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South-South Global Thinkers Scoping Paper

South-South Investment for Sustainable Development Goals: The Policy and Legal Environment in Asia

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ACRONYMS AND ABBREVIATIONS

BRI	Belt and Road Initiative
FDI	Foreign Direct Investment
LDCs	Least Developed Countries
ODA	Official Development Assistance
PPP	Public-Private Partnership
SDGs	Sustainable Development Goals
SEZ	Special Economic Zone
SSC	South-South Cooperation
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNOSSC	United Nations Office for South-South Cooperation

I. Introduction

South-South investments flows between emerging markets have become a key source of financing for developing countries. The connections created through such investments are also extensively used to transfer standards, knowledge, technology and successful business models. Foreign Direct Investment (FDI) by, and in, developing countries are now a critical driver of progress in the South, further enhanced by cooperation among countries and stronger commitment of the private sector to social and environmental values. For example, FDI outflows from the BRICS countries (Brazil, Russia, India, China and South Africa) rose 21 percent, pushing the group's outward stock to US$2.1 trillion – or more than 8 percent of the world total in 2016, up from 5 percent in 2010.[1] FDI outflows from developing countries in Asia also rose by 7 percent to $363 billion in 2016. Among these, China is the major driver of outward FDI, rising 44 percent to $183 billion in 2016 and propelling it to become the second-largest country for FDI for the first time.[2] In recent years, other developing countries, including Kuwait and Thailand, have also seen a rise in outward FDI.

Studies have shown that Southern investment typically reaches very poor and remote developing countries.[3] Southern-grown business models and technologies are often more attuned to the needs and conditions in developing countries; and are more flexible and can be adopted faster than investments from developed markets. This is due to the high relevance of the innovative, contextually tailored business models that Southern companies already employ to similar environments. South-South investments can also increase bilateral and regional trade to potentially generate more jobs and reduce the costs of goods and services, making them more affordable to the poor, and thus injecting great momentum into the implementation of the 2030 Agenda for Sustainable Development.

In the meantime, however, investment policymaking has become a more complex, divergent and uncertain process due to internal and external factors present across countries of the South. Additionally, sustainable development considerations make investment policies more challenging and multifaceted. In 2016, according to the United Nations Conference on Trade and Development (UNCTAD), 58 countries and economies adopted 124 policy measures affecting foreign investment, and developing countries in Asia led in adopting such policies. Most of these measures were investment facilitation and promotion in nature, including liberalizing entry and establishing conditions, offering investment incentives, adopting policies related to special economic zones (SEZs) and enacting public-private partnership (PPP) laws and regulations. There are also

[1] UNCTAD, World Investment Report 2017

[2] UNCTAD, World Investment Report 2017.

[3] International Finance Corporation (IFC) (2016), South-South Investment: Creating Opportunity in East Asia and the Pacific. https://goo.gl/XZXPR2

restrictive policies affecting foreign investors. Strategic industries, national security and local producers' competitiveness are often major concerns.

International investment agreements (IIAs), investment laws and policies provide the basic legal and policy framework for cross-border investment in many countries, but these policies and laws have received relatively little attention in the international community. In particular, Southern investors tend to lack knowledge regarding these issues, as they have relatively little experience in investing in other developing countries.

In this context, as one of the activities of the *South-South Global Thinkers: The Global Coalition of Think Tanks Networks for South-South Cooperation (SSC)* initiative, the United Nations Development Programme (UNDP), the United Nations Office for South-South Cooperation (UNOSSC) and Yingke Law Firm[4] launched the debate around policy incentives and barriers in a dedicated event held in Bangkok, Thailand, on 23 August 2017, and titled "South-South Investment for Sustainable Development Goals: Policy and Legal Environment in Asia." The event brought together more than 130 representatives from governments, the private sector, think tanks and civil society organizations from over 18 countries.

This scoping background paper assesses the issues that were discussed regarding South-South investments in Asia during the seminar. It also covers results from the meeting, including:

- Global, regional and country trends, experiences and perspectives on South-South investments in Asia and their contribution to the 2030 Agenda;
- PPPs and perspectives on South-South investments in Asia; and
- Opportunities and strategies for South-South investment in Asia: experience from SEZ development.

Its primary objectives are to guide a comprehensive review of the policy frameworks discussed; begin a discussion on important related topics; and identify further research questions that could feed into the development of a comprehensive study on the policy and legal environment for South-South investments in Asia. This review will serve broader goals, such as facilitating understanding of policy and legal issues that are enabling or hindering SSC in Asia; informing better policymaking; and strengthening the linkages of investment policies to the Sustainable Development Goals (SDGs).

[4] Yingke Law firm is the largest owner-operated law firm in Asia Pacific with more than 5,500 lawyers and legal professionals. It has offices in 44 cities in China and in 100 cities across Asia, Europe, South America and North America.

II. Discussions at the South-South Investment for Sustainable Development Goals: Policy and Legal Environment in Asia

2.1 Global, Regional and Country Trends, Experiences and Perspectives on South-South Investment in Asia and Their Contribution to Sustainable Development

The comprehensive set of SDGs and their related targets present a multitrillion-dollar agenda. UNCTAD has estimated that achieving the SDGs by 2030 in developing countries alone will require investment from $3.3 to $4.5 trillion annually, mainly in basic infrastructure and infrastructure related to specific goals.[5]

Foreign Direct Investment can contribute to sustainable development by improving overall economic performance and generating a dynamic economic system. FDI can also play a catalytic role in building and strengthening productive capacity as investments build connections that can lead to tangible and intangible benefits, including export growth, technology and skills transfer, employment and poverty eradication. However, financial outflows from developed countries to developing countries, including FDI, official development assistance (ODA), and remittances did not increase much between 2010 and 2016. For example, global external financial flows to developing economies were estimated at $1.4 trillion in 2016, down from more than $2 trillion in 2010.[6] Although UNCTAD predicts a modest recovery of FDI flows in 2017-2018, they are expected to remain well below their 2007 peak. Therefore, it has become essential to find new, innovate means of financing for development and the SDGs.

South-South cooperation, and connections built as a result of strengthened South-South financial flows, represents an important mechanism to accelerate implementation of the SDGs. Specifically, Asia saw a remarkable enhancement in both inflow and outflow from 2010 to 2016, although flows to least developed countries (LDCs) fell 13 percent. For example, FDI inflows to China and India increased, respectively, from $72 billion and $14 billion in 2005 to $134 billion and $44 billion in 2016.[7] Meanwhile, China, India, Malaysia, Singapore and Thailand have emerged as leading outward investors. FDI outflows from China stood at $183 billion in 2016, representing more than one-third of the total developing countries FDI outflows.[8]

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[5] World Investment Report 2014

[6] World Investment Report 2017

[7] World Investment Report 2006, World Investment Report 2017.

[8] Abdul Alim, *Perspectives on South-South investment regional trends in Asia and its contribution to sustainable development with regards to the implementation of the SDGs especially in LSCs,* presentation in the meeting.

New regional and subregional frameworks, such as the Belt and Road Initiative (BRI), championed by China, and the ASEAN Community Vision 2025, are further facilitating FDI in Asia. The BRI, as one example, is mobilizing more financial resources, including FDI in industries other than natural resources, and is helping to diversify the economies of various participating countries. The planning of new Chinese investments in Central Asia under the umbrella of the BRI focuses on building infrastructure facilities and enhancing industrial capacities and targeted agriculture and related businesses. Such trends are likely to be maintained as the BRI continues to mature.

The contribution of South-South cooperation to sustainable development as pursued by actors in Asia and crossing continental boundaries includes but is not limited to:

- Diversifying financing sources in trade, investment and development assistance;
- Providing more contextually appropriate technology and knowledge solutions, with Southern countries sharing solutions to shared or common challenges, often at lower cost compared with Northern counterparts;
- Providing opportunities to learn from successful cases, including China, India and Viet Nam;
- New Southern-led initiatives and institutions, such as the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (NDB) and the BRI, which aim at harnessing mutual benefit and trade integration, increasing choices and mobility and strengthening capacity production and value chains; and
- Increasing opportunities to reach all populations in need. For example, Chinese FDI stock in LDCs was almost three times more than the next largest investor. From 2010 to 2015, its stock in LDCs more than tripled. Other developing economies like Thailand have also emerged as prominent investors in LDCs.[9]

The SDGs emphasize the importance of "leaving no one behind." Trade and investment are key instruments to closing the development gap. For example, one important aspect of SSC focuses on regional connectivity in promoting trade and investment and reducing cross-border economic transaction costs.

During the Bangkok event, several government representatives provided examples of how South-South investments can increase bilateral and regional trade, which tends to have a positive effect on overall economic development within regions. Such trade can also potentially generate employment opportunities, increase life expectancy and decrease the cost of goods and services, thereby making them more affordable for the poor. China, for example, is now the largest investor in many Asian developing countries, such as Cambodia, the Lao People's Democratic Republic, Myanmar and Nepal. China's

[9] World Investment Report 2017

investments are contributing to job creation and industrial capacity improvement. However, the representatives also noted that FDI, whether from the South or North, tends to increase inequality and reduce the share of agriculture contributing to GDP in the recipient countries.

Participants noted that developing countries, especially LDCs, lack capacity and need support in the following areas to benefit fully from increasing South-South investments:

- Financial and technical support for project preparation and contract negotiation;
- Advisory support in investment-related dispute resolution;
- Access to information on investment facilities and risk insurance and guarantees such as through the Multilateral Investment Guarantee Agency;
- Support to improve domestic enabling environments for investments to ensure sustainable, responsible and inclusive investment policies; and
- The use of innovative mechanisms and partnerships to encourage greater international private financial participation in these economies.[10]

2.2 Public Private Partnerships (PPPs) and Perspectives on South-South Investments in Asia

Achieving the SDGs will require action by all stakeholders, including governments, civil society organizations, academia and local communities. As to PPPs, the private sector has a central role to play. PPPs can supplement limited budgets and resources of the public sector, but PPP is more than an expanded source of financing for public and social projects.

More important, it has been argued that they can raise the efficiency of public services by subjecting them to the discipline of market forces or the market test and through incorporating private-sector technology and innovation in providing better public services.[11]

PPPs can also be used to develop local private-sector capabilities through joint ventures with large international firms, as well as subcontracting opportunities. Appropriate risks can also be transferred to the private sector over the life of a project—from design to construction, operations and maintenance.

Developing countries are increasingly turning to the private sector for alternative sources of funding to meet their financial gaps, especially for infrastructure projects. However,

[10] Addis Ababa Action Agenda, Para 46

[11] Erh-Cheng Hwa, Public and Private Partnership in supporting SDGs, UNDP Conference, Bangkok Thailand, August 23, 2017.

the overall volume of PPPs is currently less than 10 percent of the total estimated developing countries' investment needs. Government resources still account for the bulk of infrastructure investment financing in developing countries (70 percent), while private resources account for about 20 percent, with most of the remainder financed by development agencies.[12] Even in PPPs, where the participation of the private sector is expected to be greater, most financing tends to come from national development banks. This indicates that the PPP model is far from mature in developing countries and that there is great room for further development.

It should be noted that there are numerous potential risks associated with PPPs. For example, transaction costs tend to be larger as development, bidding and ongoing costs in PPP projects are likely to be greater than for traditional public procurement processes. The cost attached to debt has to be borne either by the customers or the government. In China, for example, a notable issue emerging in PPP is that some local authorities have granted PPP projects with an implicit guarantee, turning them into a form of implicit government debt. Moreover, given the long-term nature of PPP projects and the complexity associated with them, it is difficult to identify all possible contingencies during project development. Events and issues may arise later, which would require further negotiation and risk management.

Participants at the event highlighted that PPPs could bring broader benefits to society, such as impacts on poverty and sustainable development, in addition to reducing costs and increasing efficiencies. It was noted that PPPs face different challenges in some developing countries, including difficulties in engaging the private sector, less developed capital markets and lack of sources for long-term financing. High uncertainties related to the functioning and stability of the legal environment (political), stability of macroeconomic variables (economic) and exchange-rate volatility also increase the risk of PPPs that involve foreign capital in developing countries and undermine their greater participation.

In addition to stable economic and political environments, it was argued that successful PPPs would need such key elements as concession plans, the stability of earnings, enabling infrastructure and diverse partnerships.

2.3 Opportunities and Strategies for South-South Investment in Asia: Experiences from the Development of Special Economic Zones (SEZs)

Representatives from Cambodia, China, Bangladesh, Indonesia, Myanmar, Nepal and Timor-Leste shared their perspectives and experiences on establishing and operating SEZs and their contributions to sustainable development.

[12] Andre de Mello e Souza, *Risk management for public-private partnership in infrastructure in developing countries,* UNDP Conference, Bangkok Thailand, August 23, 2017.

- Indonesia's SEZ is part of the country's strategy to increase economic growth, close intra- and inter-regional gaps, advance value chains on processing industries and enhance the competitiveness of the country's economy. In 2016, Indonesia transformed the status of Batam[13] from a free-trade zone to an SEZ, providing additional benefits, including tax holidays and accelerated amortizations.

- Similarly, Bangladesh has offered a new package of incentives for investors in SEZs, exempting foreign developers and investors from value-added tax and import duties on items directly linked to the development and construction of SEZs.

- Other countries, such as Cambodia and Nepal, are also greatly expanding SEZ development, using different physical and fiscal incentives for foreign investors.

There was a consensus that SEZs can play an important role in attracting FDI; developing and diversifying exports; promoting skills development, technology transfer and knowledge sharing; and generating employment, thus ensuring dynamic economic benefits for structure change and improving the competitiveness of a country's economy.

However, developing countries also face some common challenges in SEZ development and operation, including access to finance, low-quality infrastructure, and availability of skilled labor and professionals. It should be noted that SEZs often draw criticisms in terms of environmental disruption, labor rights and conditions, land issues and other concerns. A key issue of SEZs related to sustainable development is how SEZs can benefit local communities and their people.

The discussion highlighted that SEZ development would need legal certainty (clear laws, regulations and policies), institutional setup (such as one-stop services for investors), financial incentives (tax exemption etc.), and infrastructure and utility services. A successful SEZ will need a combination of policy, capital, access to talent and markets as well as local communities' involvement.

2.4 Knowledge Sharing and the Role of Think Tanks and Their Networks

Participants agreed that knowledge sharing has an important role to play in promoting South-South investment and achieving the SDGs. Data and evidence-based mutual learning can help shape policies and maximize investment impacts. In this sense, think tanks (particularly Southern ones) and research institutions and their networks can play a crucial role in ensuring that policies and frameworks are appropriate and responsive to local needs. Think tanks and related institutions also have a key role to play in evaluating the impacts of policies and programs and identifying "best fit" practices; facilitating policy dialogues by linking governments, the private sector and research institutions at domestic, regional and global levels; and promoting knowledge and information sharing that can include policy dialogues on South-South cooperation.

[13] Batam is a small island in Indonesia's Riau Archipelago in the South China Sea.

III. Follow-Up Research Questions

Given the changing landscape of financing for development and the rising significance of South-South investment in achieving the SDGs, there is a need to conduct comprehensive research focused on the policy and legal environment for South-South investments. This will help facilitate more understanding of policy and legal issues that are enabling or hindering such investments in Asia; inform better policymaking; and strengthen the links of investment policies to the SDGs. This research should cover broader issues, such as experiences and best practices of South-South investment and their contribution to sustainable development. They should also explore specific issues, such as how the SSC modality can be used to facilitate PPPs; how SEZ development can help to achieve SDGs; and how think tanks can play a better role in the process.

3.1 South-South Investment in Asia and its Contribution to Sustainable Development

To deepen understanding of the status quo and the trend of South-South investment and its contribution to sustainable development, some broad issues need to be analyzed, such as:

- What do stakeholders, particularly from the private sector, understand South-South cooperation and South-South investment to be? What are some of the specific features of South-South investments? Are they different from Northern investment (determinants, industry distribution, plant characteristics etc.); if yes, how? Are the principles of SSC reflected in South-South investment?

- What are the policy and legal frameworks for creating an enabling environment to attract South-South investment in developing countries in Asia? What are some of the policies, regulations and procedures that are already in place in countries that engage more in South-South investments? What innovative facilitation mechanisms and institutions can the host government institute to stimulate South-South investment (such as investment promotion policies and guidance, technical assistance and capacity-building)?[14]
- How can governments use South-South investments strategically to tackle inequality and maximize benefits for citizens? What lessons can be drawn from the Chinese South-South Cooperation Assistance Fund and its contribution to development in the region and beyond?

- What are the key policies initiatives and frameworks designed to promote outward investment in the region? How can they be bettering linked and aligned with the SDGs?

[14] There is a need to conduct a few case studies of selected developing countries on their FDI policy and legal framework and their implementations. These can include, but not limited to SEZ laws, land laws, environmental laws, labor laws, company and investment laws as well as safeguard policies and risks.

3.2 PPPs and South-South Investment in Asia

PPPs have become an important instrument for financing key economic infrastructure projects, but they are still underused in some developing countries. To promote PPPs and increase South-South investment, additional research should focus on these questions:

- What are some of the best practices in PPPs in countries of the South in Asia? Are the principles of SSC reflected in those partnerships? Of those best practices, what were the enabling policy and legal factors that other Southern countries can learn from? What were the risks and how were they allocated among the partners involved?[15]

- What role can PPPs play in helping to achieve the 2030 Agenda, in particular, South-South infrastructure investment? What policy, legal and institutional frameworks are required to ensure that PPPs achieve their objectives effectively and sustainably under the SSC mechanism?

3.3 SEZ development and South-South Investment in Asia

To better understand the contributions of SEZs on sustainable development, the following questions should be analyzed:

- How have SEZs contributed to economic transformation and sustainable development in developing countries? How do SEZs contribute to the productive structure of economies? What were the legal and policy frameworks and incentives that were in place to implement SEZs in those developing countries? What were the roles of government and private sector? What factors ensured the sustainability of SEZs, including environmental, social and gender roles?[16]

- How do SEZs influence local technological development and human capital development? Do South-South investments and SEZs generate linkages with regional and cross-border efforts?

[15] This will require the development of case studies that will draw on the expertise from both researchers and practitioners.

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