# Thailand 2016 – The Year of Investment

## Policy options to attract investment in priority clusters

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Bangkok

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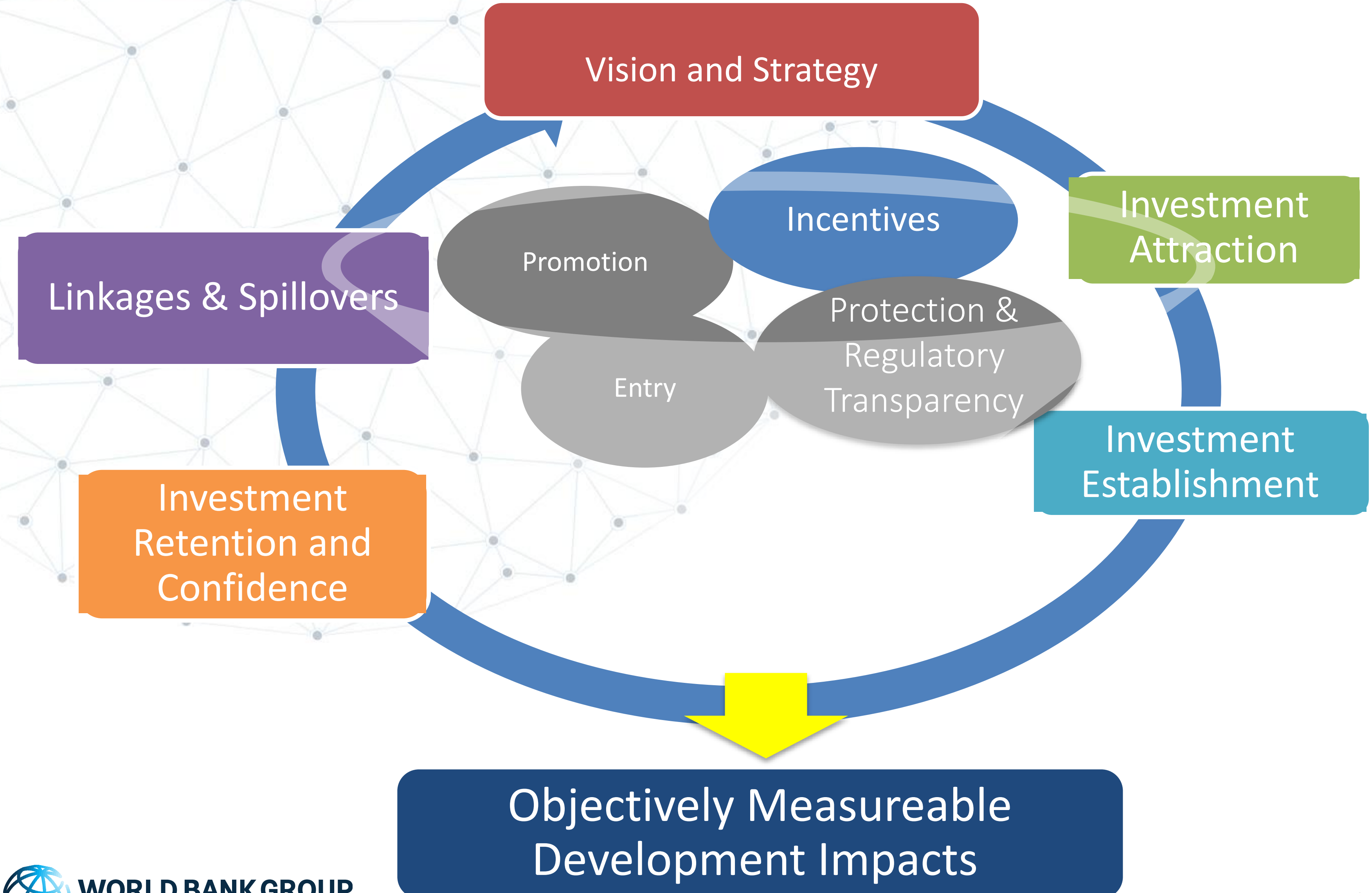
# Incentives – one element in the investment policy mix

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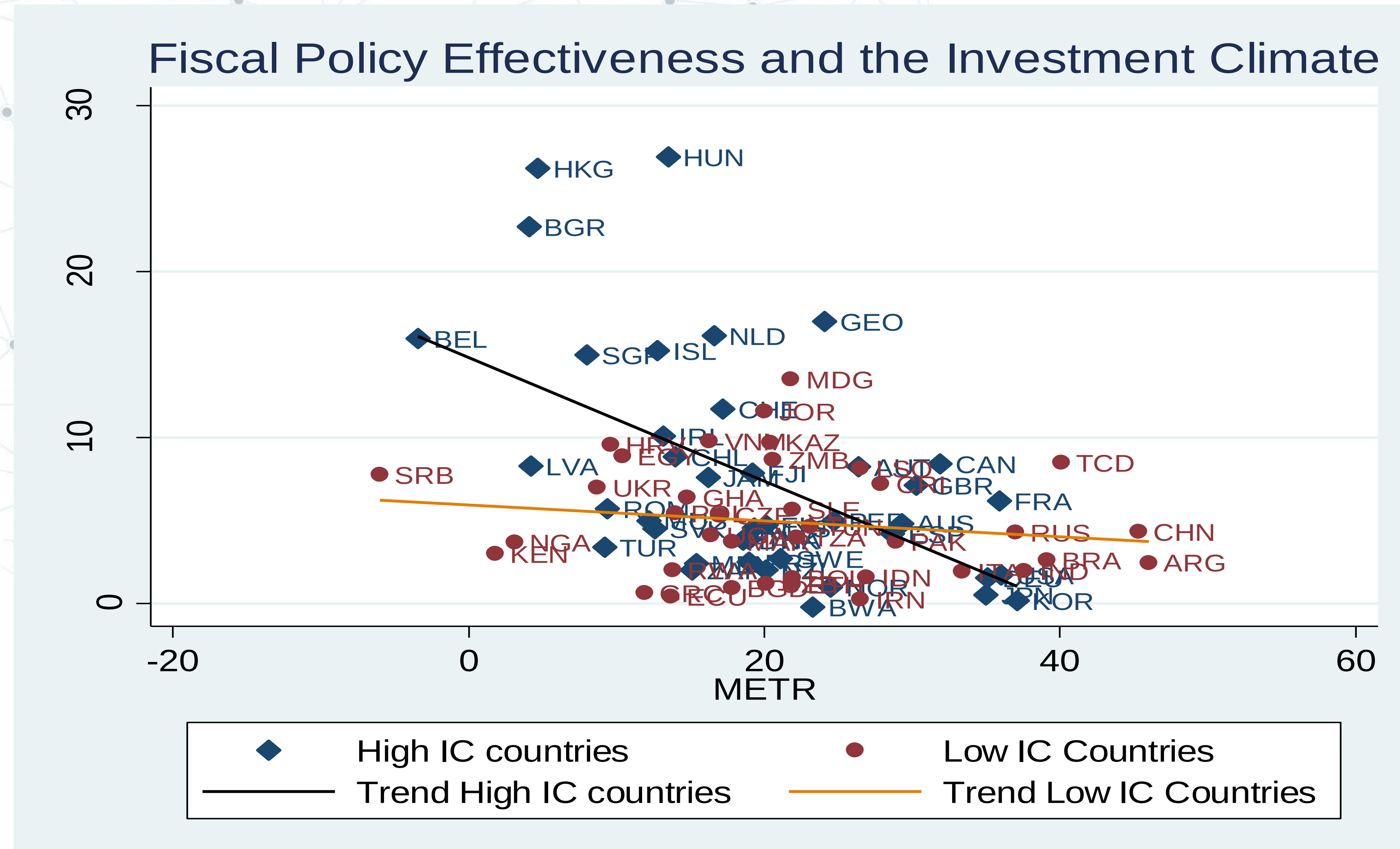
# Investment climate and effectiveness of incentives



# Key concepts to consider

**The topic of investment incentives is complex, with many different variables and issues at play.  The discussion on the role of investment incentives should be:**

i. Looking at **tax** and **non-tax** incentives

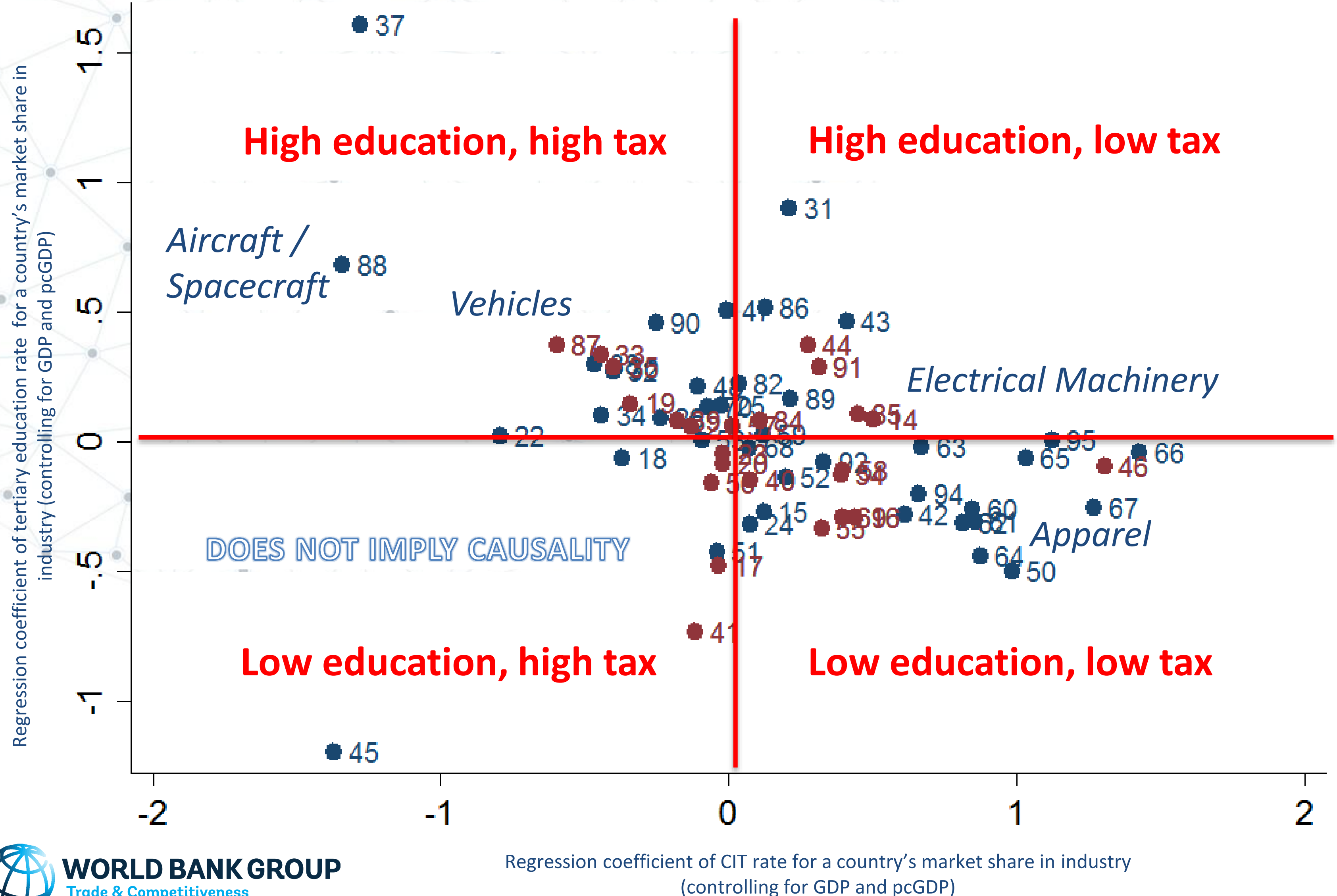
ii. Couched within a framework of a FDI typology **distinguishing motivations behind FDI locational decisions**

iii. Examined within a **sector-specific lens** (notably differentiating between different types of services and manufacturing)

# Investor motivations and responsiveness to incentives

## Applying the FDI typology to determine effectiveness of incentives policies

# Sectoral differences in the importance of taxes and education

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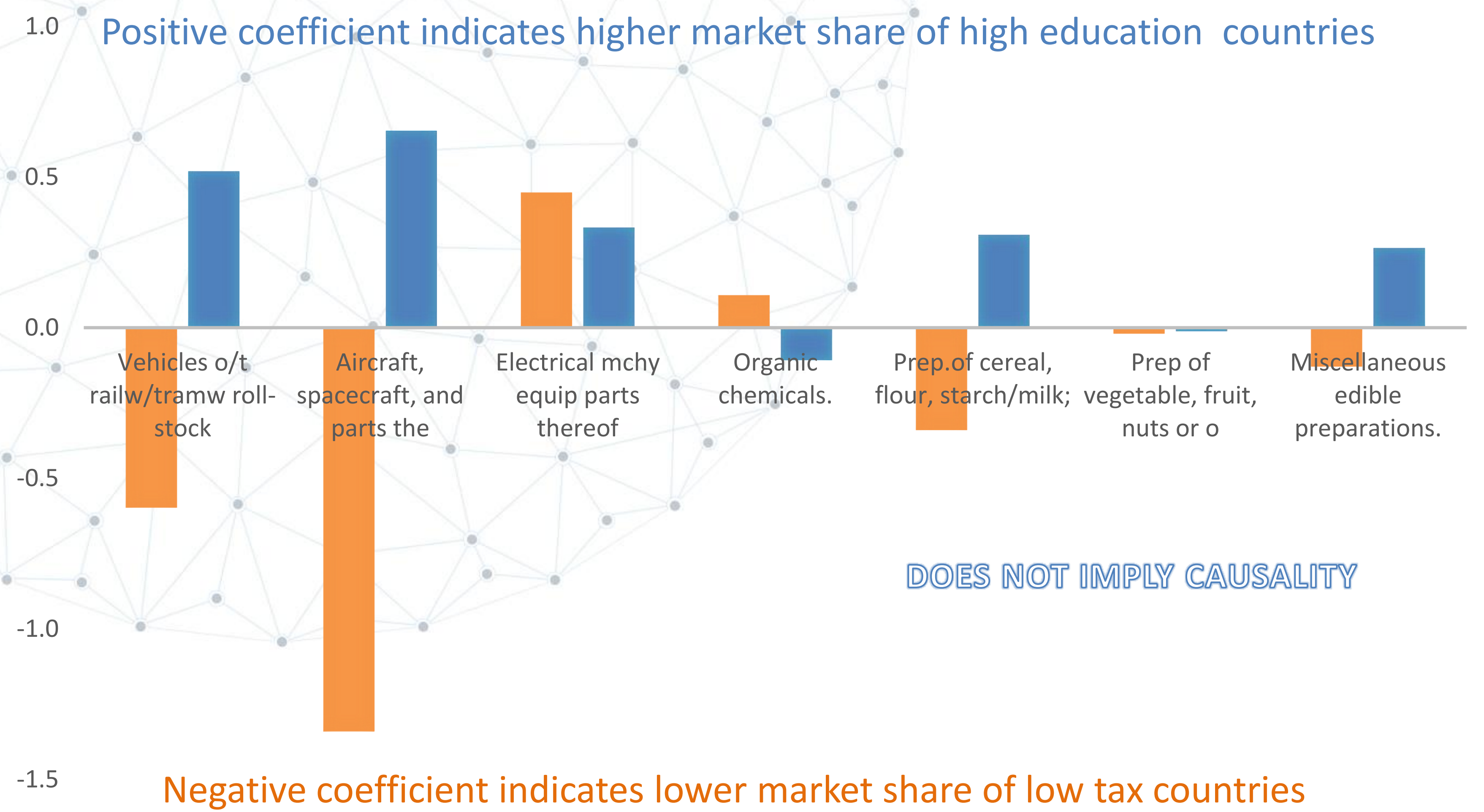
# Main competitors in priority sectors have high levels of skills, but not necessarily low taxes

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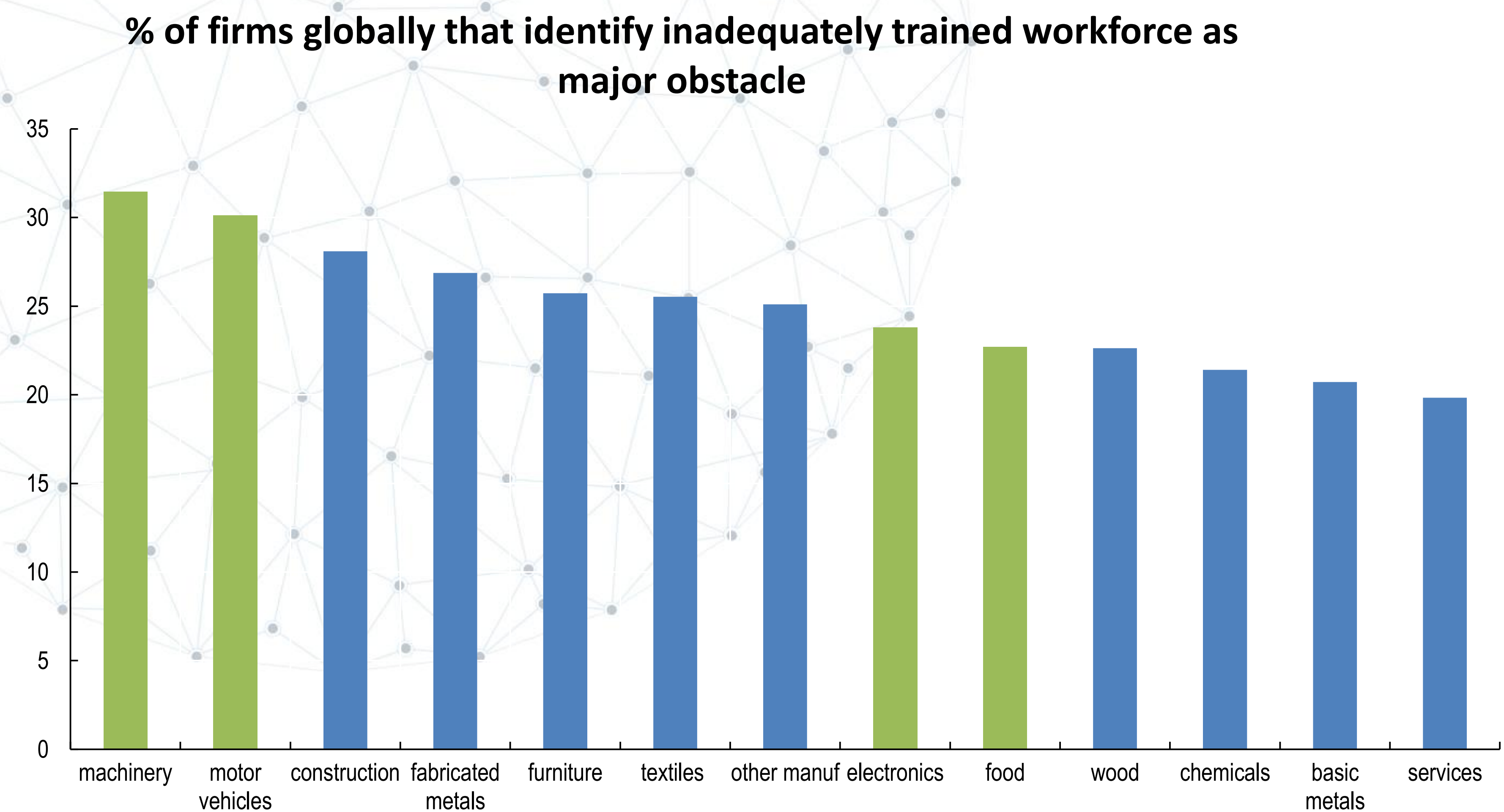
# Globally, skills shortages are common in sectors identified as priorities by Thailand




Source: Perea et al 2016

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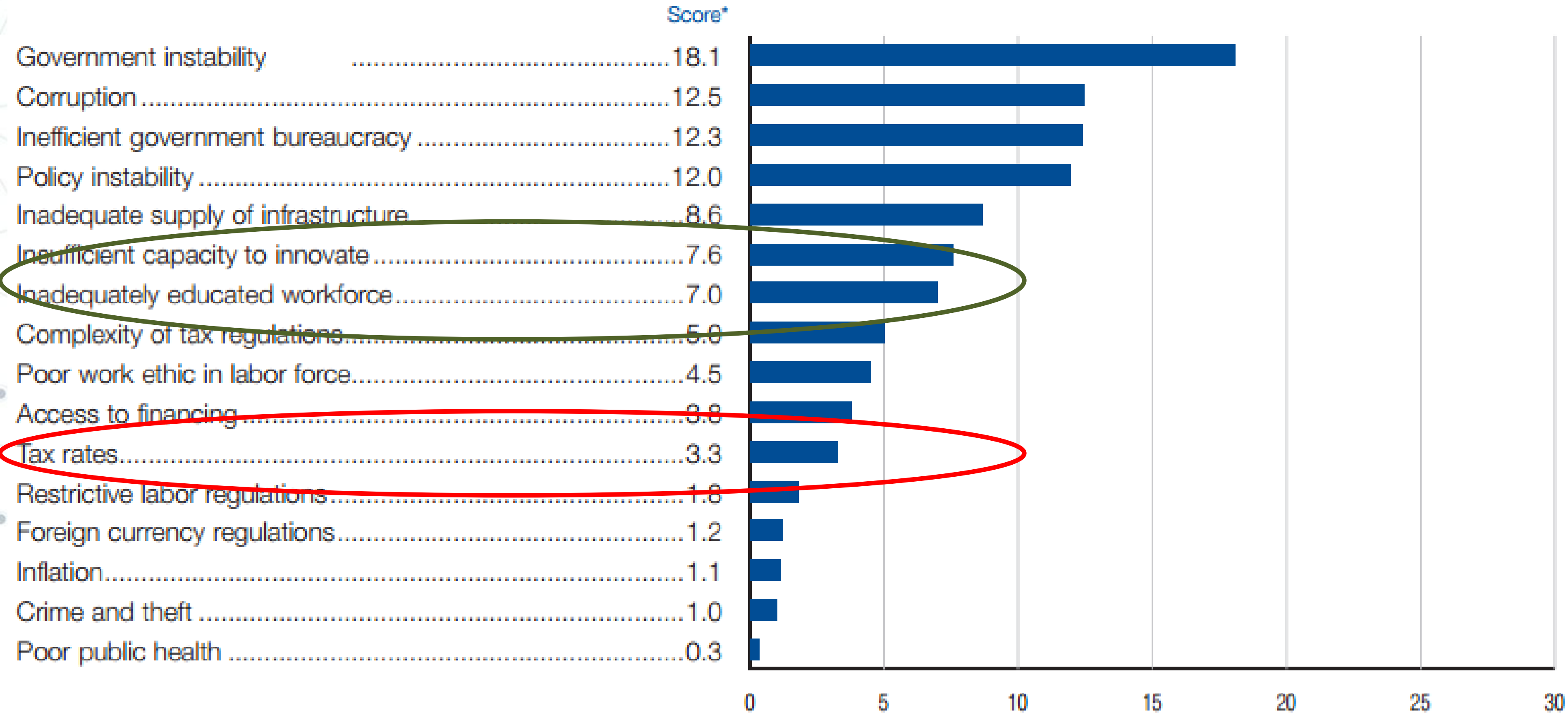
# Most problematic factors of operating a business in Thailand




* From the list of factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

Source: WEF (2015) The Global Competitiveness Report 2015–2016

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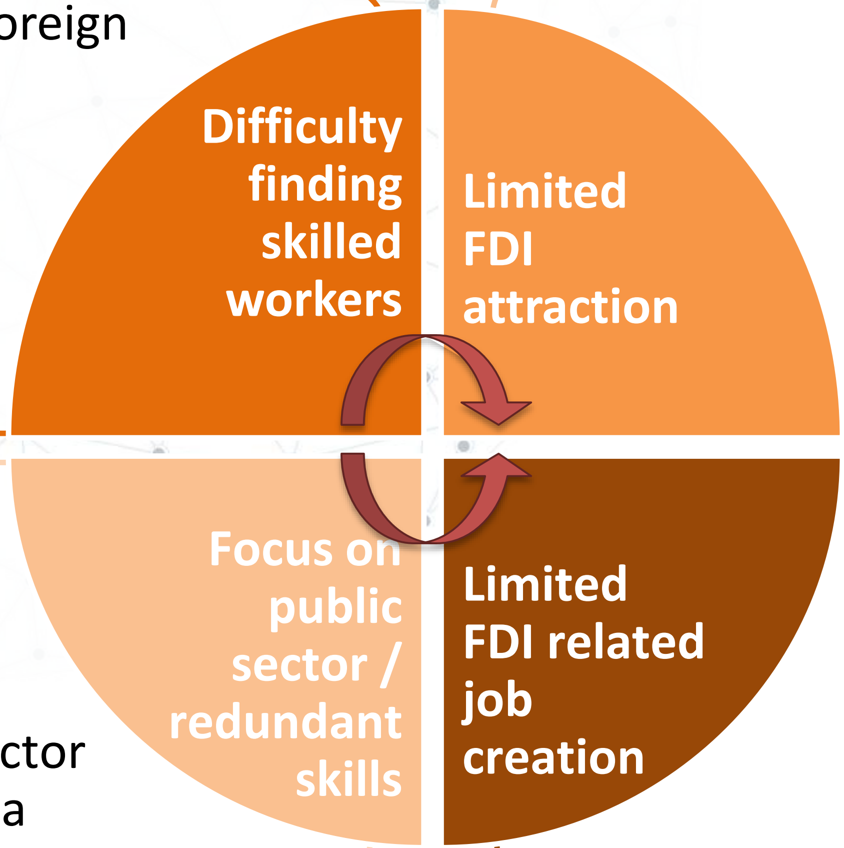
# Skills and FDI – from vicious circles …

## A vicious circle of skills and FDI, aggravated by policy failures…

- Restrictions on foreign workers

- Performance requirements




- Inadequate skills planning
- Lack of private sector inputs on curricula

- Ill-targeted investment incentives and adverse selection

# … to virtuous circles

## A virtuous circle of skills and FDI, supported by a sustainable policy framework

Regulatory incentives can facilitate visa and work permit procedures for critical skills

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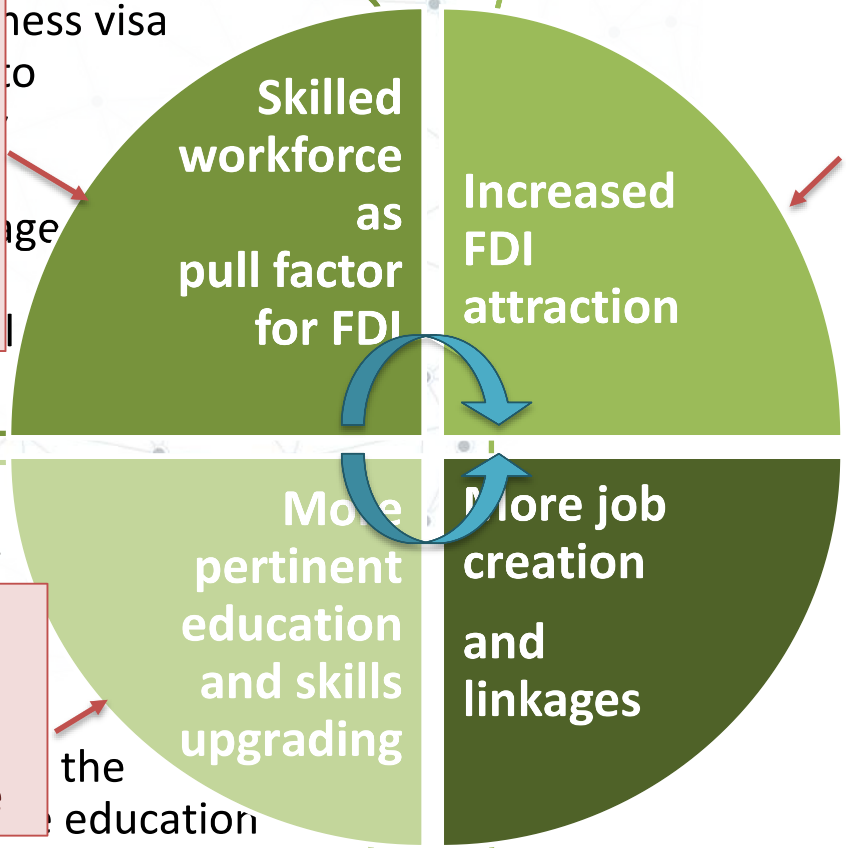
labor markets




‘skills incentives’ support training and promote pertinence of skills

- Training and skills … development, education grants, etc.
- Promoting non equity modes of investments to fast track transfer of technical skills and management capabilties
- Promoting linkages to foster indirect job creation

- Removing barriers for private particip-

Not strictly an incentive, but IPA can play an important coordination role here

the … education … system

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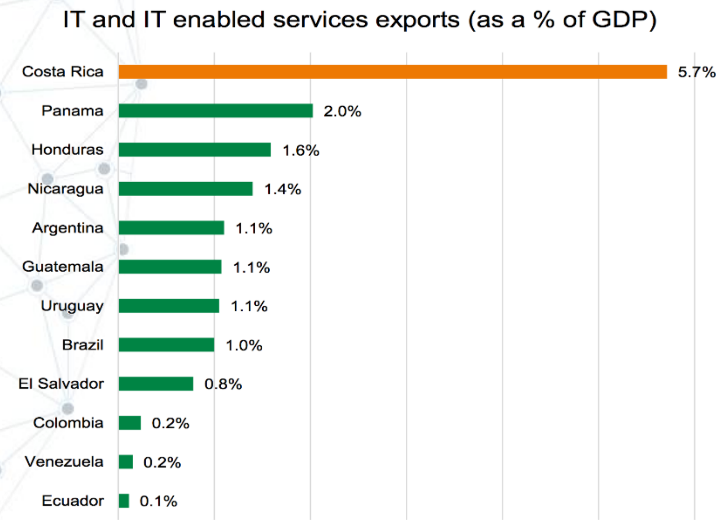
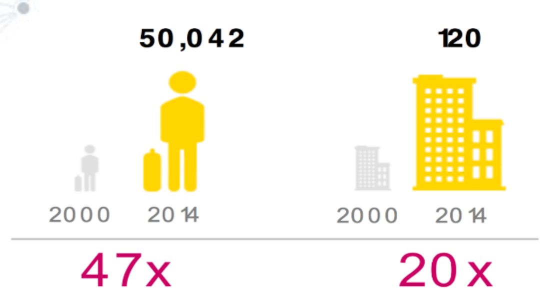
# Incentives in the IT and IT enabled services industry - the case of Costa Rica

## The IT & IT enabled services industry in Costa Rica

- CR has been proactively promoting this industry and attracting FDI in this sector for the last 20 years
- A steady evolution from
  - mostly contact centers to provide transactional operations (90ies) to
  - shared services operations in the early 2000s to
  - today: engineering & design services, software development co.'s - led to the arrival of new operations in Costa Rica in the last 5 years




- To date: 120 multinational companies in the sector
  - A diverse, sophisticated industry growing in complexity
- More than 50,000 direct employees (95% are local)
  - Yearly output per employee ranges from US$ 30.000 to US$120.000 (2014)
  - Average reaches close to US$ 65.000 in 2014 (5x increase in 10years)

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# 3 Key pillars underpinning CR's value proposition in the sector

- Facilitating investment climate
- Incentives
- Human capital

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# The evolution of CR's incentives policy

- Facilitating investment climate
- **Incentives**
- Human capital

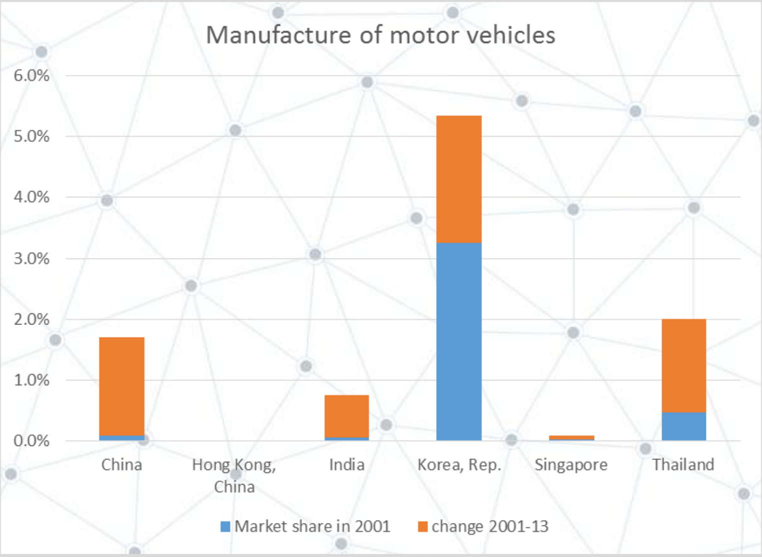
- Costa Rica's system in place since 90ies and mostly unchanged
  - Predictabilty and transparency are key
  - Efficient administration and solid institutional framework
- Primarily tax-based incentives
  - CIT exemption 100% (for 5 years)
  - VAT exemption 100%
  - WHT exemption 100%
  - Customs duties 100%

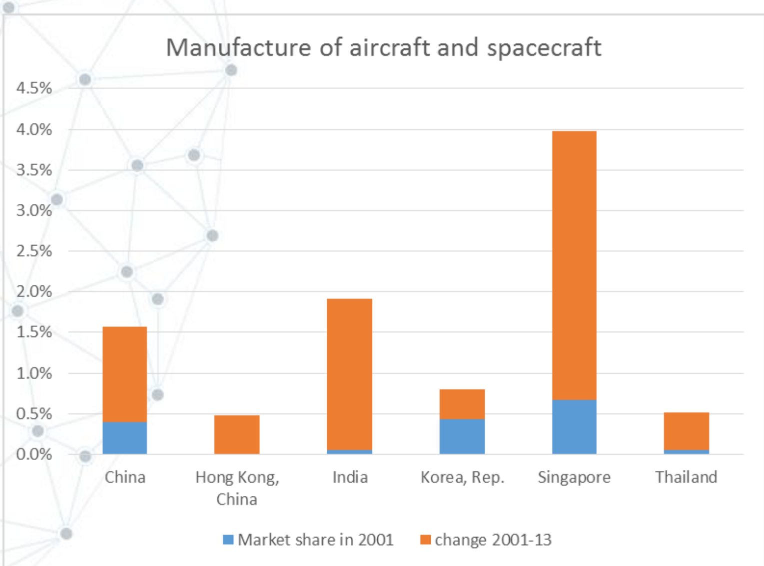
- **Recently: incipient financial incentives linked to human capital development to support IT and IT enabled industries**

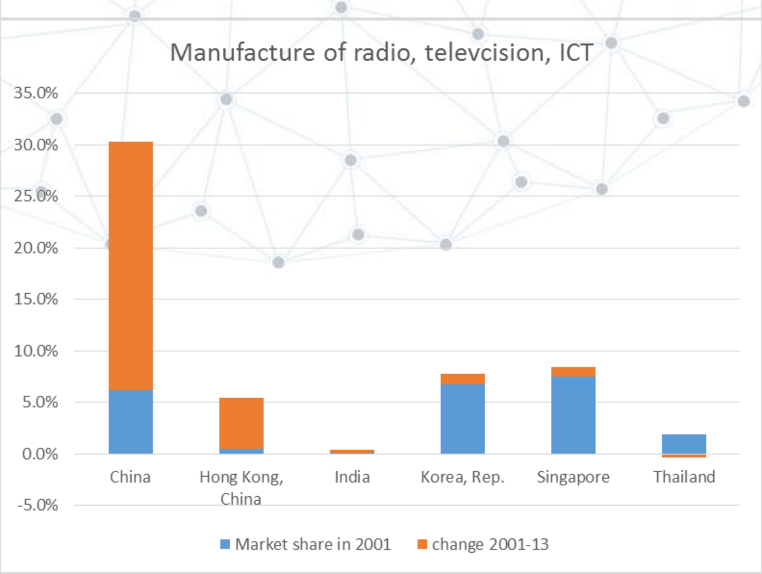
# CR - targeted policies to support human capital development

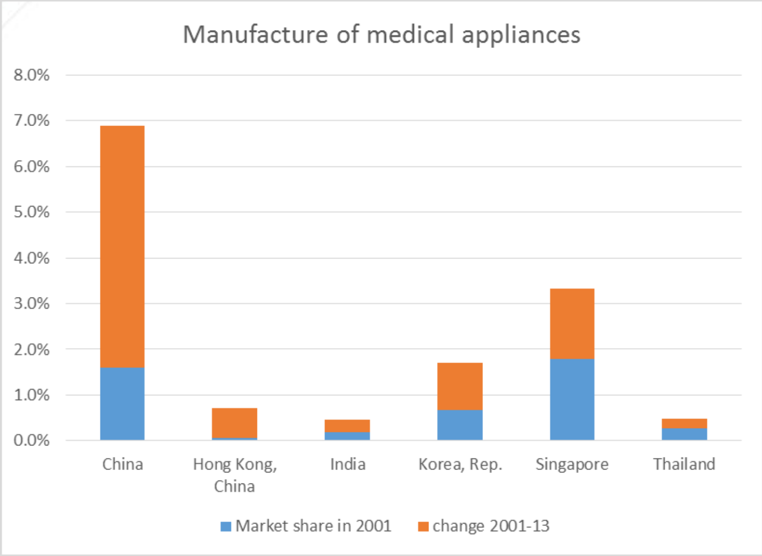
- **Forging partnerships with leading multinational companies in the country to address topics of mutual interest, i.e. human capital development**
  - ➢ Signing of MoUs between multinationals and the Government to benefit employees and potential employees
- **Setting the institutional framework for implementation & administration of talent development initiatives: Creation of a Human Capital Development Fund**
  - ➢ Catalyst and articulator between different actors and stakeholders in private and public sector to design and follow-up on human capital development initiatives
  - ➢ Administer granting of funds for training programs, scholarships and capacity building initiatives (short courses, 6 months, 2 to 5 years)
  - ➢ Administer granting of funds for relocation of foreign personnel for knowledge transfer programs
  - ➢ Administer and coordinate MoUs between companies and Govt. to incentivize industry-specific human development initiatives and share cost

# Top performers for some of Thailand's priority sectors are located in the region

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# Incentives policies (select top performers in the region)

| Country | Objectives and focus | Incentive types | Focus on skills and R&D |
|---|---|---|---|
| **South Korea** | • Highly focused incentives regime targeting high tech, high value added industries<br>• Main objectives are technology transfer and R&D intensive manufacturing | • Tax incentives for specific types of investments, greenfield and re-investment<br>• SEZ designed for specific target industries<br>• Financial incentives for on-the-job training and R&D | • Cash Grant System in KOTRA (Employment /education/training subsidy): 50:50 (100 government for interns in engineering)<br>• Special subsidies in SEZs for education and training<br>• Grants and training for "creative startups" and female entrepreneurs |
| **Singapore** | • Highly focused and targeted regime including pre-screening and approvals<br>• Focus on attracting:<br>  • Regional and Global Headquarters<br>  • Logistics<br>  • Financial service<br>  • R&D activties | • Tax incentives<br>• Financial incentives for R&D<br>• Financial incentives for human capital development. | • Productivity and Innovation Credit (PIC) Scheme: tax benefit scheme introduced in 2010 - up to 400% deduction or allowances on up to $400,000 of expenditure incurred in training of employees<br>• Research Incentive Scheme for Companies (RISC): supports development of strategic technologies, capabilities and establishment of centers of competence: Support for manpower costs (30% - 50%)<br>• Maritime Innovation & Technology (MINT) Fund: Aiming at R&D in maritime sector, same as above: up to 50% of manpower costs<br>• Initiatives in New Technology (INTECH): Companies can be supported for either trainee cost OR training cost, subject to various sub-caps |
| **India** | • Focused on attracting investment in Infrastructure and export oriented industries with high labor labor intensity<br>• Strong regionalization – diversity of state level incentives | • Several types of SEZ, depending on business activity.<br>• R&D supported by tax incentives mainly in Pharmaceuticals, Transportation and ICT<br>• General tax exemptions for knowledge-based startups | |

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# Work permits for expat labor (select top performers in the region)

| Country | Process online / one stop shop service available | Average processing time | Quota limitations (for IT specialist) | Initial validity period / extension (years) | Possibilty to switch employer | Degree of obstacle (perceived) |
|---|---|---|---|---|---|---|
| **Thailand** | No / BoI companies only | 2 weeks | Yes – linked to registered capital | 1 / +1 | Yes | Moderate |
| **South Korea** | Yes / No | 1.5 weeks | No | 2 / unlimited | Yes | Minimal |
| **Singapore** | Yes / Yes | 1.5 weeks | No | 5 / unlimited | Yes | Minimal |
| **India** | Partial / No | 3 weeks | No | 2 / 5 | No | Moderate |

Source: WBG (2013) FDI regulations database

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# Characteristics of effective incentives frameworks

**Governments can adopt different techniques in order to tailor incentives to their policy aims and maximize the effectiveness and efficiency of those incentives**

**1 Regular assessment of effectiveness**

- Periodically study the effectiveness of both tax and financial incentives to assess the extent to which the incentives could meet the stated objectives
- Measure and publish the costs and benefits of incentives and allow the public to see themselves if incentives do work
- Establish a mechanism to systematically and periodically collect and capture data required to assess the effectiveness of incentives

**2 Link to specific policy objectives**

- Ensure incentives are focused on specific objectives and tied to performance criteria rather than making them unconditional
- Investment incentives should be part of a broader coherent and consistent investment attraction strategy (public statement of policy objectives)
- Incentives should only be considered one policy instrument of a larger government effort to address key investment objectives

# Characteristics of effective incentives frameworks *(contd.)*

**Governments can adopt different techniques in order to tailor incentives to their policy aims and maximize the effectiveness and efficiency of those incentives**

**3 Increase transparency and limit discretion**

- Firms favor incentives that are transparent and easy to understand, and value certainty in incentives policy
- Minimize discretion by adopting clear and objective eligibility criteria / rules and ensure transparency
- Regularly measure and publish the cost of incentives (yearly tax expenditure statements) and place a budget on incentives

**4 Strengthen administration**

- Incentives instruments should have a clear and simple design
- Ensure incentives are administered by a well governed and adequately resourced entity awarding, selecting, and managing incentives for a specific purpose
- Strengthen monitoring and impact assessment functions

**Effective incentive regimes should be targeted, transparent, simple and affordable**

# Some inputs for consideration

- Understand your target segments - What do we know about the effectiveness of the current tax incentives vis-a-vis attracting investment in targeted priority sectors?

- Incentives to support innovation and R&D – what else can be done in addition to tax related incentives / what can we learn from success stories in- and outside the region?

- Human capital development – what additional measures / incentives can be taken to address the skills gap in the short term? How can existing positive experiences in Thailand be leveraged and scaled up?

- The details do matter – efficient incentives administration, transparency, predictabilty, effective monitoring and evaluation

# Backup

# Investment incentives – areas of WBG support

**1. Increasing effectiveness vis-à-vis objectives**

**Increased effectiveness in attracting investment and achieving policy objectives**

- Differentiated assessment of effectiveness based on types of FDI/sectors
- Evaluation tools incl. Impact evaluations, case studies, IMS

**2. Fostering transparency and better governance**

**Increased transparency, "level playing field" for investors**

- Incentives inventory
- Inventory software solution
- Transparency checklist
- Good practices / guiding principles for incentives administration

**3. Improving administrative efficiency**

**Reduced compliance costs for investors**

- Process and procedures mapping and streamlining
- Best practice principles
- Investor perception survey

**4. Minimizing distortions to competition**

**Minimized distortive effects on competition**

- Compliance with international obligations
- Legal compliance checklist
- Regional scorecard and monitoring mechanism

# Terminology

### Investment Incentives

Measurable economic advantages that governments provide to specific enterprises, with the goal of steering investments into favored sectors or regions or of influencing the character of such investments

-James, S. (2009) World Bank.

### Instrument

**Tax Incentives:** exemptions or reductions of government revenue otherwise due

**Financial incentives**: direct transfer of funds or potential direct transfer of funds and liabilities; provision of goods and services, and payments-in-kind

### Role

**Locational Incentives:** aimed at attracting investment into a country (targeting investor's decision of where to locate)

**Behavioral Incentives**: aimed at inducing investors to engage in certain activities or behaviors (e.g. fostering employment, forming linkages with local suppliers, adopting green technologies)

# The increasing diversity of investment incentives

## A typology of investment incentives

As the global competition for FDI intensifies, governments both in developed and developing countries apply a growing number and variety of incentive instruments to achieve their policy objectives.

Investment incentives fall into either of the below categories

**Key types of ...**

| Fiscal incentives | | Financial incentives | |
|---|---|---|---|
| Income tax | • Tax holiday or lower tax rate<br>• Investment allowance<br>• Accelerated depreciation<br>• Special deductions<br>• Exempted income<br>• Exemption from withholding<br>• Tax rebate/credit | Direct grants & cost-sharing schemes | • Cash grants on proof of start-up, or after x years of operation<br>• Matching grants<br>• Public sector equity participation |
| | | Reduced market values / direct provision of land | • Public land or buildings sold to investors at below market values |
| Value added tax (VAT) | • VAT zero rated goods<br>• Exemption from import VAT<br>• VAT exemption (domestic sales)<br>• Remission from VAT | Low input prices from para-statal companies | • Reduced rates on public utilities (e.g. electricity, water) and transportation |
| Customs duty | • Duty exemption<br>• Duty remission | Lending instruments and guarantees | • Soft loans<br>• Interest subsidies<br>• Loan guarantees |
| **Other non-fiscal instruments** | • E.g. Regulatory incentives, Setup assistance and aftercare | | |

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# Some evidence pertaining to the effectiveness of R&D&I incentives

## Incentives for R&D and innovation

- Both, tax credits and R&D subsidies show a positive and statistically significant association with R&D intensity and stimulating additional private investment in R&D.
- Tax credits seem to be more effective when firms are not facing financing constraints.
- Grants and subsidies seem to work best for SMEs rather than large firms.
- Tax incentives and subsidies are not substitutes, but rather complimentary policy tools for R&D. The use of tax credits in conjunction with direct subsidies is shown to have a slightly higher impact than tax credits alone.
- Best practices on R&D incentives design suggest that they should have a clear and simple design. The process of granting incentives should be transparent and incentives should be easily accessible to a broad range of firms. Direct support schemes, should be managed by a single entity and should be given according to a clear selection and ranking mechanism.
- Particularly for R&D incentives, complicated application and verification procedures discourage businesses from applying for financial assistance. This is particularly true for SMEs, which often do not have the financial resources to hire a consultant to file applications for incentive schemes.

** ... Source: internal research conducted by the Trade and Competitiveness Global Practice Group, World Bank Group, based on existing literature on impact evaluations in developing and developed economies, as well as internal operational data*

# Some evidence pertaining to the effectiveness skills and training incentives

## Incentives for skills development

- Tax incentives are more effective in reducing economy wide under investment into education and training
- Financial incentives are better suited to target specific groups, like older employees or SMEs, that have not yet invested into skills development
- A third instrument are Levy Schemes, which have shown to be effective against poaching
- Key characteristics of effective incentives design include
    - A balanced use of all instrument appears to be the most effective approach to correcting skill related market failures
    - The more targeted the instruments are used, the higher the impact they can create

** ... Source: internal research conducted by the Trade and Competitiveness Global Practice Group, World Bank Group, based on existing literature on impact evaluations in developing and developed economies, as well as internal operational data*

# Costs and benefits of investment incentives

## COSTS

**Direct Costs**
- Tax Expenditures
- Government Expenditures on Financial Incentives

**Market Distortions**
- Disadvantages incurred to business not receiving incentives
- Inefficient markets

**Incentives Competition**
- "Race to the bottom" at regional, national or subnational level

**Environmental Damage**
- Pollution
- Destruction of natural resources

**Administrative Costs by Government**
- Time and expenses to administer incentives

**Opportunity Costs**
- Potential additional gains from alternative use of public funds

**Political Economy/Corruption**
- Rent seeking
- Tax evasion/avoidance

**Social Welfare Implications**
- Uneven Development
- Growth of inequality

## BENEFITS

**Revenue Rise from Tax Collected**
- Additional tax revenues from investment growth of firms that respond to incentives

**Investment Growth**
- Additional investment generated directly and indirectly (signaling effect, ancillary services, clusters)

**Diversification**
- Growth of strategic and/or sunrise sectors

**Development of Public Goods**
- Increased adoption of green technologies
- Improved infrastructure

**Job Creation**
- Additional total employment
- Growth in number of high-skilled jobs

**Productivity Gains**
- Growth of R&D and Innovation
- Skills upgrade
- Higher value-added investments

**Improved Balance of Payments**
- Growth in proportion of exports

**Spillovers and other Indirect Benefits**
- Multipliers on jobs, productivity, etc.
- Forward/backward linkages

# Skills shortages remain an investment constraint for Thailand


Source: WBG Enterprise Surveys

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