WORLD TRADE ORGANIZATION

RESTRICTED

WT/TPR/S/196
21 January 2008

(08-0236)

Trade Policy Review Body

TRADE POLICY REVIEW

Report by the Secretariat

BRUNEI DARUSSALAM

This report, prepared for the second Trade Policy Review of Brunei Darussalam, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from Brunei Darussalam on its trade policies and practices.

Any technical questions arising from this report may be addressed to Mario Kakabadse (tel: 022 739 5172).

Document WT/TPR/G/196 contains the policy statement submitted by Brunei Darussalam.

CONTENTS

Page

Page

CHARTS

TABLES

Page

APPENDIX TABLES

SUMMARY OBSERVATIONS

(1) ECONOMIC ENVIRONMENT

1. Brunei Darussalam is a small, relatively open economy in which trade and foreign direct investment play vital roles. With one of Asia's highest per capita incomes, of US$30,000, Brunei owes its prosperity mainly to its abundant petroleum (oil and natural gas) resources, whose share of GDP grew from 53% in 2002 to 69% in 2006, and whose share of exports rose from 88% to 96% during the same period, largely due to the sharp rise in oil and gas prices. Nonetheless, between 2002 and 2006, the economy grew at a rather modest annual average real rate of 2.5%, which is insufficient to generate enough jobs for Brunei's growing labour force. As a result, official estimates put unemployment at some 4% in 2006, a cause for concern among Bruneians. Overall, inflation has remained subdued at around 1%, generally moving in line with price trends in Singapore because of the currency peg to the Singapore dollar. Inflation is somewhat repressed, however, by the price controls and subsidies with respect to essential food items and petrol.

2. The oil and gas sector's large share of GDP and exports leaves Brunei vulnerable to external shocks, particularly given the prospect of an eventual depletion of these resources. Estimates of how long Brunei's proven petroleum reserves will last at current rates of extraction vary from 10 to 25 years; gas reserves are widely estimated to last for up to another four decades. Consequently, the Government has been encouraging economic diversification, mainly into manufacturing and services, especially financial services, tourism, and transport. The private sector is being encouraged to participate, although government salaries and benefits have made it difficult for it to compete with the public sector; it is estimated that around 25% of the workforce is employed by the Government but that over 90% of Bruneians in the labour force are employed by the public sector, including state-owned enterprises. The "Bruneization" policy, which encourages companies to give preference to Bruneians in their employment policies, has been successful mainly in the government and petroleum sectors.

3. Petroleum also continues to be the main source of revenue for the Government. Corporate taxes and royalties paid by oil and natural gas companies now account for some 94% of all government revenue, up from 86% at the start of the review period in 2002. By contrast, Brunei levies virtually no tax on personal incomes or on goods and services. Tax revenue therefore fluctuates with oil and gas production, changing petroleum prices, and the profitability of the oil and gas industry. For most of the period under review, the saving of windfall revenues associated with high energy prices has placed the Government in a strong fiscal position and thus helped stabilize the economic cycle.

(2) TRADE AND INVESTMENT POLICY FRAMEWORK

4. Under Brunei's Constitution, the Sultan is the Head of State and the Executive. After many years without a legislature, the Legislative Council was reconvened as a wholly appointed legislature in 2004; no date has yet been set for a partial direct Legislative Council election. New legislation in Brunei has continued to be promulgated by the Sultan as "Emergency Orders", which carry the force of law. International agreements, including WTO Agreements, once ratified by the Sultan, must be adopted through national legislation to be enforceable in Brunei. A number of changes and revisions, partly relating to WTO provisions, have been made to national laws with respect to intellectual property rights, customs and excise as well as to recent regional and bilateral agreements and investment, including foreign direct investment.

5. In 2005, trade policy formulation and implementation was transferred from the Ministry of Industry and Primary Resources to the Ministry of Foreign Affairs and Trade, which works in cooperation with other agencies, notably the Ministry of Finance. Apart from the Auditor General, who may, under the Constitution, present an annual audit

of the Government's financial statements to the Sultan, Brunei's institutional framework is characterized by a lack of transparency with respect to trade and trade-related policies, to the detriment of government accountability. In particular, there is no independent body to evaluate government policy and, as a consequence, provide an impetus for reform of policies that are found to be ineffective. The lack of data in several key areas and activities (including national accounts, government finance, balance of payments, the financial system, assessments of national development plans, and activities of government-linked companies) continue to be an impediment to both the formulation and effective evaluation of trade and trade-related policies and measures.

6. Brunei has intensified its participation in regional and, for the first time, bilateral trade agreements. It is particularly active in ASEAN, the East Asia Growth Area, APEC, and the four-member Trans-Pacific Strategic Economic Partnership (SEP) Agreement (with Chile, New Zealand, and Singapore). In ASEAN, Brunei has reduced tariffs on 93% of tariff lines to 5% or zero for products of ASEAN origin. The Brunei Darussalam, Indonesia, Malaysia, Philippines–East ASEAN Economic Growth Area (BIMP–EAGA) aims to pool complementary resources in the region to develop selected sectors, including air and maritime linkages, construction, fisheries, and tourism. The Trans-Pacific SEP aims to liberalize and facilitate trade in goods (by removing all tariffs on traded goods over time) and a broad range of services as well as to improve the business environment among the four participating countries.

7. Brunei has also increased activity on the bilateral front. In 2002, Brunei and the United States signed a Trade and Investment Framework Agreement (TIFA) to enhance liberalization of trade and investment, and cooperation in such areas as intellectual property, information and communication technology, biotechnology and eco-tourism, aquaculture and halal products; it also includes consultations on the elements of a possible free-trade agreement. In 2007, Brunei and Japan signed the Brunei-Japan Economic Partnership Agreement to facilitate the free flow of goods, services, and investments as well as enhance cooperation in energy, human resource development and science and technology.

8. In seeking to promote private sector development in non-oil and gas industries, Brunei overhauled its investment laws, and established the Brunei Economic Development Board (BEDB) in 2001 to promote Brunei as an investment destination. The BEDB adopted a new approach to attracting FDI, focusing on a few large projects, including a global mega port hub and downstream manufacturing industries using natural gas. The Government expects these large-scale investment projects to improve the international image of Brunei, kick-start economic diversification, and provide significant employment opportunities for the local labour force. According to early indications, this approach appears to be working. Foreign investment, including up to 100% foreign equity investment, is permitted in all sectors except those involving local natural resources (notably agriculture and fisheries) and those relating to national food security, for which minimum local participation of 30% is required.

9. To encourage foreign investment, Brunei provides tax incentives, particularly under the pioneer status programme. This exempts companies from corporate tax (normally 30% for non-petroleum companies), up to a maximum of 11 years, and from customs duty on imports of plant, machinery, and equipment as well as inputs of raw materials not available in Brunei. Given that around 95% of corporate tax revenue in 2006 was raised from petroleum and natural gas companies, it would appear that most companies operating in the non-oil sector are beneficiaries of such programmes. The Brunei Investment Agency (BIA) manages the investment of Brunei's considerable fiscal surpluses. While the bulk of these funds is thought to be invested abroad, no information was provided to the Secretariat concerning the

BIA's total stock of foreign assets or its portfolio of investments.

(3) TRADE POLICIES AND PRACTICES

10. Brunei Darussalam is committed to applying MFN treatment to products coming from all WTO Members. Brunei's applied MFN tariffs are low, averaging 4.8% in 2007, zero for agriculture and 5.4% for non-agricultural products, ranging from 0% to 30%. Almost 99% of tariffs are subject to *ad valorem* rates, while 131 carry specific rates of duty, which apply mainly to matches, cigarettes, coffee, tea, and petroleum oils and lubricants. As they tend to conceal relatively high *ad valorem* equivalents, estimates of which were not available, it is likely the inclusion of these specific duties in the calculation of the average applied MFN tariff rate would raise Brunei's overall level of tariff protection. Brunei has bound nearly 93% of its tariff lines at the WTO; while the average applied tariff rate is low, the average bound rate is 25.8%, leaving a large gap between the applied and bound MFN rates. This gap can bring about uncertainty for traders and other economic agents as it provides scope for the authorities to raise applied tariffs within the higher rates. However, Brunei has not made use of this scope during the period under review.

11. Brunei has continued to reduce its already low tariff rates under ASEAN as well as more recent preferential agreements, although imports of a few products are still subject to non-tariff restrictions. As a member of the ASEAN Common Effective Preferential Tariff (CEPT) scheme, Brunei has continued to reduce its preferential tariff rate, currently at 2.4%, half of the average applied MFN rate. Differences between the CEPT and MFN tariffs exist mainly in plastic and rubber products, machinery, transport equipment, and precision instruments. As a result of the Trans-Pacific SEP Agreement, Brunei will bind its current MFN applied zero rates at zero and eliminate all the tariffs that it applies to other products by 2015, except for a short list of items, such as alcohol, tobacco, and firearms that it intends to exempt on moral, human health, and security grounds. Under the Brunei-Japan EPA, which entered into force in 2007, Brunei is committed to eliminating tariffs on a range of products, including Japanese automobiles and auto parts, whose rates are currently set at 20%.

12. Although Brunei's tariff barriers are relatively low, a number of import prohibitions, restrictions, and licensing requirements on various products for health, security, and moral reasons have remained generally unchanged during the review period. In addition, a few products (e.g. rice, sugar) are still subject to export restrictions, mainly to attain security of domestic supplies. Currently, there are no mandatory standards (technical regulations) in Brunei, only 42 voluntary standards that relate to construction and one in the food sector. There is no national body for setting standards in Brunei; the Construction Planning and Research Unit, based in the Ministry of Development, is the coordinator for standards and conformity assessment activities.

13. As the Government is the largest operator in the economy, its policies on procurement and competition also have an impact on trade. Government procurement remains an important instrument of economic policy, and government construction activities, in particular, play a major part not only in the construction industry, but in the economy as a whole. Brunei is not a signatory to the WTO Government Procurement Agreement. There is no specific legislation pertaining to competition policy, although Brunei is exploring the possibility of introducing such legislation in line with APEC principles; also, steps have been taken to increase competition through deregulation and corporatization in certain sectors, such as telecommunications. Brunei does not have its own tradeable stock exchange, and as such there is no specialized corporate governance code or takeover code.

14. In order to encourage investment in priority sectors and production for export, Brunei continues to use extensive tax and other incentives. In the absence of personal and value-added taxes, the corporate tax has

remained a leading instrument of industrial policy, offering tax incentives for companies investing in a broad range of activities under the pioneer status programme. These incentives are aimed at developing small and medium-sized enterprises (SMEs), which make up nearly 95% of enterprises in Brunei. Various national development plans, including the 8th covering the period 2001-05, have attempted to diversify the economy, the key to Brunei's medium-term growth prospects. However, despite the use of tax and non-tax incentives (whose cost-effectiveness is questionable), the non-oil, SME-dominated private sector remains embryonic and largely dependent on government spending on construction and services. In addition to investment incentives, the Government's holding company, Semaun Holdings, which is answerable to the Minister of Industry and Primary Resources, invests directly in certain sectors and still dominates the manufacturing sector. Relatively limited information is available on Semaun's contribution to GDP or its annual accounts, underlining a certain lack of transparency and public accountability in government policies.

15. Brunei has strengthened its legal framework for the protection of intellectual property rights (IPRs) and is considering accession to the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, which address copyrighted works in a digital environment. However, it still needs to implement its Patent Order (that dates from 1999) to provide patent protection for, *inter alia*, pharmaceutical and agricultural products and processes. Brunei does not have a strong track record in IPR enforcement, partly due to a lack of institutional capacity, and could therefore benefit from targeted technical assistance in this area.

(4) SECTORAL POLICIES

16. Through successive development plans, the Government has sought to diversify Brunei's economy and create sustainable employment in the non-oil private sector. The 8th Plan emphasized the need to move the economy away from oil and gas as the primary source of economic activity (and revenue) through the expansion of agriculture and industry and the development of certain services with the potential to achieve growth, namely: business services; financial services; hospitality and tourism; and transport and logistics. However, Brunei's economy has become even more heavily dependent on the oil and gas sector. The non-oil and gas manufacturing sector remains weak and underdeveloped and has shrunk from 3% to 1% of GDP since 2002, indicating that Brunei's diversification policy has met with little overall success.

17. In several key sectors of the economy, such as oil and gas, telecommunications, transport and energy generation and distribution, there continues to be a strong government presence, often in the form of state-owned monopolies, which can act unencumbered by any competition law. The resulting lack of competition may have adversely affected prices and the cost of doing business in Brunei, although relevant data were not available. The very small size of the domestic market discourages local and foreign participation in the economy and hampers the ability of non-oil and gas industries to achieve economies of scale, and thus to compete against imports as well as in export markets. The only other major source of export revenue has been the garment industry, which was established to take advantage of the international quota system under the ATC (Agreement on Textiles and Clothing), but following the ATC's expiry at the beginning of January 2005, exports have seriously declined.

18. The export of oil and gas continues to dominate Brunei's economy. Brunei is the fourth-largest oil producer in South East Asia and is also the ninth-largest exporter of liquefied natural gas in the world. The Government encourages diversification, including downstream activities related to the petroleum and natural gas sector. At present, around 93% of Brunei's petroleum and 90% of its natural gas output is exported as crude oil and LNG, respectively. The remaining crude oil output is refined for domestic use. The

Petroleum Unit, established in 1982, is the principal regulator of the petroleum and gas sector in Brunei. It reports to the Minister of Energy, whose portfolio was created in May 2005. The Petroleum Unit's responsibilities include: overseeing the exploitation of Brunei's petroleum and gas reserves, and promoting the development of downstream industries; fixing crude oil prices; and ensuring that internationally acceptable standards on technical, accounting, health and safety, and the environment are complied with. A plan to merge Petroleum Brunei with the Petroleum Unit was scrapped.

19. Farming has become a part-time business for most rural families, owing to the availability of more lucrative forms of employment. Brunei's agriculture sector is very small, accounting for under 1% of nominal GDP in 2006, and Brunei imports more than 80% of its food requirements. To reduce Brunei's dependence on food imports and to attain a greater degree of self-sufficiency in agriculture, government policy has sought to: boost domestic production of rice, vegetables, poultry, and livestock; develop the agri-food industry; produce high-value-added products using new techniques; and conserve and protect the country's biological diversity.

20. Apart from the energy and construction sectors, Brunei's industrial base remains limited. The main industries are cement production, garment making, production of pre-cast concrete structures, mineral water, canned food, dairy products and publishing and printing. The small domestic market, a poorly developed local private sector, high wage costs, a shortage of skilled labour, slow bureaucratic procedures and a lack of transparency, and the ban on foreigners owning land have all deterred foreign capital and technology from non-oil and gas industries in Brunei. However, the manufacturing sector accounted for 13% of employment in 2005 (latest available figure), indicating that labour productivity in manufacturing is less than one tenth of that in the rest of the economy; statistics pertaining to productivity trends in the manufacturing (indeed in any) sector were not available from the Brunei authorities.

21. The share of services (excluding construction) in Brunei's GDP has fallen from 23% in 2001 to under 17% in 2006. The leading services sectors are finance and business services, the wholesale and retail trade, and transport and communications. In recognition of the importance of the services sector for economic growth, the Government has aimed to transform Brunei into a "Service Hub for Trade and Tourism" by promoting trade, travel, business, and communications in and through Brunei and by developing Brunei's infrastructure including: upgrading facilities at Brunei International Airport; expanding Muara Port, Brunei's main port; and increasing capacity in the telecommunications services network to increase penetration rates; as well as expanding coverage by the domestic and international postal services. These efforts have met with some success.

22. During the review period, there has been considerable strengthening of financial sector supervision and regulation, including efforts to enhance monitoring of financial soundness indicators. In particular, the enactment of the new Banking, Finance Company, Insurance and Securities Amendment Orders brings the regulatory framework more in line with international standards. The legislation has paved the way for on-site inspection, increased capital requirements for local Brunei incorporated banks, and tightened provisions affecting financial leasing and other financial services, money transmission services, means of payment such as credit cards, guarantees, and foreign exchange. The Government has continued to encourage Islamic banking (which in mid 2007, accounted for 38% share of commercial banks' assets) on the basis of legislation to support banks operating under Islamic principles, including taking a share of profits from the firms it funds rather than charging them interest. To establish Brunei as an off-shore banking and trading centre for the region, the Government has continued to

develop the Brunei International Financial Centre (BIFC); legislation, enacted to accompany the formation of the BIFC, has sought to introduce measures against money laundering activities and to bring Brunei's standards up to international standards, thereby attracting companies to the BIFC.

23. Telecommunications throughout Brunei are of a high standard and it ranks well in Asia in terms of penetration and infrastructure. Brunei has a telephone household penetration rate of 100% and there has been significant growth of cellular subscribers; mobile penetration, which stood at a healthy 32% by end 2001, continued to grow strongly and reached 74% by 2006. There has also been significant investment in a rural telecoms network, which permits all rural and remote areas to have access to the telephone and Internet. Telecommunications used to be dominated by the public sector, with the Government department Jabatan Telekom Brunei (JTB) providing all fixed line telecommunications services, and DSTCom, also owned by the Government, providing mobile services. Following lengthy delays, JTB was corporatized in 2006 with its duties shared between Telekom Brunei (TelBru), responsible for the supply of telecom services, and the Authority for Info-Communications Technology Industry (AiTi), established as an independent statutory body to regulate the local ICT industry. Brunei's telecommunications industry has recently shifted from a monopoly situation in fixed-line and mobile telephony to a state of oligopoly with the eventual goal of creating a competitive environment where home-grown companies would be challenged to rise to global standards and even break into international markets. Currently, TelBru, the successor to the Government Telecoms Department that operated the fixed-line network, has a monopoly over the fixed-line network; B-mobile has a monopoly over the provision of 3G telephony, and the DST Group has a monopoly over the provision of GSM telephony. According to the authorities, there is some competition in mobile telephony with the entry of B-mobile into the market in 2005, and in the dial-up internet access segment with both TelBru and DST Group in competition.

24. Tourism has been identified as a major contributor to exports with the potential to play an important role in Brunei's economic diversification plans. However, the tourism industry in Brunei remains relatively undeveloped, with around 200,000 foreign tourists in 2007. Around 70% of tourists come from other ASEAN and Asian countries, in particular Malaysia, Singapore, and China. In addition, a much larger number of same-day visitors from Malaysia enter Brunei through land-entry points. The Government's objective is to increase international tourist arrivals as well as increase the average length of stay and expenditure by developing activities such as eco-tourism, adventure and culture tourism, theme parks, and cruising. In order to reach a target of 250,000 tourists by 2010, additional facilities, including accommodation, transport and communication, and banking services, need to be developed.

(5) OUTLOOK

25. The major challenge to Brunei's economy stems from its continuing high dependence on oil and natural gas. The authorities have to deal with volatile government revenue caused by energy prices and prepare for the depletion of oil and gas resources in the coming decades, by creating sustained growth in the non-oil private sector, while reducing the role of the Government. According to growth estimates by the Brunei authorities based on the first six months of 2007, however, it appears unlikely that growth would reach 2% in 2007. In the longer run, the Government recognizes the need for diversification away from petroleum and energy-based industries, but to date, Brunei's diversification policies seem to have met with little success.

26. A key, internal, long-term risk therefore continues to be the lack of progress concerning the Government's diversification programme. Despite the provision of investment incentives, the private sector in

Brunei remains small and weak, a point noted by the Brunei Darussalam Economic Council eight years ago, in part because the public sector remains pervasive and provides attractive salaries with which very few private companies can compete.

27. A related factor is the lack of transparency in government policies and the manner in which they are administered. Foreign investment policies, while encouraging investment in all sectors, are unclear about limits on foreign equity holdings and the sectors in which investment is restricted, thereby providing scope for discretion in government decision-making. As the IMF has pointed out, the financial and statistical database in Brunei is considered weak with regard to coverage, quality, timeliness, and frequency. Lack of reliable and timely data on, *inter alia*, investment income, balance of payments, monetary statistics, the labour market, and the national accounts, as well as scant or non-existent information about the progress made under the latest national development plan, highlight the general lack of transparency, and thus public accountability, in the management of the economy.