A REVIEW OF INVESTMENT INCENTIVES IN ASEAN COUNTRIES

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A REVIEW OF INVESTMENT INCENTIVES IN ASEAN COUNTRIES

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Rosario G. Manasan*

1. INTRODUCTION

Most developing countries offer tax concessions to promote investments, in general, and to direct resources into selected activities and/or locations, in particular. The ASEAN countries are no exception to this "rule".

Investment incentives, per se, in ASEAN countries are usually designed to provide equal inducements to qualified foreign and domestic investors. Moreover, all countries in the aggrupation with the exception of Singapore impose certain limitations on foreign equity participation in domestic activities. These regulations are further modified by performance requirements and saturation laws.[1/]

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The views expressed in this study are those of the author and do not necessarily reflect those of the Institute.

However, it is apparent that there is a conscious effort on the part of most developing countries, the ASEAN countries included, to attract foreign direct investment. Thus, all ASEAN countries supplement their tax incentives with various guarantees covering expropriation, losses due to nationalization, war, and inconvertibility of currency, remittances of profits, dividends and interest payments, and repatriation of capital (see Annex Table 1). It has been observed that countries, particularly those in the same geographical area, engage in some form of competition for foreign capital by trying to outbid each other in terms of providing more generous investment incentives than their neighbors (Shah and Toye, 1978). Recent reforms in the area of investment incentives undertaken by some ASEAN member countries and the concomitant policy discussions attest to this.

Given this perspective, there appears to be a need to review the investment incentives of the ASEAN countries for the purpose of assessing their competitiveness from the point of view of individual investors. To achieve this, this paper will attempt to quantify the impact of the investment incentives on the profitability of prospective projects. Specifically, this study will quantify the effect of the incentive provisions of the different countries on the inter[illegible]ate of return of hypothetical projects. This approach, in effect, finesses the largely unsettled issue of

whether tax incentives are effective or not in increasing the overall level of investment, or, at the very least, in influencing the composition of total investment (Shah and Toye, 1978; Galenson, 1984).

On another vein, optimum tax theory suggests that investment incentives should be neutral with regards to both production and consumption choices. In this light, a number of scholars have expressed concern over the unintended distortion introduced by tax incentives and the resulting reduction in the overall level of economic efficiency (Williamson, 1971; ILO, 1974; Power and Bautista, 1979). They have pointed that a number of investment incentives are non-neutral in their treatment of capital and labor. In particular, these incentives directly bear on the user cost of capital. By altering relative factor prices faced by promoted enterprises, these incentives may adversely affect relative factor intensities in preferred activities. This study will also assess the impact of the investment incentives of ASEAN countries on the user cost of capital.

To summarize, this paper will (1) provide a broad overview of the investment incentive schemes made available by ASEAN countries in the context of their overall tax systems; (2) appraise the impact of these tax incentives on the profitability of prospective investments; and (3) quantify the changes induced by the investment incentives on the user cost of capital.[2/]

2. NATURE OF INVESTMENT INCENTIVES IN ASEAN COUNTRIES

Various writers have experimented with different classification schemes in analyzing investment incentives. Some have grouped incentives according to (1) whether or not their subsidy equivalent is some function of the scale of the capital outlay; and (2) whether or not their subsidy equivalent is some function of the level of the enterprise's profits . Others have focused on whether the benefits obtainable from the incentives are made available up front at the start of the project or are spread out over an extended period. These distinctions are helpful in deciphering both the usefulness of the incentives from the point of view of the individual investors and the biases inherent in particular forms of incentives.

Annex Table 2 presents the tax concessions offered by the ASEAN countries. All countries in the group grant promoted enterprises exemption from duties and taxes on imported capital equipment. It has been noted that this incentive is valuable to the firm because it is an up front incentive whose benefits accrue to the project regardless of the enterprise's level of profits. This incentive also provides relief from the cash flow difficulties common in the initial year that are usually perceived to be a stumbling block to the investment decision. On the other hand, the amount of benefit arising from this incentive

hinges on the size of the investment outlay and is, therefore, biased in favor of capital use.

Another capital-related incentive, the investment allowance, is available in three of the countries under study. Malaysia provides for the additional deduction from taxable income of up to 100 percent of the value of qualified capital expenditures of promoted activities that do not enjoy pioneer status while expansion projects are allowed a 25 percent investment allowance. Singapore offers an investment allowance equal to a maximum of 50 percent of the value of approved capital expenses of promoted activities that are not enjoying the concessions granted to pioneer firms. The Philippines permits 100 percent of the cost of infrastructure expenditures of registered enterprises locating in promoted areas to be deductible from taxable income in the year they are incurred. It should be pointed out the investment allowance is of value to the registered firms only if they have profits against which to charge it. This problem may be alleviated but is not totally eliminated by the presence of loss carry forward provisions.

Accelerated depreciation is granted by Malaysia (for investments incurred before December 31, 1988) and Singapore to promoted firms. Both countries permit approved capital expenditures to be written off in three years from date of purchase. On the other hand, accelerated

depreciation is a regular feature of the tax systems of Indonesia and Thailand. This incentive shares the shortcomings of the investment allowance as discussed above.

Of all the ASEAN countries, only Indonesia does not grant an income tax holiday. The duration of the tax holiday offered in the other four countries ranges from three to ten years at the maximum. All countries allows for the extension of the basic tax relief period if the registered enterprise meets a minimum level of net foreign exchange earnings, a prescribed capital-labor ratio, a pre-determined rate of indigenous raw material utilization or locational requirements. At the same time, Thailand varies the duration of its tax holiday provision according to the size of the investment or the number of jobs created by the promoted activity. The income tax holiday has been described as a "perverse" type of incentive in that it provides little or no assistance when it is needed most, i.e., in the initial years of operation when firms (especially infant industries) are likely to suffer losses or to make little profits. On the other hand, firms which are highly profitable in the early years of its life would benefit the most from this provision. Furthermore, the benefits of the income tax holiday do not accrue to the foreign investor from a capital exporting country that taxes its citizens and corporations incorporated within its borders on a global income basis unless tax sparing

arrangements exist between the home and the host countries. Tax sparing agreements allow the foreign investor to credit income taxes not paid to the host country because of the income tax holiday against income taxes due in the home country.

Like other incentives whose benefits are contigent on the target enterprises' profitability, the income tax holiday becomes more meaningful in the presence of a loss carry forward provision. All ASEAN countries except the Philippines have included this as a regular feature of their general tax structures. The loss carry forward provision also minimizes the other incentives' bias against long-term and high risk projects.

Both Malaysia (to all promoted investments, in general) and Singapore (to a more limited degree) permit depreciation allowances to be deferred to the post income tax holiday period. This feature of their incentive systems increases the value of their tax holidays to the prospective investors.

The Philippines is the only country in the association that offers an employment-based incentive. It is in the form of an additional deduction from taxable income, available in the first 5 years from the date of registration, of an amount equal to 50 percent of the incremental labor expense. However, the income tax holiday

provision renders this incentive redundant to a large extent.

Aside from the exemption from or tax credit for duties and taxes on raw materials used in export production that is generally made available in all ASEAN countries, Malaysia, Singapore and Thailand grant other incentives that are specifically geared to the promotion of exports. Thailand permits exporter to deduct from taxable income an amount equal to 5 percent of incremental income from exports. Both Malaysia and Singapore allow the double deduction of promotional expenses for exports. In addition to this, Malaysia provides for the additional deduction of an amount equal to some proportion x of taxable income (where x is computed as the ratio of 50 percent of export sales to total sales) and 5 percent of the value of indigenous raw materials used for export production.

Finally, all countries with the exception of Indonesia offer incentives to enterprises locating in preferred geographical areas.

3. IMPACT OF THE INVESTMENT INCENTIVES ON THE INTERNAL RATE OF RETURN

The effect of the different incentives on the direction of investments may be evaluated by quantifying the impact of these incentives on some measure of the registered enterprise's profitability. Implicit in this approach are the following assumptions: (1) entrepreneurs base their

investment decisions on some measure of profitability; (2) they perceive additional profits attributable to the incentives as such; and (3) they react to the incentive-induced increments in after-tax profits in the same manner that they would respond to changes in the level of profitability arising from variations in other economic variables, other things being equal. This procedure also abstracts from other factors that are not explicitly included in the profitability measure used.

Using survey data, Allen (1979) and Lindsey (1980), found that political and economic stability, size and growth potential of the domestic market, availability of raw materials, etc. are the major consideration in the investment decision of foreign investors. In the analysis undertaken, it is also assumed that these important factors are equal in the countries under study.

In this paper, the concept of the internal rate of return (IRR) is used to trace the impact of the various incentives on the profitability of promoted enterprises. The pre-tax internal rate of return is defined by the following relationship:

$$\sum_{j=1}^{u} \frac{x}{(1+r_o)^j} - q = 0 \qquad (1)$$

where q is the initial outlay or the acquisition cost of capital ; x is the annual pre-tax profit stream; r_o is the

IRR before taxes; and, n is the life span of the capital asset.

On the other hand, the after-tax internal rate of return may be obtained from:

$$\sum_{j=1}^{u} \frac{(1-u)x + ud_j}{(1+r_T)^j} - (1+tm)q = 0 \qquad (2)$$

where u is the income tax rate; r_T is the after-tax IRR; tm is the tariff rate on capital; and d is the amount of depreciation charges that may be deducted from gross income for tax purposes in year j.[3/] With an income tax holiday of n_1 years, (2) becomes:

$$\sum_{j=1}^{n_1} \frac{x}{(1+r_H)^j} + \sum_{j=n_1+1}^{n} \frac{(1-u)x + ud_j}{(1+r_H)^j} - (1+tm)q = 0 \qquad (3)$$

where r_H is the IRR with the tax holiday.

The exemption of capital from tariff charges reduces (2) into:

$$\sum_{i=1}^{n} \frac{(1-u)x + ud_j}{(1+r_{TM})^j} - q = 0 \qquad (4)$$

where r_{TM} is the IRR with the duty exemption of capital.

Taking the investment allowance into account, the IRR formula can be rewritten as:

$$\frac{(1-u)x + uk(1+tm)q + ud_j}{(1+r_{IA})^j} + \sum_{j=2}^{n} \frac{(1-u)x + ud_j}{(1+r_{IA})^j} - (1+tm)q = 0 \qquad (5)$$

where r_{IA} is the IRR with the investment allowance ; and, k is the proportion of the acquisition cost of capital that is allowed to be deducted immediately from taxable income in addition to normal depreciation.

Other additional deductions can be considered by using the following variant:

$$\sum_{j=1}^{n} \frac{(1-u)x + ud_j + ua_j}{(1+r_D)^j} - (1+tm)q = 0 \qquad (6)$$

where r_D is the IRR with the additional allowable deduction; and a_j is the amount of additional deduction permitted in year j.

Our procedure is to solve for the "with incentives" IRR, using the different IRR formulas outlined above, given the value of the pre-tax profit stream (expressed as a proportion of the acquisition of capital) that will result in a before-tax IRR of 20 percent. Table 1 summarizes the impact of selected investment incentives on the internal

Table 1

Internal Rate of Return of a Hypothetical Firm
Under Selected Incentive Schemes in ASEAN Countries, 1988

	Indonesia		Malaysia		Philippines		Singapore		Thailand	
	n=10	n=20	n=10	n=20	n=10	n=20	n=10	n=20	n=10	n=20
1. Regular Taxes	11.0	13.0			10.25	11.5	15.0	16.5	11.25	13.25
(no incentive)	10.0	12.5	10.25	11.1						
	9.0	12.0								
2. Tax Holiday	NA		16.5	15.0	12.5	13.5	17.0	17.25	12.0	13.5
(min. no. of							19.0	18.75		
years allowed)										
3. Tax Holiday	NA		16.75	17.0	14.1	15.0	20.0	19.0	14.0	15.0
(max. no. of							20.0	19.75		
years allowed)										
4. Duty Exemption	15.0	16.5	12.25	12.25	13.75	14.0	NA		15.0	16.5
on Capital	14.25	15.75								
	13.5	15.25								
5. (2 + 4)	15	16.5	19.35	17.35	17.5	17.0	17.0	17.25	16.5	17.0
	14.25	15.75					19.0	18.75		
	13.5	15.25								
6. (3 + 4)	15	16.5	20.0	19.25	19.25	18.4	20.0	19.0	19.0	18.5
	14.25	15.75					20.0	19.75		
	13.5	15.25								
7. Investment	NA		16.0	15.1	NA		18.0	18.25	NA	
Allowance										
Only										
(max. allowed)										

	Indonesia		Malaysia		Philippines		Singapore		Thailand	
	n=10	n=20	n=10	n=20	n=10	n=20	n=10	n=20	n=10	n=20
8. (7 + 4)			17.7	17.0	NA		18.0	18.25	NA	
9. Export Allowance Only			16.5	16.0					11.5	13.5
10. (2 + 4 + 9)	NA		20.0	19.5	NA				17.0	17.5
11. (3 + 4 + 9)	NA		20.0	20.0	NA				19.5	19.0
Memo items:										
tm	.25		.12		.2		0		.2	
u	.15/.25/.35		.40 + .05		.35		.33		.35	

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* The assumed income stream used in these calculations is that which yields before tax IRR of .20.

a/ for u = 15, 25, 35%, respectively.

b/ special allowance for depreciation in tax holiday period.

c/ for 100% export.

rate of return of a hypothetical enterprise in ASEAN countries.

Singapore is the most attractive location tax-wise if no investment incentives were made available in all countries. The before-incentives but after-taxes internal rate of return in Singapore is 3.5 percentage points higher than the ASEAN average. This is largely due to the zero tariff on capital in Singapore since its corporate income tax rate is not much lower than those of the other countries.

The tax systems of the other 4 countries are competitive with each other. While Malaysia has a very high income tax rate relative to the others, its low tariff on capital equipment and its accelerated depreciation allowance available to all investments, in general, compensates for the former disadvantage. Although the Philippines and Thailand have equal income tax rates and tariff rates on capital, the tax system in Thailand yields a slightly higher after-tax internal rate of return because of the more liberal treatment of depreciation there.

After incentives are taken into account, Indonesia appears to be the least generous. The impact of the totality of the major incentive provisions in the other four countries averaging an increment of 9 percentage points in the IRR, are not negligible. However, the incentives do not

add much to the relative competitiveness of these countries except Singapore which lost some of its edge. Malaysia, the Philippines, Singapore and Thailand offer roughly equal inducements in terms of the impact of their incentives on the internal rate of return.

This finding suggests, that the widespread practice of many countries of using investment incentives as a bidding instrument to attract more foreign capital may be self-defeating. The analysis suggests that the ASEAN countries are generally equally competitive before incentives as well as after incentives. The implication is that these countries are throwing away precious government revenues in exchange for an edge that is largely illusory. Some form of cooperation amongst the ASEAN countries in this regard is, thus, indicated.

It is apparent that the income tax holiday yields significant additions to the IRR (up to 6 percentage points) in Malaysia, Singapore, the Philippines, and Thailand. The tax holiday is the single most important provision in terms of its effect on the internal rate of return in the first three of the above mentioned countries. In Thailand, it is the second most important incentive, next to the duty-free importation of capital. Note, however, two points that bear on the efficacy of the income tax holiday. First, for firms that incur losses in the early years of their operations, the income tax holiday may not be as useful an

incentive as our computations indicate since our hypothetical firm is assumed to be uniformly profitable over its life span. Second, the absence of tax sparing arrangements between the ASEAN and the major capital exporting countries like the United States, Japan and most of the OECD also negates the potential value of this incentive to foreign investors. The global income concept used by these countries in calculating income taxes imply that the benefits of the tax holiday go to the home countries' Treasuries rather than to the individual foreign investors.

Malaysia's export allowance provision has a significant impact on the internal rate of return of prospective projects when taken by itself. However, when it is combined with the other incentives, specifically the income tax holiday it becomes redundant.

The investment allowance which Malaysia and Singapore grant to promoted activities in lieu of the tax holiday has approximately the same impact as the latter on the IRR.

4. IMPACT OF THE INVESTMENT INCENTIVES ON THE USER COST OF CAPITAL

It has been observed that many incentives are capital-use related and as such effectively diminishes capital cost. To evaluate the impact of investment incentives on capital cost the concept of the user cost of capital is used.

The user cost of capital and its relationship with tax policy parameters is well defined within the neoclassical theory of capital accumulation which assumes that firms maximize the net present value of net revenue after tax (Hall and Jorgenson, 1967). The user cost of capital or the implicit rental of one unit of capital service per unit of time is defined by:

$$c = \frac{q(i+D)\ (1-uk-uz)}{(1-u)} \qquad (7)$$

where i is the rate of interest; D is the rate of replacement of capital stock; k is the proportion investment expenditures permitted as additional deduction from taxable income; z is the discounted value of the stream of depreciation charges generated by a peso of investment; q is the price of the capital good; and u is the corporate income tax rate.

To trace the effect of any given incentive on c, we first determine which of the variables on the right-hand side of (7) is affected by the said incentive and then we differentiate (7) with respect to the explanatory variable in question (see Appendix 1). Next, the proportional change in the user cost of capital is computed numerically given the assumed values of the different variables.

Table 2 presents the estimates of the impact of selected major incentives on the user cost of capital. The

investment allowance, followed by the income tax holiday and the duty-free importation of capital introduce marked reductions in the user cost of capital. The negative increments in the user cost of capital due to these incentives vary from 1 to 64 percent. Furthermore, we note the absence of employment-based incentives that will effectively counteract the implied capital bias of the other incentives. Neoclassical theory suggest that this additional distortion in relative factor prices in the ASEAN countries is likely to result in increased capital intensity. Unless these countries can show that such a policy-originating bias compensates for other biases in the economic system, tax theory dictates that these countries should search for more factor-neutral incentives.

5. CONCLUSIONS

The analysis of the impact of the investment incentives on the internal rate of return indicate that ASEAN countries are to a large extent as competitive with each other before incentives as after incentives. At the same time, the income tax holiday is the single most important incentive offered by most ASEAN countries. These findings suggest the following recommendations. First, ASEAN countries should not try to outbid each other in attracting foreign capital to their shores by attempting to provide more generous incentives than their neighbors.

Annex Table 2

Investment Incentives in ASEAN Countries

	Philippines	Indonesia	Malaysia	Singapore	Thailand
1. Tax Exemptions					
A. Income Tax	Exemption from 35% income tax for 6 years from commercial operation for pioneer firms and 4 years for non-pioneer firms, extendible for another year (but not to exceed 8 years) in each of the following cases: (a) project meets prescribed capital-labor ratio; (b) utilization of indigenous raw materials; (c) net foreign exchange earnings of at least US$500,000.00 annually during the first three years of operation. For expanding firms, the exemption shall be proportionate to their expansions for a period of 3 years from commercial operations.	None	Exemption from income tax of 40%, development tax of 5% and excess profit tax of 3% for 5 years from production date extendible for another 5 years for pioneer status firms. Dividends paid from exempt income are also exempt from tax in the hands of stockholders.	Exemption from 33% tax on profits for a period of 5-10 years for pioneer status firms. This also applies to incremental income of expansion projects.	Exemption from 30% or 40% corporate income tax for a period of 3 to 8 years depending on size, type of industry & number of employees. For firms in the investment promotion zone, reduction of 50% of corp. income tax for 5 years after the normal tax holiday given above.

They do not stand to gain much by following this strategy. In fact, it is likely that they will end up as net losers. Second, it will benefit the ASEAN group if they cooperate with each other for the purpose of harmonizing their investment incentives. Third, the benefits of the tax holiday do not accrue to the individual investors unless tax sparing arrangements between the host country and the capital exporting countries are in place. This implies that the ASEAN countries should initiate, individually or as a group, negotiations with the capital exporting countries to remedy the anomalous situation of the ASEAN countries transfering revenues to the Treasuries of the more developed economies. Otherwise, the ASEAN countries should seriously reconsider providing the tax holiday to foreign investors.

Estimates of the impact of the investment incentives of the ASEAN countries on the user cost capital suggest that the more important incentives offered by these countries are non-neutral with respect to relative factor prices. Unless this distortion is introduced into the system by design, i.e., for the purpose of compensating for genuine market failures and/or policy originating distortions that work in the opposite direction, and not by accident, then the incentives currently granted by the ASEAN countries is likely to result in a worsening of the resource allocation in these economies. What is implied is the need to formulate more neutral incentives.

NOTES:

1/ For instance, while it is common for investment legislations to limit foreign ownership in most activities to x percent it is also widespread practice to relax these regulations for foreign entrepreneurs proposing to engage in "pioneer" projects and/or export production. Furthermore, some countries allow foreigners to own more than x percent of the equity in the first so many years of operation provided they agree to divest the difference within a specified period of time.

2/ Brunei is not included in this study because of the inavailability of complete data.

3/ dj is usually a function of q. For example, if straight-line depreciation is followed then $dj = q(1+tm)/n$.

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Annex Table 1

Regulations and Guarantees Governing Foreign Investment in ASEAN Countries

	Indonesia	Malaysia	Philippines	Singapore	Thailand
1. **Regulations regarding ownership of enterprise and foreign equity participation**	The initial minimum shareholding required of the Indonesian participant is generally set at 20%. The initial shareholding of the Indonesian partner may be as low as 5%, which has to be increased to 20% within 5 years from the date of commercial production and further to 51% within 10 years. Provided, these investments fulfill one of the following requirements: (i) The intended investment amounts to at least $10 million; (ii) The project is to be located in a remote area; or	(i) Industrial projects substantially dependent on the domestic market may require majority Malaysian equity. (ii) Projects involing the extraction and primary processing of depletable domestic resources should have at least 70% Malaysian equity, including 30% Bumiputra equity. (iii) Export-oriented projects are allowed foreign majority ownership. Where it is justified, 100% foreign equity may be considered. Under redefined guidelines, foreign companies can own up to 100% foreign equity if the company exports 50% of its production or employs 350 full-	In most economic activities, foreign investment should account for not more than 40% of the total equity. Foreign-equity participation in excess of 40% is allowed if: (i) the enterprise proposes to engage in a "pioneer" project; (ii) at least 70% of its production is for exports; or (iii) the enterprise is located in an export processing zone. In these cases, the foreign investor is required to direct their shares to attain 40% limit within 30 years.	Generally, there is no restriction on foreign participation in equity, except for certain industries like banking, newspapers, and companies owning residential properties. In the construction industry, a 5% preferential margin is given to companies with majority local equity participation for certain government projects.	With the enactment of the Alien Business Law on November 26, 1972 (NEC 281), aliens are granted permission to engage in certain business enterprises in Thailand only if more than 50% of the capital is owned by Thais. For certain industries, foreign control of the business may be allowed on certain conditions prescribed by the Director-General of Trade Registration. Foreign control is also possible for promoted companies engaged in priority activities, as approved by the BOI.

Indonesia	Malaysia	Philippines	Singapore	Thailand
(iii) At least 85% of production is intended for exports.	time Malaysian workers. These new rules apply only to investments made from October1, 1986 to December 31, 1990.	Furthermore, foreign equity participation in excess of 40% is permissible provided the following are established. (1) the investment is made in an area of economic activity that contributes to the sound and balanced development of the national economy on a self-sustaining basis; (2) the area is not yet adequately exploited by Pilipinos; (3) the activity will not conflict with the Constitution or laws of the Philippines; (4) the operations of the enterprise are not		

	Indonesia	Malaysia	Philippines	Singapore	Thailand
			inconsistent with the Investment Priorities Plan; and (5) the enterprise will not pose a clear and present danger of promoting monopolies in restraint of trade.		
2. Basic rights and guarantees					
a. Guarantee against expropriation	Freedom from nationalisation or revocation of ownership rights or restriction of rights of control and management of foreign-capital enterprises is granted. A revocation of these rights requires an Act of Parliament undertaken in the interest of the State. Bilateral investment guarantee agreements with Belgium,	Malaysia has signed foreign investment guarantee agreements against expropriation with Canada, the U.S.A., the Netherlands, the Federal Republic of Germany, France, Switzerland, Sweden, Belgo-Luxembourg, the United Kingdom, Sri Lanka, Romania, Norway, Austria, and Finland. The government is prepared to sign similar agreements with other countries.	The Philippines guarantees foreign investments against expropriation except for public use or in the interest of national welfare and defense and upon payment of just compensation. In such cases, foreign investors or enterprises shall have the right to remit sums received as compensation for the expropriated property in the currency in which the investment was originally	Investors from the U.S.A., the United Kingdom, Canada, the Netherlands, Switzerland, Belgo-Luxembourg, the Federal Republic of Germany, France, Sri Lanka, and the People's Republic of China are covered by investment guarantees provided for in bilateral treaties between their respective governments and the Government of Singapore. These treaties	All industries are guaranteed against expropriation without just compensation.

	Indonesia	Malaysia	Philippines	Singapore	Thailand
	Canada, Denmark, the Federal Republic of Germany, France, the Republic of Korea, the Netherlands, Norway, Switzerland, the United Kingdom, and the U.S.A. cover compensation guarantees for expropriation.		made and at the exchange rate at the time of remittance.	contain guarantees against expropriation. Specific protection schemes are also available to US and UK investors through the Overseas Private Investment Corporation (OPIC) in the U.S.A. and the Crown Agents in the U.K. Investors bear the cost of the protection.	
b. Guarantee against losses due to: Nationalization; Damage caused by war; Inconvertibility of currency	The foreign investment guarantee agreements also contain provisions covering compensation guarantees for nationalization, losses due to war and inconvertibility of currency.	The foreign investment guarantee agreements also contain provisions guaranteeing against losses due to nationalization.	None	The foreign investment guarantee agreements also contain provisions guaranteeing against losses due to nationalization and war.	Guarantee is provided against losses due to nationalization.

	Indonesia	Malaysia	Philippines	Singapore	Thailand
c. Remittance of foreign exchange (i) Earnings, profits, and dividends (on investments/ principal and interest on foreign loans/ others).	Foreign investors are guaranteed remittance of: 1) Earnings (in proportion to the shareholding of the foreign participants and after deduction of taxes and other financial obligations); 2) Payments of interest and principal on foreign loans (if the loan agreement is approved by Bank Indonesia; 3) Expenses for foreign personnel; 4) Depreciation allowance for capital assets with respect to imported plant, machinery, and equipment, in accordance with the foreign investment scheme;	Except for the completion of the usual exchange control forms for amounts exceeding M$10,000, no restrictions are placed on remittance of earnings or profits.	All earnings and profits accruing to nonresidents and earned on foreign investments duly registered with the Central Bank may be remitted in full, net of taxes, in the currency in which the investment was originally made and at the prevailing exchange rate, subject to emergency restrictions on exchange operations.	No restrictions are imposed on the remittance of earnings, profits, and dividends on investments.	Remittance of earnings or profits is permitted but may be temporarily restricted by the Bank of Thailand if required by the balance-of-payments situation. However, in case of such restriction, earnings corresponding to at least 15% of paid-up capital brought in can still be remitted annually.

	Indonesia	Malaysia	Philippines	Singapore	Thailand
	5) Proceeds of the sale of shares by foreign partners to Indonesian partners or to other Indonesian nationals/ companies; and 6) Compensation in case of nationalization.				
(ii) Principal and interest on foreign loans		Remittances of interest and principal payments on foreign loans and foreign obligations are not restricted if these are within the repayment terms previously approved by Bank Negara of Malaysia.	The remittance of foreign exchange to meet the payments of interest and principal on duly registered foreign loans and obligations arising from technological assistance contracts is allowed, subject to the emergency restrictions on exchange operations.		Remittance of foreign exchange to meet repayment of principal and interest on foreign loans is permitted subject to some qualifications. Even in extreme cases where Thailand's balance-of-payments position is under severe strain, the Bank of Thailand still permits such remittance at a rate of not lower than 20% annually after two years from the date of original investment.

	Indonesia	Malaysia	Philippines	Singapore	Thailand
d. Repatriation of capital	Repatriation of remaining invested capital in the original foreign currency is guaranteed. However, repatriation is not permitted while any of the tax concessions are still in effect.	Repatriation of capital is freely permitted subject to the completion of the usual exchange control forms for amounts exceeding M$10,000.	The entire amount of foreign investments duly registered with the Central Bank may be repatriated in the currency in which the original investment was made, in accordance with the schedule of priorities imposed by the Central Bank, subject to emergency restrictions for exchange operations.	Repatriation of capital is not restricted.	Repatriation of capital is permitted but may be temporarily restricted by the Bank of Thailand if required by the balance-of-payments situation. However, in case of such restriction, investment capital may still be repatriated at the rate of not less than 20% annually after two years from the date of principal investment.
3. Employment of aliens	Employment of foreigners for managerial and technical positions for which qualified Indonesians are not yet available is generally allowed, provided (1) the specific positions are included in the investment proposal, and (2) adequate training programs are provided for Indonesian nationals. Certain key expatriates essential to	The government allows the employment of foreign technical and skilled personnel in industrial establishments. However, it requires that a training program be drawn up for Malaysians to acquire the necessary skills and expertise so that within a period of time they will be able to assume positions held initially by expatriate personnel.	BOI-registered enterprises and EPZA-registered enterprises may, for five years from registration, employ foreign nationals in supervisory, technical, or advisory positions extendable for periods at the discretion of the BOI. In the case of a BOI-registered pioneer enterprise and an EPZA-registered enterprise whose majority stock is owned by foreigners	Employment of suitably qualified foreign engineers, technicians, and other professionals as well as skilled workers is allowed, if such personnel are not available in Singapore. Applications for their employment are judged on their merits.	Employment of aliens is subject to the restrictions imposed by the Alien Occupation Law, which bans aliens from certain types of occupations. Admissions to the country of skilled workers or technicians, including their spouses and children, is allowed for a promoted com-

	Indonesia	Malaysia	Philippines	Singapore	Thailand
	the safeguarding of the interests of the foreign investors will be permitted for the duration of the investment.	To attract new investments into Malaysia, a company with a foreign paid-up capital of US$2 million will be automatically allowed five expatriate posts.	key positions may be filled by foreigners.		pany, even in excess of immigrant quotas, for a period to be fixed by the BOI. Foreign nationals are also allowed to undertake investment feasibility studies.
4. Patent protection	Indonesia does not yet have a patent law. As a member of the International Convention for the Protection of Industrial Property (Paris Union), Indonesia abides by and honors its terms. In practice, applications for a grant of patents can be provisionally filled with the Department of Justice pending the enactment of the patent law. The Law on Trademark of 1961 stipulates the procedure for registration of trademarks and the rights of trademark holders.	Patents in Malaysia are protected under the Patents Act of 1983 and the Patents Regulations. Under the Act and the Regulations, a patent can be registered for the whole of Malaysia, as opposed to registration by territory under the old law.	The government grants protection from infringement on duly registered patents, trademarks, copyrights, trade names, and other proprietary rights where such patents, trade names, and other proprietary rights have been registered with the appropriate government agencies. Compulsory licensing takes place two years from registration.	Although there is no provision for the grant of original patents in Singapore, registrations obtained in the U.K. will receive protection in Singapore provided that the patent is registered in Singapore and is properly advertised in Singapore newspapers. Trademarks can be protected by registration under the Trade Marks Act.	Patent protection is available upon registration with the Trademark and Patent Division of the Ministry of Commerce. A registered patent is protected by Patent Act B.E. 2522 (1979). A patent registered in Thailand is not protected internationally. Registration is required in a particular country where protection is needed. This applies also to foreign patents that require protection in Thailand.

	Indonesia	Malaysia	Philippines	Singapore	Thailand
5. Real estate ownership by alien investors	The land laws in Indonesia distinguish among the following rights: freehold, exploitation for agricultural estates, building for industries and other building purposes, and use for purposes other than the above. Of the foregoing rights, only the right of building for industrial, commercial, and residential properties can be obtained by foreign investment companies. A foreign investment company engaged in agriculture, fish/shrimp farming, and cattle ranching may use land. of which the right of exploitation is held by an Indonesian partner, for the duration of the joint venture under the provisions of the joint venture agreement.	Foreigners are allowed to own land, whether for industrial or agricultural use. A change in the use of land requires the approval of the goverment. Land in the industrial estates is for lease for a normal period of 60 to 99 years. However, foreign citizens and foreign companies are not allowed to buy or acquire building land without prior approval of the State Authority.	The Philippine Constitution limits the ownership of land and the development, exploration, exploitation, and use of natural resources to citizens of the Philippines and to corporations or associations at least 60% of whose capital is owned by Filipino citizens.	No restrictions are placed on the ownership of industrial or commercial land and properties. In the case of residential land unrestricted sale is confined to Singapore citizens; noncitizens can only buy and sell apartments or approved condominiums in buildings of not less than six stories and are also exempt from the 10% property tax surcharge on such properties. Applications to purchase residential properties from foreigners who contribute to the economic development of Singapore will be favorably considered by the government subject to certain conditions.	The promoted company is permitted to own land for industrial activities in excess of the maximum area normally allowed by law.

Source: SGV, 1988

Annex Table 2

Investment Incentives in ASEAN Countries

	Philippines	Indonesia	Malaysia	Singapore	Thailand
I. Tax Exemptions					
A. Income Tax	Exemption from 35% income tax for 6 years from commercial operation for pioneer firms and 4 years for non-pioneer firms, extendible for another year (but not to exceed 8 years) in each of the following cases: (a) project meets prescribed capital-labor ratio; (b) utilization of indigenous raw materials; (c) net foreign exchange earnings of at least US$500,000.00 annually during the first three years of operation. For expanding firms, the exemption shall be proportionate to their expansions for a period of 3 years from commercial operations.		Exemption from income tax of 40%, development tax of 5% and excess profit tax of 3% for 5 years from production date extendible for another 5 years for pioneer status firms. Dividends paid from exempt income are also exempt from tax in the hands of stockholders.	Exemption from 33% tax on profits for a period of 5-10 years for pioneer status firms. This also applies to incremental income of expansion projects.	Exemption from 30% or 40% corporate income tax for a period of 3 to 8 years depending on size, type of industry & number of employees. For firms in the investment promotion zone, reduction of 50% of corp. income tax for 5 years after the normal tax holiday given above.

		Philippines	Indonesia	Malaysia	Singapore	Thailand
B.	Tax and Duty on Imported Capital Equipment	For new and expanding registered enterprises 100% exemption from taxes and duties on imported capital acquired before August 12, 1992.	Exemption or reduction of duties and value added tax (VAT) on sales of imported equipment.	100% exemption from import duty, surtax & sales tax on imported equipment upon application.	Zero tariffs are levied on capital equipment, on general.	50% to 100% exemption from import duties and business taxes on imported equipment for registered firms.
C.	Tax and Duty on Imported Spare Parts	100% exemption from taxes and duties provided that 70% of production is exported, such spare parts are not locally available at reasonable prices, sufficient quantity and comparable quality and that all importations of spare parts shall be transferred only to the firm's bonded warehouse.	Exemption from or reduction of duties & VAT on imported spare parts as listed by BKPM.	None	None	None

	Philippines	Indonesia	Malaysia	Singapore	Thailand
D. Tax on Imported Raw Materials	100% exemption from taxes and duties for firms located in export processing zones and firms operating bonded manufacturing warehouses. 100% exemption from breeding stocks and genetic materials imported within 10 years from the date of registration or commercial operation provided such breeding stocks and genetic materials are not locally available and/or obtained locally in comparable quality and at reasonable prices; are reasonably needed in the registered activity; and approved by the Board.	Exemption or reduction of import duties for two years.	100 % exemption from customs duties & surtax for export-oriented firms. For firms producing for the domestic market, 100% exemption if it complies with the equity condition, management and employment structure. In other cases, partial exemption in which manufacturers are required to pay 2% or 3%.	100% exempt for those not available locally.	up to 90% exemption from import duties and business taxes for 1 year period. Export enterprises are also exempted from taxes and duties on raw materials for an indefinite period.
E. Capital Gains Tax	None	Capital gains are taxed as ordinary income.	None	No capital gains tax.	Capital gains are taxed as ordinary income.

	Philippines	Indonesia	Malaysia	Singapore	Thailand
II. Tax Deductions					
A. Investment Allowance	100% of the cost of major infrastructure undertaken in areas designated as necessary for industry dispersal or areas deficient in infrastructure (for less developed areas).	None	100% of qualifying capital expenditure incurred within 5 years from date of approval of the project determined according to priorities termed as promotional activities/products. This is granted into firms not given pioneer status. Reinvestment allowance equal to 25% is granted to a manufacturing company which incurs qualifying capital	10-50% of outlays on new investments in plant machinery and factory building may be deducted from profits for approved manufacturing and technical services, research and development (R&D) activities, construction operations and projects for reducing consumption of potable water. This is valid for the year in which the expenditure is incurred and may be carried forward until after a tax	None

	Philippines	Indonesia	Malaysia	Singapore	Thailand
			expenditures (plant, machinery and factory building) for the purpose of approved expansion before 31 Dec. 1988.	holiday period.	
B. Deduction of Research & Development Program	None	None	Additional allowance of 10% in 1st year and 2% thereafter of cost of buildings used for research.	On a case-by-case situation manufacturing firms that conduct R&D and R&D institutions are given the following incentives: (a) one or more years of pioneer status; (b) investment allowance of 50% of capital	None

	Philippines	Indonesia	Malaysia	Singapore	Thailand
				investment (excluding building); (c) double deduction of R&D expenses; (d) accelerated depreciation of R&D plant & equipment; and (e) complete exemption from or reduction of 20% with-holding taxes for royalty, fees, etc.	
C. Accelerated Depreciation	None	Normal rate of 50% if asset life is less than 4 years, 25% if less than 8 years, 10% if more than 8 years.	Qualified capital incurred before December 31, 1988 may be written off in three years:	Plant & machinery may be written off in 3 years; computers and automation equipment in 1 year.	Normal annual rate: 20% for assets not identi-fiable as land or merchandise Plant equipment, vehicles and R&D expenses are included in this category.

	Philippines	Indonesia	Malaysia	Singapore	Thailand
D. Net Loss Carry-Forward	None	Losses carried forward for next 5 to 8 years after loss.	Losses carried forward for unlimited period.	Losses may be carried over provided there is no substantial change in ownership.	Losses incurred during the tax holiday period may be carried over for the next 5 years after the tax holiday.
E. Labor Expenses	50% of the incremental labor expense of a registered enterprise for the first 5 years from registration provided it meets the prescribed ratio of capital assets to annual labor; 100% of the incremental labor if located outside Metro Manila.	None	None	None	None
F. Export Deductions	None	None	1. Export producers are allowed to deduct from Y. (a) some prop X of Y where X is 50% of X sales total sales plus	double deduction of promotional expense for exports.	5% of incremente X income

Philippines	Indonesia	Malaysia	Singapore	Thailand
	total sales plus			
		(b) 5% of value indigenous product used for export production. 2.5% of the FOB value of export sales is granted as export allowance to trading companies/ agri-producer for exports. 3. Double deduction of export credit insurance pre- miums and export promo- tion expenses, i.e., overseas advertising exhibit par-		

	Philippines	Indonesia	Malaysia	Singapore	Thailand
			ticipation, fares, etc.		
G. Others	None	None	5% of taxable Y for the first 5 years. for firms located in promoted areas, for small scale enterprises and for firms meeting capital participation requirement.	None	None
III. Tax Credits					
A. Taxes & Duties on Raw Materials	Equivalent to the National Internal Revenue taxes and customs duties paid on the suppiies, raw materials and semi-manufactured products used in the manufacture, processing or production of export products and forming part thereof; exported directly or indirectly by the registered enterprise.	For exports, the VAT will be charged at zero rates meaning that the payment of any taxes for previous purchases will be refunded.	Equivalent to the import duty and surtax on raw materials used as parts or ingredients in the manu-facture of export products excluding packaging materials.	None - Free port, no turnover, sales & excise taxes except on petroleum, alcoholic beverages & cigarettes produced locally.	None. Refer to II-D above.

	Philippines	Indonesia	Malaysia	Singapore	Thailand
B. Purchase of Domestic Capital Equipment & Accompanying Spare Parts	For purchase of domestic capital equipment made before 8-12-92 tax credit equivalent to 100% of the value of taxes and duties that would have been waived on the machinery and spare parts had these been imported. Provided, (1) that the said equipment, machinery and spare parts are reasonably needed and used exclusively by the registered enterprise unless otherwise exempted by the Board; and (2) that the approval of the Board was obtained.	None	None	None	None

Source: Various materials on investment incentives provided by Embassies of ASEAN countries in Manila.

Appendix

Investment Incentives and User Cost of Capital

The concept of the user cost of capital and its relationship to tax policy parameters is well defined within the neoclassical theory of capital accumulation originally formulated by Hall and Jorgenson (1967) which assumes that firms maximize the net present value of net revenue after tax. Here, the user cost of capital or the implicit rental of one unit of capital service per unit of time is defined ir the following equation:

$$c = \frac{q(i+D)\ (1-ku-uz)}{(1-u)} \qquad (1)$$

where
- r is the rate of interest,
- d is the rate of replacement of capital stock,
- k is the proportion of investment expenditures permitted as additional deduction from taxable income,
- z is the discounted value of the stream of depreciation charges generated by a peso of investment,
- q is the price of capital goods, and
- u is the corporate income tax rate.

To trace the effect of any given incentive on c, we first determine which of the variables on the right hand side of (1) is affected by the said incentive and then we differentiate (1) with respect to the explanatory variable in question.

Thus, to evaluate the effect of the accelerated depreciation provision on the user cost of capital, equation (1) is differentiated with respect to z:

$$\Delta c = \frac{-(i+D)qu}{(1-u)} \Delta z \qquad (2)$$

Without the accelerated depreciation provision z', the present value of the stream of depreciation charges, would be

$$z_o = \sum_{j=1}^{n} \frac{(1/n)}{(1+i)^j}$$

if straight-line depreciation is followed.

If accelerated depreciation is allowed,

$$z_1 = \sum_{j=1}^{n} \frac{b_j}{(1+i)^j}$$

where b_j is the amount of depreciation charges allowed in year j for every peso of investment.

Also, in order to study the effect of the tax reduction/exemption on imported capital equipment, we differentiate (1) with respect to q:

$$\Delta c = \frac{(i+D)\ (1-ku-uz)\Delta q}{(1-u)} \qquad (3)$$

We note that $\Delta c/c = \Delta q/q$.

Now, with full exemption from taxes and duties on imported capital,

$$\frac{\Delta q}{q} = - \frac{tm}{(1+tm)} \qquad (4)$$

$$\frac{\Delta q}{q} = - \frac{.5tm}{(1+tm)} \qquad (5)$$

Similarly, to trace the effect of the investment allowance on the user cost of capital, we differentiate (1) with respect to k to obtain:

$$\Delta c = \frac{-qu(i+D)}{(1-u)} \Delta k \qquad (6)$$

Without this provision clause, k = 0; with this incentive k ranges from zero to 1.0.

Finally, the impact of the income tax holiday on the user cost of capital may be assessed by differentiating (1) with respect to u:

$$\Delta c = \left[- \frac{q(i+D)\ (k+z)}{(i-u)} + \frac{c}{(i-u)} \right] \Delta u \qquad (7)$$

To evaluate Δu, we should first solve for the value of u uniformly applicable to the whole n-year period that will result in the same pre-tax profit stream, IRR as that obtaining from a tax holiday situation.

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