attracting FDI, then it would have more to do with the domestic investment climate in these countries. In terms of the two components of the domestic investment climate, it would appear that it is the general investment environment rather than the foreign investment regime that plays the more limiting role. The general investment environment is compromised by the inherent deficiencies that these countries face, such as poor physical infrastructure, limited domestic capacity in the form of human capital and entrepreneurial skills, and underdeveloped legal, judicial, and administrative structures. Weaknesses in the financial and banking sectors and vulnerabilities in the corporate sector add to the perception of high risk. To varying degrees, policy uncertainty and perceived political interference or instability has affected perceptions of risk and hindered investment inflows as well.

In such an environment, investors will require a higher minimum return on their investment to compensate for the higher level of perceived risk. This has implications not only for the volume of FDI flowing to these countries, but also the quality of FDI that they receive. The higher levels of return required usually results in a large share of investments that are short-term in nature. These investments are sometimes described as being “footloose” in that the sunk cost involved is low and firms are able to liquidate their investments easily and quickly, should the need arise. This can cause significant disruption to labor markets and result in other forms of adjustment costs in the domestic economy.

The longer-term investments tend to be made only under certain preconditions. First, the investments tend to focus on resource-based activities. The expected returns also need to be sufficiently high, which usually translates into the host countries receiving a lower share of direct rents (royalties, taxes, dividends, etc.) than they would otherwise be able to negotiate. Second, the involvement of a third party, in the form of an honest broker, may be required before the project can be successfully concluded. Often this role is played by a multilateral development agency that can provide various forms of implicit and explicit guarantees. When the involvement of such a third party is either infeasible or unsolicited, then foreign investors may try to protect their investments through ad-hoc arrangements with local officials and partners. Corruption in this instance can occur not as a means to bypass government regulations, but rather to substitute for a lack of them. Such arrangements provide opportunities for rent seeking activities that can impose costs on the domestic economy and distort the local investment climate. Most rent seeking activities also run counter to national interests.[4]

The effectiveness of the foreign investment regime in attracting FDI is critically linked to the general investment climate. The literature on the effectiveness of incentives suggests that tax concessions and other profit-related incentives are relevant only if the general investment climate is conducive for profit making. In other words, incentives may matter only if the overall political, financial and macroeconomic environment is conducive for investment. Even if the overall investment climate is attractive, incentives offered by a given country can be quickly matched by

[4] For instance, Tanzi and Davoodi (1997) suggest that corruption induced by inadequate controlling or auditing systems may alter the design of projects by increasing its size and complexity. The size of the “commission” that public officials receive for assisting an enterprise win a foreign investment license or contract is usually a function of the size or complexity of the project itself.

other countries competing for the FDI dollar. Indeed, this process of trying to match incentives—or tax competition—offered by competitors can lead to an inferior, non-cooperative outcome. This basic problem is exemplified by Baldwin (1994, p.139) using the so-called passing parade parable:

> "Imagine that a crowd gathers to watch a parade. As the parade passes, people in the front stand on their toes to see better, thus forcing all those behind them to also stand on their toes. In the end, most see no better than before, but all have to stand on their toes".

On this basis, there may be a case to be made for harmonizing tax incentives across countries that tend to compete for similar types of FDI (see Box 1). Although investment incentives may indeed be too generous, in that the costs outweigh the benefits, in the CLV countries, there are other reasons for having them. Investment incentives may, for instance, have an "image building" role to play; a country widely perceived as being unfriendly to foreign investors may use generous incentives as a tool to regain an image that is welcoming to FDI. Specific, well-targeted incentives can be a useful instrument in winning so-called investment tournaments when it comes to attracting large investment projects. Finally, incentives offered to FDI in countries where corruption is present and the administrative capacity to collect domestic taxes is weak are often perceived as playing a role in leveling the playing field. These incentives can work to enable legitimate business to compete more fairly with illegitimate ones.

4. Different Types of FDI

Assuming a favorable investment environment, what are the typological characteristics that determine a country's comparative advantage in international production? In answering this question, it is important to emphasize that FDI is not a homogeneous phenomenon, but a complicated and finely differentiated instrument in the globalization of production. For the purpose of discussing factors impacting on foreign firms' decision to locate production in a given country, it is important to distinguish between three categories of MNE affiliates in terms of their operations.[5]

These are: (i) market-seeking investors – producers largely engaged in serving the domestic market; (ii) resource-seeking investors – firms involved in extraction and processing of natural resources, usually for export but sometimes for the domestic market as well; and (iii) efficiency-seeking investors – those engaged in production for the global market. In the discussion that follows, we group resource-seeking investment with efficiency-seeking investment because, in the context of the transitional economies of the Mekong region, resource-seeking investment is almost completely export-oriented.

a. Market-seeking Investment

When it comes to *market-seeking* investment in developing countries, the forces explaining the location decisions of MNEs are about the same as those explaining their presence in industrialized countries. The location decision depends primarily on the prevalence of production opportunities in the host country for meeting domestic demand. Given minimum efficient scale requirements and generally small domestic markets in many developing countries, a major (if not the key) determinant of this type of FDI relates to restrictions imposed on international trade. When market-seeking FDI is driven predominantly by barriers to trade, it is described as "tariff jumping" FDI. The so-called "life-cycle" investors who expand their production networks globally on scale-

[5] There are other typologies of FDI. For example, Kawai (2005, pp. 173-5) distinguishes six types of FDI in East Asia. Considering the pattern of FDI in the CLV countries, we use a broader classification in this report.

Box 1: Harmonizing Investment Incentives

Is there a case for reducing incentives through harmonization? Given the generosity of the current incentive system in the CLV countries (see Table 1 in the Appendix), there would appear to be a strong case for considering this option, perhaps in the context of GMS or ASEAN frameworks. The harmonization approach would ensure that FDI is not diverted to neighboring countries purely as a result of incentives when they are reduced. This would work to minimize any reduction in overall FDI inflows as a result of this policy change, and so address the main concern associated with reducing incentives. What then are the benefits of doing this? First, it would allow governments to use the revenue savings to improve the overall fiscal environment, and improve the physical and social infrastructure of the country. These improvements would increase the country's attractiveness as an investment site. Indeed, the international evidence suggests that these factors bear more prominently in the foreign investor's location decision than do specific incentives.

Apart from increasing revenue to the government, the harmonization policy would also benefit the participating countries in other ways.

A significant portion of government revenue in the transitional economies of the GMS is collected from import taxes. In this context, the provision of fiscal incentives to investment indirectly translates into a policy of *taxing imports to subsidize production*. This policy can be inflationary as it could result in an increase in the prices of both exportables and importables (see Menon 1998). Reducing incentives could reduce the inflationary impact that the current tariff-subsidy policy has on exportables and importables. Investment incentives that are selectively provided also distort relative prices. These changes to relative prices will have resource allocation effects. Reducing investment related incentives would reduce the inefficiencies associated with resource misallocation.

The proposal to harmonize investment related incentives is not a proposal to limit competition for FDI among GMS countries. Competition for FDI can be a good thing if it leads to pressure to address issues such as the protection of intellectual property rights, guarantees against nationalization, unhindered rights to remit profit, and the like. Competition among potential recipients of FDI could also lead to the relaxation of conditions such as minimum export requirements, domestic content rules, and quotas relating to employment of local staff. If competition produces these outcomes, then it would be beneficial to the reforming countries. The relaxation of these conditions is often difficult for governments to implement for domestic political reasons, however. With this political constraint, competition usually spills over into the provision of investment related incentives instead.

If competition results in a race to win in the arena of investment related incentives, it would be costly to all parties trying to attract investment. Thus, harmonization of investment related incentives could assist in shifting the pressures of competition away from incentives and toward areas in which reform could benefit the recipient countries. In other words, if the discretionary power of governments to provide incentives is removed through committing to a harmonization program, then any competitive pressure could force reform in politically sensitive but economically inefficient areas such as domestic content rules and local employment quotas.

The proposal to harmonize investment related incentives is also not to deny or devalue the importance of low taxes and tariffs in establishing a climate that is attractive to FDI. When assessing the costs and benefits of fiscal incentives, the issue is not whether taxes and tariffs should be high or low. The issue is one of *neutrality* of policy. Policies that encourage inflows of capital in a discriminatory manner are market-distorting. Policies that encourage investments based on export potential, investment type or by sector distort prices and decision-making, and results in less than optimal outcomes that are welfare reducing on the whole. These types of policies currently apply to a lot of the incentives in the Lao People's Democratic Republic and Viet Nam and, to a lesser extent, Cambodia.

To illustrate, consider the minimum export requirement to avail of fiscal incentives. This requirement tends to discriminate against local firms in practice, although there is no discrimination in the application of the rules in theory. Most local firms are small- and medium-sized enterprises that predominantly cater for the domestic market. Most foreign firms, on the other hand, tend to be export oriented in nature, and so would probably export a significant portion of their output even in the absence of this minimum export requirement.

economy and efficiency considerations do not generally find low-income countries an attractive investment location under free-trade conditions.

When the country concerned is a member of a free trade area (FTA), then the tariff-jumping motive needs to be considered in the context of the regional rather than the domestic market. In other words, there is a market enlargement effect that now combines the domestic market of the country concerned with the markets of the rest of the countries in the FTA. Furthermore, the attractiveness of the country within the FTA for tariff-jumping investment depends on the magnitude of the "margin of preference," the difference between the preference tariff and the tariff applicable to trade with third parties. Differences in tariff rates between members may be important for procuring low-cost imported inputs, which could influence the location of investment in relatively low tariff countries within the FTA from third countries as well as from high tariff countries within the FTA. This influence would be magnified if there are significant differences among member countries in terms of non-tariff barriers to third country trade (Athukorala and Menon 1997).

In theory, under certain circumstances, MNE affiliates originally set up to serve local or regional FTA markets could well develop competitive advantage over time and penetrate markets in third countries without government support. But in the real world such cases are rare and limited predominantly, if not solely, to middle-income and upper-middle-income developing countries with sizeable domestic markets.

b. Efficiency-seeking Investment

The role of MNEs in *efficiency-seeking* investment is distinctively a developing-country phenomenon. In determining the attractiveness of a host country in drawing in export-oriented FDI, it is important to distinguish between two different categories of export-oriented production: labor-intensive final consumer goods (clothing, footwear, toys, sports goods, etc.); and assembly processes within vertically integrated global production systems (electronics, automotive products, etc.).

For the typical developing economy, labor-intensive consumer goods are generally considered the natural starting point in the process of export-led industrialization. However, the role of FDI in this area remains a controversial issue. In the spectacular export take-off of the East Asian newly industrialized economies (NIEs) in the 1960s, the key role was played by indigenous firms with the help of marketing services provided by foreign buyers—the Japanese trading houses and the large retail buying groups in developed countries.

5. Lessons from the East Asian Experience

Can the East Asian NIE experience of local-entrepreneur dominance in exports be replicated in the so-called "latecomer" countries of developing Asia today? This appears unlikely for at least two reasons. First, perhaps the most important factor behind the East Asian experience was the unique entrepreneurial background of these countries. Hong Kong, China, and Taipei,China and to some extent Singapore started with a stock of entrepreneurial and commercial talents inherited from the pre-revolution industrialization period in the PRC; Hong Kong, China; and Singapore also had well-established international contacts based upon entrepot trade that involved exporting manufactured goods to begin with. Therefore, there was not such a large difference between domestic and foreign firms in these countries with regard to knowledge of and access to production technologies and market channels. However, the initial level of entrepreneurial maturation in latecomer countries is generally not comparable to that of the NIEs. In many of these countries, the import-substitution growth strategy pursued

indiscriminately over a long period of time has thwarted the development of local entrepreneurship. Domestic firms are generally weakly oriented toward, and have limited knowledge of, highly competitive export markets.

Second, from around the mid-1980s, export-oriented firms from the East Asian NIEs have begun to play an increasingly important role as direct investors in the labor-intensive export industries of latecomer countries. Two main factors account for this trend: the erosion of international competitiveness of labor-intensive export products from their home countries as a result of rising real wages and exchange rates; and the imposition and gradual tightening of quantitative import restrictions under the Multifibre Arrangement (MFA) by industrialized countries on certain labor-intensive exports (mostly textiles, garments, and footwear).

These investors from East Asia possess a critical advantage over many other investors. Unlike MNEs from developed countries, they are usually familiar with and are able to more easily adapt to the relatively difficult business conditions in latecomer countries. In other words, they are better suited to dealing with prevailing constraints such as poor infrastructure, bureaucratic red tape, and unpredictable policy settings, among other things. Given that NIE firms are equipped with considerable specialized knowledge of small scale and labor-intensive production processes in the manufacture of standardized products, they have a powerful competitive advantage over both local firms and MNEs from the industrialized world in the difficult local business environments in the latecomer countries. There are indications that, consistent with rapid structural transformations that are taking place in the NIEs, the intermediary role that these "new" investors are playing in linking latecomers to world markets may become increasingly important in years to come.

Production of labor-intensive components and their assembly within vertically integrated international industries (“international product fragmentation” or “outsourcing”) in developing countries has been an important feature of the international division of labor since about the late 1960s. The process was started by US electronics MNEs in response to domestic real-wage increases and rising import competition from low cost sources. The transfer abroad of component assembly operations now occurs in many industries where the technology of production permits the separation of labor-intensive components from other stages of production. Assembly operations in the electronics industry (in particular assembly of semi-conductor devices, hard disk drives, etc.) are still by far the most important. The other industries with significant assembly operations located in developing countries are electrical appliances, automobile parts, electrical machinery and optical products, musical equipment, watches, and cameras. In general, industries that have the capacity to break up the production process to minimize the transport cost involved are more likely to move to peripheral countries than other heavy industries.

The expansion of overseas assembly operations as an important facet of international production has been hastened by two mutually reinforcing developments over the past few decades. First, rapid advancements in production technology have enabled the industry to slice up the value chain into finer, “portable”, components. Second, technological innovations in communication and transportation have shrunk the distance that once separated the world’s nations, and improved speed, efficiency, and economy of coordinating geographically dispersed production process. There is evidence emerging that global assembly exports are growing much faster than total manufactured exports (Feenstra 1998, Athukorala 2006).

While the availability of cheap and trainable labor is a prerequisite for attracting FDI into both these product areas, it is not the only determining factor. The availability of a wider array of

complementary inputs, including operator, technical and managerial skills, availability of domestic inputs, and high-quality infrastructure are critical in making assembly operations efficient by world standards. Also, given the heavy initial fixed costs involved, MNEs appear hesitant to establish assembly plants in countries without a record of policy continuity and political stability. All of these reasons may account for the fact that only a limited number of developing countries—mostly the high-performing East Asian countries and more recently some transition economies in Eastern Europe—have been able to attract FDI in assembly operations.

Based on the above typology of FDI, what are the opportunities available for Cambodia, Lao PDR, and Viet Nam in attracting FDI? The ability of Cambodia and the Lao PDR to attract market-seeking, import-substituting FDI is limited by the relatively small size of domestic markets. Given its larger domestic market, Viet Nam may be better placed to attract such investment but there are other reasons why this is unlikely to happen to any significant degree. Enticing import-substituting FDI by raising tariff barriers is unlikely to work when borders are so porous, and furthermore any such move would run counter to its overall development policy geared toward greater openness and outward-orientation. Even if we consider the larger regional market covered by the ASEAN Free Trade Area (AFTA), the fact that both most-favored nation (MFN) and preferential tariffs in the CLV countries are higher than in the original ASEAN members (so that the "margin of preference" in the former would not be necessarily higher) would limit opportunities to attract tariff-jumping FDI (ADB 2004).

All three countries, the Lao PDR in particular, have substantial untapped potential in attracting resource-seeking investors. The extent to which such investment materializes appears to depend mainly on political-economy considerations impinging on natural resource management policy.

In the area of export-oriented FDI, the attractiveness of the Lao PDR to foreign investors has been limited mainly because of high transport costs arising from its landlocked geography and opportunities appear to be limited to labor-intensive consumer goods production. In recent years, this constraint has been alleviated with the development of cross-border transport, for example within the framework of the GMS Economic Cooperation program. Furthermore, a country can adapt to high transport costs and other trading disadvantages arising from its being landlocked and distance from markets by specializing in "low weight per unit value" products, provided, of course, the overall economic environment is conducive for such a market response.

As a low-wage country located in proximity to rapidly growing East Asian economies, Cambodia has significant potential for attracting FDI in standard labor-intensive manufacturing. But, in terms of key criteria such as political stability, institutional quality and supply of skilled labor, it has a long way to go in becoming attractive as a location for assembly activities in vertically integrated global industries.

B. Investment Climate

As noted earlier, the term "investment climate" encompasses both the foreign investment regime and the general investment environment. In this section, we survey the evolution of FDI regimes under market-oriented reforms followed by a comparative assessment of the current state of the overall investment climate.

1. FDI Policy

The opening up of Cambodia, Lao PDR, and Viet Nam to FDI occurred almost concurrently in the late 1980s. Since then the FDI regimes of the three countries have gone through several changes as an integral part of the ongoing policy of transition toward market-oriented economies. In general, FDI policy regimes have become more liberal and the sectors open to foreign investment have expanded over the past 2 decades. Nevertheless, much remains to be done in order to deepen the reforms and improve the business environment in order to make the economies more attractive to foreign investors and to enhance gains to the national economy.

a. Cambodia

The Kampuchea People's Revolutionary Party (KPRP) government embarked on a market-oriented reform process in 1985. As part of these reforms, the government promulgated a liberal foreign investment code in July 1989 and a National Investment Council was set up in 1991 with the task of reviewing all foreign investment applications. The outcome of these reforms was somewhat lackluster however, and perhaps unsurprising given the continuing warfare between KPRP forces and the Khmer Rouge. As an outcome of the UN-led peace process, elections were held in July 1993 and a multi-party democratic government was established in September 1993.

The new government set up the Cambodian Investment Board (CIB) under the Council for Development of Cambodia (CDC) to be the "one stop" service organization responsible for approving foreign investment applications. The new *Laws and Regulations on Investment in the Kingdom of Cambodia* passed by the National Assembly on 4 August 1994 set out rules and regulations governing FDI and offered an incentive package to foreign investors that was very generous compared to those in other countries in the region. The new incentives included a tax holiday of up to 8 years and a concessionary corporate tax rate of about 9% after that (as against a standard rate of 20%). Total freedom to repatriate profits or proceeds of investment without paying withholding tax was granted. Reinvested profits were exempt from corporate tax. Investors were also provided with guarantee against nationalization and against price control, and relatively unhindered access to foreign exchange. The business turnover tax was abolished in 2000.

The foreign investment regime in Cambodia underwent an overhaul in 2003. The revised Law on Investment came into force on 27 September 2005, and represented a major attempt to equalize incentives for foreign and local investors, to achieve greater transparency in incentives provided, and to minimize distortions and delays arising from policy maker discretion. The 8-year blanket tax holiday for foreign investors was replaced with a "3 years + *n*" tax holiday for all qualifying new investors (foreign and local), under which "*n*" is conditional on annual certification of compliance as part of the general tax administration of the country rather than at the discretion of the investment monitoring authority (CIB). When the tax holiday expires, all investment projects are subject to the standard corporate tax rate (currently 20%) and all previously approved and operational projects currently subject to the 9% concessionary corporate tax are to be brought under the standard corporate tax rate within the next 5 years. In place of the provision of tax-free reinvestment of profits, a generous accelerated depreciation allowance was introduced under the general tax law for all qualified investors, irrespective of source of finance. Profit that is repatriated is now subject to a 1% withholding tax. As part of the new reforms, a fast track procedure has been introduced with the aim of approving investment applications within a 14-day period under the "one-stop service" at CIB. Seven working groups,

which involve both private and public sector participation, have been set up in key sectors to work in collaboration with CIB to facilitate speedy investment approval, monitoring, and promotion. An investor forum, headed by the Prime Minister, is held twice a year as part of the new investment regime.

In December 2005, a sub-decree was passed to provide the legal framework for setting up special economic zones (SEZs), which may include general industrial zones and/or export processing zones (EPZs). As of March 2006, proposals for setting up SEZs had been approved with one (Bavet Zone near the Viet Nam border) already accepting investors.

b. Lao PDR

The process of transition to a market-oriented economy in the Lao PDR began in 1986 with the implementation of the *New Economic Mechanism,* a major program of economic reforms. As part of the reform program a Foreign Investment Code was passed in July 1988 and the Foreign Investment Management Committee (FIMC) was set up under the direct purview of the Prime Minister to act as the apex agency that approves monitors and promotes FDI. At the initial stage, the prime objective of the FDI policy in the Lao PDR was to engage foreign investor participation in restructuring of state-owned enterprises (SOEs). The Investment Code was supplanted by the Law on Promotion and Management of Foreign Investment in July 1994 which was again substantially revised in October 2004.

Foreign investment is permitted in all business sectors, with 100% ownership allowed in most sectors, except in mining and energy projects in which the Government contributes to share capital or retains the right to buy a pre-agreed share of equity. In joint ventures, foreign equity participation is required to be at least 30% of total invested capital.

The structure of tax incentives for foreign investors has been designed to take into account the country's geography (mountainous terrain) and uneven quality of infrastructure in different parts of the country. Investment projects in areas where there is no economic infrastructure to facilitate investment (Zone 1), are eligible for a 7-year tax holiday and 10% concessionary tax rate (compared to the standard corporate income tax rate of 35%) thereafter. Investment projects in areas with a certain level of economic infrastructure (Zone 2) are eligible for a 5-year tax holiday, a concessionary tax rate of 5.5% for the following 3 years and a 15% rate thereafter. Investment projects in areas regarded as having good infrastructure are entitled to a 2-year tax holiday followed by half of the standard corporate tax rate for 2 years and the full corporate tax rate thereafter.

In the forestry sector, the Government intends to establish a financially viable and self-sustaining Lao Plantation Authority, which will spearhead the efficient and sustainable development of the plantation subsector in the country. A number of foreign companies in the pulp and paper industry have invested or are in the process of investing in plantations in the country.[6]

[6] In the past 2 years, Oji Paper Company of Japan has acquired BGA Lao Plantation Ltd., which itself was set up in 1996 by investors mainly from New Zealand. A number of Thai pulp and paper companies have also invested in plantations in Savannakhet province. The Aditya Birla Group of India has also identified 50,000 hectares in Savannakhet and Khammuane provinces for a possible pulp fiber plant.

For projects in mining and energy sectors (which by their very nature tend to be located in remote areas), specific taxation arrangements are negotiated on a case-by-case basis. For instance, the incentive package offered to the Sepon Gold and Copper mining project[7] includes a 2-year tax holiday initially, then 50% reduction in the corporate tax rate for 2 years, which then reduces to 33% for the 2 years following that. A 4.5% royalty on mineral production applies throughout the period of commercial operation. A 5-year tax holiday followed by 10% and 15% corporate profit tax during the next 5-year periods is applicable to the Nam Theun 2 hydroelectricity project, a $1.3 billion trans-basin diversion power plant in the central region of the country implemented by an international investment consortium led by *Electricite du France*.

The FIMC aspires to be a "one-stop shop" for foreign investors with the aim of approving investment applications within 60 working days. However, the Lao investment law lacks supporting implementing regulations and some of its elements are not compatible with various other laws, including the domestic investment law and some other sector-specific legislation. Thus, in practice FIMC must consult other government bodies and agencies on applications for large investment projects. There is also likely to be some input from the Lao Government on investment proposals pertaining to sensitive or strategic sectors. As a result, the 60-day deadline for approving FDI applications is not always observed. After receiving an investment license, the foreign investor must also obtain other licenses and permits to operate, for which FIMC may only provide assistance.

c. Viet Nam

The opening of the economy to FDI was part of Viet Nam's "renovation" (*doi moi*) reforms initiated in 1986. The Vietnamese National Assembly passed the first Law on FDI on 29 December 1987. The law specified three modes of foreign investor participation, namely (i) business cooperation contracts (BCCs), (ii) joint-ventures, and (iii) fully foreign owned ventures. Foreign participation in the fields of oil exploration and communications was strictly limited to BCCs. In some sectors such as transportation, port construction, airport terminals, forestry plantation, tourism, cultural activities, and production of explosives, joint-ventures with domestic state-owned enterprises (SOEs) was specified as the mode of foreign entry. Fully foreign-owned ventures were to be allowed only under special circumstances relating primarily to policy priorities for domestic industrial development.

The Government provided constitutional guarantees against nationalization of foreign affiliates and the revocation of ownership rights of enterprises. The incentives offered to foreign investors included exemption from corporate tax for a period of 2 years, commencing from the first profit-making year, followed by a preferential corporate tax rate of between 15% and 25% in priority sectors (as against the standard rate of 32%). Foreign investors were permitted to repatriate after tax earnings subject to a 10% withholding tax. Overseas remittance of payments for the provision of technology services and repayment of principal and interest on loans were freely allowed. The specific emphasis on joint ventures with SOEs as the prime mode of foreign entry reflected the Government's decision to use FDI as a vehicle for industrial transition while ensuring state dominance in the economy. However, in 1990, the foreign investment law was amended to permit economic organizations in the private sector to engage in joint ventures with foreign partners. In 1991, legislation was passed allowing EPZs to be set up, and generous incentives were provided to firms involved in the production of goods for export (Box 2).

[7] This is the largest mining project in the Lao PDR and is located in the south of the country. It is operated by Oxiana, an Australian company.

Box 2: Export Processing Zones in Viet Nam

A widely debated aspect of trade and foreign direct investment (FDI) policy in developing countries relates to the role that export processing zones (EPZs) can play. The early studies on this topic found their developmental contribution to be at best marginal, in terms of either employment creation, linkages to the rest of the economy, or net foreign exchange earnings (Warr, 1990, pp. 35–36). A number of more recent studies have however identified them as a useful transitional tool in the process of integrating the national economy with the world economy (ADB 1997, Johansson and Nilsson 1997, Radelet and Sachs 1997).

According to the "new view", the early studies had ignored important *catalytic* effects of EPZs by focusing narrowly on the direct economic impacts. In other words, it is claimed that the early studies ignored the impact on potential domestic exporters operating through exposure to marketing know-how and technology, and other direct demonstration effects. In many countries, EPZs failed to generate these externalities and to provide a conducive setting for an export takeoff, not because of any intrinsic limitation of the zones themselves but because they operated as appendages to a highly regulated domestic economy. Moreover, the "footloose industry argument" against EPZs (i.e., that they possess shallow linkages with the rest of the economy and would quickly migrate in response to rising domestic costs) ignored the inevitable time lags involved in the process of linkage formation with the domestic economy. There is convincing evidence that EPZ firms tend to increase their local purchases and shift over to more sophisticated production process as their operations in the host country mature, provided the local business environment is conducive to such behavior.

Of the six EPZs set up in Viet Nam since the mid-1990s, only three are currently in operation: Linh Trung and Tan Thuan (both in Ho Chi Minh City) and Numura in the North (Hai Pong). The other three have been converted into industrial zones given the poor investor response from pure export-producing foreign investors. Although this is a mixed record, it does not necessarily mean that EPZs have no role to play in Viet Nam's drive to promote export-oriented FDI. On the contrary, the performance record of the two Southern zones suggests that export-oriented investors have a distinctive preference for locating in these zones and the export performance of firms located there has been superior to the national average.

Investment in the two zones, both in terms of the number of new firms entering and value of committed investment, has increased continuously over the past 7 years, despite the decline in total FDI inflows to the country. During this period, exports from the two EPZs have increased much faster than total manufactured exports by foreign investment enterprises (FIEs). Their share in total non-oil manufactured exports increased from 11% in 1995 to over 35% in 2003. By 2003 total employment stood at 75,000, slightly more than a quarter of total FIE employment in the country.

The other EPZs in Viet Nam seem to have failed because of their location and various implementation problems. For instance, even though Nomura Zone has high quality infrastructure including port facilities, it has suffered from problems associated with labor availability because of its remote location. The other two failed zones were also located in relatively underdeveloped and remote regions. Both Southern zones are well located with easy access to port facilities and urban infrastructure. Moreover, the EPZ administration in Ho Chi Minh City seems to have exploited the administrative flexibility provided under the decentralized FDI administration mechanism of the country to provide a more favorable business environment (including a speedy import clearance system) for firms located in the zone.

Viet Nam's experience with EPZs clearly suggests that location, and the physical and social infrastructure as well as human capital that comes with it, does indeed matter. Because of this, attempts to use EPZs as a means of developing remote regions have been ineffective. Initiatives to further improve the performance of the more successful EPZs located in the South include: (a) expanding the product coverage beyond manufacturing production into services, trading, and other related activities; and (b) extending the current duty rebate and turnover tax rebate schemes for exporters to cover local producers who supply inputs to firms in EPZs.

Procedures for the approval of investment projects were streamlined and fresh investment incentives were granted under a new Law on Foreign Investment enacted in 1996. Under this Law, authority to issue licenses for projects, up to specified sizes, was delegated to local governments. For investments in so-called priority sectors, the tax holiday period was extended to 8 years, after which a rate of 10% applied. A three–tier withholding tax of 5%, 7%,

and 10%, based on the “priority status” of the investment, was introduced in place of the original flat rate of 10%.

These revisions to the foreign investment law led to a massive influx of FDI, which in turn fuelled a growing sense of resentment within Viet Nam. This resentment resulted in a number of measures that raised serious concerns in the international investment community about Viet Nam’s commitment to promote itself as a new investment center. These included a proposal to establish liaison offices of the Government in all foreign ventures, the doubling of commercial and residential rents for foreign enterprises and expatriate staff, the imposition of a maximum time limit of 3 years on work permits issued to foreigners employed in FDI projects, and restrictions on foreign participation in labor-intensive industries. There is also some evidence that suggests that the foreign investment approval process was skewed in favor of key high-tech industries such as metallurgy, basic chemicals, machinery, pharmaceuticals, fertilizer, electronics, and motor vehicles. Notwithstanding the new legislation that permitted domestic private enterprises to enter into joint ventures with foreign firms, joint ventures with SOEs continued to receive powerful support in senior policy circles as the prime mode of FDI entry.

All of this changed after the Asian financial crisis. Policy reforms following the economic downturn during 1997–1999 placed renewed emphasis on FDI promotion. Under an amendment to the FDI law on 9 June 2000, foreign invested enterprises (FIEs) and parties to BCCs were given freedom to change the mode of investment, and to split, merge and consolidate enterprises. Recently there have been several cases of joint ventures being converted into 100% owned FIEs. The three-tier withholding tax on profit transfers was reduced to 3%, 5% and 7%. The approval procedure for new investment proposals was streamlined, with automatic registration of export-oriented FIEs. Foreign investors were allowed to implement so-called “less sensitive” projects (that is, those deemed not to have any implications on national defense, cultural, and historical heritage or the natural environment) without licensing scrutiny of the Ministry of Planning, provided they are export oriented. In April 2003, 100% foreign-owned companies were allowed to become shareholding companies (that is, they were allowed to establish joint ventures). The implementation of a new Enterprise Law in 2000 permitting greater participation of domestic private enterprises in the economy also significantly contributed to improving investor confidence in the reform process. Finally, the Unified Enterprise Law and Common Investment Law passed in December 2005 aim to boost private investment by further reducing administrative barriers to business development and expansion, and to facilitate WTO membership.

The FDI regime in Viet Nam has certainly become more investor friendly since about 2000. However, the investment regime remains less open to FDI compared to its more advanced Southeast Asian neighbors. For instance, there is a 30% minimum requirement on the foreign partner’s contribution to the registered equity capital of a joint venture. BCCs remain the only permitted mode of foreign entry into oil exploration and telecommunication sectors. Only joint ventures or BCCs are allowed in air transportation and airport construction, industrial explosive production, forestry, culture, and tourism. Viet Nam’s current business legislation is also not conducive to cross-border mergers and acquisitions (M&As). Foreign investors are permitted to acquire only up to 49% of a local (listed or unlisted) company, if it operates within one of the 35 approved business sectors. Local companies may issue shares to foreign investors only in these sectors, and approval from the Prime Minister’s office is required. This restrictive approach to M&As is a major constraint on the expansion of FDI inflows to Viet Nam because cross-border M&A activity has been increasing as a share of global FDI flows in recent years.

There are export performance requirements (that is, the need to export certain percentage of output in order to become eligible for investment incentives) in some industries. In industries such as dairy production and dairy processing, sugar and sugar cane, natural oil, and wood processing, FDI projects must include investment in associated processing activities. Firms that export over 30% of production and/or use up to 30% of local materials in the production process are eligible for concessionary duties on imported inputs. There are stringent local content requirements in automotive, electronics, and engineering industries: import tariffs are set in these industries according to local content ratios with the aim of promoting backward input linkages.

In sum, Viet Nam has progressed a long way in terms of opening up its markets to FDI, especially in the aftermath of the Asian financial crisis. There is, however, still plenty of room for reform. If Viet Nam is to try and emulate its more advanced ASEAN neighbors that have successfully used FDI as an engine of growth, then a new wave of wide-ranging reforms will need to be undertaken with some urgency. The commitments under the ASEAN Investment Area (AIA), the Bilateral Trade Agreement with the US and the impending accession to the WTO could prove to be a catalyst in this respect.

The key elements of FDI policies in Cambodia, Lao PDR, and Viet Nam are summarized in Table 1. In an overall comparison, the Cambodian policy regime is more liberal compared to that of the other two countries. Following the recent (2003) reforms, Cambodia has also achieved greater neutrality in investment incentives offered to foreign and local investors. In the Lao PDR and Viet Nam, the incentive regimes favor foreign investors over domestic investors in various specific, and often distortionary, ways. Moreover, FDI regimes in these two countries are characterized by a greater degree of selectivity.

2. Business Environment

After a decade and a half of policy reforms, how do international investors rate Cambodia, Lao PDR, and Viet Nam as potential investment sites? Have recent attempts to reform the FDI regimes and streamline the investment approval procedures brought about anticipated results? What are the key concerns of investors about the investment environment? There is no straightforward way of providing answers to these fundamental questions, but the information summarized in Tables 2 through 4 does provide some useful insights that should guide future reforms.

The World Economic Forum in its World Competitiveness Report ranks countries in terms of two composite indices measuring long-term growth prospects and business competitiveness. In 2005, Cambodia ranked 112th in terms of growth competitiveness and 104th in terms of business competitiveness out of 117 countries covered (Table 2; the Lao PDR is not covered in World Economic Forum rankings). Viet Nam was better placed in both rankings compared to Cambodia but it ranked below all other high growth countries in the region. The Economic Freedom Index (Table 3), which measures overall quality of the institutional and policy frameworks for private-sector growth comes up with a slightly different ranking. On this index, Cambodia performs better than Lao PDR and Viet Nam and its relative performance has improved over time (68th among 157 countries in 2005, compared to 108th among 161 countries in 1997).

The *Doingbusiness* database of the World Bank Group ranks countries in terms of 10 key indicators of business environment and provides detailed information on the characteristics

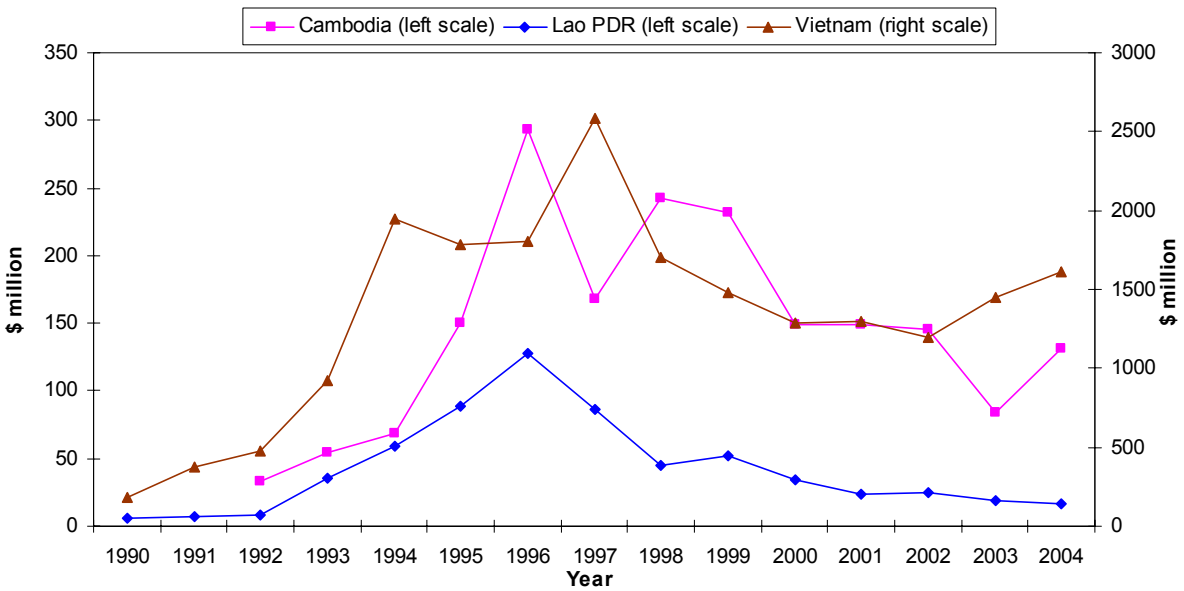
of individual countries relating to each indicator. Information from this database for the three countries together with the PRC and Thailand is summarized in Table 4. There are significant differences among the three countries in their rankings based on these criteria, but overall they rank poorly among the countries in the region (and globally). They perform particularly poorly in terms of labor market flexibility (hiring and firing), credit availability, registering property, investor protection, ease of trading across borders, and enforcing contracts. There is clear evidence that recent attempts to streamline and expedite investment approval procedures have yet to deliver expected results. To some extent, this may be a reflection of issues relating to implementation policy may have changed, but practices may have not. In all three countries, the complex bureaucratic requirements and procedures for getting a project approved and implemented appear to remain a major obstacle to investors.

Finally, a number of recent firm-level surveys on investment climate have identified many constraints in doing business in these countries. In Cambodia, corruption is rated as the biggest hurdle, and the high cost of electricity due to a lack of generating capacity also increases the cost of doing business there. Poor infrastructure is identified as a significant constraint in all three countries.

C. FDI: Trends and Patterns

Data on gross FDI inflows to Cambodia, Lao PDR, and Viet Nam over the post-reform era are depicted in Figure 7. Table 5 shows relative performance of these countries as hosts to FDI in a comparative regional and global context.

Figure 7: FDI Inflows to Cambodia, Lao PDR and Viet Nam, 1990-2004 ($ million)



Lao PDR = Lao People's Democratic Republic
Source: UNCTAD. *World Investment Report* (various years).

The response of foreign investors to economic opening of the three countries was swift and notable, but the investment boom was rather short-lived. Annual gross FDI inflows to Viet

Nam surged from negligible levels in the first half of the 1980s to an annual average of $780 million in 1990–1995 and to $2.6 billion in 1997. FDI amounted to over a third of gross domestic capital formation (GDCF) and nearly 10% of GDP during 1995–1997. There was a precipitous fall in FDI that started in 1997, and bottomed out at $1.2 billion in 2002. Since then there has been a notable recovery, reaching $1.6 billion in 2004. Official investment approval records suggest that this trend should continue well beyond 2005; total registered investment in realized FDI projects increased persistently from $19 billion in 2001 to $29 billion in 2005. Annual FDI inflows to the Lao PDR increased from $23 million (8% of GDCF, or 1.7% of GDP) in 1990–1994 to $128 million (23.6% of GDCF, 6.8% of GDP) in 1996, before declining thereafter to reach a low of $17 million (3.2% of GDCF, 0.7% of GDP) in 2004[8]. In Cambodia, inflows of FDI reached a peak of $294 million (72.4% of GDCF, 8.7% of GDP) in 1997. As in the Lao PDR, the ensuing years have seen a general decline but with a greater degree of variability.

FDI approvals data for both countries point to a likely reversal in the declining trend from 2004 onwards. In the Lao PDR, a number of large investment projects in the mining and hydroelectricity sectors are currently being implemented. In Cambodia, approved investment in 2005 ($1.1 billion) was roughly equal to the cumulative figure for the preceding 5 years, mainly as a result of Chinese investment in the clothing industry. This investment appears to be mainly driven by mounting domestic wage pressure in the PRC, but may also be a safeguard move against the recent US and EU initiatives to curb clothing exports from the PRC (see also Box 3).

The surge in FDI in the aftermath of the policy shift from “plan to market” was a common pattern observed across transition economies worldwide. Significant initial reforms and the general media-propelled euphoria about the opening of a “new investment frontier” naturally heightened investor interest in becoming the first to exploit new investment opportunities. Moreover, in the immediate aftermath of economic liberalization, there were often many quick return but low-risk long-term investment opportunities in infrastructure development and the provision of utilities (power, telecommunication, etc.) and in resource-based sectors (e.g., forestry, hydropower, and mining in the Lao PDR and oil exploration in Viet Nam). Large infrastructure and energy projects, often with the involvement of international developmental agencies such as ADB and the World Bank, have also provided an added impetus for investment in related areas. Once these initial stimuli dissipated, the sustainability of the investment surge hinged on the ability of the governments to deliver on promised reforms and the “natural” attractiveness of the country as an investment location.

The onset of the East Asian financial crisis in mid-1997 acted as an additional factor in the cessation of the post-reform surge in FDI in the CLV countries. Investors from the so-called East Asian “miracle economies”—in particular Republic of Korea, Malaysia, Singapore, and Thailand—played a key role in the investment surge on the back of the economic boom in their economies in the lead-up to the crisis. These substantial intra-Southeast Asian FDI flows were severely disrupted by the onset of the financial crisis in mid-1997. Cambodia and the Lao PDR were more affected by this external shock than Viet Nam because of the dominance of regional investors in these countries. In addition to this direct effect, the financial crisis also had a damaging impact (at least in the short to medium term) on investor bullishness about East Asia in general as a favored investment location.

[8] The data refer to FDI coursed through the banking system. As such, they are likely to understate the actual amount of FDI in the Lao PDR.

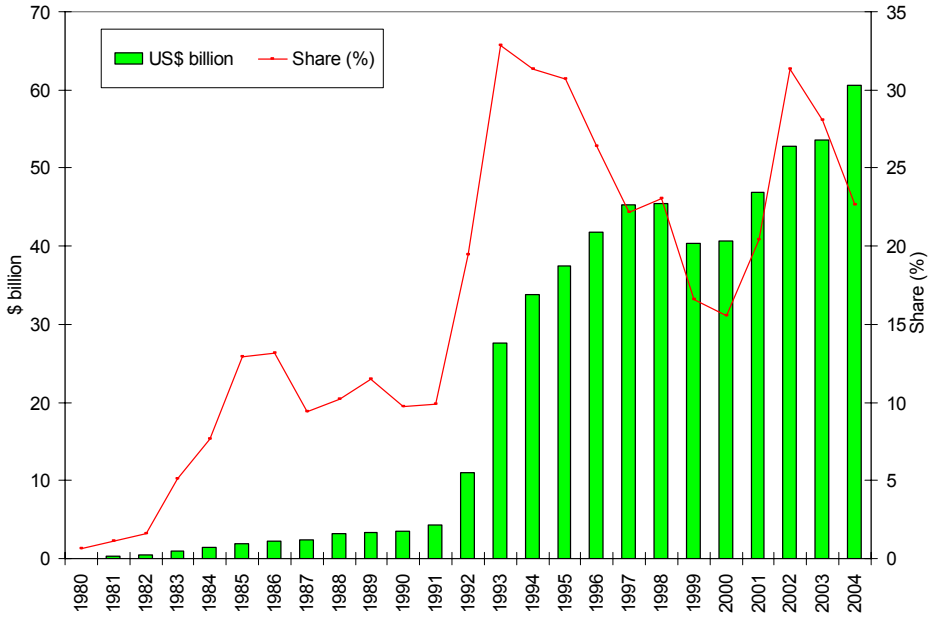
Box 3: Investment Competition from the People's Republic of China: Myths and Realities

Perhaps the most significant element in economic reforms in the People's Republic of China (PRC) since 1979 has been the opening up of the economy to foreign direct investment (FDI). The 1979 Joint Venture Law permitted FDI for the first time since 1949. This landmark legislation codified the right of foreign firms to invest in the PRC and to cooperate with Chinese enterprises in various ways. It defined the nature of joint ventures that would be allowed and set the stage for the process of establishing an institutional and administrative framework for monitoring FDI. Several laws aimed at specific issues relating to foreign investment were introduced between 1979 and 1986 (Huang 2003).

The centerpiece of the PRC's formal FDI promotion policy has been the special economic zones (SEZs). PRC authorities chose SEZs as a compromise solution to the problem of introducing foreign investors and their capital participation into the PRC, while limiting the political repercussions of opening up. The original inspiration for the SEZs came from the export processing zones (EPZs) of East Asia, but they have special Chinese features. The SEZs were much larger than EPZs. Unlike EPZs elsewhere in the region which are typically run by management companies or boards which come under the purview of the Central Government, SEZs are government units in their own right. In terms of objectives, the SEZs were supposed to be more than just vehicles for expanding exports. They were also assigned a central role in the reform process as "windows and bridges" to the outside world, in both directions, and also as "economic laboratories" in which economic policy experiments could be carried out in a geographically restricted area.

Investment flows to the PRC during the first 4 years of reforms (1979–1983) were modest, amounting to about $2 billion. Inflows began to gather momentum in the latter half of the 1980s, but were interrupted by the Tiananmen Square incident in 1989. Then, from 1991, FDI began to increase dramatically. Over the past 2 decades, the PRC has been by far the largest developing country recipient of FDI. The PRC's share in total FDI inflows to developing countries and the share of transition economies increased from 11% during 1985–1989 to 29% during 2000–2004. (Figure B3). For 2000–2004, the PRC has been the second largest recipient of foreign investment in the world, accounting for 7% of total gross inflows ($50 billion per annum) after the US (13% of total inflows or $140 billion per annum) (UNCTAD 2005). Some anecdotal evidence of foreign firms relocating to the PRC[9] have led to concerns that Southeast Asia has begun to lose its position as the star performer in the FDI arena in the face of the PRC's meteoric rise as an investment location. There is no doubt that some of the FDI inflows to the PRC have been at the expense of ASEAN countries, but there are also strong grounds for not overstating the "China factor".

Figure B3: Gross FDI Inflow to the PRC: Amount (left scale) and as a Share of Total Inflows to Developing Countries and Transition Economies, 1980–2004



Source: UNCTAD, World Investment Report, Geneva, various issues.

First, there is some controversy over the PRC's actual FDI inflows (Wei 2000; Pomfret 1991). FDI from Hong Kong, China has accounted for over 40% of total FDI inflows to the PRC over the past 10 years, and it is believed that some part of this (maybe 15% or so) is "round tripping" capital. This is capital that originated from the mainland and returned to it disguised as investment from Hong Kong, China in order to take advantage of tax, tariff and other benefits accorded to foreign-invested firms. Also, the official data on FDI is believed to contain "serious fat" in it given the competition among various regions and provinces to demonstrate their superior performance in attracting foreign investors. The comparison of FDI flows to the PRC reported by official sources with those reported by investing countries in Table B3 is consistent with this view. Total investment from countries listed in the table during the 3 years from 2000 to 2002 is almost twice that reported by the investing countries.

Secondly, investors from Hong Kong, China and Taipei,China accounted for approximately 66% of PRC's total FDI inflows between 1983 and 2004. These flows are presumably driven largely by Chinese ethnic links in addition to the general economic considerations impacting on overseas investment decisions (Huang 2003, Wei 2000, Pomfret 1991). Thus, even if the statistical errors noted above and the official data are taken at face value, it is not realistic to assume that these flows are completely at the expense of other investment locations.

Thirdly, data on global investment patterns clearly indicate that the *measured* decline in the share in ASEAN in total developing country inflows was not entirely due to the increase in flows to the PRC. In fact, inflows to other developing countries (that is, countries other than the PRC and ASEAN) have increased at a much faster rate, from about 30% of total flows to developing countries to over 53% by 2002. This compares with a *mild decline* in the PRC's share from 32% to 28% between 1995 and 2002 (Table 5 in the Appendix). Much of these "other developing country" flows were triggered by liberalization reforms in Eastern Europe, formation of North American Free Trade Agreement (which triggered massive relocation of production units from North America to Mexico) and regional cooperation initiatives in many parts of Latin America.

Table B3: FDI Flows to the PRC as Reported by the PRC and by Investing Countries, 2000-2002[a]
($ million)

Home Country	As Reported by PRC (1)	As Reported by Investing Country (2)	Difference between (1) and (2) (%) (3)
France	1,928	1,053	83.1
Germany	3,182	2,682	18.6
Japan	11,454	5,706	100.7
Malaysia	834	203	310.8
Netherlands	2,138	600	256.3
Thailand	586	36	1,527.8
UK	3,112	2,708	14.9
USA	14,241	4,653	206.1
Total[b]	37,475	17,641	112.4

[a] 3-year total.
[b] Total for the countries listed here.
Source: Compiled from UNCTAD (2005), Box Table 1.1.1.

Finally, there is significant complementarily of FDI in the PRC and other developing countries in the region. There are two relevant points here. On the one hand, as an outcome of dramatic economic transformation over the past 2 decades the PRC itself is now becoming a significant overseas investor, predominantly in the developing countries of the region. Countries like Cambodia, Indonesia, Lao PDR, and Malaysia are attractive to Chinese investors because of their rich natural resource base. There is also evidence that the PRC's rapid growth has resulted in rising real wages that has already started to erode some of its relative cost advantage. Manufacturing wages in coastal PRC are already much higher than in Cambodia, Lao PDR, and Viet Nam and the gap is increasing rapidly. These wage differentials have already begun to entice Chinese firms involved in labor-intensive manufacturing (clothing and footwear in particular) to relocate production in the latter countries. As noted in the text, Chinese investors are already the largest investors in the clothing industry in Cambodia and are increasing their presence in Viet Nam.

On the other hand, migration of some production processes within vertically integrated high-tech industries such as electronics, motor vehicles, and cameras to the PRC does not necessary imply a zero sum game when it comes to attracting FDI. To the contrary, it can open up opportunities for producing original-equipment-manufacturer goods and back-room operations in the Southeast Asian countries for the PRC market. For instance, at the dawn of the new millennium, Intel Corporation invested more than $200 million in a new semiconductor chip facility (first phase) in the Central Chinese city of Chengdu (in addition to its $500 million assembly and testing facility in Shanghai) and at the same time opened a $40 million design and development center in Malaysia. More recently Intel signed agreements with the government of Viet Nam to set up a large electronics component assembly plant and the prime target market for the new venture is the PRC. These cases suggest that the highly publicized cases of multinational enterprises migrating from ASEAN to the PRC may simply reflect only one side of the ongoing process of restructuring international production within the region. There is evidence of rapid expansion of components and parts exports from the five major ASEAN countries to the PRC (Athukorala 2005). This evidence supports the view that export-oriented FDI flows to individual countries are largely "complementary" rather than "competing".

The role that the Asian financial crisis played in the drop-off in post-reform FDI flows to these countries should not be overstated however. For instance, a close look at investment approvals data in Viet Nam suggests that investor interest in that country began to decline from about mid-1996. This had more to do with the legislative assembly not delivering on anticipated reforms and domestic opposition to foreign firms on the basis of their perceived adverse socio-economic implications (Kokko 1997). FDI flows to the Lao PDR began to decline well before the onset of the Asian financial crisis as well. In Cambodia, the political crisis in the mid-1990s had a much more damaging impact on FDI inflows than the Asian financial crisis.

In an overall international comparison, the three countries still remain small players in the global investment scene. In many ways, this should not seem surprising given the transitional nature of these economies and their relatively small size. But even during the investment boom of 1992–1995, FDI in Viet Nam amounted to a mere 1.2% of total FDI flows to developing countries. Furthermore, this figure had declined to 0.6% by 2000–2005. Total FDI inflows to the three countries during 2000–2005 amounted to 0.7% of total FDI inflows to developing countries. During this period, they accounted for 33.4% of total FDI inflows to the GMS region, with Viet Nam accounting for 29.8%, Cambodia 2.9%, and Lao PDR 0.7%. Historically Thailand has been the largest FDI recipient in the region (excluding the PRC) (see Box 4 below on Thailand's experience with FDI), but Viet Nam has been catching up in the last couple of years.

Box 4: FDI in Thailand: Recovering from the Crisis?

In the 1960s and 1970s, policy toward foreign direct investment (FDI) in Thailand, as in Indonesia, Malaysia and Philippines, remained somewhat ambivalent; alternating between a national distrust of foreign firms and the hope that new foreign investment could provide the technology and capital for rapid industrialization (Lindblad 1998; Athukorala and Hill 2001). The policy was characterized by a mix of incentives and restrictions, with the balance between the two varying among countries and over time depending on the strength of prevailing anti-FDI sentiment. Although the promotion of FDI started to receive greater emphasis from about the late 1970s, foreign participation remained generally limited to minority ownership. Only "pioneer status" accorded in terms of national development priorities at the time would qualify for full foreign ownership during the initial stage of operations.

From the late 1980s, FDI policy regimes became increasingly liberal as an integral part of a palpable shift away from import-substitution toward export-oriented development strategy. By the mid-1990s, full foreign ownership in firms producing for exports was a common feature across all industries and ownership restrictions had become increasingly liberal even for firms involved in domestic-market oriented production. The requirement for foreign investors to register with the Board of Investments was abolished and the investment approval process shifted to the so-called "negative list" approach. With this approach, any activity is open to foreign investors unless explicitly listed as closed by the government. However, governments continued to restrict foreign participation in services such as media, real estate, energy, and utilities.

These moves toward providing greater opportunities for global integration through FDI occurred in a general economic setting that was becoming increasingly conducive to private sector participation in the growth and development process. The investment environment has been favorable for a number of reasons. First, most countries in the region have enjoyed policy stability for much of the past 2 decades. Whenever new governments have come in, they have not reneged on the promises of previous governments, and therefore essentially all contractual agreements reached with foreign investors have been maintained and continued. Second, up until the Asian financial crisis, the region has had an impressive record in maintaining macroeconomic stability. Third, and perhaps most important, the governments of this region have been fully committed to liberalizing their economies and integrating them with the global economy.

Following the onset of the financial crisis in 1997, the Government of Thailand embarked on a more active program of promoting of FDI as part of the crisis management policy. Nearly all services and manufacturing sectors were opened to FDI and restrictions on FDI in the real estate and financial sectors were considerably relaxed as part of the policies that Thailand agreed to implement in the context of request for financial support from the International Monetary Fund.

Total FDI flows to Thailand rose sharply from an annual average of $732 million or 3% of the gross domestic capital formation (GDCF) in the second half of the 1980s to over $7.5 billion (29% of GDCF) in 1998 (Table 5 in the Appendix). This impressive record was broken by the 1997–1998 financial crisis. Interestingly, the impact of the crisis on FDI inflows was not felt for about a year, reflecting perhaps the materialization of pre-crisis investment approvals and "fire-sale" investment based on the perception of some buyers that the crisis would be short lived. FDI flows to Thailand declined precipitously from 1998 reaching a 2-decade low of $947 million in 2002. Although there has been some recovery in the past two years, so far total flows have remained less than a fifth of the average for the period 1990–1998. Thailand's share in total inflows to developing and transition economies increased from 3% during 1985–1989 to 4.8% during 1992–1997 but fell back again to 1% during 2000−2004.

During the post-crisis years, the relative importance of mergers and acquisitions (M&As) in total FDI inflows has increased sharply. The annual average inflows of M&A-related FDI increased from $168 million between 1990 and 1996 to $1,564 million between 1997 and 2002. However, greenfield investment still accounted for more than two thirds of total FDI.

Japan has been the largest direct investor in Thailand over the past 3 decades, accounting for 23% of total annual flows during 1970–2004. The Japanese share has however declined to about 19% in the past decade because of the faster growth of flows from Republic of Korea and Taipei,China.

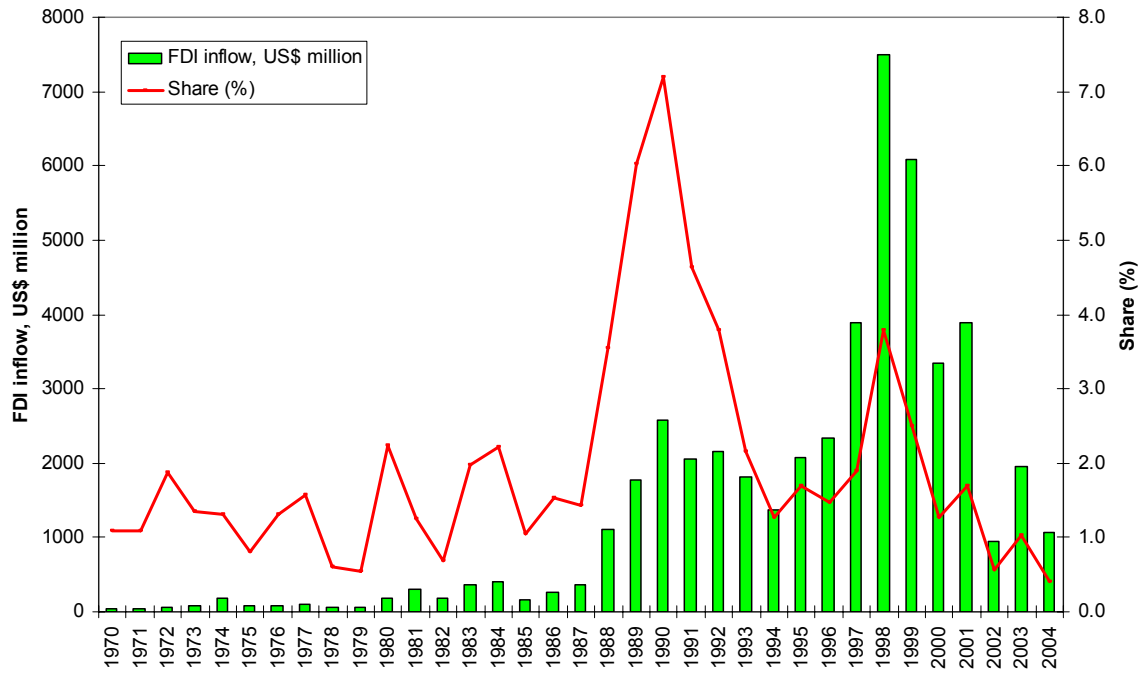
Table B4.1: Thailand: Sectoral Composition of FDI Inflows, 1970–2003 (%)

	1970–2005	1970–1975	1976–1980	1981–1985	1986–1990	1991–1995	1996–2000	2001–2005
Manufacturing	41.8	29.9	33.5	32.9	49.2	30.7	44.9	44.1
- Food & sugar	3.0	4.0	2.5	1.7	3.5	2.5	3.1	3.2
- Textiles	2.0	13.1	7.0	2.8	3.0	1.8	1.5	1.4
- Metal & non-metallic	5.6	1.7	1.2	4.0	5.3	4.2	5.9	6.9
- Electrical appliances	10.0	3.4	12.5	9.2	17.9	11.1	10.5	4.3
- Machinery & transport equipment	9.2	0.7	3.5	2.9	2.8	3.8	12.8	13.1
- Chemicals	4.9	3.6	4.9	4.0	6.2	5.9	5.5	2.5
- Petroleum products	0.1	1.6	0.5	6.4	1.7	-2.4	0.7	-0.4
- Construction materials	0.4	0.6	(1.2)	0.2	0.1	0.6	0.6	0.0
- Others	6.6	1.2	2.5	1.7	8.8	3.3	4.2	13.2
Financial Institutions	3.9	20.1	1.1	0.8	7.1	7.2	8.1	(7.5)
Trade	18.2	20.3	22.0	17.5	17.0	17.2	21.5	14.3
Construction	4.7	10.0	16.6	16.1	7.5	10.4	1.6	1.1
Mining & quarrying	1.1	14.8	10.0	21.9	1.7	4.8	(1.5)	(2.0)
Agriculture	0.3	0.3	2.0	0.6	1.4	0.4	0.0	0.1
Services	7.6	2.9	12.0	7.0	4.0	3.4	9.3	10.3
Investment	1.5	0.0	0.0	0.0	0.0	0.6	6.0	(3.8)
Real estate	12.6	1.8	2.9	3.1	11.3	27.6	6.4	12.8
Others	8.3	0.0	0.0	0.0	0.7	(2.2)	3.8	30.5
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Compiled from data from Bank of Thailand website, http://www.bot.or.th/bothomepage/databank/EconData/EconFinance/tab61-1e.asp.

Over the past 3 decades, the manufacturing sector has been the main focus of FDI. It accounted for over 40% of total inflows from 1970 to the present, followed by trade (18%) (Table B4.1). The change in composition of manufacturing FDI has mirrored Thailand's transition from import-substitution to export-oriented industrialization. Between 1970 up to the mid-1980s, FDI in manufacturing was mainly involved with import-substituting industries such as textiles, automobiles, and chemicals. From the mid-1980s, foreign firms shifted their interest from import-substituting industries to traditional labor-intensive manufacturing industries such as clothing, footwear, and toys. More recently, labor-intensive assembly activities in electrical machinery and electronic appliances have been the main attraction for foreign investors. The share of electrical machinery and electronic appliances in total manufacturing FDI inflows increased from 14.3% in the 1970s to over 30% from about the late 1990 (Kohpaiboon 2007 forthcoming).

Figure B4: Gross FDI Inflow to Thailand: Amount (left scale) and as a Share of Total Inflows to Developing Countries and Transition Economies, 1970–2004



Source: UNCTAD, World Investment Report, Geneva, various issues.

1. Source Country Composition of FDI

The source country composition of FDI to Cambodia, Lao PDR, and Viet Nam is characterized by a clear regional bias. Investors are predominantly from ASEAN, Northeast Asia and the PRC (Table 6). This is in sharp contrast to the other Southeast Asian countries (Indonesia, Malaysia, Philippines, Singapore, and Thailand) where the bulk of FDI originates from OECD countries. Intra-GMS FDI inflows are predominantly from Thailand, PRC, and some Vietnamese investment in Cambodia and the Lao PDR. There is hardly any investment by Cambodian or Lao companies in other countries.

In Cambodia, ASEAN investors accounted for 54% of total foreign investment (with Malaysia alone accounting for 44%), Northeast Asia 26%, and OECD countries 20%, during 1994–1999 (Table 7). Since then, the composition has shifted strongly in favor of Northeast Asia. In 2005, 76% of total investment was accounted for by investors from Northeast Asia, with Chinese investors alone accounting for 66%. This was accompanied by a decline in the ASEAN share to 19% and the combined OECD share to a mere 4%. Most Chinese investment is in the garment industry. Recently, two Chinese companies have applied to invest in oil refining. There has also been Chinese interest in investing in hydroelectricity, railway, and oil and gas exploration. In April 2006, the PRC provided a further $600 million in aid and soft loans for the construction of bridges, a hydropower plant, and government offices. Some commentators fear that the PRC's newfound enthusiasm in investing in the country may distract attention from much needed reforms to improve the overall business environment.

In the Lao PDR, investors from ASEAN countries accounted for over 55% of total approved investment in the early 1990s, with Thailand alone accounting for more than half (Table 8). The ASEAN dominance dissipated during the ensuing decade, but not as fast as in Cambodia. By 2005, ASEAN investors still accounted for over 40% of total investment. The relative importance of the PRC and Republic of Korea as source countries has increased sharply in recent years, but the combined non-ASEAN share is still small (18% during 2000–2004) compared to Cambodia. Unlike in Cambodia, the share of OECD countries has increased consistently, from 15% in 1988–1994 to 32% in 2000–2004. This is mostly a reflection of large and lumpy investments by Australian and French companies, in particular, in mineral and hydropower projects.

The source country composition of FDI in Viet Nam is much more diversified, reflecting a wider range of investment opportunities available in a larger economy (Table 9). Over the years, the relative position of ASEAN countries as sources of investment has declined while the importance of investors from other East Asian and OECD countries has grown. During 2000–2005, Northeast Asia and the PRC accounted for 44% of total approved investment, with OECD and ASEAN countries accounting for 36% and 20%, respectively. At the individual country level, the relative position of Singapore, which was the largest investor until 1999, has declined (from 16% during 1988–1999 to 12.5% during 2000–2005) and that of Republic of Korea and Taipei,China has increased (from 9% to 16%, and 12% to 23%, respectively). Investment from the PRC has increased rapidly, but from a low base, reaching 4% of total investment during 2000–2005.

During the early years of market-oriented reforms in Viet Nam, analysts often referred to the US economic embargo as a major constraint to the country's ability to rely on FDI in the process of economic transition. However, the lifting of the embargo in 1994 and the signing of the Viet Nam-USA Bilateral Trade Agreement in 2001 has not yet ushered in a significant change in the source country composition of FDI in Viet Nam. It may, however, have had positive demonstration effects on other countries. The US share in total approved investment amounted to a mere 1.5% during 2000–2005. This tepid response from US investors so far seems to suggest that the domestic business environment is the ultimate determinant of the country's ability to attract investors from the US, whose comparative advantage in international production lies mostly in high-tech and heavy industries. In particular, US FDI in countries in the Asia-Pacific region is heavily concentrated in assembly activities in vertically integrated high-tech industries. Investors in these product lines place a much greater weight on the stability and transparency of the domestic investment climate than do investors coming into less complex labor-intensive product lines. The domestic business environment may improve as Viet Nam implements further reforms under the Bilateral Trade Agreement and in anticipation of the impending accession to the WTO. In this respect, the recent decision by Intel to set up a large electronics component assembly plant in Viet Nam is encouraging.

2. Industry Composition of FDI

At the initial stage (1994–1999), FDI in Cambodia was heavily concentrated in the services sector, mostly in tourism (43% of total investment in approved projects). During the ensuing years, the investment share in manufacturing has increased sharply, from an average of 35% in 1994–1999 to 59% in 2005 (Table 10). FDI in manufacturing is largely concentrated in the garment industry, with investors from the PRC accounting for over 90% of investment approvals over the past 5 years. The enthusiasm of Chinese investors in expanding investment in the Cambodian garment industry alleviates the widely-held concern that the abolition of the

MFA may result in massive export losses. It would appear that producers based in low-wage countries like Cambodia have ample opportunities to expand exports based on relative cost advantage in a quota free world, without the fear of being subject to punitive tariffs imposed by the US, EU, and other importing countries.

In the Lao PDR, the industry composition of FDI is dominated by the mining and electricity (hydropower) sectors (Table 11). In recent years, the share of agriculture and forestry in FDI approvals has also increased substantially, partly reflecting interest in plantations (see footnote 6). It is generally believed that there is ample potential for the Lao PDR to attract more FDI into the mining sector. For instance, only 25% of land area has been geographically mapped. Hydropower is also likely to remain one of the key sectors for FDI given expanding demand from neighboring Thailand, as well as Cambodia and Viet Nam. The share of manufacturing in total approved FDI has remained around 10%, the lowest among the three countries. The Lao PDR has not benefited as much as Cambodia from new investment in its clothing industry following the abolition of the MFA. Nevertheless, quota-hopping foreign investors who entered the garment industry in Lao PDR during the MFA era have not left and a few investors, including at least one Japanese firm, have recently applied for approval to set up plants to produce garments for export to niche markets.

In Viet Nam, extraction of crude petroleum and gas, and construction and services sectors were the initial areas of interest to foreign investors, with the manufacturing sector accounting for less than a fifth of total approved projects (Table 12). The relative importance of manufacturing has been increasing over the years however. By 2005, manufacturing accounted for 42% of cumulative approved investment in realized projects. During the early years, much of FDI in manufacturing was market-seeking, or production that catered to the domestic market. During 1988–1990 for instance, more than 80% of approved projects had export-output ratios of less than 50%. From the late 1990s onwards, there has been a notable compositional shift from domestic market-seeking to efficiency-seeking export-oriented production in manufacturing. By 2000, over 70% of approved FIEs in manufacturing had export-output ratios of 50% or more, with the majority clustering within the 80–100% range. Until recently, most of the export-oriented FDI projects were in garment, footwear, furniture, and other wood products industries. Over the past 5 years, however, MNEs have begun to invest in assembly activities in the electrical and electronics industries.

The decline in FDI during 1998–2002 was largely confined to non-traded goods sectors (construction, in particular), and import competing (domestic market oriented) manufacturing. FDI flowing to the export-oriented industries has continued to increase, *albeit* at a slower pace than in the early 1990s. The share of export-oriented projects has persistently increased from about 1997. The explanation seems to lie in Viet Nam's strong comparative advantage in international production in labor-intensive production and assembly activities. It may also be that export-oriented FIEs are more resilient to adverse developments in the domestic policy scene, so long as the trade policy regime assures uninterrupted access to imported inputs.

3. Spatial Distribution of FDI

In all three countries, FIEs have so far been concentrated in the capital city and a few other urban centers, despite specific incentive schemes and special investment zones designed to achieve a wider spatial distribution. In the Lao PDR, although resource-based sectors are by their nature located away from urban areas, according to investment approval records, two-thirds of all firms in the industrial sector are located in Vientiane (the capital), Savannakhet,

Champassak, and Luang Prabang. Two thirds of all large manufacturing enterprises are located in Vientiane itself. The concentration of approved projects in the capital city of Phnom Penh and surrounding areas seems to be even greater in Cambodia.

Table 13 presents data on the spatial distribution of approved investment in operational projects in Viet Nam. There has been a heavy concentration of projects in the South East [mainly Ho Chi Minh City (HCMC)] and in the Red River Delta (around Hanoi). These two regions accounted for 61% and 28%, respectively, of the total cumulative approved investment during 1988–2005. HCMC alone accounted for over a fifth of this investment. There has not been any notable change in the spatial distribution of FDI over the past 2 decades. There is little evidence that the Government's incentive schemes have encouraged foreign investors to move to remote regions.

The spatial distribution of FDI in all three countries points to the importance of transportation and other infrastructure facilities, and access to administrative services, in determining investment location decisions. Until such physical and social infrastructure is improved in other regions, FDI is likely to continue to be concentrated in and around the major cities.

D. Economic Impact

A systematic comparative analysis of the economic implications of FDI in the three countries is constrained by a paucity of data. This is particularly the case for Cambodia and the Lao PDR. Unlike in Cambodia and the Lao PDR, the investment monitoring organization in Viet Nam, the Ministry of Planning and Investment (MPI), collects information annually on the operation of approved projects, and the General Statistics Office (GSO) conducts an annual census of industry based on a well-designed and comprehensive questionnaire. For this reason, this section largely focuses on the Vietnamese experience, and reports empirical estimates of various impacts using both published and unpublished data from MPI and GSO. The section then provides some tentative observations on the experiences of Cambodia and the Lao PDR based on the limited data that is available. Finally, the section considers some of the potential negative social and environmental impacts of large projects and measures to mitigate them, using the Nam Theun II project in the Lao PDR as an example.

1. Viet Nam

a. Impact on GDP and its Domestic Components

FDI has undoubtedly made a significant contribution to the process of economic transition in Viet Nam (Table 14). The share of foreign invested enterprises (FIEs) in GDP increased from 6.3% in 1995 (the earliest year for which such information is available) to 15% in 2003, and they accounted for over 20% of the total increment in real GDP between these two years. The share of FIEs in gross industrial production increased from 25% in 1995 to 36% in 2003, accounting for over 30% of the total increment in gross industrial output between these 2 years.

This notable contribution of FIEs to expansion in GDP and industrial output seems to have occurred against the backdrop of a consistent decline in the share of FIEs' gross domestic

capital formation in the economy, from 32% in 1995 to 18% in 2003. There are two possible explanations for this. First, it may be that efficiency of factor usage (productivity growth) in FIEs has improved over time (see below). Second, the decline may be a reflection of the increase in FIE involvement in export-oriented production, which tends to be more labor-intensive.

b. Impact on Employment

In 2003, FIEs accounted for 15% of total industrial employment (up from 12% in 2001) and 23% of total female employment (up from 16.3%) in the country. The increase in the share of women workers in total FIE employment coincides with the increased export orientation of FIE production. Further information on the patterns of employment in FIEs in the industrial sector is given in Table 15. Total industrial employment in FIEs increased at an annual rate of 23% during the 4-year period from 2000 to 2003, compared to 8% growth in employment in non-FIE (pure local) firms. FIEs also contributed to over 44% of the increase in total industrial employment between 2000 and 2004. The average wage of FIEs has been consistently higher than that of non-FIEs across most industries. If foreign firms have higher productivity growth than domestic firms (see below), then they have the capacity to pay higher real wages than do domestic firms, assuming that workers are paid according to their marginal product. Thus, domestic workers employed in foreign firms could earn higher real incomes, and make a greater contribution to real GDP, than their counterparts in domestic firms (Menon 1998).

While employment in FIEs has increased notably, their share in industrial employment has persistently lagged behind the share in gross industrial output (Table 14). This seems to reflect the capital intensity bias infused into FIE production through the heavy-industry emphasis of the investment approval policy in the 1990s, and the continuing domestic market bias in the trade policy regime. Despite the recent expansion in labor-intensive export oriented product sectors, the output composition of FIEs is still dominated by highly capital-intensive sectors promoted by the protectionist trade regime. For instance, chemical, metallic and non-ferrous minerals, fabricated metal products, consumer electronics and motor vehicle production accounted for over 70% of total output, compared to a combined employment share of less than 20%. There are signs that, with the continuing increase in the relative importance of export-oriented ventures among FIEs, the employment potential of FIEs has begun to improve. Of particular significance in this connection is the growing importance of assembly activities in the global electronics industry and other high-tech industries as an area of involvement for foreign investors in Viet Nam. However, it does appear that Viet Nam has some way to go in replicating the East Asian success story in this sphere.

c. Impact on Exports

The most visible contribution of FIEs to the Vietnamese economy is in export expansion. The share of FIEs in total non-oil merchandise exports increased from 2.5% in 1991 to 30.2% in 2000 and 43.5% in 2005 (Table 16). The role of FIEs is especially important in some key export industries, such as footwear, where they accounted for over three-quarters of total exports, garments and textiles (35%), and electronics and electrical goods (mostly components) (95%).

Table 17 provides data on the commodity composition of exports by FIEs. The patterns emerging from the data are basically consistent with the typology developed in Section A. Contrary to the expectations of policy planners, FIEs in so-called heavy industries such as chemicals, basic metal products, fabricated metal products, and motor vehicles have not begun

to make a significant contribution to exports, despite special incentives linked to export performance requirements. The standard labor-intensive goods (in particular garments, footwear and wood products) dominated the export composition to begin with. From about the late 1990s, exports of parts and components of office, accounting and computing machines, electrical machinery and apparatus and other machinery have begun to gain importance.

This important structural shift in export composition highlights the role that FDI is playing in linking Viet Nam to the ongoing process of product fragmentation in global manufacturing. However, small and medium scale assembly plants have dominated this product line so far. The only significant large scale player is Hitachi, which runs an assembly plant in the South and employs over 4,000 workers, although in January 2006 Intel announced plans to invest $600 million in a chip making plant. So far, Viet Nam has not been able to attract any of the other major electronics MNEs that played a significant role in the electronics revolution that occurred in countries such as Singapore, Malaysia and, more recently, the Philippines.[10]

d. Impact on Productivity Growth

FIEs are expected to contribute to productivity growth both directly, through their role as part of the domestic economy, and through spillover effects on the performance of domestic firms. In the remainder of this section, we undertake a preliminary analysis of the direct productivity implications of FIEs in Vietnamese manufacturing using data at the two-digit industry level for the 4 years from 2000 to 2004 tabulated from unpublished returns to the annual Industrial Census conducted by the General Statistics Office (GSO).

The most widely used indicator of factor productivity is labor productivity (LP), measured as valued added per unit of labor input. Growth of labor productivity refers to an increase in the value of goods produced by the average worker (or the increased efficiency of the average worker). In reality, workers may produce more not only because of an increase in efficiency but also because they have more inputs (capital, in particular) to work with. Thus LPG could spuriously capture changes in capital per worker as part of measured productivity. Total factor productivity growth (TFPG)—the residual output after accounting for growth in all factor inputs—avoids this problem and this is a preferred productivity measure. However, it is important to check the sensitivity of the results to the use of LPG in place of TFPG, because the former is the most widely used indicator of factor productivity.

Estimates of labor productivity growth (LPG) and total factor productivity growth (TFPG) are reported in Table 18, together with some supplementary data to facilitate the interpretation - of results.[11] There is a sharp contrast in productivity performance of FIEs during 2000–2003 in terms of the two alternative indicators. LPG of FIEs in total manufacturing contracted at a compound rate of 2.4% during this period in a context where LPG of all firms remained virtually unchanged. By contrast, TFPG of FIE production *increased* at a compound rate of 2.2% compared to a mere 0.6% increase recorded by pure local firms and 1.2% by all firms. At the disaggregate level, FIEs' contribution to productivity improvement is particularly impressive in office, accounting and computing machines (11.1%), electrical machinery (9.8%), and other transport equipment (17.9%)—industries which have become increasingly export oriented over time. By contrast, in most of the domestic-market oriented heavy industries, where FDI participation was encouraged by the government at the initial stage of reform, productivity growth in FIEs is either negative or near zero. Moreover, in these industries there is no notable difference in productivity performance between FIEs and local firms.

The difference between measured LPG and TFPG for FIEs points to an important on-going structural change, which is the decline in the capital intensity of production. In total manufacturing, the degree of capital intensity of FIEs declined at an annual compound rate of 5.1% during this period (whereas capital intensity of local firms increased by 2.9%). By contrast, TFPG is negatively related with the change in capital intensity (whereas labor productivity growth is positively related with capital intensity).[12] As already noted, the decline in capital intensity is a reflection of increased export orientation of FIE production.

2. Cambodia

The experiences of Cambodia and the Lao PDR also point to the important role that FDI has played in export expansion and employment generation. In Cambodia, the clothing industry is entirely foreign-owned. Clothing exports have been the major foreign exchange earner for the past decade or so (Table 19).

Direct employment in the garment industry in Cambodia increased from an estimated 19,000 in 1995 to nearly 200,000 in 2003. In addition, an estimated 150,000 workers are indirectly employed by being involved in associated activities (CDRI 2005, p. 66). The clothing industry is now the second largest employer in this predominantly agricultural country. Over 85% of workers in the industry are women and over 90% of them come from rural areas. If overtime work is included, a garment worker could earn about $60 per month, an attractive salary by Cambodian standards. It is estimated that these workers remit about 50% of monthly wages to family in rural provincial areas. In this way, the rapid expansion of FDI-driven clothing exports has become a major vehicle for the empowerment of women, improving livelihoods, and narrowing the urban-rural income gap.

In recent years, FDI has also begun expanding into other labor-intensive export lines, such as shoes, toys, and wood products. As FDI-driven exports in these sectors increase over time, significant inroads can be made in addressing underemployment and poverty in Cambodia.

3. Lao PDR

In the Lao PDR, the FIE-dominated hydroelectricity industry accounted for more than 40% of total current account receipts in the balance of payments in 2004. Foreign-owned factories account for most of clothing exports, which in turn constitutes more than 90% of total manufactured exports. Although there are no FDI-related employment figures for the Lao PDR, a tentative estimate based on investment approvals suggests that around 60,000 workers are currently employed in FIEs.

A major factor that needs to be taken into account in assessing the developmental gains from FDI in the Lao PDR is the relatively heavy concentration of FIEs in the mining and hydroelectricity industries, as well as in forestry. Conservative estimates show that as many as 150,000 hectares may be under industrial plantation by 2015, creating assets in the form of productive plantation land, and providing the poor with an important source of cash income and sustainable livelihood. The Nam Theun II hydroelectric power project, which is to be commissioned by 2009/10, not only has the potential to alter the FDI landscape of the country, but will provide significant benefits to the economy of the Lao PDR. The large foreign investment inflow, estimated at approximately $1.3 billion, is expected to generate a sizable

income stream for the next 3 decades and beyond. Through taxes, royalties and dividends, the people of the Lao PDR stand to be significant beneficiaries, as long as these revenue streams are well managed. The construction phase will directly employ about 4,000 people, with more than double (perhaps even quadruple) this number of jobs expected to be created as a result of support services and other multiplier effects. Poverty in the site area is severe and the project has the potential to open the area to eco-tourism and promote commercialization of agriculture through access to markets via improved infrastructure. More generally, GDP growth could be spurred by a full percentage point, which could help to raise some 60,000 people nationwide above the poverty line.

Commissioning of the project in 2009/10 will strongly boost export and foreign exchange earnings. Apart from its contribution to exports and foreign exchange earnings, the Nam Theun II project will also promote economic and social development by providing reliable and least-cost power supply domestically. Electricité du Laos (EdL) has made a prudent commitment to purchase at least 200 gigawatt-hours (GWh) from the project but has the option to purchase up to 300 GWh to meet domestic demand.

4. Potential Negative Impacts of FDI

The discussion so far has highlighted the positive impacts that FDI can have in host countries. Large investment projects involving the exploitation of natural resources in particular can have a range of negative social and environmental impacts however. Although this does not necessarily depend on the source of funding—whether domestic or foreign—these costs are real and can be quite significant. The Nam Theun II project in the Lao PDR provides a useful illustration of such costs, since they are likely to apply to most large projects not only in the hydropower sector but also other forms of resource-based industries. For this project, the principal adverse environmental impact is likely to be the loss of habitats (both terrestrial and aquatic) in and around the project site area. This loss of habitat will increase population pressures on wildlife that are dependent on these habitats. There are water quality issues associated with the reservoir and downstream receiving waters as well, which are cross-boundary in nature. Poor water quality in the reservoir could affect the viability of reservoir fisheries programs, and greenhouse gas emissions from the reservoir could contribute to global carbon dioxide levels.

On the social side, there are resettlement and social dislocation issues relating to the communities that will be displaced directly as a result of the project. Relocation in this case could entail loss of livelihoods (e.g., from loss of fields for rice and other crops and vegetables, forestland, and fishing grounds) and forced changes in lifestyles and associated social stress. Since the majority of those that need to be resettled are from vulnerable groups such as ethnic minorities, the social dislocation cost is likely to be particularly high since they will find it quite difficult to adapt to new living and working environments. The influx of construction workers into the project area could also create potential health, safety, and natural resource management problems.

The Nam Theun II project has in place a range of mitigation and social safeguard measures designed to address these costs. Although such measures may not always be able to fully compensate for such costs, they can go a long way toward minimizing them. In this case, the involvement of multilateral development agencies such as ADB and the World Bank provide further assurance that these measures are likely to be designed and implemented effectively.

Finally, on the economic side, large FDI projects such as these that involve a massive influx of foreign capital raises concerns relating to adverse implications for domestic resource allocation that operate through the appreciation of the real exchange rate, or decline in prices of tradable relative to that of nontradable goods. In the case of Nam Theun II, these effects are expected to be moderate and manageable as the project is essentially an “enclave project”. Almost all inputs except labor will be imported, and the Lao PDR is a labor surplus economy. In other words, it is unlikely that there will be much of a “Dutch Disease” type effect resulting from this project, and should not have any significant deindustrialization impacts. This is also likely to be the case for most resource-seeking FDI projects in the CLV countries because most, if not all, tend to operate similarly as enclave projects. If, however, the real exchange rate appreciation turns out to be stronger than anticipated, then a sensible policy response would be to accelerate trade liberalization to ensure that the competitiveness of the tradable goods sector is not significantly harmed.

IV. CONCLUSIONS

The macroeconomic performance of the economies in the Greater Mekong subregion remained strong in 2005. Although GDP growth was lower than in the previous year, it averaged a robust 7.9% as most of the economies, with the notable exception of Thailand, continued their upward trend. Inflationary pressures have increased in recent years because of higher oil and food prices, but they are in the single digits. The fiscal balance remained stable overall. Net capital inflows, with a significant contribution from FDI, are sufficient to finance current account deficits and foreign exchange reserves remain at comfortable levels.

As transitional economies, the CLV countries require substantial amounts of investment to transform their economies and meet the economic, social, and other developmental goals that they have set themselves. The levels of domestic savings in these countries are far from adequate to meet these investment requirements. Support from bilateral and multilateral development agencies in the form of grants, loans (both soft and market-based) and technical assistance have an important role to play in this process. Furthermore, external debt levels in Cambodia and the Lao PDR in particular are already quite high, so borrowings alone cannot be relied upon to fill resource gaps. This is where FDI comes in.

FDI can provide the resources to increase investment beyond domestic savings levels without adding to the external debt burden. But it can do much more than this. FDI can bring with it firm-specific knowledge in the form of technology, managerial expertise, marketing know-how, and other things such as these that cannot easily be leased or purchased on the market by the host country. Indeed this may well be the key advantage provided by FDI. After all, ideas can be as important as physical inputs, and an economy can grow just because new ideas beget more new ideas, as postulated by endogenous growth theory.

Combining the direct contribution to growth through investment with the various indirect spillover effects suggests that FDI has the potential to play an important catalytic role in countries in the process of transition from command to market economies.

The experience of all three countries confirms this. FDI has played an important role in promoting GDP growth, export expansion and employment generation in the CLV countries. There is empirical evidence that FDI has contributed to productivity growth in Viet Nam, and a host of anecdotal evidence that it has done the same in Cambodia and the Lao PDR.

In Cambodia, the rapid expansion of FDI-driven clothing exports has become a major source of employment and income for women, reducing poverty and helping narrow the vast urban-rural income gap. Recently, FDI has also begun expanding into other labor-intensive export industries, such as shoes, toys, and wood products, which is further contributing to employment generation.

In the Lao PDR, foreign investment in the hydroelectric power and mining sectors are boosting GDP growth and creating substantial employment opportunities in this landlocked country. Furthermore, through taxes, royalties and dividends, the citizens of the Lao PDR stand to be significant beneficiaries of such FDI projects, as long as these revenue streams are well managed. FDI is also behind the rapid increase in mining-related exports, and there appears to be vast untapped potential in this area.

FDI has played an important role in transforming the economy of Viet Nam. There is a substantial amount of evidence that highlights the role that FDI has played in driving growth in

GDP, exports and employment, as well as positive spillover effects in the economy through productivity growth. As long as the investment climate remains open and receptive, Viet Nam has the potential to further diversify FDI inflows, shifting it from the light-manufacturing sector to assembly and related activities in the electronics industry. If this happens, Viet Nam looks well placed to emulate the spectacular developmental achievements of its more advanced ASEAN neighbors.

To a large extent, the role that FDI can play in assisting in the transformation of these countries is limited by inherent deficiencies in the investment environment─poor physical infrastructure, limited domestic capacity in the form of human capital and entrepreneurial skills, and weaknesses in legal, judicial, and administrative structures. To varying degrees, policy uncertainty and perceived political interference or instability has affected perceptions of risk and hindered investment inflows as well. These are long-term developmental challenges that the CLV countries need to address, and significant progress has been made since the reform process began around the mid-1980s. Much more remains to be done in the future, however, if these countries are to attract the amounts of FDI that their more advanced ASEAN neighbors had done in transforming and modernizing their economies.

Strengthening of the financial and banking sectors and addressing vulnerabilities in the corporate sector are crucial in improving the investment climate in the CLV countries. Despite visible progress achieved thus far, issues relating to transparency, disclosure and governance in the banking sector in particular require urgent attention. Banking sector reforms should also deal with operational restructuring such as rationalizing branch networks, revamping loan processing, and strengthening risk management. An efficient banking sector would considerably reduce the cost of doing business, and significantly improve the investment climate in these countries, not only for foreign firms but also domestic ones.

There are a number of other more immediate policy issues that can be addressed in order to improve the investment climate in these countries. These are policy changes that could be introduced almost immediately if the political will to do so exists. The first of these relate to investment incentives. Cambodia presents a useful model for other countries to emulate, having successfully liberalized and neutralized its system of investment incentives recently. One way in which the Lao PDR and Viet Nam could proceed with reform in this area is to pursue harmonization of incentives using the Cambodian system as a benchmark. In any case, there is a need to increase neutrality and reduce distortions that currently exist in the structure of investment incentives in these countries. A harmonized reduction in incentives offered could allow governments to use the revenue savings to improve the overall fiscal environment, and improve the physical and social infrastructure of the country. If they can do this, then it could be more effective in attracting FDI than the incentives themselves.

The evidence presented here suggests a number of other changes that could be introduced in reforming the system of incentives. The experience of the Lao PDR highlights the fact that incentives geared to promote investment in less developed regions have been rather ineffective. Since there is a real cost associated with administering such a system, and a perceived cost to investors of dealing with a complicated maze of preferences, there is a strong case to be made for simplifying the system by neutralizing it. Furthermore, there will be no loss in benefit since the current system of preferential incentives based on location has not resulted in any change in the spatial distribution of FDI. The same arguments would equally apply to EPZs in Viet Nam that are designed to attract investment into less developed regions.

There is also a need to ensure that so-called “one-stop shops” for foreign investors operate as such and are effective in practice. In the Lao PDR for instance, FIMC is supposed to play this role but because the process has not been integrated and coordinated across government departments, FIMC has become a ”one-*more*-stop shop”, and this serves to delay applications processes to the point where a significant amount of FDI is being denied the country.

Addressing these short-term policy issues are likely to produce immediate results in terms of the volume of FDI. Addressing the longer-term challenges particularly in relation to infrastructure, human capital, and legal, judicial, and administrative structures will affect not only the volume but also the quality and industrial composition of FDI. Longer-term investments in a more diversified array of sectors can be expected, as well as greater productivity and other spillovers to the domestic economy. Through the direct involvement of multilateral development agencies such as ADB and the World Bank or through public-private partnerships that are facilitated by them, FDI may also be able to play an important role in addressing these challenges. This is already happening today in the region, with road, energy, and telecommunications infrastructure through the GMS Economic Cooperation program of ADB for instance, as well as other broader regional cooperation initiatives. But the role that FDI can play in this process has yet to be fully tapped.

Table 1: Foreign Investment Policy Regimes in Cambodia, Lao PDR, and Viet Nam (circa 2006)

Area	Cambodia	Lao PDR	Viet Nam
Govt. agency dealing with FDI	Cambodian Investment Board, Council for the Development of Cambodia (CDC)	Committee for the Promotion and Management of Investment	Investment Promotion Board
Limits on foreign equity participation	100% foreign ownership is allowed in all sectors/industries	At least 30% foreign capital is required in joint ventures 100% foreign ownership is allowed in all sectors except mining and electricity	Only business corporation contracts allowed in mining and telecommunications At least 30% foreign capital is required in joint ventures (may be lowered to 20% in priority projects) At least 5% foreign capital is required in joint ventures 100% foreign ownership is allowed in export-oriented and priority projects
Tax incentives	A tax holiday period determined according to the formula: "trigger period + 3 years + n priority years". (Trigger period: the first year of profit or 3 years after the first revenue is made, whichever is sooner. Priority period: to be determined by CDC according to national developmental priorities) A standard 20% corporate tax rate for all new projects (domestic and foreign-invested firms) from May 2005. The 9% corporate tax rate applicable to foreign invested enterprises approved prior to the promulgation of the new law (5 August 1994) to be phased out,	Investment in Zone 1: 7 year tax holiday and 10% income tax thereafter[1] Investment in Zone 2: 5 year tax holiday and 7.5 % income tax thereafter [2] Investment in Zone 3: 3 year tax holiday and 10% for the next 2 years and 20% thereafter [3] Reduced import duties on inputs: 0% for exporters and 1% for other foreign firms	Tax holiday for 8 years and 10%, 15% or 20% income tax for 10 years when certain criteria are met Exemption from import duties and value added tax in certain sectors

Area	Cambodia	Lao PDR	Viet Nam
	20% within the ensuing 5 years Accelerated depreciation Duty free importation of capital equipment and spare parts for initial installation of promoted investment 100% exemption from export tax Tax refund on reinvested earnings		
Tax on repatriation of profits and expatriates income	100% repatriation of capital and dividends is allowed Profit repatriation subject to 1% withholding tax	100% repatriation of capital, profits and dividend is allowed after paying a 10% withholding tax, creditable against corporate tax	3, 5, or 7% on dividends remitted abroad
Export processing zones			Various additional incentives apply in these zones
Ownership of land	Not permitted	Not permitted	Not permitted
Employment of foreign personnel	No limit	Up to 10% of total employment	Project specific
Performance requirements	Not applicable	Not applicable	Domestic content and export performance requirements in some key manufacturing industries
Protection of foreign investment	(i) Guarantee against nationalization (ii) International convention for settlement of industrial disputes	(i) Settlement of disputes is governed by the Indian Arbitration Act 1940 (ii) UN Convention for the recognition and enforcement of foreign arbitral awards	(i) Guarantee against nationalization (ii) Dispute settlement through mutual consultations and in accordance with the arbitration rules of UN Commission on International Trade Law

Notes:
a) Zone 1: Zones with no economic infrastructure to facilitate investment.
b) Zone 2: Zones with a certain level of infrastructure to accommodate investment.
c) Zone 3: Zones with good infrastructure to support investment.
Source: Compiled from various country sources.

Table 2: World Economic Forum: Growth Competitiveness and Macroeconomic Environment Indices, 2005 (ranking among 117 countries)

	Growth Competitiveness[a]	Business Competitiveness[b]
Singapore	6	1
Hong Kong, China	28	8
Taipei,China	5	17
Malaysia	24	19
Republic of Korea	17	25
Thailand	**36**	**26**
People's Republic of China	**49**	**33**
India	50	50
Viet Nam	**81**	**60**
Indonesia	74	64
Pakistan	83	69
Philippines	77	71
Bangladesh	110	83
Sri Lanka	98	94
Cambodia	**112**	**104**
Highest:	(Finland) 1	(Singapore) 1
Lowest:	(Chad) 117	(Zimbabwe) 117

[a] Based on an index of long-term growth prospects which encompass the quality of macroeconomic environment, public institutions, and domestic technology.

[b] Business competitiveness ranking based mostly on micro aspects, with emphasis on the quality of a country's business environment.

Source: World Economic Forum. *Global Competitiveness Report 2005–06*, September 2005, Geneva.

Table 3: Index of Economic Freedom[a]
(ranking among all countries covered)

	1995	1997	2000	2005
Hong Kong, China	1	1	1	1
Singapore	2	2	2	2
Taipei,China	12	15	12	27
Republic of Korea	17	25	37	38
Malaysia	19	37	50	68
Cambodia	**---**	**108**	**81**	**68**
Thailand	**20**	**35**	**49**	**71**
Sri Lanka	42	38	56	92
Philippines	55	67	65	98
Pakistan	54	81	105	110
People's Republic of China	**84**	**111**	**104**	**111**
India	90	122	125	121
Nepal		123	120	125
Indonesia	68	67	109	134
Bangladesh	85	114	133	141
Viet Nam	**98**	**141**	**152**	**142**
Lao PDR	**---**	**144**	**156**	**149**
North Korea	101	150	161	155
Country coverage	101	150	161	157

--- = Not covered in the given year.

[a] An index of factors that most influence the institutional setting of economic growth. Based on 50 variables grouped into several categories: trade policy, fiscal burden of government, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulations, and informal market activity.

Source: www.heritage.org

Table 4: Indicators of Ease of Doing Business: Cambodia, Lao PDR, People's Republic of China, Thailand, and Viet Nam, 2005

Ease of doing business: Rank among 155 countries	Cambodia	Lao PDR	PRC	Thailand	Viet Nam	Regional Average (East Asia and Pacific)[a]
1. Starting a business	137	102	126	29	82	
2. Dealing with licenses	140	111	136	8	18	
3. Hiring and firing	79	62	87	23	122	
4. Registering property	84	135	24	22	39	
5. Getting credit	154	152	113	59	106	
6. Protecting investors	55	130	100	33	143	
7. Paying taxes	24	36	119	34	107	
8. Trading across borders	117	143	48	89	83	
9. Enforcing contracts	127	143	47	49	102	
10. Closing business	144	149	59	37	95	
Overall	133	147	91	20	99	
Details on each criteria						
1. Starting business						
Procedures (number)	10	9	13	8	11	8.2
Time (days)	86	198	48	33	50	52.6
Cost (% of income per capita)	276.1	15.1	13.6	6.1	50.6	42.9
2. Dealing with licenses						
Procedures (number)	28	24	30	9	14	18.0
Time (days)	247	208	363	147	143	157.7
Cost (%of income per capita)	606.7	224.5	126.0	17.3	64.1	137.4
3. Hiring and firing workers						
Difficulty of hiring index	67	11	11	33	44	26.0
Rigidity of hours index	80	60	40	20	40	29.6
Rigidity of firing index	30	80	40	0	70	23.0
Rigidity of employment index	59	50	30	18	51	26.2
Hiring cost (% of salary)	0.0	5.0	30.0	5.0	17.0	8.8
Firing cost (weeks of wages)	38.8	35.9	90.9	47.0	98.0	44.2
4. Registering property						
Procedures (number)	7	9	3	2	5	4.6
Time (days)	56	135	32	2	67	62.2
Cost (% of property value)	4.7	4.2	3.1	6.3	1.2	5.0
5. Getting credit						
Legal rights index[b]	0	2	2	5	3	5.3

Ease of doing business: Rank among 155 countries	Cambodia	Lao PDR	PRC	Thailand	Viet Nam	Regional Average (East Asia and Pacific)[a]
Credit information index[c]	0	0	3	4	3	1.8
Public registry coverage (% adults)	0.0	0.0	0.4	0.0	1.1	1.7
Private bureau coverage (% adults)	0.0	0.0	0.0	18.4	0.0	9.6
6. Protecting investors[d]						
Disclosure index	5	4	10	10	4	5.6
Director liability index	9	2	1	2	1	4.2
Shareholder suits index	2	4	2.3	6	2	6.2
Investor protection index	5.3	3.3	4.3	6	2.3	5.3
7. Paying taxes						
Payments (number)	27	31	34	44	44	28.2
Time (hours)	97	180	584	52	1,050	249.9
Total tax payable (% of gross profit)	31.1	24.7	46.9	29.2	31.5	31.2
8. Trading across borders						
Documents for export (number)	8	12	6	9	6	7.1
Signatures for export (number)	10	17	7	10	12	7.2
Time for export (days)	43	66	20	23	35	25.8
Documents for imports (number)	12	16	11	14	9	10.3
Signatures for import (number)	18	28	8	10	15	9.0
Time for import (days)	55	78	24	25	36	28.6
9. Enforcing contracts						
Procedures (number)	31	53	25	26	37	30.0
Time (days)	401	443	241	390	343	406.8
Cost (% of debt)	121.3	30.3	25.5	13.4	30.1	61.7
10. Closing business						
Time (years)	..	5	2.4	2.7	5.0	3.4
Cost (% of estate)	..	76	22	36	15	28.8
Recovery rate (cents on the dollar)	0.0	0.0	31.5	44.0	19.2	24.0

[a] This is based on the World Bank regional grouping.
[b] The legal right index ranges from 0 to 10 with higher scores indicating that those laws are better designed to expand access to credit.
[c] The credit information index ranges from 0 to 6 with higher scores indicating better scope, access and quality of credit available through public registries or private bureaus.
[d] The indicators below describe three dimensions of investor protection: transparency of transactions (disclosure index), liability for self-dealing (director liability index), shareholders' ability to sue directors for misconduct (shareholder suits index) and strength of investor protection index. Each index varies between 0 and 10, with higher values indicating better performance.
Source: *Doingbusiness* database, The World Bank Group (http://www.doingbusiness.org/ExploreEconomies/)

Table 5: FDI Inflows: Cambodia, Lao PDR, and Viet Nam in Global Context

	1985–1989	1990–1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Value, $ million												
World	128,541	205,098	341,086	392,922	487,878	701,124	1,092,052	1,396,539	825,925	716,128	632,599	648,146
Developed economies	105,019	139,502	218,738	234,868	284,013	503,851	849,052	1,134,293	596,305	547,778	442,157	380,022
Transition economies in Eastern Europe	6	1,572	4,803	6,308	12,101	10,647	10,492	9,067	11,775	12,821	24,106	34,897
Developing economies	23,515	64,024	117,544	151,746	191,764	186,626	232,507	253,179	217,845	155,528	166,337	233,227
Developing Asia	12,197	38,670	77,717	90,006	100,925	91,459	109,695	141,955	101,483	86,318	94,755	137,705
Northeast Asia and PRC	7,082	22,542	46,545	56,069	61,823	65,503	77,265	116,162	78,611	67,205	71,928	104,890
PRC	2,620	16,028	37,521	41,726	45,257	45,463	40,319	40,715	46,878	52,743	53,505	60,630
Hong Kong, China	2,978	4,588	6,213	10,460	11,368	14,765	24,578	61,924	23,777	9,682	13,624	34,035
Taipei,China	790	1,154	1,559	1,864	2,248	222	2,926	4,928	4,109	1,445	453	1,898
Korea, Republic of	568	756	1,250	2,012	2,640	5,040	9,448	8,591	3,692	2,975	3,785	7,687
ASEAN	4,058	12,243	23,794	25,157	26,538	12,270	21,127	17,616	13,123	11,997	13,563	22,279
Brunei Darussalam	2	7	583	654	702	573	748	549	526	1,035	2,009	103
Indonesia	442	1,691	4,346	6,194	4,678	-241	-1,865	-4,550	-2,978	145	-597	1,023
Malaysia	799	4,423	5,815	7,297	6,323	2,714	3,895	3,788	554	3,203	2,473	4,624
Philippines	389	942	1,459	1,520	1,249	1,752	1,725	1,345	899	1,792	347	469
Singapore	2,427	5,181	11,591	9,493	13,586	7,472	16,624	16,485	14,122	5,822	9,331	16,060
GMS countries		3,736	5,305	5,987	8,647	11,196	8,952	5,682	6,000	3,038	4,383	3,899
PRC: Yunnan Province and Guangxi Zhuang AR		744	898	843	1,045	1,032	789	653	449	529	586	520
Cambodia	0	31	151	294	168	243	232	149	149	145	84	131
Lao PDR	1	23	88	128	86	45	52	34	24	25	19	17
Myanmar	11	167	318	581	879	684	304	208	192	191	291	556
Thailand	732	1,990	2,070	2,338	3,882	7,492	6,091	3,350	3,886	947	1,952	1,064
Viet Nam	3	780	1,780	1,803	2,587	1,700	1,484	1,289	1,300	1,200	1,450	1,610

	1985–1989	1990–1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
FDI inflow as a percentage of gross domestic investment												
Developed economies	3.6	3.4	4.5	4.8	5.9	10.3	16.4	21.6	11.9	11.0	8.8	7.4
Transition economies in Europe	0.0	3.7	4.7	5.2	10.4	12.5	15.8	11.4	11.8	11.3	16.8	19.3
Developing economies	3.5	5.8	8.2	9.8	11.8	12.5	16.1	16.3	14.2	9.8	10.6	15.0
Developing Asia	3.7	6.3	9.0	9.5	10.7	11.6	13.2	15.5	11.0	8.5	11.7	21.3
Northeast Asia and PRC	3.8	6.0	8.8	9.6	10.4	12.0	13.4	18.1	12.0	9.3	8.8	11.4
PRC	2.5	8.8	15.4	14.9	14.9	13.4	11.3	10.3	10.5	10.4	9.2	9.1
Hong Kong, China	22.9	15.2	14.4	21.4	19.5	29.4	58.6	138.9	55.7	25.8	32.2	71.1
Taipei,China	3.5	2.5	2.4	3.0	3.4	0.4	4.4	6.8	7.8	2.9	0.9	3.9
Korea, Republic of	1.3	0.6	0.7	1.1	1.6	5.3	8.4	6.6	3.2	2.3	2.7	4.9
ASEAN	8.9	13.6	16.5	14.9	16.0	13.3	23.2	17.3	13.9	11.8	11.5	20.3
Indonesia	2.0	4.3	7.6	9.2	7.7	-1.0	-6.6	-14.3	-10.0	0.4	-1.6	2.4
Malaysia	8.7	20.3	15.0	17.0	14.6	14.0	22.5	16.4	2.5	14.5	10.8	19.4
Philippines	5.7	7.7	8.9	7.8	6.2	12.7	11.9	8.4	6.4	11.9	2.2	2.7
Singapore	31.7	30.4	41.3	27.1	36.8	24.3	59.8	60.1	56.4	26.0	39.9	65.9
GMS countries	0.6	6.4	5.4	6.8	14.3	22.6	8.7	5.0	3.8	3.5	5.4	4.8
Cambodia	.0.09	12.0	34.6	72.4	38.9	65.7	48.7	29.1	27.5	21.0	9.5	11.7
Lao PDR	0.9	8.1	19.1	23.6	18.0	13.9	14.0	7.9	5.5	5.3	3.9	3.2
Viet Nam	0.3	33.5	33.8	27.8	35.1	22.9	20.1	15.0	13.9	11.6	12.7	12.7
Myanmar	0.6	6.9	10.2	16.0	24.9	21.1	7.2	3.8	2.9	3.0	4.6	8.9
Thailand	3.9	4.7	3.0	3.1	7.6	29.9	23.8	12.4	14.7	3.3	6.1	3.1
FDI inflows as a percentage of GDP												
Developed economies	0.8	0.7	0.9	1.0	1.2	2.2	3.5	4.6	2.5	2.2	1.6	1.2
Developing economies	0.8	1.4	2.1	2.5	3.0	3.1	3.8	3.8	3.3	2.4	2.3	3.0
Developing Asia	0.7	1.4	2.0	2.2	2.4	3.0	3.2	4.4	3.0	2.3	2.3	3.1

	1985–1989	1990–1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Northeast Asia and PRC	1.0	1.9	2.9	3.1	3.3	3.8	4.1	5.7	3.8	3.0	3.0	4.0
PRC	0.8	3.0	5.4	5.1	5.0	4.8	4.1	3.8	4.0	4.2	3.8	3.9
Hong Kong, China	5.6	4.2	4.4	6.7	6.5	8.9	15.3	37.4	14.6	6.0	8.5	21.6
Taipei,China	0.7	0.6	0.6	0.7	0.8	0.1	1.0	1.6	1.5	0.5	0.2	0.7
Korea, Republic of	0.4	0.2	0.3	0.4	0.6	1.6	2.3	1.9	0.9	0.6	0.7	1.3
ASEAN	2.2	3.9	5.2	4.9	5.3	3.9	5.5	4.3	3.4	2.7	2.8	4.1
Brunei Darussalam	0.0	0.2	11.2	12.4	13.7	14.7	17.7	12.7	12.7	24.2	43.4	2.1
Indonesia	0.5	1.2	2.2	2.7	2.2	-0.3	-1.3	-3.0	-2.1	0.1	-0.3	0.4
Malaysia	2.3	7.5	6.5	7.2	6.3	3.8	4.9	4.2	0.6	3.4	2.4	4.1
Philippines	1.0	1.7	2.0	1.8	1.5	2.7	2.3	1.8	1.2	2.3	0.4	0.6
Singapore	10.6	10.2	13.8	10.3	14.2	9.1	20.4	18.0	16.6	6.7	10.4	17.2
GMS countries	0.8	2.2	2.0	2.2	3.6	5.9	4.3	2.5	2.7	1.1	1.5	1.3
Cambodia			4.6	8.7	5.1	8.0	7.0	4.4	4.4	3.9	2.1	3.1
Lao PDR	0.2	1.7	5.0	6.8	4.9	3.5	3.5	2.0	1.4	1.4	1.0	0.7
Myanmar	0.1	0.9	1.4	2.4	3.4	2.5	0.9	0.5	0.4	0.3	0.5	0.9
Thailand	1.2	1.9	1.2	1.3	2.6	6.7	5.0	2.7	3.4	0.7	1.4	0.7
Viet Nam	0.0	6.3	8.6	7.3	9.4	6.2	5.2	4.1	3.9	3.4	3.8	3.9

Notes:
a) Annual average.
b) Based on the United Nations standard classification (under which all Asian countries other than Japan are classified as developing countries).
c) Developing Asia: South Asia + member countries of ASEAN + East Asia and the People's Republic of China (PRC).
d) For the Lao PDR, data refer to FDI inflows coursed through the banking system.
Source: Compiled from UNCTAD, *World Investment Report* (various years).

Table 6: ASEAN Countries: Source Country Composition of FDI Inflows (5-year average, %)[a]

Source Country	Host country							
	Cambodia 2001–05	Lao PDR 2001–05	Viet Nam 2001–05	Indonesia 2000–04	Malaysia 1999–2003	Philippines 1999–2003	Singapore 2000–2004	Thailand 1999–2003
Total ASEAN	23.57	48.03	20.05	3.17	19.75	10.16	4.26	13.67
GMS-5	10.79	44.11	2.71	3.16	0.13	0.24	0.94	0.04
Cambodia	0	0.04	0.01	0.00	0.01	0.00	0.00	0.02
Lao PDR	0	0	0.05	0.00	0.00	0.00	0.00	0.02
Viet Nam	2.04	19.27	0.00	0.00	0.02	0.01	0.01	0.00
Thailand	8.75	24.79	2.66	3.16	0.11	0.23	0.90	0.00
Myanmar	0	0.01	0.00	0.00	-0.01	0.00	0.03	0.00
Indonesia	0	0.00	0.49	0.00	1.01	0.38	1.28	0.13
Malaysia	9.72	2.56	3.35	1.82	0.00	0.77	1.74	0.53
Philippines	0.09	0.00	0.39	-0.04	0.46	0.00	0.16	0.09
Singapore	2.97	1.36	13.12	-1.15	16.70	8.76	0.00	12.89
Northeast Asia and PRC	70.99	13.09	34.94	7.18	3.27	12.02	4.67	10.66
PRC	50.40	10.57	0.77	-0.83	0.48	3.01	0.54	0.03
Korea, Rep. of	12.27	2.16	10.02	8.56	-0.41	2.33	0.35	0.58
Hong Kong, China	0.81	0	9.34	0.07	0.98	4.68	1.90	7.21
Taipei,China	7.51	0.38	14.80	-0.62	2.22	2.00	1.88	2.84
OECD	5.44	38.88	30.19	68.38	75.29	68.53	63.30	51.51
Australia	0.58	12.85	0.50	-8.27	0.93	0.86	-2.48	0.90
Canada	0.99	0.19	0.19	5.46	-0.93	0.03	4.02	0.07
France	1.40	16.81	3.48	8.66	0.56	2.74	2.28	2.63
Germany	0.00	0.07	0.32	9.00	13.68	1.27	0.35	2.32
Italy	0.00	0.00	0.04	0.01	0.21	0.08	-0.01	0.10
Japan	0.37	0.23	14.55	24.93	9.84	22.64	13.66	23.28
Netherlands	0.08	4.85	3.05	37.15	-2.67	4.13	8.47	2.52
New Zealand	0.00	0.00	0.01	0.01	0.12	-0.04	0.00	0.02
Sweden	0.00	0.54	0.68	-0.25	-1.06	0.11	1.08	0.61
UK	0.94	0.25	3.32	21.15	8.45	6.84	15.90	4.40
USA	1.07	0.75	3.85	-31.90	44.02	27.86	19.05	14.25
Others	0.00	2.34	0.20	2.43	2.13	2.00	0.99	0.42
Others	0.00	1.49	14.82	21.27	1.69	9.30	27.78	24.15
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a] A negative figure represents a net outflow of FDI.
Source: Compiled from ASEAN Secretariat (2005), *ASEAN Statistical Yearbook 2005*.

Table 7: Cambodia: Source Country Composition of FDI Inflows, 1994–2005 (%)

Source Country/Region	1994–1999	2000–2004	2005	1994–2005
OECD countries	20.0	10.7	4.4	16.9
Australia	0.8	0.4	0.9	0.8
Canada	1.4	1.1	0.8	1.3
France	4.5	2.1	1.1	3.8
Germany	0.0	0.0	0.0	0.0
Japan	0.4	0.7	0.0	0.4
Netherlands	0.3	0.2	0.0	0.3
Sweden	0.3	0.0	0.0	0.2
UK	3.7	3.2	0.9	3.3
USA	8.2	3.0	0.6	6.6
Others	0.4	0.0	0.0	0.3
ASEAN	54.0	29.9	19.4	46.8
Indonesia	1.2	2.3	0.0	1.2
Malaysia	43.7	13.8	3.8	35.1
Philippines	0.0	0.2	0.0	0.0
Singapore	5.2	2.7	3.7	4.7
Thailand	3.8	7.3	11.9	5.2
Viet Nam	0.0	3.6	0.0	0.5
Northeast Asia and PRC	25.9	59.3	76.2	36.2
PRC	5.7	26.3	66.2	15.7
Hong Kong, China	5.5	2.0	0.2	4.4
Korea, Rep. of	4.5	16.4	8.2	6.4
Macau	0.0	0.0	0.0	0.0
Taipei,China	10.1	14.7	1.5	9.6
Others	0.1	0.0	0.0	0.1
Total (%)	100.0	100.0	100.0	100.0
Total ($ million)	4,139.7	664.8	682.4	5,487.0

Source: Compiled from data provided by the Cambodian Investment Board, Phnom Penh.

Table 8: Lao PDR: Source Country Composition of Approved FDI, 1988–2005 (%)

Source Country/Region	1988–1994	1995–1999	2000–2004	2005	1988–2005	Number of Projects, 1988–2005
OECD countries	15.18	37.03	35.41	31.90	31.30	397
Australia	2.03	28.36	18.97	0.20	14.82	56
Belgium	0.04	0.13	0.01	0.00	0.05	8
Canada	0.20	1.17	0.28	0.00	0.49	19
Denmark	0.02	0.02	0.00	0.00	0.01	5
France	1.26	1.42	2.40	31.67	7.88	121
Germany	0.16	0.09	0.11	0.00	0.09	18
Italy	0.01	0.04	0.06	0.01	0.04	6
Japan	0.26	0.97	0.51	0.01	0.50	42
Netherlands	0.05	0.01	7.20	0.00	2.07	5
Norway	5.10	0.07	1.34	0.00	1.39	6
Sweden	0.03	0.04	0.80	0.00	0.25	8
Switzerland	0.02	0.00	2.06	0.00	0.59	8
UK	0.28	1.23	0.36	0.01	0.55	23
USA	5.73	0.62	1.11	0.00	1.62	58
European transition economies	2.69	0.03	0.26	0.00	0.61	25
Russia	2.68	0.03	0.25	0.00	0.60	23
Ukraine	0.02	0.00	0.00	0.00	0.00	1
Cuba	0.00	0.00	0.01	0.00	0.00	1
ASEAN	55.48	56.49	42.36	41.24	49.13	491
Cambodia	0.00	0.01	0.13	0.00	0.04	4
Myanmar	0.00	0.00	0.01	0.00	0.00	2
Thailand	51.71	37.04	10.19	37.40	32.27	339
Viet Nam	0.22	0.93	26.16	3.58	8.55	73
Indonesia	0.49	0.00	0.00	0.00	0.09	2
Malaysia	2.41	17.67	3.85	0.25	7.20	41
Singapore	0.64	0.84	2.03	0.01	0.97	30
Northeast Asia and PRC	11.30	5.79	17.95	3.80	9.92	345
PRC	6.20	3.76	14.15	3.08	7.06	198
Korea, Rep. of	0.45	1.14	3.26	0.73	1.53	107
Taipei,China	4.66	0.88	0.54	0.00	1.33	40
Others	15.34	0.66	4.01	23.06	9.05	9
Total	100.00	100.00	100.00	100.00	100.00	1,267
$ million	1,097	1,797	1,625	1,166	5,686	

Source: Compiled from data provided by the Committee for the Promotion and Management of Investment, Vientiane.

Table 9: Viet Nam: Source Country Composition of Approved FDI, 1988–2005

Source Country/Region	1988–1999		2000–2005	
	Number of projects	Approved Investment (%)	Number of projects	Approved Investment (%)
OECD countries[a]	848	30.6	741	36.1
Australia	92	3.0	23	4.8
Belgium	12	0.1	13	0.2
Canada	34	0.6	20	0.4
Denmark	6	0.1	27	0.9
France	149	5.8	15	0.3
Germany	35	0.6	36	0.9
Italia	---	0.0	21	0.4
Japan	270	9.1	330	19.6
Luxembourg	---	0.0	15	5.8
Netherlands	39	1.6	23	10.2
Norway	7	0.1	7	0.1
Sweden	9	1.0	2	0.2
Switzerland	30	1.7	3	0.4
UK	37	3.2	31	0.5
USA	108	3.5	157	1.0
Others	20	0.3	18	1.5
European Transition economies	79	4.4	---	---
Russia	62	4.1	---	---
Czech Republic	5	0.1	---	---
ASEAN	495	23.2	309	19.8
Lao PDR	4	0.0	3	0.1
Thailand	126	2.9	4	2.8
Brunei			15	0.2
Indonesia	18	0.9	13	0.9
Malaysia	80	3.0	104	3.2
Philippines	27	0.6	3	0.0
Singapore	238	15.8	165	12.5
Northeast Asia and PRC	1,118	31.0	2,085	43.7
PRC	88	0.4	269	4.4
Taipei,China	458	12.4	964	22.8
Korea, Rep. of	266	8.5	798	15.7
Hong Kong, China	306	9.7	54	0.8
Other countries[b]	260	10.7	95	0.4
TOTAL	2,800	100.0	3,230	100.0
$ million		37,088		13,930

--- = not covered in given year.
[a] OECD Europe, Australia, New Zealand, and Japan.
[b] Predominantly tax-haven islands.
Source: Compiled from data provided by the Ministry of Planning and Investment, Hanoi.

Table 10: Cambodia: Sectoral Distribution of Approved FDI, 1994–2005 (%)

Sector	1994–1999	2000–2004	2005	1994–2005	No. of Projects, 1994–2005
Agriculture	5.51	5.83	2.55	5.15	95.00
Mining	0.36	0.57	17.01	2.65	16.00
Manufacturing	35.26	28.52	59.58	37.56	814.00
Food processing	1.92	3.84	11.25	3.47	47.00
Garment	6.88	16.26	46.5	30.33	466.00
Textiles	1.20	1.58	0.00	1.09	10.00
Others	25.27	6.84	1.68	2.68	291.00
Construction	5.95	7.14	3.38	5.78	29.00
Electricity and gas	2.50	7.42	7.05	3.84	15.00
Services	43.43	50.53	10.42	40.00	153.00
Tourism	35.63	32.49	9.77	31.66	87.00
Total	100.00	100.00	100.00	100.00	1,122.00
$ million	5,559	1,142	1,050	7,751	

Source: Compiled from data provided by the Cambodian Investment Board, Phnom Penh.

Table 11: Lao PDR: Sectoral Distribution of Approved FDI, 1988–2005 (%)

Sector	1988–1994	1995–1999	2000–2004	2005	1988–2005	No. of projects, 1988–2005
Agriculture	2.04	4.68	6.24	38.83	4.64	152
Mining	0.96	2.27	22.46	45.94	8.35	86
Industry	74.51	76.66	52.74	6.35	67.87	489
Electricity	59.24	30.44	36.26	0.00	42.22	24
Telecommunication	3.47	31.59	2.48	0.00	12.34	17
Construction	2.54	0.87	3.36	0.00	2.20	580
Manufacturing	9.25	13.76	10.64	6.35	11.10	390
Handicrafts	3.56	7.55	8.61	5.04	6.38	243
Wood Industries	3.32	5.50	1.29	1.31	3.41	62
Garment	2.37	0.71	0.74	0.00	1.31	85
Services	22.48	16.38	18.55	8.88	19.14	541
Hotel-Restaurant	14.93	12.05	4.37	1.58	10.68	93
Trading	2.35	0.85	2.73	7.02	2.03	176
Banking	2.55	1.17	0.62	0.00	1.49	10
Consultancies	0.25	0.13	0.26	0.14	0.21	58
Other Services	2.40	2.19	10.57	0.14	4.72	204
Total	100.00	100.00	100.00	100.00	100.00	1,268
$ million	1,097	1,796	1,625	1,166	5,684	1,268

Source: Compiled from data provided by the Committee for the Promotion and Management of Investment, Vientiane.

Table 12: Viet Nam: Sectoral Distribution of Cumulative Approved Investment —1991, 1995, 2000, 2005 (%)[a]

Sector	1991	1995	2000	2005
Primary production	50.64	27.93	16.36	25.74
Crude oil	45.21	24.10	10.51	19.80
Agriculture and forestry	5.43	3.82	5.85	5.93
Manufacturing Industry	15.66	33.66	49.01	41.93
Foodstuff	3.41	18.17	23.85	6.77
Sea food	1.77	10.21	14.90	0.56
Textile, clothing and footwear	2.18	0.52	0.74	11.23
Others	8.30	4.77	9.53	23.38
Construction	---	3.26	4.69	16.74
New resident park	---	---	---	8.31
New cities	---	---	---	0.18
Office-building	---	---	---	6.36
EPZ&IZ infrastructure construction	---	---	---	1.88
	---	---	---	---
Service	20.99	26.44	18.86	15.59
Transportation & Telecommunications	10.12	7.10	4.67	2.65
Hotel-tourism	7.60	12.18	9.69	8.37
Finance-Banking	2.77	4.93	2.48	2.30
Cultural-Health-Education	0.03	0.03	0.15	1.02
Others	0.46	2.21	1.87	1.27
Total	100.00	100.00	100.00	100.00

---Data not available.
[a] Figures for a given year show the shares in cumulative approved investment since 1988.
Source: Compiled from data provided by the Ministry of Planning and Investment, Hanoi.

Table 13: Viet Nam: Spatial Distribution of FDI, 1988–2005[a]

	1988	1990	1995	2000	2005
Mountain North	0.27	0.16	0.92	0.71	1.57
Red River Delta	0.49	16.91	27.08	29.27	28.39
Ha-noi	0.41	13.79	17.66	19.30	18.27
Hai-phong	0.00	0.91	4.64	3.54	3.99
Hai-duong	0.00	0.84	0.87	1.28	1.41
Central Coast	27.36	8.28	7.38	9.20	5.35
Thanh-hoa	0.00	0.16	2.37	1.11	1.40
Da-nang	27.28	6.58	3.11	2.04	0.95
Central High Land	0.00	0.20	0.66	2.40	0.52
Dak Nong	0.00	0.00	0.00	0.00	0.02
South East	69.54	73.13	60.55	56.03	61.16
Ho Chi Minh City	19.36	40.44	33.85	27.80	23.99
Dong-nai	0.00	1.04	10.97	8.54	16.65
Baria-Vungtau[b]	50.18	31.57	12.44	13.58	9.38
Mekong Delta	2.34	1.32	3.40	2.39	3.00
Long-an	0.00	0.13	0.69	0.73	1.50
Can-tho	1.39	0.51	0.32	0.39	0.22
Total	100.00	100.00	100.00	100.00	100.00

[a] Figures for a given year show the shares in cumulative approved investment since 1988.
[b] Includes investment in the petroleum industry
Source: Compiled from data provided by the Ministry of Planning and Investment, Hanoi.

Table 14: Viet Nam: Foreign Invested Enterprises in the Vietnamese Economy: Key Indicators, 1995–2003

FIEs' share in …	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP	6.3	7.4	9.1	10	12.2	13.3	13.8	13.8	14.5
Gross domestic investment	32.3	28.6	31.3	25	18.2	18.7	18.4	18	17.5
Gross industrial output	25.1	26.7	28.9	32	34.7	35.9	35.3	35.4	36.0
Fixed capital in industrial enterprises	---	---	---	---	---	---	35.9	34.1	30.9
Employment in industrial enterprises (total)	---	---	---	---	---	---	11.5	12.4	14.8
Employment in industrial enterprises (female)	---	---	---	---	---	---	16.3	18.6	22.9

--- = Data not available.
Source: Compiled from General Statistics Office, *Statistical Data of Vietnam Socio-Economy*. Hanoi: Statistical Publishing House (various issues).

Table 15: Viet Nam: Contribution of Foreign Invested Enterprises to Industrial Employment, 2000–2003

VSIC Number/Industry	Employment ('000) [a]	FIE Share in Employment [a] (%)	Composition of FIE Employment [a] (%)	Growth of FIE Employment [a] (%)	Growth of Employment in Local Firms [a] (%)	FIE Share in Employment Increment from 2000 to 2003 (%)	Average Wage of FIEs (dong million) [a,b] (%)	Average Wage of Local Firms (dong million) [a,b] (%)
Total industry	2,253	19.9	100.0	22.7	8.3	44.6	17.0	12.5
(A) Mining and Quarrying	149	4.4	1.2	3.8	2.1	11.2	101.5	13.9
10: Mining of coal and lignite	74	0.4	0.0	(19.1)	2.9	(3.8)	19.3	18.2
11: Extraction of crude petroleum and gas	7	88.0	1.1	3.8	(20.8)	100.0	112.0	38.9
13: Mining of metal ores	7	1.4	0.0	34.7	15.8	2.5	32.5	11.5
14: Other mining and quarrying	62	0.5	0.1	18.4	0.9	(11.2)	16.9	8.8
(B) Manufacturing	2,024	22.3	98.6	23.0	9.2	45.6	15.9	11.5
15: Food products and beverages	317	12.9	7.6	10.9	8.1	17.1	24.2	10.3
16: Tobacco products	13	2.8	0.0	(2.3)	4.3	(2.7)	19.5	29.6
17: Textiles	144	19.6	5.4	11.5	6.5	31.3	14.2	9.9
18: Wearing apparel	317	19.2	17.2	43.3	9.9	58.6	11.7	10.4
19: Footwear and leather products	373	38.5	30.8	22.4	5.7	75.2	11.8	8.3
20: Wood and wood products	69	14.9	1.6	14.2	13.4	11.0	12.9	7.5
21: Paper and paper products	44	10.7	1.1	21.1	7.5	29.0	17.4	12.5
22: Publishing and printing	28	1.7	0.1	40.6	9.0	9.1	20.6	20.1
23: Coke and refined petroleum products	1	48.7	0.1	7.0	9.5	(1.5)	92.6	15.2
24: Chemicals and chemical products	72	14.3	2.3	14.6	4.4	38.1	35.8	17.2
25: Rubber and plastic products	68	27.0	3.6	22.3	15.4	37.0	16.5	13.9
26: Non-metallic mineral products	161	8.1	2.6	16.3	11.3	11.9	28.7	12.6
27: Manufacture of basic metals	33	8.8	0.6	15.1	5.7	22.1	37.1	18.1
28: Fabricated metal products	65	21.0	2.7	21.4	17.3	26.2	20.5	11.4
29: Machinery and equipment n.e.c.	43	10.0	0.8	16.1	11.1	15.4	22.2	12.7

VSIC Number/Industry	Employment ('000) [a]	FIE Share in Employment [a] (%)	Composition of FIE Employment [a] (%)	Growth of FIE Employment [a] (%)	Growth of Employment in Local Firms [a] (%)	FIE Share in Employment Increment from 2000 to 2003 (%)	Average Wage of FIEs (dong million) [a,b] (%)	Average Wage of Local Firms (dong million) [a,b] (%)
30: Office, accounting and computing machineries	3	98.3	0.6	11.6	66.1	79.9	21.7	15.6
31: Electrical machinery and apparatus n.e.c.	50	56.8	5.3	15.9	9.5	70.2	17.7	20.8
32: Radio, television and communication equipment	20	49.2	2.0	15.7	1.4	98.3	22.9	17.8
33: Medical and optical instruments, watches and clocks	9	45.8	0.8	17.5	9.5	62.8	21.3	12.2
34: Motor vehicles, trailers and semi-trailers	22	32.5	1.5	24.2	14.5	47.3	23.9	12.9
35: Other transport equipment	56	22.4	3.2	32.7	9.2	57.1	19.4	13.6
36: Manufacture of furniture, manufacturing n.e.c.	117	34.6	8.6	31.4	19.0	50.0	12.8	10.1
(C): Electricity, gas and water supply	80	1.0	0.1	0.8	4.8	0.2	48.3	29.8
37: Electricity, gas, steam and hot water supply	63	1.2	0.1	0.9	4.3	0.2	47.5	33.0
38: Collection purification and distribution of water	17	0.5	0.0	0.8	6.6	0.0	55.7	17.9

( ) = negative, VSIC = Viet Nam Standard Industry Classification (based on the International Standard Industry Classification, ISIC).
n.e.c. = not elsewhere classified.
[a] Period average.
[b] At constant (2000) price.
Source: Compiled from unpublished returns to the Annual Manufacturing Census (2000, 2002, 2003, 2004) provided by the General Statistics Office, Hanoi.

Table 16: Viet Nam: Export Performance of Foreign Invested Enterprises

Year	Exports of FIEs, $ million			FIE share in …	
	Total	Crude oil	Others	Total Exports	Share in Non-Oil Exports
1991	52	0	52	2.5	2.5
1992	112	0	112	4.3	4.3
1993	269	0	269	9.0	9.0
1994	352	0	352	8.7	8.7
1995	1,473	1,033	440	27.0	10.0
1996	2,132	1,346	786	29.4	13.3
1997	3,203	1,413	1,790	34.9	23.0
1998	3,215	1,233	1,982	34.3	24.4
1999	4,682	2,092	2,590	40.6	27.4
2000	6,811	3,491	3,320	47.0	30.2
2001	6,796	3,123	3,673	45.2	30.9
2002	7,877	3,275	4,602	47.2	34.3
2003	10,161	3,821	6,340	50.4	38.8
2004	14,487	5,671	8,816	54.7	42.3
2005	17,300	7,000	10,300	56.4	43.5

Source: Compiled from data provided by the General Statistics Office, Hanoi.

Table 17: Viet Nam: Commodity Composition of Exports by Foreign Invested Enterprises, 1996–2004

VSIC	Industry	1996	1997	1998	1999	2000	2001	2002	2003	2004
15	Food products and beverages	7.80	5.71	4.32	6.15	4.94	5.67	5.10	3.46	10.89
16	Manufacture and tobacco products	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
17	Manufacture of textiles	17.21	8.20	6.69	7.50	6.55	5.33	4.84	3.10	4.18
18	Manufacture of wearing apparel	11.37	7.80	9.22	6.65	10.05	11.30	14.22	13.70	7.69
19	Manufacture of leather products	33.06	32.53	27.14	30.37	21.73	23.43	22.30	29.00	12.17
20	Manufacture of wood and wood products	0.01	0.01	0.00	0.01	0.02	0.37	0.54	0.05	0.61
21	Paper and paper products	0.66	0.15	0.04	0.23	0.44	0.68	0.66	0.12	0.91
22	Publishing and printing	0.01	0.00	0.00	0.00	0.00	0.00	0.05	0.11	0.19
23	Coke and refined petroleum products	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
24	Chemicals and chemical products	2.13	2.30	1.97	2.67	3.34	4.45	3.44	1.74	3.43
25	Rubber and plastic products	1.49	1.01	1.06	1.10	1.46	1.68	1.86	1.34	3.13
26	Manufacture of other non-metallic mineral products	1.21	1.29	0.98	0.73	1.37	1.30	1.43	0.39	0.73
27	Manufacture of basic metals	0.12	0.13	0.26	0.01	0.75	0.70	0.74	0.44	1.44
28	Fabricated metal products	0.45	1.03	2.49	1.64	2.37	2.59	2.98	1.50	1.99
29	Machinery and equipment n.e.c.	1.23	0.82	1.06	1.98	6.07	4.83	4.97	8.20	12.72
30	Office, accounting and computing machineries	0.00	0.00	0.00	0.00	0.00	0.00	0.07	0.25	0.31
31	Electrical machinery and apparatus n.e.c.	19.46	32.34	35.69	35.95	30.39	24.55	22.20	26.70	25.63
32	Radio, television and communication equipment	0.21	2.27	4.18	0.90	1.54	2.33	2.20	0.83	1.30
33	Medical and optical instruments, watches and clocks	0.59	0.31	0.50	0.24	0.44	0.23	0.94	0.37	0.59
34	Motor vehicles, trailers and semi-trailers	0.09	0.41	0.22	0.57	0.69	1.43	2.91	1.10	1.72
35	Manufacture of other transport	0.00	0.00	1.19	0.79	3.02	4.49	4.11	2.33	5.94
36	Manufacture of furniture, manufacturing n.e.c.	2.92	3.70	3.00	2.50	4.82	4.65	4.42	5.30	4.45
	Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
	Total ($ million)	658	1,141	1,529	1,767	2,917	2,963	3,985	3,369	1,987

n.e.c. = not elsewhere classified, VSIC = Viet Nam Standard Industry Classification (based on the International Standard Industry Classification, ISIC).
Source: Compiled from data provided by the General Statistics Office, Hanoi.

Table 18: Viet Nam Manufacturing: Estimates of Productivity Growth and Related Data (2000–2003)

VSIC Number/Industry	FIE Share in Output (%)	Composition Output (%)			Growth of Capital Intensity (%)			Labor Productivity Growth (LPG) (%)			Total Factor Productivity Growth (TFPG) (%)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
		Total	FIEs	Local	Total	FIEs	Local	Total	FIEs	Local	Total	FIEs	Local
D: Manufacturing	38.9	70.4	54.1	85.5	0.01	-5.12	2.86	0.3	-2.4	1.0	1.2	2.2	0.6
15: Food product and beverages	34.5	20.1	13.5	26.2	-0.06	-3.24	1.65	8.5	4.0	10.5	2.3	1.7	2.6
16: Tobacco products	0.5	4.4	0.0	8.5	1.98	-22.80	2.92	6.5	2.2	6.4	-2.1	3.4	-2.1
17: Manufacture of textiles	33.8	3.0	2.2	3.7	0.55	-1.87	1.53	3.6	12.4	-0.6	5.3	6.9	4.1
19: Footwear and leather products	60.1	3.7	5.0	2.5	0.09	-3.36	2.12	-5.1	-6.6	-5.7	-0.6	-1.2	-0.1
20: Wood and wood products	21.2	1.1	0.4	1.8	1.43	1.96	1.64	-16.5	-14.5	-16.9	-5.8	-8.1	-5.2
21: Paper and paper products	15.0	1.4	0.5	2.3	0.78	-7.46	2.70	-11.2	-3.7	-12.5	-0.8	-1.0	-0.9
22: Publishing and printing	2.0	1.4	0.0	2.6	2.43	4.48	2.40	2.2	-6.4	2.5	2.2	0.5	2.3
24: Chemicals and chemical products	44.3	5.2	4.4	5.9	2.57	-1.84	3.63	-4.4	-4.6	-6.6	-3.4	-2.2	-4.5
25: Rubber and plastic product	33.4	2.8	1.8	3.7	-0.47	-4.43	2.01	-5.0	-7.5	-3.9	-0.5	1.2	-1.6
26: Non-metallic mineral products	27.2	8.6	4.2	12.7	-2.56	-9.35	1.59	-0.6	-1.5	-0.9	0.6	1.2	0.1
27: Basic metal products	31.8	2.2	1.7	2.7	7.55	-3.06	14.38	1.1	-6.6	3.6	1.9	-1.8	4.2
28: Fabricated metal products	40.3	2.1	1.7	2.5	-1.26	-5.78	2.40	-18.3	-17.2	-20.1	-14.3	-10.2	-17.6
29: Machinery and equipment n.e.c.	33.8	1.3	0.8	1.8	2.37	-4.41	5.08	1.2	-2.4	2.1	2.3	2.2	2.2
30: Office, accounting and computing machineries	99.0	0.4	0.8	0.0	-7.45	-6.82	1.10	-3.4	-2.7	2.3	10.8	11.1	-3.0
31: Electrical machinery and apparatus n.e.c.	63.4	2.4	3.2	1.7	-0.06	-2.46	4.43	23.2	18.9	31.3	9.8	9.1	10.8
32: Radio, television and communication equipment	68.9	1.7	2.5	1.0	-1.78	-4.23	0.46	-3.1	-1.4	-9.5	0.3	0.3	-0.4
34: Motor vehicles, trailers and semi-trailers	80.6	2.6	4.3	1.1	4.42	1.05	8.53	-17.8	-18.8	-21.7	-5.1	-6.4	-0.7
35: Other transport equipment	61.5	3.4	4.3	2.5	2.11	-5.73	6.47	17.0	2.6	1.6	17.9	18.6	16.5
36: Furniture, manufacturing n.e.c.	44.9	2.0	1.9	2.1	2.90	-1.04	5.84	-5.6	-7.4	-4.6	1.1	-0.4	2.1

Notes: n.e.c. = not elsewhere classified, VSIC = Viet Nam Standard Industry Classification (based on the International Standard Industry Classification, ISIC).
LPG = $G_o - G_L$, where G_o and G_L denote annual compound growth of output (value added), and labor (number of production workers).
TFPG = $G_O - S_L G_L - S_K G_K$ where, G_O, G_L, G_K denote annual compound growth of output (value added), labor and the stock of capital; and S_L , and S_K denote the average value shares of labor, capital, and materials in output.
Estimates are based on data compiled from unpublished returns to the annual Industrial Census conducted by the General Statistics Office (GSO) during the 4 years 2000-2003. Firm-level data were aggregated to 3-digit VSIC using a concordance map provided by the GSO. The real output (value added) series was derived by deducting real intermediate inputs from real gross output. Nominal gross output is deflated by two-digit level producer price indices. Intermediate input price indices were derived by applying input weights (derived from the 2000 Input-Output Table) to two-digit producer price indices. Capital stock data were deflated by the implicit deflator for fixed capital formation derived from the national accounts. Labor input share is estimated as the share of nominal wages in nominal value added. Clothing (VSIC 38), coke and refined petroleum products (VSIC 23) and medical and optical products (VSIC 33) are not covered in the estimates because of serious data gaps which made it difficult to construct reliable data series on the capital stock.

Table 19: Cambodian Garment Industry: Key Performance Indicators, 1995-2004

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Investment ($ million)	30	46	97	123.6	66.5	37.2	19.5	36.5	25.0	---
Number of factories	20	24	67	129	152	190	186	188	197	206
Employment ('000)	19	24	52	79	97	123	188	210	234	246
Exports ($ million)	26	106	224	355	653	965	1,120	1,338	1,582	1,987
Export as % of total merchandise exports	3.1	11.2	27.1	45.2	58.7	70.8	73.9	76.8	78.2	83.6
Wages paid to Cambodian workers ($ million)							12.6	15.1	15.9	15.4

Source: Cambodia Development Resource Institute (CDRI) (2005), Tables 3.1 and 3.2.

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