Addressing Barriers to the Integration of Brunei Darussalam's Business Services Sectors into Global Value Chains

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Contents

Acronyms and Abbreviations

2PL	2nd Party Logistics
3PL	3rd Party Logistics
4PL	4th Party Logistics
ACTS	ASEAN Customs Transit System
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AEC Center	ASEAN Economic Community Strategy Center
AFAFGIT	ASEAN Framework Agreement on the Facilitation of Goods in Transit
AFAFIST	ASEAN Framework Agreement on the Facilitation of Inter-State Transport
AFAMT	ASEAN Framework Agreement on Multimodal Transport
AMBD	Autoriti Monetari Brunei Darussalam (Brunei Monetary Authority)
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BEDB	Brunei Economic Development Board
BIBD	Bank Islam Brunei Darussalam Berhad
CBTP	ASEAN Framework Agreement on Facilitation of Cross-Border Transport Passengers by Road Vehicles
CIBFM	Centre for Islamic Banking, Finance and Management
CIS	ASEAN Framework for Cross-Border Offerings of Collective Investment Schemes
CPTPP	Comprehensive and Progressive Trans-Pacific Partnership
CSCMP	Council of Supply Chain Management Professionals
DARe	Darussalam Enterprise
EDB	Economic Development Board of Singapore
ERIA	Economic Research Institute for ASEAN and East Asia
FAPAA	Federation of Asia Pacific Air Cargo Associations
FDI	Foreign Direct Investment

FTA	Free Trade Agreement
FTZ	Free Trade Zone
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GPS	Global Positioning System
GVC	Global Value Chain
IFSB	Islamic Financial Services Board
IL	Inbound Logistics
IIMM	Islamic Inter-Bank Money Market
IoT	Internet of Things
IPO	Initial Public Offering
IT	Information Technology
JICA	Japan International Cooperation Agency
LSP	Logistics Service Provider
M&A	Mergers and Acquisitions
MCT	Muara Container Terminal
MFS	Micro Financing Scheme
MNC	Multinational Corporation
MPC	Muara Port Company Sdn. Bhd.
MSMEs	Micro, Small and Medium-Sized Enterprises
NSW	National Single Window
OEC	Observatory of Economic Complexity
OECD	Organisation for Economic Co-operation and Development
OL	Outbound Logistics
PC	Personal Computer
RBA	Royal Brunei Airlines
RCEP	Regional Comprehensive Economic Partnership
RKN	Rancangan Kemajuan Negara (National Development Plan)
TEU	20-Foot Equivalent Unit
UK	United Kingdom
USA	United States of America
WEF	World Economic Forum
WTO	World Trade Organization

Executive Summary

Brunei Darussalam's government has identified some critical challenges for the future. The oil and gas revenues that have sustained the country's growth for decades are winding down. Diversification of the economy is therefore more critical than ever.

The issue of diversification has been placed squarely at the heart of various government plans, including its Vision, Wawasan Brunei 2035. The desire to integrate more deeply into the regional and wider economy has also driven engagement efforts at the Association of Southeast Asian Nations (ASEAN) level and with Asia Pacific partners through important initiatives like the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership trade negotiations.

Despite significant planning, however, Brunei's economy still remains heavily centred on oil and gas and dominated by a large pool of micro, small and medium-sized enterprises. These smaller firms continue to underperform, with limited contributions to overall economic growth and fewer connections to global value chains (GVCs) than other economies in the region (e.g. OECD, 2018, p. 209).Foreign inbound investment figures remain low and export figures in the non-oil and gas sector are limited.

This situation represents a puzzle. It may be that Brunei's inability to plug into GVCs is a function of missing, inefficient or uncompetitive 'backbone' services. If so, then addressing these services may go a long way towards powering the overall growth of the economy and driving the diversification agenda the government seeks.

Two backbone services have been identified as particularly important and potential areas for growth: logistics and financial services. Each is relevant for firms seeking to plug into GVCs and both are needed for greater domestic firm opportunities.

This report highlights multiple challenges in both sectors. Brunei is neither efficient nor effective in delivering logistics or financial services to its own companies and cannot currently compete with regional players in delivering such services more broadly.

The single biggest challenge is the chicken-and-egg problem of the economy. These backbone services require sufficient demand to develop, but the current state of the domestic economy is too small to drive much demand for better services. This has left these important services too expensive and inefficient, in many cases rendering domestic firms more uncompetitive in a GVC world than they would otherwise have been. A GVC world requires firms to deliver goods and services quickly and seamlessly at globally (or at least regionally) competitive prices. At the moment, Brunei companies struggle to deliver on this promise.

What is to be done? The domestic economy in Brunei is unlikely to suddenly grow significantly larger in the near term. Demand will not come from this source. Instead, Brunei must work much harder to harness regional demand and build up capacity and infrastructure to deliver the required backbone services on the back of wider regional companies. Fortunately, Brunei has at least two immediately available opportunities that must be seized for creating regional demand.

Brunei is a member of ASEAN. One of the primary purposes of this bloc is to create a seamless regional integration platform. Brunei must better harness ASEAN's infrastructure at the domestic level to get Brunei-based firms to 'think ASEAN'. Rather than a market of 400,000, Brunei companies should be working with visions of the sixth largest economy in the world.

Second, Brunei is an original signatory to the CPTPP. This high-quality trade agreement gives Brunei a unique opportunity to access important markets across the Pacific. Quick ratification and implementation do not just help firms trade within the CPTPP but also provides a signal of Brunei's intention to foster trade and investment more intensely than in the past. Firms should latch onto the CPTPP and, as with ASEAN, consider the wider market from the very beginning.

Finally, Brunei should take important steps to drive demand in a few key sectors, like halal food, aquaculture and downstream oil and gas industries, to help spur the domestic economy directly. Brunei should also work to develop online digital services, as these can be delivered seamlessly directly from Brunei and will allow smaller firms to plug directly into GVCs.

Taken together, Brunei has the resources to deliver many of the outcomes it wants to achieve. The plans are largely in place. It is time for the country to seize the opportunities presented by the wider regional and Pacific economy to integrate more fully into GVCs. It is only with greater demand from outside the domestic economy that more efficient backbone services in logistics and financial services can be built. In addition, it is only with more productivity in such services that Brunei companies can become more competitive. Peicing together the puzzle shows that Brunei has to work on both ends at once: demand and supply have to be delivered in tandem.

1. Introduction

Over the past two decades, international competition, globalisation and economic liberalisation have encouraged the development of global value chains (GVCs). Value chains used to be called 'supply chains', but the GVC label more accurately captures the range of activities included in the production of goods, the delivery of services and the intermingling of the two.[1]

Technological advancements, preferential trade treatments and free trade more broadly have enabled firms to diversify their production and manufacturing processes. Firms have increasingly opted to fragment their production stages into different countries and industries in the drive for higher competitiveness in dynamic global markets. Today, GVCs are deeply embedded in conversations of the global economy and cross-border flows of goods, services and investment.

Production networks, like supply chains and value chains, are becoming predominant in both developing and developed economies, as firms seek creative ways to reduce costs and tap into new technologies in the market. While multinational corporations (MNCs) have been leading the way by participating in GVCs as suppliers, recipients and partners in strategic ventures, the development of new information and communication technologies has enabled micro, small and medium-sized enterprises (MSMEs) to increasingly integrate into GVCs. Brunei Darussalam is one of the countries taking the initiative to anchor new pathways to economic growth and development in GVCs.

With a population of approximately 400,000, Brunei is the smallest country in Southeast Asia. The domestic economy will never be substantial since the total number of potential consumers is likely to remain modest, although an abundance of natural resources like oil and gas has given Brunei one of the highest gross domestic product (GDP) per capita rates in the world, with a skilled workforce. Unlike many neighbouring countries, the presence of these resources has meant that Brunei has not actively sought or intensively promoted inbound foreign direct investment (FDI). Most of Brunei's domestic investment has been limited to resource extraction, with downstream industries related to oil and gas processing, petrochemicals and the like done elsewhere in the region.

Over the past decade, however, Brunei's growth rate has been relatively stagnant, particularly in the private sector. Heavy reliance on the oil and gas sector has made the country vulnerable to volatile changes in the prices of these commodities. The inevitable decline in natural resources available for extraction has added additional urgency to the need to rethink existing policies.

The Brunei government is interested in seeking opportunities to diversify its economy in a bid to reduce its dependency on its extractive oil and gas industries and to improve productivity in its economy. To realise this goal, Brunei has released its long-term development vision, Wawasan Brunei 2035, which sets out the country's core principles and frameworks to increase economic growth and enhance diversification.

As one of the five priority clusters for economic diversification, the business services sector can help Brunei better integrate into the global economy and achieve Wawasan Brunei 2035. Brunei's definition of business services includes logistics and transportation, as well as innovative financial services products. Having these services exist on their own is not an especially useful end goal, however. Instead, these services should be seen as complementary to the broader objectives of integration of Brunei firms into the global and regional economy. Both transport/logistics and financial services are enabling services for other sectors of the economy.

To help jumpstart improved productivity in the economy, it makes sense to focus on improved connectivity between Brunei and other firms through GVCs. These chains can include both traditional chains for the oil and gas sector and new GVCs in a wide range of goods.

The Brunei government has been active in a range of trade agreements that have been specifically crafted with the goal of encouraging the development of GVCs, including the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the Regional Comprehensive

1 Value chains can be regional or global, but the shorthand is typically GVC rather than RVC, to avoid confusion with Regional Value Content used in Rules of Origin.

Economic Partnership (RCEP) and the Association of Southeast Asian Nations' (ASEAN's) ASEAN+1 agreements, which provide new or renewed incentives for firms to choose Brunei as a GVC location. The timing is therefore particularly ideal to explore how the development of supporting services can facilitate the diversification of the Brunei economy.

To encourage GVCs to locate in Brunei and thrive, or to spur the improved integration of existing Brunei firms into regional and global value chains, effective and efficient business services such as transportation, logistics and financial services are critical. The development and growth of business services are directly linked to the development of a highly skilled labour force, innovation, technology, higher levels of economic dynamics and sustainability. This is a good opportunity for Brunei's business services sector to expand and integrate while contributing to Wawasan Brunei 2035 goals.

This project aims to contribute to Wawasan Brunei 2035 by supporting the integration of Brunei's business services sector into GVCs. This report provides a diagnostic assessment of current domestic and international barriers as well as opportunities for Brunei's business services. In addition, it provides a framework and roadmap that will allow Brunei to overcome challenges and take advantage of new opportunities.

Section 2 introduces the concept of GVCs and identifies important trends and drivers within the development of GVCs.

Section 3 highlights the increasing role that services activities play in the growth and diversification of GVCs. It maps services activities across different stages of a GVC and outlines the impact of service activities in the Asia Pacific region.

Section 4 provides an overview of Brunei's economy and outlines the country's economic development and diversification plans.

Sections 5 and 6 define logistics and financial services, outline their relationship to GVCS and provide a market overview of Brunei's logistics and financial services sectors. In addition, both sections provide an assessment of Brunei's logistics and financial services sectors based on (i) the country's development goals, (ii) a regional analysis of market opportunities and (iii) stakeholder interviews with relevant private and public financial services stakeholders in Brunei.

The sections outline domestic and international barriers and opportunities for the integration of Brunei into GVCs.

For both sectors, the competitiveness of the existing businesses is extremely low. While logistics, for example, has improved, with additional port and air cargo capacity coming on stream, the volumes remain very modest. As long as volumes stay so small, costs are extremely high, particularly compared with regional competitors. High costs and low productivity limit integration into GVCs for goods and services companies of all types. These factors, in turn, make it harder for backbone services like logistics and financial services to flourish and grow.

Section 7 offers a roadmap and framework that Bruneian businesses and authorities can use to overcome some of these domestic and international challenges and take advantage of opportunities to better enable the creation of local GVCs and the integration of firms into regional and global value chains.

The path ahead is complicated. While the roadmap identifies opportunities, the challenges should not be underestimated. Both logistics and financial services are underdeveloped in Brunei at the moment, meaning there is significant potential room for growth. Both should be viewed as backbone services. Neither is likely to thrive in the absence of a wider growing domestic economy. Logistics services, for example, are of limited utility if there are few goods to move. Financial services matter little if firms have few demands for new capital. Hence, the key challenge for Brunei is less how to make logistics and financial services competitive and more about how to drive the overall economy forward.

Until Brunei is more successfully integrated into the wider economy, with goods and services of value and interest to GVC firms, backbone services will similarly struggle to grow and become competitive. Brunei must focus on growing its own economy, including building investments in halal food and aquaculture as well as creating additional GVC opportunities in oil and gas. These should be 'low hanging fruit' that can be exploited to help build demand for local services. In addition, Brunei needs to better tap the potential of helping MSMEs, including through financial services, by getting smaller firms to 'think regional' from birth, and creating platforms to help them grow and develop outside the local market.

2. Global Value Chains

This section defines GVCs and introduces key trends characterising and driving their development. In light of these trends, the section establishes the rising relevance and significance of services input to GVCs.

2.1 What are global value chains?

A value chain refers to a full range of activities that a firm may undergo during its production process. This starts from the conception stage and continues to the end stage, when final consumers use a product or service (OECD, 2012, p. 4). GVCs typically include the following activities: design, production, marketing, distribution and support to the final consumer (ibid, p. 9).[1]

A good example of a GVC is presented by a complex product like the iPhone. This is designed by Apple in the USA, created through the inclusion of thousands of parts and components drawn from across the world, assembled in China, then shipped and sold globally in merchant shops. The iPhone includes goods like semiconductors, screens and screws, services like research and design or retail sales and intellectual property like patents.

A GVC need not be such a complicated product. Even a bar of soap made by a small firm in Brunei can be viewed as part of a GVC if it involves an idea hatched in Brunei, contains ingredients sourced regionally and from overseas, is manufactured in Brunei and is sold to customers regionally or globally through online digital platforms. Given the dominance of smaller firms in Brunei, it is important to encourage MSMEs to see themselves as 'mini-MNCs' able to engage with the wider world as part of GVCs.

While the primary focus of GVC work has been on trade in goods, it should be noted that GVCs that are entirely made up of services could be created. For example, large consultant firms can bundle together a wide variety of services sourced from individuals and other firms from across the globe and deliver them to clients located in MNCs. The growth of the internet allows for the digital delivery of services from anywhere. Brunei's highly skilled workforce should provide opportunities for engagement with services GVCs.

Brunei is very involved in GVCs but the economy has been largely stuck at the start of the process – with the extraction of oil and gas. These products are then shipped to other countries to be converted into higher-value items. Brunei needs to think about not just diversification away from oil and gas but also how to leverage the sector to move up the value chain in what has been a key element of its economy for decades. Oil and gas can be further processed in Brunei rather than allowing value to be added in other markets. This has been a perennial item on the 'to do' list, but the urgency in creating domestic demand is growing since ancillary activities are also dependent on improved local competitiveness.

2.2 Changing patterns of global value chains

In recent years, various developments like technological advancements have enabled the expansion and evolution of GVCs. Therefore, in studying GVCs, it is crucial to understand the trends shaping their development.

The GVC phenomenon can be best represented by two main trends. First, value chains are becoming increasingly regional and less global. Since 2013, the intraregional share of global goods trade has increased by 2.7 percentage points. Before 2012, the intraregional share of global goods trade had declined for more than a decade – from 51 per cent in 2000 to 45 per cent in 2012 (Lund et al., 2019, p. 9). This is a shift from before, when value chains revolved around long-haul trade across oceans and countries. In regions like Asia, regionalisation and lower communication and transportation costs have led to increased regional trade.

Second, developing countries have increased their participation in GVCs. MNCs appear to be shifting their development and production to emerging and developing markets. According to the McKinsey Global Institute, developing countries receive the most benefit from value chains and are projected to account for more than half of all global consumption

1 Organisation of Economic Co-operation and Development. 2012. "Mapping Global Value Chains." (7) Accessed July 12, 2019.

(Lund et al., 2019, p. 11). Overall, these trading patterns have led to the increased role of services in the development of GVCs. In the past decade, trade in services has grown more than 60 per cent faster than trade in good (ibid., p. 5).

However, traditional trade statistics do not fully represent the impact of increased flows of services. For instance, they do not track increasing cross-border flows of digital services. The McKinsey Global institute reports that YouTube, Facebook and WeChat may have created an estimated US$8.3 trillion in value annually. Overall, gross services trade, services embedded in goods trade and free cross-border digital service account for more than half of value added in overall trade (Lund et al., 2019, p. 7).

It is therefore relevant to consider the relationship between services inputs and value chains, so that emerging markets like Brunei can capture the benefits of GVCs. In order to better understand how to leverage GVCs, it is crucial to recognise the forces that shape them. The next subsection outlines some of the main factors driving the development of value chains.

2.3 Key drivers of global value chains

Three important forces drive the development of GVCs: decreasing trade costs, technological advancements and preferential trade agreements. Although not exhaustive, these three factors have encouraged more firms to fragment their production and manufacturing processes across multiple localities.

2.3.1 Decreasing costs

When trading, firms incur land transport costs, port costs, freight and insurance costs, tariffs and duties and costs associated with non-tariff measures, as well as mark-ups from importers, wholesalers and retailers. These trade costs vary by country and sector and will affect a firm's direct participation in value chains.

The United Nations Economic and Social Commission for Asia and the Pacific/World Bank Trade Cost Database estimates that 0-10 per cent of trade costs are tariffs, 10–30 per cent arise as a result of natural geographical and cultural factors and, lastly, 60–80 per cent come from non-tariff policy measures. For instance, it is suggested that Southeast Asian countries face the lowest costs and consequently have the greatest GVC participation when compared to other regions (OECD and WTO, 2015). As trade costs decrease, firms are encouraged to relocate their facilities to countries that will reduce business costs. This can in turn drive regional and global value chains.

One key premise driving the development of ASEAN over the past decades has been precisely the development of an integrated regional production base. This has led member states to drop all tariffs to zero across the region, a focus on cutting barriers in services and investment and improved trade facilitation, particularly through the creation of the ASEAN Single Windows. The path culminated in the launch of the ASEAN Economic Community (AEC) in 2015 and renewed progress towards additional integration in the AEC Blueprint 2025.

2.3.2 New products and stakeholders

Today, advancements in digital platforms like blockchain and the Internet of Things (IoT) are reducing transaction and logistics costs 'either by changing the economics and location of production or by changing the actual goods and services demanded' (Lund et al., 2019, p. 14).

New technologies encourage the creation of new products, which promote trade and further participation in GVCs. The World Bank reports that 45 per cent of the world is online; this gives developing nations access to communications and interactions. New technologies like big data, GPS and drones have 'enabled improved extension services' and more efficient logistics and supply chain management (Rodrik, 2018, p. 2).

In addition, new features of production technology have caused disruptions to traditional configurations of value chains, further introducing new players into the development of industries. For instance, developments in technology allowed PC manufacturers from Taiwan to enter the PC industry, once heavily dominated by Japanese companies (Satoshi, 2017). This created healthy competition among firms and spurred firms to find innovative ways to reduce their production costs by engaging in GVCs.

2.3.3 Role of free trade agreements

FTAs, especially comprehensive FTAs that include wider and broader commitments across a range of areas, including goods, services, investment, intellectual property rights and standards, boost participation in GVCs by both improving existing linkages between GVCs and creating new linkages (Laget et al., 2018). These deeper agreements encourage GVC development because they foster the placement of investment and delivery of goods and services in exactly the right geographic location for optimum efficiency with minimum friction.

Current data from the World Bank shows that FTAs are becoming deeper and more comprehensive, allowing countries to take advantage of provisions and tariff reductions that significantly reduce their trade costs (Ruta, 2017). The CPTPP is an example of a deep FTA that aims to integrate diverse economies from different continents by promoting the fragmentation of manufacturing processes.

Brunei's participation in the CPTPP will be discussed further later in the report but note for now two important elements in the agreement. First is the principle of 'full accumulation', which allows goods produced with content from more than one CPTPP member to qualify as originating products, and therefore access preferential tariff treatment. Second is the CPTPP's self-certification system. which allows firms to self-certify the origin of their goods, to reduce cost and clearance times at customs (Chang and Phuong, 2019).

Understanding the significance of trade agreements, technological advancements and lowering trade costs can provide a foundation to analyse barriers that prevent the growth of GVCs. This fundamental information also provides governments a snapshot of a myriad of factors that they can leverage to increase their involvement in GVCs.

3. Services Activities in Global Value Chains

Services activities are becoming a key contributor to GVCs. In order to increase their participation in such chains, some governments have pushed for the development of an internationally competitive services sector.

This section discusses the role of services in GVCs and highlights the importance and relevance of services inputs for the development of GVCs today. First, it provides a definition of services. Second, it identifies relevant services across the different stages of a value chain. The last subsection provides an overview of the development of services and GVCs within the Asia Pacific region.

3.1 What are services?

According to the World Trade Organization (WTO), services activities can typically be categorised into either 'embodied' or 'embedded' services. Embodied services refer to services inputted during the production process of other goods and services. Embedded services refer to services input during post-production processes, such as during marketing, retail and repair (Anukoonwattaka et al., 2017). This distinction allows for a better understanding of the types of services rendered during different stages of the GVC.

In addition to embodied and embedded services, services activities can be distinguished as producer or consumer services (Anukoonwattaka et al., 2017). According to the Organisation for Economic Co-operation and Development (OECD) Glossary of Statistical Terms, producer services are 'intermediate inputs to further production activities' and possess high information content, such as business and professional services, financial services and insurance services.[1] Consumer services are referred to as 'final or end-use services' and are often directly used or received by consumers (Anukoonwattaka et al., 2017).

3.2 Services in global value chains

Services activities are now the largest contributor to GDP and employment. The latest WTO Trade Report highlights at length the types of key contributions services make to domestic economies (WTO, 2019). In most developed economies, services now account for up to 75 per cent of GDP, with international trade in services growing much faster than global trade in goods.

Service activities also account for a significant proportion of the development of GVC activities. Lanz and Maurer (2015) have shown that services trade accounts for 70 per cent in GDP accounts even though it comprises only 20 per cent of global balance of payments.

The accelerating share of services inputs in GVCs can be understood through their role as intermediaries in manufacturing value chains. The role of services in a GVC can perhaps be compared to a glue, as manufacturing firms are often highly dependent on a myriad of services to link and coordinate their production activities across different countries and sectors.

Evidence from OECD countries shows that manufacturers increasingly buy, produce and export services (Anukoonwattaka et al., 2017). This is known as the 'servicification' of the manufacturing sector or the 'the increased use of services in manufacturing, both in terms of production processes and sales'. As a result of this servicification, services have helped increase the productive capacity of firms to gradually embed themselves into GVCs.

Demand for services activities happens at every stage of a value chain. Services can be located upstream from the manufacturing phase of production, in the manufacturing phase and downstream, when conveying the product to the final consumer. According to the Asia-Pacific Economic Cooperation (APEC) Policy Support Unit, services inputs can be mapped onto value chains across six separate stages. Table 1 lists the categories and provides illustrative examples of services falling within each of the categories.

In recent years, services companies have been able to create new production models that deviate from traditional linear models common

1 https://stats.oecd.org/glossary/detail.asp?ID=2440

Table 1. Mapping services onto GVC production stages

Production stage		Examples of services inputs
Establishment	Embodied services	Government negotiations and licence applications; land clearing and preparation; construction
Pre-manufacture	Embodied services	Design; research and development; procurement and transport of inputs; customs services; licensing requirements for health, safety and environmental compliance of inputs; storage of inputs
Manufacture	Embodied services	Transport and handling of raw materials; testing; maintenance and repair of equipment; cleaning; utilities; compliance inspections for environment, health, safety and working conditions
Post-manufacture	Embedded services	Packaging; transport; installation; advertising; marketing; branding; retail; quality control standards assessment
Post-sales services	Embedded services	Repair and maintenance of machinery and other facilities; inventory and warehouse services for parts; reverse logistics*
Back-office services	Embedded services	Back-office accounting; legal services; personnel; insurance

Note: * 'Reverse logistics' has been added by authors into the list of examples.
Source: Adapted from Low and Pasadilla (2015).

in manufacturing processes. In fact, there has been a rising phenomenon of 'networked' GVCs (Anukoonwattaka et al., 2017). This happens when service providers offshore or out-source their work to other service providers, therefore creating a constellation of service providers in one production chain. Modern communication and transport technologies have enhanced the tradability of services, which has facilitated their incorporation in supply chain production as traded inputs (Low, 2013). Such practices have enabled the mapping of services inputs into various networks of value chains. For instance, developments in IT now allow service providers from the information and communications, marketing, computer and finance sectors to offshore and out-source their work to service providers from other countries.

Services used to be considered 'difficult to trade across borders'. In the past, services activities were described as 'immobile' and highly non-transportable (Anukoonwattaka et al., 2017). As a result, many countries did not account for the share of services in supply chains, or measure the value of services in GVCs. Many services inputs thus tend to be uncaptured and unaccounted for in statistics. However, the increasing input and contribution that services activities have in GVCs make it imperative for countries to assess the extent of the contribution and potential of services to build a more diversified, prosperous and dynamic economy. Those that succeed in doing so can participate in higher value added segments of supply chains and broaden the scope and of their participation in GVCs (Low, 2013).

3.3 Managing services in trade agreements

Brunei's government has recognised the importance of opening services sectors in new and innovative ways to help facilitate growth. Early attempts to tackle the vexing issue of making commitments for sectors that could not be easily seen, tracked or measured across borders gave way to the General Agreement on Trade in Services (GATS) system in the WTO. The GATS system divided services into four 'modes' of supply, depending on 'who or what' moved across the border. As an example, under mode 1 no one moved – neither the supplier nor the consumer – just the service that crossed the border. At the time, the primary mechanism for mode 1 delivery was by post or letter. Now, of course, most mode 1 delivery is via the internet.[2]

2 Mode 2, to continue the simplification, has consumers 'moving' to consume a service, like patients going to get hospital services in a foreign country. Mode 3 is what most view as FDI, where the provider firm 'moves' to deliver the service: the hospital 'moves to' or invests in the host country to provide hospital services. Finally, under mode 4, the service provider (or the person) moves to deliver the service: the doctor moves temporarily (typically for less than three years) to provide hospital services.

This system of splitting services delivery made sense to negotiators grappling with services for the first time in the late 1980s and early 1990s. A similar system of working on services trade has continued in many trade agreements since then, including most ASEAN trade deals.

However, businesses today tend to find the four modes of supply completely incomprehensible. Firms do not view operations through the same lens at all. Instead, they deliver services by whatever mechanism makes the most sense: online, in person, via investment or using any combination of the above at once.

Many of the latest trade agreements have opted to abandon the GATS-type schedules and approach. As a member of ASEAN, Brunei has some commitments that reflect GATS approaches. However, as a member of the CPTPP, Brunei has also taken the leap to transform services commitments to a different approach. The CPTPP dispenses with the 'modes' entirely and simply opens services sectors under whatever method of delivery firms opt to use.

Further, CPTPP members have taken a radical approach compared with ASEAN agreements by starting from the premise that *all* services sectors will be automatically opened for member competition unless specifically closed. This is a bold step and shows Brunei's determination to handle services in a radical new way. Under the CPTPP, Brunei has agreed to open all 160 sectors and subsectors, including logistics and most of financial services, to CPTPP members.

The reason for taking such an approach is precisely to encourage the growth and development of GVC firms across the CPTPP member states. Given the close connections between goods, services and investment for GVC operation, it is not possible to build a flourishing GVC environment if services sectors are not opened for participation for CPTPP companies. Hence, member governments agreed to allow nearly every single services sector to be opened to one another under this trade agreement.

The Brunei government also agreed. While Brunei's ratification of the CPTPP and its entry into force has been delayed,[3] the commitments found within the CPTPP can be seen as a clear signal of intent.

3.4 Services activities in the Asia Pacific region

Partly as a result of various trade agreements, service activities have seen unprecedented growth in the Asia Pacific. In the region, the share of services activities in exports grew from 20.4 to 24.1 per cent between 1990 and 2013 (ASEAN–Japan Center, 2017). In 2016, services generated about 60 per cent of GDP, employed more than 40 per cent of the labour force, generated most new jobs and attracted an increasing share – 60 per cent – of greenfield FDI projects (Anukoonwattaka et al., 2017).

Specifically, the transportation, storage and communications sector saw an increase in foreign value added ASEAN exports from 28.4 to 32.8 per cent. Another high-growth sector was the finance industry, which saw an increase of about 4 percentage points from 12.6 to 16.3 per cent (ASEAN–Japan Center, 2017). These figures likely understate the importance of both sectors, as services statistics are often less reliable.

The next section introduces Brunei's involvement in GVCs and discusses how services activities are being mapped into value chains in the country.

3 As of 15 December 2019, Brunei has not yet signalled its intent to proceed with the CPTPP.

4. Brunei's Economy and Diversification

Increasingly, countries are interested in doing a better job of harnessing the potential of services. This is especially the case for developed economies, as services are a large and growing share of the economy for every developed economy. For Brunei, the situation is the same. Brunei's strategic plans for economic development have been outlined in Wawasan Brunei 2035 and Brunei's national development plans (RKNs), as well as current Strategic Plan 2018–2023. After reviewing these policies, this section examines Brunei's plans for diversification.

4.1 Overview of Brunei's economy

Negara Brunei Darussalam, or Brunei, is located on the coast of Borneo, Malaysia, in Southeast Asia. Since its independence from the UK on 1 January 1984, Brunei has transformed itself into a modern economy.

Brunei has historically been heavily reliant on natural gas and petroleum products. Given the wide fluctuations in the pricing of these commodities, it makes sense that Brunei's growth figures have also varied. Most developed economies tend to grow more slowly than developing economies. Brunei's GDP figure of 1.33 per cent growth in 2017 highlights this trend, from US$8.33 billion to US$8.84 billion (World Bank, n.d.a). In a similar fashion, Brunei's FDI, imports and exports of goods all underwent a sharp rise in 2017, after years of steady decline.

Brunei is a small and wealthy economy, with a current GDP of roughly B$18.4 billion (US$13.6 billion) (Trading Economics, n.d.). Yearly net inflows of FDI into Brunei experienced a steep decrease from 2013 to 2016; in 2017, FDI growth surged by 134 per cent (World Bank, n.d.b). According to Brunei's Ministry of Finance and Economy, the surge was the result of FDI inflows in the manufacturing sector, which increased by US$470 million between 2016 and 2017 (Department of Economic Planning and Statistics, 2017). The value of Brunei's imports and exports in goods escaped negative growth in 2017, attaining increases of 13.2 per cent and 12.5 per cent, respectively (World Bank, n.d.c).

Traditionally, Brunei has been heavily reliant on its oil and gas industry: oil and natural gas account for almost 90 per cent of exports. In 2017, petroleum gas represented 51.2 per cent (B$3.84 billion or US$2.84 billion) and crude petroleum 41.3 per cent (B$3.09 billion or US$2.29 billion) of its exports. The main five commodities exported are crude materials, mineral fuels, chemicals, manufactured goods and machinery & transport equipment. Mineral fuels, the main exported commodity, decreased steadily between 2014 and 2016 and rose again in 2017 and 2018. Currently, the main largest export partners are Japan, South Korea, Malaysia, Thailand and India (OEC, n.d.).

The top five commodities that Brunei imports are manufactured goods, machinery & transport equipment, food, chemicals and mineral fuels. All five commodities experienced fluctuations and finally surged significantly in 2018, except for chemical fuels, which registered only a 1.05 per cent increase on the previous year.

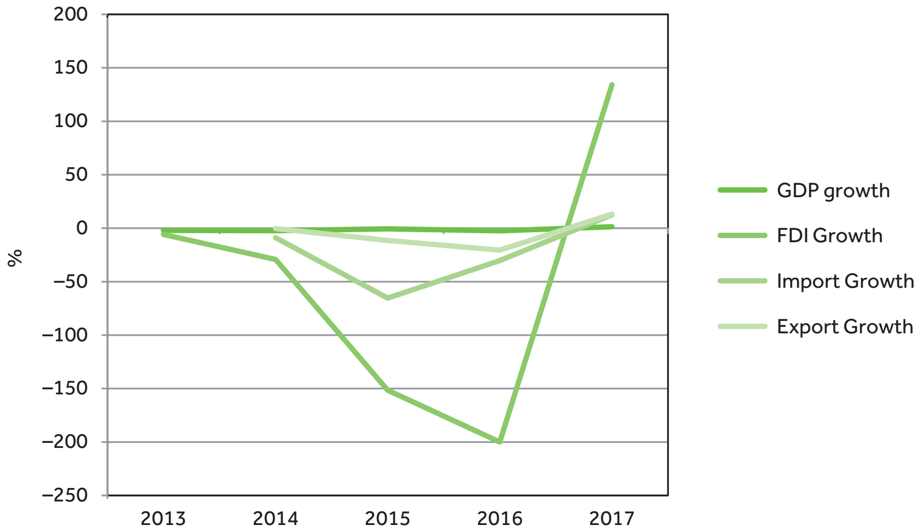
Unlike other countries in ASEAN, which have become major and competitive global or regional production centres for a wider range of products and services, there are almost no such industries in Brunei (Lawrey, 2010).

In Brunei, the main commodity – oil and gas – accounts for the bulk of the economy and adds little value to other industries. These industries do not appear to be closely inter-related with other sectors of the economy and therefore produce weak value chains between them (ASEAN–Japan Center, 2018).

According to a GVC analysis completed by the ASEAN-Japan Center (2018), in ASEAN as a whole, 40 per cent of exports are foreign inputs. In comparison, foreign value added in Brunei is only 12 per cent. Out of US$7 billion in gross exports, foreign value added amounts to under US$900 million. Over the past two to three decades, this share has declined to less than 10 per cent.

Because of the heavy reliance of exports on the oil and gas industry, this foreign value added share is determined almost entirely by the mining industry.

Figure 1. Growth in Brunei's GDP, FDI, imports and exports, 2013–2017 (%)



Source: World Bank (n.d.a, n.d.b, n.d.c).

Evidence from the OECD (n.d.a) shows that mining and quarrying account for more than 60 per cent of both outputs and value added in Brunei.

The lack of foreign value added, the absence of other industries and the lack of linkages between primary industries and other sectors result in an absence of significantly developed GVCs as well as regional value chains.

Poor GVC participation has also manifested in a low level of FDI and a negligible share in FDI to ASEAN. In recent years, FDI inflows have not exceeded US$1 billion, except in 2003. The country's FDI stock as a share of GDP is lower than the ASEAN average: 51 per cent versus 73 per cent in ASEAN in 2016 (OECD, n.d.b).

Similarly, FDI outflows from the country have been small, at less than 1 per cent of total FDI outflows from ASEAN (ASEAN–Japan Center, 2018). Outward FDI is typically related to the creation of GVCs outside the country. Both the small value and the small share indicate an almost complete lack of production networks outside the country.

The weak presence of GVCs and RVCs in Brunei Darussalam reflects the current characteristics of the economy, which does not necessarily require the existence of value chains uses little foreign inputs for its exports and attracts a small amount of FDI.

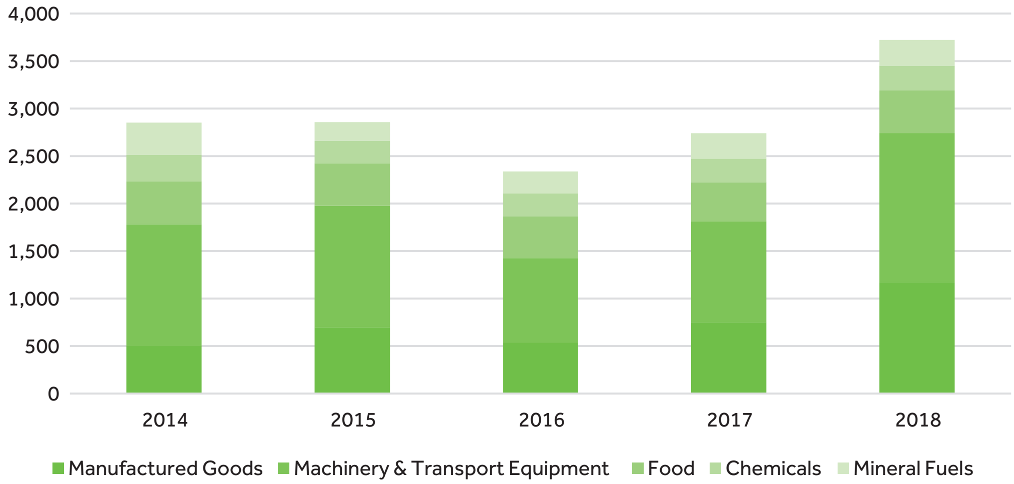
In recent years, researchers from BP World Energy Outlook have forecast that Brunei's oil reserves will sustain the economy only until 2035, giving the government a timeline of about 15 years to diversify (Khidir, 2018). As a result, diversification has become a top priority of the Bruneian government.

Table 2. Brunei's top five exports, 2014–2018 (US$ millions)

Year	Crude materials	Mineral fuels	Chemicals	Manufactured goods	Machinery & transport equipment
2014	13.0	9082.6	439.6	49.6	133.2
2015	9.4	5919.9	138.3	53.7	182.2
2016	17.4	4364.2	237.2	37.8	241.2
2017	16.7	5046.2	204.8	24.7	141.2
2018	19.1	5898.0	243.1	64.5	169.4

Source: Department of Economic Planning and Development (2014).

Figure 2. Brunei's top five imports, 2014–2018 (US$ million)



Source: Department of Economic Planning and Development (2014).

In a bid to promote diversification, the government has laid out several economic plans. The most important current document is Wawasan Brunei 2035, which guides the country's national development agenda, setting the direction for implementation of Wawasan Brunei 2035 and providing information to enable better joint implementation and collaboration of programmes and action plans holistically. Brunei also uses 5-year national development plans (or RKNs) and ministry strategic plans, which are, aligned with Wawasan Brunei 2035 and guided by the Wawasan Brunei 2035 Framework.

The next section discusses these plans and their relevance to Brunei's economy.

4.2 Strategic goals and planned outcomes

4.2.1 Wawasan Brunei 2035

The National Vision, known as the Wawasan Brunei 2035, aims to ensure that, by 2035, Brunei Darussalam will be recognised globally for the accomplishments of its well-educated and highly skilled people, its high quality of life and its dynamic and sustainable economy.[1]

In achieving this, the country's national development agenda is guided by the Wawasan Brunei 2035 Framework, which sets the direction for implementation of Wawasan Brunei 2035 and provides information to enable better joint implementation and collaboration of programmes and action plans holistically.

The Framework articulates Wawasan Brunei 2035 into Desired Outcomes – the specific achievements to be achieved for each of Wawasan Brunei 2035's Goals; Key Areas – the priority areas or specific actions that need to be focused on in order to achieve the Outcomes; and National Key Performance Indicators, which are used to measure performance on each of the Key Areas identified. It serves as a guide to the provision of national development programmes and projects towards achieving the Wawasan Goals, for example infrastructure development specifically to improve the quality of life of the people.

Goal 1 aims to establish a strong base of human resources as the engine of economic growth, thus putting high importance on the quality of the education system and development of human capital. One particular emphasis is on equipping youth with marketable skills and knowledge that will allow them to compete effectively within the country and in the international arena. Goal 1 is supported by three national outcomes:

1. First class education;
2. Equal educational opportunities; and
3. Human resource development.

1 Wawasan Brunei 2035 information supplied by the government, December 2019.

Goal 2 sets out to achieve the highest quality of life and well-being for the Bruneian people, in a peaceful and healthy environment. Five national outcomes are identified:

1. High standard of living;
2. Upholding sovereignty and stability;
3. A sustainable environment;
4. A resilient and cohesive society; and
5. Excellent health and safety in the workplace.

Goal 3 sets out the target of increasing Brunei's per capita income to be among the top 10 in the world. This target will help sustain Brunei's desire to have a high standard of living, and a strong economy to help achieve this by providing greater opportunities and high-quality employment in both the public and the private sectors. Four national outcomes are identified under Goal 3:

1. High and sustainable growth;
2. Diversified economy;
3. Low unemployment; and
4. Macroeconomic stability.

In achieving the aspiration of ensuring a sustainable economy for Brunei's future generations, the nation is required to accelerate economic growth with a large proportion of it to be contributed by the non-oil and gas sector. As such, economic diversification is still high on the economic development agenda.

Economic diversity is an indispensable factor to ensure a strong and sustainable economy for the country in the long run. Increasing high-value growth in production and services with an emphasis on innovation and usage of high technology, and building a broader trading network to enhance the exports of various sectors, will help attain high non-oil and gas fiscal revenues.

4.2.2 National development plans

To supplement its long-term development plans, the Brunei government has actively promoted the growth of target sectors through national development plans, also known as the rancangan kemajuan negara (RKNs).

The RKN has played a key role in the economic development of Brunei. Since the inception of the first five-year RKN, Brunei has grown into a country with a high level of per capita GDP and a high quality of life. In 1953, Brunei launched the first RKN, with an investment of B$100 (US$73.4 million). This RKN increased living standards in the country and introduced a pension scheme that remains in place to date. Since the first RKN, investment in implementation of the plans has increased to B$6.5 billion (US$4.77 billion) – the implementation budget of RKN 2012; GDP rose from US$0.11 billion in 1965 to US$19.04 billion in 2012 (Yunos, 2016).

The first four RKNs were used to stabilise the government agencies of Brunei. In the earlier periods of Brunei's development, ministers did not hold their positions for a long time, which made it difficult to develop long-term strategic plans. As Brunei gained political and economic stability, the restructuring of later RKNs worked to diversify Brunei's economy by creating a healthy, educated and skilled workforce (Yunos, 2016).

Brunei is currently actualising RKN11 (2018–2019). A total of B$900 million (US$666 million) has been allocated to finance 192 projects. Of these projects, 151 are new projects and 31 have been brought over from RKN10 (2012–2017). Moving forward, it is therefore likely that any project will reflect the key principles and strategic thrusts of RKN10. As RKN11 is currently in its development stage and has yet to be announced, RKN10 still forms the bedrock for any future project developments in Brunei. Therefore, any policy assessment and recommendation should comply with these standards and goals.

4.2.3 Strategic Plan 2018–2023

In addition to the RKN, Brunei lays out strategic plans defining the milestones to be achieved for a sustainable economy. Currently, Brunei is implementing its Strategic Plan 2018–2023. THIs has four specific goals as well as guiding principles to achieve these. The goals are:

1. Ensuring high accessibility to quality and reliable public infrastructure and services;
2. Enabling affordability for infrastructure and services that support inclusive development;
3. Optimisation of resources and assets primarily through efforts for integrated and sustainable development; and
4. Effectively implementing public–private partnerships in order to facilitate investment in infrastructure development for vibrant economic growth.

As a result of its long-term plans, the contribution of Brunei's non-oil and gas sectors has been increasing, from 34.8 per cent of its national GDP in 2013 to 42 per cent in 2015 (Oxford Business Group, 2016a). Currently, the government is focusing its efforts on increasing and sustaining its inflow of FDI into this non-oil and gas sectors.

In 2019, the Brunei Economic Development Board (BEDB) named food, infocommunications technology, services, tourism and downstream oil & gas as five priority industries for inward FDI. The goal is to ensure these five sectors help Brunei integrate itself into the global economy. Successful ventures have brought in some major investments in recent years, such as the multi-purpose defence and aviation training centre with CAE of Canada and investments in research and development in the halal food industry.

As services represent one of the five priority clusters for economic diversification, it is crucial that current developments in the sector complement Brunei's plans to integrate into the global economy.

The following sections assess the readiness of Brunei's business services sector – in particular logistics and financial services, and their capacity to integrate into GVCs.

5. Logistics

This section defines logistics services and their relationship to GVCs and provides an overview of Brunei's sector and related government initiatives. Integrating logistics into GVCs and Brunei's ongoing diversification and development schemes is critical to future growth.

For Brunei, more efficient and effective logistics services bring multiple benefits. What matters is not only the direct effects on employment and the potential for a new source of economic growth from having a strong logistics sector but also the utility of a smoothly functioning, lower-cost method of moving cargo for local Brunei firms. A key element of plugging into GVCs is the ability to connect with many just-in-time manufacturing processes. Brunei currently has a slow, inefficient and expensive logistics sector that makes it impractical for Brunei-based firms to participate in GVC operations. An expensive logistics sector also makes it impossible for Brunei's smaller firms to operate in larger markets. Finally, inefficient logistics raise operating costs, making it hard for Brunei companies to participate in e-commerce where suppliers and consumers expect fast, inexpensive shipping to be part of the offerings.

Getting improved logistics services, however, is especially difficult given the small size of the domestic market and the lack of competitiveness with the wider regional market players. Until and unless the domestic market grows, it will be hard for the logistics sector to become more competitive with lower costs. Absent lower costs and better competitiveness, the sector will continue to struggle compared with the region. Bringing additional investment into the sector is also challenging, as foreign businesses will find it hard to make a good financial case for putting money into the economy at this time.

5.1 What are logistics services?

The Council of Supply Chain Management Professionals (CSCMP, n.d.) has defined logistics as the 'part of the supply chain process that plans, implements and controls the efficient, effective forward and reverse flow and storage of goods, services and related information between the point of origin and the point of consumption in order to meet customer requirements'.

The logistics process can be divided into two parts: Inbound Logistics (IL) and Outbound Logistics (OL). IL refers to the movement of unprocessed materials from suppliers to processing or storage facilities (i.e. factories or warehouses). Those working in IL ensure raw materials arrive in the most cost-effective and prompt manner. OL, also called distribution, is the process that oversees the movement of goods from production or storage facility to a firm's customers or offshore distribution centre. OL often covers freight transportation, packaging and warehousing of finished products (BARCELOC, n.d.).

The terms 'logistics' and 'supply chain management' are often used interchangeably within the supply chain management industry; however, they are two distinct concepts. Supply chain management is the process that oversees the management of all activities required to source, produce and distribute goods. Logistics is a specialised part of the supply chain management process that ensures the effective movement and storage of goods and services (BARCELOC, n.d.). Logistics services encompass not only warehousing and freight forwarding services but also services used across the supply chain – from pre-manufacturing to after sales. Therefore, services provided by logistics service providers (LSPs) may encompass a wide variety of services ranging from inventory management to logistics distribution consultancy.

When a business requires assistances in the operation and movement of their goods, it works with LSPs to manage the flow of goods between points of origin and end-use destination (Business Dictionary, n.d.a). LSPs may provide services such as contract management, freight forwarding, logistics optimisation, management consulting, order fulfilment, transportation, warehousing, freight transport, (re)packaging, quality control, configuration and customisation, assembly and kitting, consultancy, direct store delivery, e-fulfilment, maintenance and repair and reverse logistics (BARCELOC, n.d.).

LSPs can be categorised into three distinct types: 2nd, 3rd and 4th Party Logistics (2PL, 3PL and 4PL). A 2PL provides transportation services

Table 3. Logistics services in global value chains

Production stage	
Pre-manufacture	Recommendations on smart purchasing, supply chain management of inputs, arranging of transport/logistics, obtaining permits and customs clearance, live monitoring and tracking, packaging design, assortment, inventory control and management, vendor managed inventory, inventory planning
Manufacture	Monitoring of inventory level, monitoring of adherence to IMMEX Programme and sales of inputs if necessary, supply chain management of inputs, configuration and customisation, building and unbundling, assembly
Post-manufacture	Product warehousing, testing of products, installation of software, packaging/repackaging of products, delivery of products, freight forwarding, last mile logistics, testing and quality inspections/technical inspection, regulatory compliance, labelling, kitting, fulfilment, cross-docking
Post-sales services	Collection of faulty products, reinstallation of software, reverse logistics, spare parts management, maintenance and repair

Source: Adapted from Low and Pasadilla (2015) and BARCELOC (n.d.).

using physical assets like trucks, airplanes and ships. Typically, a 2PL moves materials along a specific stage of the supply chain. A 3PL is a third-party distributor that offers logistics services to businesses, through curated services for producers across more than one stage of a supply chain (CardinalCommerce, n.d.). A 4PL is an independent provider that offers comprehensive logistics services for businesses. 4PLs do not own any physical assets and can offer logistical planning services for their clients.

Brunei currently has a handful of 2PL firms and no 3PL or 4PL companies. The volumes, as discussed further below, do not currently justify the expense of investing in these higher levels by supply chain services providers.

5.2 Logistic services and global value chains

Logistics services allow goods and services to flow efficiently within the supply chain. A GVC framework, which refers to all value-adding activities across global supply chains, is distinct from a traditional logistics supply chain framework. First, GVCs encompass all tangible and intangible activities that contribute to the value of a product. For example, the marketing of a product via social media is a contribution to that product's GVC – a value added service often not included in traditional supply chain structures. Second, while supply chains often span different countries (i.e. sea freight), GVCs emphasise a global process that includes inputs from producers and service providers across multiple geographical spaces (Duke University Global Value Chains Center, n.d.). Thus, GVCs are a more global and extensive reincarnation of traditional logistics supply chains.

Logistics add value to GVCs through value added logistics activities, which can be mapped across each stage of a GVC. Table 3 maps logistics services across the GVC stages.

5.3 Market overview of Brunei's logistics services sector

As Brunei prepares to diversify away from its oil and gas industries, recent government actions show the importance placed on the logistics sector.

To kick-start its economic diversification, Brunei's government introduced tax reductions and exemptions as business incentives. According to the Brunei Ministry of Primary Resources and Tourism (n.d.), Investment Incentive Order 2001 offered investment incentives in the form of tax exemption for 13 headings. These headings outlined different types of industries, companies and aspects of business (such as company expansion) that can be used as a rationale for income tax exemptions. Logistics-related services like warehousing and storage were listed as a rationale for a tax exemption. The Brunei government has also introduced customs tax reductions for specific goods. For example, Mordor Intelligence (n.d.) reports that machinery, heavy vehicles and industrial equipment will see a 15 per cent decrease (from 20 to 5 per cent) in taxes. These types of tax incentives could strengthen economic diversification by enabling the growth of logistics activities in the country.

Since Brunei does not have the domestic capacity to manufacture heavy vehicles, machinery or equipment, most of these goods must be imported. High taxes (and potentially high duties depending on the country of import) can discourage firms from buying equipment or upgrading existing facilities to improve efficiency or enhance productivity.

In order to expand and improve its logistics capabilities, Brunei's government has also invested in the expansion and modernisation of its domestic freight, shipping and airfreight infrastructure.

5.3.1 Domestic freight

The Bruneian government is trying to improve the efficiency of its domestic freight through the construction of a cross-sea bridge connecting the country. Brunei is separated into two sections by the Limbang region of Malaysia. Movement between the two regions is possible only through water taxi services or through Malaysia (Brunei Direct, 2017). Vehicles carrying goods must travel through Malaysia and undergo a lengthy and cumbersome process that includes multiple immigration checkpoints (Oxford Business Group, 2016b).

To eliminate this transportation inconvenience and unify the country, the Brunei government is planning the construction of a B$1.6 billion (US$1.18 billion) cross-sea bridge. The 30 km Temburong Bridge will be the longest bridge in Southeast Asia and cut down travel time by more than half. The government hopes the bridge will ensure more efficient transport of domestic freight, promote parity in national development and establish Brunei as a logistics port in the region. The bridge, which is being built by the Chinese state-owned China State Construction Engineering Corporation and the South Korean firm Daelim, is scheduled for completion by November 2019 (Xinhua, 2019a).

The opening of the bridge will certainly improve the efficiency of intra-Brunei trade and movement of goods. It is less clear how it will contribute, on its own, to the country becoming a better logistics port in the region.

5.3.2 Shipping

Brunei's geographical location situates it as a potential shipping hub for the region. To address this untapped economic potential, the Brunei government has tried to improve the capabilities of Brunei's most significant port, Muara Port.

The government has established an independent statutory body, the Brunei Maritime and Ports Authority, to regulate and maintain port logistics activities. However, even though Brunei has five ports, approximately 90 per cent of import and export items (except oil and gas) go through Muara Port. Located 28 km from the capital city and managed by the Ports Department of the Ministry of Communications (JICA, 2015), Muara Port is the only deep-water seaport in Brunei (Oxford Business Group, 2016b). According to the Ocean Freight Statistic Data Report by the Brunei Freight Forwarders Association, about 105,000 container 20-foot equivalent units (TEUs) came into Brunei in 2018.[1]

The Brunei government is enhancing Muara Port to increase profit-maximising activities and thereby improve the efficiency of logistics in the country. In 2014, Guangxi Zhuang Autonomous Region of China signed a memorandum of understanding with Brunei to establish the Brunei–Guangxi Economic Corridor. The agreement called for B$500 million (US$370 million) in joint investments in a cooperative effort to promote efficient trade between the two countries (Kassim, 2016). Following creation of the Brunei–Guangxi Economic Corridor, bilateral trade between the two countries in 2018 reached B$1.3 billion (US$0.96 billion) – an increase of 90 per cent from 2017 (Tiezzi, 2018).

A major step to strengthen this economic corridor was the creation of Muara Port Company Sdn. Bhd. (MPC), the result of a joint venture between Guangxi Beibu Gulf Port Group (a Chinese state-owned company) and Brunei Darussalam Assets (a share of the Brunei Ministry of Finance and Economy). This venture called for the joint maintenance and operation of the Muara Container Terminal (MCT). On 18 July 2018, the MPC took full control over the operation and management of the MCT.

1 For comparison, in 2017, Singapore handled more than 33 million TEUs and Jakarta more than 13 million TEUs (see World Bank, n.d.d.). For Brunei data, see FAPAA (2018).

The MPC has undertaken work to further improve the capacities of Muara Port. For example, the MCT has increased its capacity from 220,000 to 330,000 TEUs and dredged the channel depth from 12 to 14 metres (Oxford Business Group, 2016b). Since 2017, the MPC has also incorporated new services that improve the operation efficiency of the MCT by allowing the movement of containers out of the port in a shorter time (AEC Center, 2017). Such infrastructure developments will facilitate more shippers to dock in Brunei and encourage more logistics services in the area (Oxford Business Group, 2016b).

However, the shareholders involved in these projects have stressed the need for continual growth and improvements in their joint ventures. For instance, in an April 2015 report, Peng Qinghua, Secretary of the Communist Party of China's Guangxi Committee and Chair of the Standing Committee of Guangxi People's Congress, emphasised that cooperative projects in the corridor (such as the MCT) had to be accelerated. He suggested that effective collaboration between Chinese and Bruneian ventures would increase Muara Port's container throughput from 220,000 to 1 million TEUs by 2021 (Kassim, 2016).

The Brunei government is also planning to modernise its liquefied natural gas transport fleet. In a bid to double output by 2030, up from 250 million tonnes, the government is seeking new venture partnerships with big corporations such as Shell and Diamond Gas Carriers to replace ageing fleets with newer ones. This may create new transport services to Malaysia, Japan, South Korea and Taiwan (Oxford Business Group, 2016b).

5.3.3 Air transport

Brunei's government has actively sought to expand its air cargo logistics sector by developing its air cargo infrastructure and entering joint ventures with foreign firms. Air cargo is critical to engagement in e-commerce and facilitating trade in GVCs by smaller firms, which are rarely able to fill containers with goods.

Currently, Brunei has two main airports: Brunei International Airport in Bandar Seri Begawan City and Anduki Airfield in Seria Anduki District, both of which are managed by the government of Brunei (Oxford Business Group, 2016b). The former is used as the international airport and a base for the Royal Brunei Air Force, whereas the latter is used to operate helicopters to support offshore oil platforms.

The international airport has been through major renovation works in a bid to attract more travellers and air cargo to the Sultanate. The B$130 million (US$133 million) renovation project introduced new facilities as well as an additional 18,000 m^2 of floor space. After the renovation works, BEDB forecast an increase in passenger capacity from 1.5 to 3 million (Oxford Business Group, 2016b).

In terms of the air cargo that Brunei imports and exports, most imports coming into Brunei are urgent cargo and sanitary and phytosanitary goods (or food and agricultural products) (FAPAA, 2018). To expand its air cargo freight beyond direct trade between Brunei and its primary trading partners, in 2013 Royal Brunei Airlines (RBA) created a partnership with the UK-based Air Logistics Group. Under this, RBA assigned its entire air cargo business to Air Logistics. This deal was regarded as a landmark cooperation case for the air cargo industry and a crucial step for Brunei in its quest to establish itself as an important air cargo transhipment point in Southeast Asia (Aircargo News, 2013).

In addition to its efforts to increase Brunei's global cargo freight presence, RBA is implementing its five-year plan (2016–2021, unpublished), which aims to enhance international connectivity through new market routes. To accomplish this, RBA has announced plans to increase the air fleet from 10 to 14 aircraft and to upgrade 2 existing aircraft (CAPA, 2015). The airline has also announced codeshare agreements with foreign airlines such as Hong Kong Airlines. This agreement allows travellers in Brunei to travel seamlessly through Hong Kong to Tokyo and for Hong Kong travellers to take advantage of daily RBA flights between Hong Kong and Brunei (RBA, 2016). Through such agreements and infrastructure improvements, RBA aims to deepen aviation agreements and further promote open-air services.

5.4 Logistics: promise and opportunity

The promise of Brunei's various initiatives for the elements that are important for the logistics sector appear to match up well with the schemes embedded in Brunei's economic planning documents. Given the need for efficient and effective logistics operations as a key part of growth plans for GVCs, it is important for the logistics sector to flourish to meet Brunei's ambitious diversification targets and objectives. The following section explores evidence drawn from existing literature and interviews with logistics companies operating on the ground in Brunei and the region to see whether the promise of such ambitious plans matches the reality of daily operations.

5.5 Assessment of Brunei's logistics services sector

Logistics services can only grow alongside the complementary development of the goods and services-producing industries. A review of existing logistics data and interviews with LSPs in Brunei and the region shows that Brunei has not built an economic environment that drives (i) the industrial development necessary to increase demand for better logistics infrastructure and value added logistics services and (ii) the cargo volumes required to offer price-competitive freight and warehousing services and attract foreign LSPs or increase demand for transhipment services.

This section uses data collected from interviews with logistics providers in Brunei and the ASEAN region and literature assessing the success of logistics hubs like Singapore and Dubai to outline the need to focus on the following factors or barriers to growth in Brunei:

1. Trade flows and competitive prices;
2. Quality logistics infrastructure;
3. Efficient logistics management;
4. Institutional and regulatory incentives;
5. Comprehensive value-added logistics services.

5.5.1 Consistent cargo volumes

Competitive logistics costs and comprehensive and efficient logistics value added services are key to the development of a thriving logistics sector. High and consistent cargo volumes are key to the price competitiveness and availability of these services. Vital to Brunei's diversification efforts is the development of consistent and substantial cargo flows in and out of the country that would guarantee competitive freight rates.

Most of Brunei's non-oil-related cargo throughput is dedicated to imports, which, as the GVC analysis in the previous section showed, are final goods used for domestic consumption. Such information is corroborated by interviews conducted by the Asia Trade Centre with cargo operators at both Muara Port and Brunei's International Airport. For instance, air cargo operators claim that 90 per cent of air cargo throughput is made up of imports and 10 per cent of exports; almost none is transhipment.

Imports, it should be noted, are not automatically a problem. After all, given Brunei's limited domestic resources, even a thriving manufacturing economy will require substantial imported materials to produce products for export. All GVC economies are heavily involved in both importing and exporting. However, many imports in a GVC world need to be destined for more than simply domestic consumption. A ratio of 90/10 is deeply problematic for an economy that is striving for integration into GVCs.

A logistics hub requires cargo.

Cargo volumes for Brunei have also remained very low when compared with the capacity and throughput of other logistics hubs around the world. In 2018, Brunei's Muara Port handled 105,000 container TEUs; according to a port representative, the number was closer to 113,000 TEUs (China Daily, 2019). In contrast, Singapore's scale of operations in sea freight was 36,599,281 TEUs in 2018 (GovTech Singapore, n.d.) and Hong Kong's was 20,770,000 in 2017 (Hong Kong Census and Statistics Department, 2018).

The case is similar for Brunei's air cargo capacity. Brunei's airport has the capacity to handle 50,000 tonnes of cargo per year (Global Investment and Business Center, 2018). In contrast, Singapore's airport had an annual container throughput of 2.15 million in 2018 and a capacity to handle 3 million tonnes per year (Department of Statistics Singapore, n.d.).

The imbalance between imports and exports of cargo and the relatively low cargo capacity and throughput affect freight prices and the quality of logistics services in Brunei. They both lead to a directional imbalance – a discrepancy between inbound and outbound traffic – that results in empty backhauls and both divergent and high freight rates. According to interviewees in Brunei's air and sea cargo facilities, Brunei's freight, logistics and transhipment rates are higher than Singapore, Indonesia and Malaysia's.

As a result, the Brunei government has heavily subsidised logistics costs. When certain costs are not subsidised, logistics-associated costs can be extremely high. According to interviewees, after tugboat services at Muara Port had been transferred to a private service provider – and therefore not subsidised – earlier in 2019, tugboat prices jumped up to 300 per cent for some LSPs.

Current freight and transhipment rates make it difficult for Brunei to be an attractive location for foreign LSPs and lead to high export costs for domestic producers.

5.5.2 Adequate logistics infrastructure

Even though Brunei has made significant progress upgrading the logistics infrastructure of Muara Port and its international airport, logistics services and facilities remain inadequate to cope with the increasing trade volumes and the demand for more comprehensive and diversified logistics services.

According to the World Bank's Logistics Performance Index 2018, based on the quality of trade and transport infrastructure, Brunei's logistics infrastructure is only better than that of Myanmar, Cambodia and Lao PDR in ASEAN.

Cargo operators in Brunei's logistics centres corroborated a lack of substantial logistics infrastructure. According to interviewees, a lack of substantial export or transhipment cargo activity has reduced incentives to grow existing logistics infrastructure or develop specialised logistics services and facilities.

Moreover, if cargo volumes are to rapidly increase, Brunei will likely encounter significant capacity and storage constraints. According to cargo operators at Muara Port and Brunei's international airport, both lack sufficient rental and specialised warehousing infrastructure, like cold chain facilities, to cope with hikes in cargo volume. For instance, Muara Port has only one container terminal with a container wharf of 250 metres, which can service only one vessel at a time (MPC, n.d.). Thus, it has limited capacity to handle multiple container vessels. As a result, the few LSPs and shipping line operators in Brunei need to time their deliveries and pick-ups to vessel arrivals to reduce port congestion and decrease waiting times. Similarly, according to airport cargo operators, warehousing space and human resources are both over and underutilised based on inconsistent airport traffic.

Overall, Brunei needs to address a lack of substantial cargo flows and the use of inadequate logistics infrastructure to ensure it can meet the needs of industries with high growth potential and foreign LSPs.

5.5.3 Logistics management and efficiency

Customs procedures and inspections are key for the movement of freight expeditiously, reliably and at low cost. Clear, firm rules in customs, consistent classifications of product codes, single point entry of customs and time to clear documentation are critically important for the provision and growth of logistics services (Hollweg and Wong, 2019).

According to the World Bank's Logistics Performance Index 2018, based on the efficiency of customs clearance process by border control agencies, Brunei's customs clearance processes are less efficient than the other ASEAN markets of Vietnam, Singapore, Malaysia, Thailand and Indonesia.

To address some of these limitations, Brunei has put in place the following reforms. First, it has made enhancements to its National Single Window (NSW), which have enabled auto-approval of customs declarations and import permits on some goods. Second, it has implemented a new Port Clearance Module that allows electronic application for clearance procedures (APEC, 2018).

Despite improvements, interviewees operating in Muara Port and domestic LSPs all reported some delays with the customs clearance process, which can take up to two days. Interviewees also reported technical difficulties with the implementation of the NSW. Nevertheless, they all acknowledged that customs clearance procedures were transparent and predictable and that implementation of the NSW had continued to improve.

Overall, it is important that Brunei continue to improve the efficiency of its customs procedures to minimise the cost and barriers to trading partners and logistics companies operating in the port.

5.5.4 Institutional and regulatory incentives

Successful logistics hubs also typically provide MNCs and international LSPs with institutional incentives schemes, like tax incentives, that make it attractive to place their business operations in specific port regions.

Governments may provide incentives like pioneer status, preferential taxation, loan guarantees, credit insurance, low-interest financing and bonded services in the development of logistics centres

(Pettit, 2019). Free trade zones (FTZs) can be part of wider port policies aimed at inducing port traffic and producing value added services by attracting logistics centres of MNCs and international logistics companies.

FTZs can promote host country participation in trade and commerce by eliminating or reducing the unintended costs or obstacles associated with host country trade laws. Countries like Singapore and Dubai have also introduced new developments in their FTZs. For instance, Jebel Ali Free Zone in Dubai provides extensive corporate tax exemptions, allows 100 per cent foreign ownership, gives 100 per cent tax exemptions on imports and exports and liberal visa policies and provides abundant availability of space and energy (Sundarakani, 2017).

Brunei has developed tax incentives that include zero personal income, sales, payroll, capital gains and manufacturing tax. The government set up one FTZ in 2014, which is used mostly by petrochemicals and pharmaceutical firms.[2]

Brunei has not implemented liberal visa policies for the hiring of new staff. According to interviewees from local logistics companies, domestic employment rules require the employment of locals whenever possible and restricts the number of foreigners who can be hired. Such restrictions limit the ability of potential foreign investors and logistics operators to hire the staff required for their operations.

5.5.5 Build logistics for e-commerce for MSMEs

Brunei is overwhelmingly dominated by MSME firms. Many of these companies offer products of interest to the wider regional community. Some products could be sold into GVCs through various e-commerce platforms.

However, currently, engaging in e-commerce costs too much for most MSMEs to find overseas markets competitive at all. For a small firm that manufactures soap, for instance, the costs of shipping one bar of soap to Singapore can exceed the total cost of producing the soap. This completely stops trade.

2 In 2014, the government provided the legal framework for an FTZ. See http://www.agc.gov.bn/AGC%20Images/LAWS/Gazette_PDF/2014/EN/S079.pdf. For information on usage, see Healy Consultants Group (n.d.).

Brunei should think creatively about how to solve this problem and get local MSMEs to engage more competitively in e-commerce. As an example, it may be possible to have a specific warehouse for MSME vendors that holds shipments, or consolidates cargo, until a certain day or time during the week and then ships all cargo simultaneously, reducing the costs for shipment for all e-commerce companies at once. It will still leave Brunei's MSMEs unable to deliver in a timely fashion, but it would at least lower overall costs, which are currently the biggest obstacle. As demand for Brunei-based products grows, shipments could potentially be scheduled more frequently, solving the timing issue.

5.5.6 Offer value added logistics services

Specialised LSPs or 3PLs offer global firms advantages like reduced need for capital investment and working capital and the ability to penetrate into new markets more quickly and with less capital. As a result, it is important that aspiring logistics centres attract and develop word-class providers of customised logistics services in order to attract other global firms to set up their regional logistics centres.

Successful logistics hubs have attracted global 3PL providers for new logistics centres. For instance, in Singapore, 20 of the largest LSPs in the world are operating or have set up their regional or global headquarters (EDB, 2010). In contrast, in Brunei there are not many domestic 3PLs and only a few foreign LSPs in operation. According to logistics stakeholders in Brunei, most importers of consumer goods in Brunei do not outsource their logistics needs but operate their own specialised containers and logistics facilities.

Overall, Brunei lacks the market demand and the facilities to enable the growth of its 3PL market. It needs to ensure that potential industrial growth and increased trade volumes are met through the development of a diversified and comprehensive 3PL market.

By investing in the expansion and modernisation of its domestic freight, shipping and air freight infrastructure, Brunei hopes to leverage its strategic location to attract FDI from companies to establish their regional trading, processing and distribution markets. However, a lack of strong cargo volumes, sub-optimal logistics efficiency and infrastructure and low demand for logistics services make it difficult to offer competitive prices or really grow the logistics market.

6. Financial Services

Like logistics, financial services should be viewed as a critically important 'backbone service' for integration into GVCs. Financial services are relevant not just in their own right, as a key business sector, but also as an enabling service for every other business operation. Financial services could be provided to regional or even global markets. Hence getting the policy settings right is vital to support Brunei's diversification efforts.

While the government may want to foster the growth of the sector on its own, like in logistics it is hard to develop an innovative and competitive product offering without a clear market niche for service delivery. Competition in financial services is fierce, with many sophisticated firms present even within ASEAN. The capital requirements are, of course, significant, making it harder to break into this than nearly any other services area. Even the new areas of financial services, loosely grouped under 'fintech', are rapidly growing in the region, making it harder for new entrants to find a niche.

This section defines and classifies financial services, specifies their relationship to GVCs and provides an overview of Brunei's financial services sector and government initiatives to strengthen the country's financial services market.

6.1 What are financial services?

Financial services play an indispensable role in sustaining the growth and competitiveness of any modern economy. Services such as banking, investment and insurance enable individuals to save for major purchases and plan for their future, while allowing businesses to set up, expand and eventually compete in cross-border markets (Sutton and Jenkins, 2007). The institutions providing these services can be understood as the brain of an economy, meeting financial service needs at various stages of the GVC. A well-functioning financial services sector provides tools for businesses to manage and mitigate the 'cost and risk of producing and trading in goods and services', ensuring the smooth operation of the value-adding process (Herring and Santomero, 1991).

In any country, financial services is typically made up of banks, trust and loan companies, credit unions, life and health insurance companies, property and casualty insurance companies, securities traders and exchanges, investment fund companies, pension funds, finance and leasing companies, insurance agents and brokers and a myriad of auxiliary service providers, such as independent financial advisors, actuaries and intermediaries (WTO, n.d.). As Table 4 shows, the sector can

Table 4. Financial services classification

Banking services	Investment services	Insurance services	Compliance services
• **Retail banking** (savings and checking accounts, mortgages, personal loans, debit/credit cards and certificates of deposit, etc.) • **Corporate banking** (commercial loans and other credit products, treasury and cash management services, equipment lending, commercial real estate, trade finance, employer services, strategic advisory services, etc.)	• **Wealth and asset management** (hedge funds, pension funds, private equity, investment management) • **Mergers and acquisitions (M&A)** • **Investment advisory** (due diligence, regulatory compliance)	• **Life and non-life insurance** • **Reinsurance** • **Insurance intermediation** (brokerage and agency services) • **Insurance-related services** (consultancy and actuarial services)	• **Audit** • **Accounting advisory** • **Tax advisory**

Box 1. Financial services definitions

Corporate banking provides a range of banking services targeted towards companies that enable them to run their day-to-day operations, grow and hire people (Mortlock, 2015). GVCs rely on the following corporate banking services in particular:

- **Commercial loans** refer to loans granted to businesses to assist with short-term funding needs for operational costs, the purchase of equipment necessary for the operating process or more basic operational needs (such as funding for payroll) (Kenton, 2019a).
- **Trade finance** involves the financial instruments companies utilise to facilitate international trade and commerce and make it easier for importers and exporters to conduct business transactions. Trade finance helps reduce the risk of taking part in cross-border trade by reconciling the needs of an exporter and importer (Kenton, 2019b).
- **Strategic advisory** involves advising businesses in areas such as strategic alternatives, M&A and corporate restructurings, and capital structure (DBS Bank, 2018). Businesses can receive advice on capital formation and cash flows during the global value-adding process (Business Dictionary, n.d.b).

Insurance: Businesses use insurance policies throughout the GVC to manage the risk of financial losses resulting from costly and common value chain interruptions.

Compliance: Accounting firms and banks can provide businesses with audit, accounting and tax advice and guidance on a wide range of transactions, including 'adherence to new or revised accounting standards and effective management of the financial reporting processes, to support through an IPO [initial public offering] process' (KMPG, n.d.), all of which ensure regulatory compliance throughout the GVC.

be broadly divided into four categories: banking services, investment services, insurance services and compliance services.

This study focuses on the financial services most relevant to GVCs:

1. Corporate banking services (particularly commercial loans, trade finance and advisory services);
2. Insurance-related services;
3. Compliance services.

Please refer to Box 1 for the respective definitions:

6.2 Financial services and global value chains

Businesses require different types of financial services depending on where they lie on the GVC. Typically, financial services are integrated into almost every stage of the production line, as they are demanded by businesses at almost every level of a GVC.

Table 5 uses the GVC structure developed in the APEC Manufacturing-Related Services Summary Report, to list down financial services that businesses might employ at different stages of a manufacturing value chain. Of course, services firms and services GVCs also need financial services to deliver their own services. In other words, financial services are needed by both goods and services firms, making such products indispensable to all GVCs and companies of any size in all markets.

During the pre-manufacturing stage, for example, businesses need to ensure they have adequate capital to set up their manufacturing processes. If a business is short on funds, it may apply for a commercial loan. Usually issued by financial institutions such as banks, commercial loans are mostly short in term and used to address operational needs, which may include the purchase of equipment and inventory, operational costs or funding for payroll (Business Dictionary, n.d.c). Businesses may also rely on strategic advisory services from banks to provide them with advice on capital formation and cash flows to ensure adequate funding throughout the GVC.

Once businesses enter the manufacturing stage, they may choose to minimise losses emerging from potential disruptions of the GVC process by entering supply chain insurance programmes. Examples of such disruptions can range from

Table 5. Financial services across manufacturing value chains

Production stages	
Pre-manufacture	Corporate banking (commercial loans, strategic advisory)
Manufacture	Insurance
Post-manufacture	Corporate banking (trade finance), Insurance
Post-sales services	Insurance
Back-office services	Compliance

man-made events such as financial crises to natural disasters such as tsunamis or earthquakes, which suspend the manufacturing process for indefinite periods of time. Although there may be no direct physical damage, for uninsured businesses, especially MSMEs, disruption and associated expenses can have devastating consequences (Marsh Risk Consulting, n.d.). Businesses can also apply for insurance coverage in the post-manufacturing stage to cover the shipping and delivery period, particularly if the product is being sold overseas.

After the manufacturing process has been completed, banks and trade financing companies can provide businesses with trade financing tools to streamline the process. As GVCs involve international trade, these trade-financing tools make it easier for importers and exporters to make cross-border business transactions. Many banks offer services for importers, exporters and intermediaries, which minimise the risks of cross-border transactions. These include lending lines of credit; letters of credit that guarantee payment to the seller for the goods shipped; and export credit or working capital.

Finally, throughout the GVC, businesses need to ensure their products and processes meet country- and region-specific regulatory compliance requirements. In order to do so, they can rely on either banks or accounting firms to provide the appropriate back-end audit, accounting and tax advisory services.

To date, GVC firms have not relied on what is called 'fintech', which is a broad and rapidly growing category of financial services products enabled by the internet. Fintech is currently ill defined and can cover product offerings that simply transfer offline services to a digital environment as well those that are entirely new, including those offered by new categories of companies that are not typical financial services firms at all. In the GVC space, the easiest fintech 'products' to imagine may be digital letters of credit or other forms of trade financing that promise to speed up product offerings that have been unchanged for hundreds of years. New services are also likely to emerge in the near term.

While it is important for Brunei's GVC manufacturing firms to have access to efficient and effective financial service products and services, the country's own financial services offerings may also be of interest to GVC companies located offshore. The financial services marketplace should be viewed as wider than just Brunei.

6.3 Market overview of Brunei's financial services sector

The major financial institutions in Brunei's financial sector are commercial and Islamic banks and the Islamic Trust Fund (Perbadanan TAIB). Non-banking institutions include finance companies, insurance companies, takaful companies,[1] moneychangers, money remitters, pawnbrokers, registered agents and trust companies. Thus far, Brunei appears to have limited exposure to fintech, although a regulatory 'Sandbox' was set up in 2017 for testing fintech products and services through use of a framework that enables qualified companies or businesses to experiment with innovative solutions in a relaxed regulatory environment, for a limited period of time and boundaries.[2]

The Brunei Monetary Authority (AMBD) is the central bank of Brunei and conducts monetary and financial policy planning, including the management of currency exchange and the supervision of financial institutions. For instance, AMBD adopts a 'risk-based supervisory framework' that regularly assesses the adequacy of risk management capabilities of banks in order to ensure each bank maintains financial soundness (AMBD, 2019). The Currency Interchangeability Agreement was signed in 1967 and was administered by the Brunei

1 A takaful is a form of sharia-compliant insurance in which members form a cooperative to guarantee one another against loss or damage. A general takaful provides coverage for losses arising from an accident, fire, flood, liability or burglary. See http://www.malaysiantakaful.com.my/Consumer-Zone/FAQs/General-Takaful/Praesent-euismod-blandit-sapien,-sed-ultricies-nis.aspx

2 For more details on the Sandbox see https://www.ambd.gov.bn/fintech-office

Currency Board. On the establishment of AMBD, this absorbed the functions of the Brunei Currency and Monetary Board.

Since the introduction of Islamic finance in the 1990s, the banking sector has seen a shift in preference towards Islamic banking, with B$8.9 billion (US$6.59 billion) held in Islamic banks and BN$8.1 billion (US$6 billion) in conventional banks (Oxford Business Group, 2016c). Some commercial banks, such as HSBC and Citigroup, have since left Brunei, noting the size of the domestic market, consolidation of the industry globally, and a stronger shift in local demand for product offerings.

As of 2019, there are seven commercial banks and one Islamic bank registered in the country. The largest of these banks are Bank Islam Brunei Darussalam Berhad (BIBD) and Baiduri Bank Group, which respectively reported US$7.1 billion (BIBD, 2017) and US$2.5 billion (Baiduri Bank Group, 2018) in assets in 2018. BIBD and Baiduri Bank Group offer financing services to businesses operating in the GVC with the aim of 'enabling Brunei's entrepreneurs to become more competitive in international trade' (BIBD, n.d.a). Only BIBD is licensed to provide shariah-compliant banking products. Islamic banking has also seen a surge of regional and global interest. The use of Islamic banking tied directly into GVCs has been more limited to date but may provide a growth opportunity.

Table 6. Breakdown of Brunei's financial institutions

Financial institution	Number
Conventional banks	7
Islamic banks	1
Islamic Trust Fund (Perbadanan TAIB)	1
Conventional finance companies	2
Islamic finance companies	1
Life insurance	3
Non-life insurance	6
Licensed adjuster	1
Licensed broker	1
General takaful	2
Family takaful	2
Moneychangers	20
Money remitters	18
Pawnbrokers	1
Registered agents and trust companies	11

Source: AMBD (n.d.).

Baiduri Bank Group's corporate financing services include the issuing of overdrafts, letters of credit, trust receipts and invoice financing, while its trade financing services encompass the issuing of letters of credit, trust receipts, invoice financing, foreign exchange, shipping guarantee, export documents and import documents. BIBD's extensive corporate financing services include Naqad financing (short-term revolving financing in the form of an overdraft facility that may be utilised over the period of the financing) (BIBD, n.d.a), demand financing, demand line financing, term financing, development financing and Musyarakah financing (a shariah contract that merges capital provided by the partners for profit-sharing purposes) (BIBD, n.d.b). BIBD's trade financing services include shariah-compliant letters of credit, trust receipts, collection bills, shipping guarantees and foreign exchange hedging (BIBD, n.d.a). These services help ensure better and more efficient access to international markets by providing steady sources of credit and risk mitigation (for both importers and exporters) to businesses aiming to enter the global economy.

As a whole, the financial sector in Brunei has seen steady progress. Brunei's banks have 'high levels of liquidity, good capital adequacy ratios and well-managed levels of non-performing loans' (Oxford Business Group, 2016a). However, there is still room for improvement and potential for growth. The goal for AMBD is to increase the contribution of the financial services sector from 5.1 per cent in 2016 to 8 per cent in 2035. This growth is to be assisted by government efforts (Rahman, 2017).

6.4 Government initiatives in Brunei

The Brunei government has introduced several initiatives to enable the growth of the financial services sector and advance its integration with the global economic system. The initiatives focus on building a secure and sustainable financial infrastructure to ensure the continued growth of Brunei's financial sector. The government hopes to achieve this by (i) establishing a comprehensive regulatory framework, a national securities exchange, a credit bureau and a comprehensive electronic payment system; and (ii) supporting the overall growth of the financial services sector (AMBD, 2015).

6.4.1 Development of regulatory framework

The Brunei government is working to raise its national banking standards by developing a regulatory framework that meets international financial regulation standards. The aim is to encourage coherent and uniform regulatory standards across banks and monetary authorities. AMBD is also participating in the Islamic Financial Services Board (IFSB) working groups to determine whether its standards and guidelines meet the objective of promoting a more transparent Islamic Finance industry in Brunei (IFSB, 2018). The aim of the working groups is to adopt a regulatory framework that meets international standards while also remaining consistent with shariah principles.

6.4.2 Development of a national securities exchange

In order to establish a national securities exchange, the Brunei government has allocated up to B$5 million to ensure its launch in a few years (Bandial, 2018). Currently, the government is working with AMBD to lay the groundwork (AMBD, 2015). The introduction of a securities exchange is likely to attract investment and capital, leading to significant benefits for the Bruneian economy.

6.4.3 Establishment of a credit bureau

In 2014, AMBD established a credit bureau, now used by banks and finance companies to assess the creditworthiness of customers. The credit bureau acts as a risk management tool, allowing lenders to mitigate credit risk by providing them with customer information. Banks and finance companies can provide customised products and services to their customers, while customers with good credit are able to benefit from having easier and more favourable access to credit.

6.4.4 Development of an electronic payment system

AMBD has laid the groundwork for Brunei to transition from a cash and cheque-based payment and settlement system to a more secure electronic payment system. In 2014, AMBD introduced an electronic high-value settlement system, followed by an Automatic Clearing House in 2016, which allows for the electronic clearing of checks. AMBD is now developing the infrastructure for retail payments, which utilise internet banking, mobile payments and other new electronic-based payment tools. The government's objective is to reduce the use of cheques by approximately 50 per cent by 2020 and to ensure all high-value interbank cheques are replaced by electronic payments (AMBD, 2015).

Like many governments, Brunei is likely to have to craft regulations to address the growing role of the fintech sector, particularly as non-bank entities provide financial services. This could include remittances, cross-border payment and lending solutions, and insurance offerings.

6.4.5 Growth of financial literacy and skills development

The Brunei government aims to support the sustainable growth of its financial services sector by raising financial literacy standards among its citizens. The Centre for Islamic Banking, Finance and Management (CIBFM) provides professional training programmes for specialised divisions of the financial sector such as Islamic banking, insurance, finance, capital markets and management studies. As of 2016, over 4,000 participants have enrolled in CIBFM programmes (AMBD, 2015). The Centre places a focus on Islamic finance as Brunei is aiming to become one of the world's leading knowledge hubs in the area. The professional development programmes are expected to produce competent financial services professionals well versed in both international standards and Islamic finance.

6.5 Financial services: promise and opportunity

Like in the logistics sector, it is clear from the various initiatives undertaken by the Brunei government that officials intend to seize the opportunities offered by the spread of regional and global value chains to help diversify Brunei's economy. Financial services, in particular, can be easily offered to firms domestically and overseas to support growth. The following subsection examines the reality on the ground, based on existing literature and interviews conducted in Brunei and across the region, to see how closely Brunei's ambition for logistics services development has matched economic development plans.

6.6 Assessment of Brunei's financial services sector

As mentioned in the previous subsection, Brunei has already put in place a series of regulatory and institutional reforms to ensure the continued growth of its financial sector. According to BEDB, such reforms and Brunei's strategic advantage as a provider of Islamic finance solutions will allow Brunei to fund the growth of local industries and become an Islamic finance hub for the region (AMBD, 2015).

The emergence of the financial services sector for financial hubs like Hong Kong and Singapore, or Islamic finance hubs like Malaysia, was supported by thriving trade flows, growing domestic demand, comprehensive market components – such as government bonds and other types of financial assets – and the proliferation of both domestic and foreign financial institutions (Rojas, 2014).

Despite efforts to develop its financial market, Brunei has not created the institutional and economic conditions to enable such growth. Based on interviews with financial sector specialists from across the region and the financial services literature, Brunei needs to address the following aspects to ensure the growth of its financial services industry:

1. Development of working capital and trade finance solutions for local enterprises, especially MSMEs;
2. Development of strong capital markets through the growth of the demand and supply of multiple financial asset classes and the implementation of institutional and regulatory reforms.

6.6.1 Access to working capital and trade finance solutions

Ensuring that local companies have access to adequate corporate, insurance and trade finance solutions is key to the growth of the financial services industry and the global competitiveness of those firms. Access to comprehensive working capital and trade finance solutions often allow suppliers and producers in growing markets to develop products that meet the standards required by multinational manufacturers and trading partners. In Brunei, the corporate banking and insurance sectors remain vital for the successful implementation of the country's diversification programme (AMBD, 2015).

In Brunei, promoting the development of fast-growing domestic companies, especially MSMEs, will enable the innovation required to strengthen the diversification of the economy. An estimated 6,047 enterprises were operating in Brunei Darussalam in 2017, of which MSMEs accounted for 97.2 per cent. MSMEs in Brunei accounted for 54.5 per cent of employment and 34.8 per cent of gross business revenue in 2015. Of 5,876 MSMEs in 2017, 41.6 per cent were micro, 42.4 per cent were small and 16.1 per cent were medium (Department of Statistics, 2018).

The dominance of MSMEs is not necessarily unusual. Many economies around the world are similarly driven by an abundance of smaller firms. However, the gap between the overwhelming proportion of enterprises that are MSMEs and the relatively limited contribution of business revenue suggests a particular challenge in Brunei. It especially highlights the difficulty in relying on this segment of the economy to drive innovation, competitiveness and – most critically – demand for financial services. An underperforming MSME marketplace is going to provide a shaky foundation for creating a powerhouse financial services sector.

It is important that financial institutions in Brunei offer corporate banking and trade finance solutions that enable domestic enterprises to grow and develop innovative products that can be incorporated into GVCs.

In Brunei, formal external finance, which includes MSME finance services, is mainly provided by banks. The primary instrument in place to increase bank lending to MSMEs is a subsidy programme, known as the Micro Financing Scheme (MFS), which is co-managed by Darussalam Enterprise (DARe) and BIBD. While banks like BIBD have successfully transitioned from a focus on consumer lending towards MSMEs and corporate business, the loan, insurance and trade finance markets for MSMEs remains underdeveloped (OECD and ERIA, 2018).

Interviewees from the regional financial sector highlighted the importance of offering asset-based financing solutions, factoring and trade finance securitisation to MSMEs. These services are not currently offered in Brunei, while other asset-backed lending instruments, such as leasing or trade and purchase order finance, are offered but at relatively low volumes, particularly to MSMEs (OECD and ERIA, 2018).

Furthermore, even if Brunei's domestic banking and insurance system develops products that meet the needs of domestic enterprises, Brunei's total market size is too small to attract the levels of capital and foreign interest required to become a financial hub. In fact, over the past decade, multiple foreign banks have exited the Brunei market. Citibank left in March 2014, UOB sold its retail assets to Baiduri Bank in October 2015 and HSBC departed in 2016 (Bandial, 2017).

Overall, lack of a strong production and industrial base, limited local demand and low exports make the development of working capital and trade finance solutions for domestic enterprises a limited solution in enabling the growth of Brunei's financial services sector.

6.6.2 Development of strong capital markets

Capital markets play a critical role in economic development by pooling domestic savings and mobilising foreign capital for productive long-term investment. However, in many emerging economies, which currently represent about half of global GDP, capital markets remain underdeveloped or are altogether non-existent (WEF, 2016).

The development of capital markets not only enables provision of the long-term capital that firms need to invest and expand but also creates an environment that enables FDI and international capital flows (WEF, 2016). In Brunei, the government has focused on the development of the domestic Islamic financial markets and the internationalisation of Islamic finance, in the hopes that this will give Brunei a more significant role in the intermediation of international financial flows (AMBD, 2015).

According to existing literature on traditional and Islamic capital markets, the establishment of strong capital markets relies on the development of three key factors:

1. Liquid government debt securities markets;
2. Attractive and diverse investment opportunities, by creating a sufficient pool of attractive products for investors; and
3. Adequate regulatory and institutional frameworks.

Each of these issues is examined in turn.

First, to create a strong capital market, it is important to have a government debt securities market. The development of such a market provides a benchmark to price other assets and hedge mechanisms against interest rates (Jain et al., 2017). Sukuk, or Islamic debt instruments, represent the second largest asset class in the Islamic financial industry, accounting for 13.5 per cent of global Islamic finance assets (Najeeb, 2013). Government sukuks have been developed by countries like Brunei, Malaysia and United Arab Emirates to enable the growth of a debt securities market that is shariah-compliant (McMille, 2006).

The objective of Brunei's sukuk programme is both to develop Brunei's yield curve as a benchmark for corporate sukuk and to provide a safe and liquid investment instrument for domestic financial institutions (AMBD, 2015). However, the Brunei sukuks market has remained stagnant, with no issuances since 2011 and a total outstanding value of US$856.5 million (Najeeb, 2013). As the issue size for the sukuk is small and demand is high, the issuance has been only offered domestically (ADB, 2017). By way of contrast, the Malaysian sukuk industry is well developed and has continued its stable growth, with a global market share of 71.6 per cent (Najeeb, 2013).

A second key element in creating a strong capital market is the importance of creating attractive and diverse investment opportunities. The development of a government securities market could also help widen the investor base and assist with the development of the issuance of non-government securities such as corporate bonds as well as asset-backed, revenue-backed and mortgage-backed securities. In Islamic finance, it is possible to finance Islamic equities or liquid management facilities. Either option could help build up Brunei's financial services sector.

The indexing of Islamic equities and the subsequent development of the Islamic mutual funds industry has rapidly expanded over the past two decades to become an important emerging component of the Islamic finance industry (McMille, 2006). Malaysia is currently the second largest market in the Islamic mutual funds industry, with an overall share of 21.8 per cent of the market. Saudi Arabia is the largest market, with a 33.2 per cent share in the industry (Najeeb, 2013).

Brunei has no Islamic equity indices or funds yet. Currently, BIBD shares are the only ones trading in the local bourse, which remains underdeveloped and lacks liquidity (Najeeb, 2013).

Malaysia established the world's first Islamic Inter-Bank Money Market (IIMM) in January 1994 (ADB, 2017). Structured on the foundations of conventional money markets, the Malaysian IIMM provides Islamic banks with all the facilities that a conventional money market provides to conventional banks.

Brunei is not an attractive market for liquidity management. There are no Islamic money market initiatives of any kind. Besides the recent development of a short-term local currency sukuk programme, Brunei Islamic liquidity markets are virtually non-existent (Najeeb, 2013).

Overall, Brunei's Islamic capital market remains relatively underdeveloped and is not competitive with regional markets like Malaysia's.

Third, as part of the path to creating a strong capital market, governments need to ensure adequate regulatory and institutional frameworks. In a globalised financial services sector shaped by ever-increasing complexities and financial instruments, having in place regulatory frameworks that meet international standards is critical to any country ambitions to become a financial hub.

The main objective of sound regulation is to create a transparent environment with predictable enforcement and to promote standardisation that decreases financial cost and risk for market participants (WEF, 2016). Reforms that encourage foreign and domestic investment include tax regimes that align with financial development objectives, strengthened regulatory and legal frameworks that protect investors and strong corporate governance frameworks (Jain et al., 2017).

Brunei's existing legal frameworks for the banking, insurance and securities markets are adequate for the domestic market. Brunei places considerable importance on ensuring that Islamic finance operates in accordance with shariah principles (AMBD, 2015). Continuing efforts will be required from AMBD to align any remaining market gaps and ensure Brunei can extend its role as a provider of financial services internationally (Siddiqui, 2008).

Given a highly competitive international environment, Brunei will have to place continuing emphasis on the resilience of its Islamic finance sector. This includes strengthening the relevant regulatory and legal framework for Islamic finance and promoting greater harmonisation in shariah interpretations (AMBD, 2015).

Existing literature and input from capital market professionals from across the region also highlight the importance of cornerstone institutions like stock exchanges and credit rating agencies in the development of standards and pooling of resources (Jain et al., 2017).

While Brunei has not developed a credit rating agency, the launch of a standalone securities exchange is expected to catalyse economic growth and business expansion (AMBD, 2015). The development of a national securities market has the potential to expand the country's capital markets platform and trigger greater foreign investment opportunities and inflows. However, as of now there is no timeline for the development of a stock exchange.

6.6.3 Transforming Brunei into an Islamic finance hub

A key focus for the development of Brunei's financial and financial services sector is the strengthening of Brunei into an international Islamic finance hub. However, the underdeveloped government sukuk and Islamic finance capital assets markets, limited domestic demand and the highly competitive Islamic finance market of Malaysia just next door make this a difficult task.

To promote the country as an international financial centre, Brunei needs to effectively position itself alongside established financial centres like Singapore, which offers economic and political stability and well-developed infrastructure. Brunei can distinguish itself from these other markets because of its strong leadership and commitment to the development of Islamic financial products. However, markets like Malaysia have developed a more robust Islamic finance infrastructure.

The Islamic financial industry in Malaysia is characterised by having comprehensive market components, covering Islamic banking, takaful, Islamic money market and Islamic capital market. Malaysia continues to be the main driver for both sukuk outstanding and issuance, commanding a market share of 51.0 per cent and 36.2 per cent, respectively (Najeeb, 2013). In Brunei, capital markets are virtually non-existent, with the exception of some sukuk issuances. Since the first Islamic institution was set up in 1991, Brunei's Islamic finance industry has remained stagnant.

Brunei needs not only to develop standards and offer different types of Islamic asset classes but also to put in place the reforms required to drive the development of internationally competitive domestic firms and build an environment conducive to FDI. Without such reforms, the growth of Brunei's financial services sector will be limited by weak local demand and relatively low industrial development.

6.6.4 Crafting fintech for the future

Like many governments, Brunei will need to address the growing role of fintech. This may mean starting with creating an appropriate regulatory framework for foreign fintech products rather than ensuring competitive product offerings for Brunei banks and other financial services in the wider marketplace. Rather than jump straight in to the creation of new service offerings, Brunei may benefit from watching developments in the region. Singapore's regulatory 'Sandbox' should be a particular area of focus, since many ideas can be discarded or selected from the wide range of testable offerings.

The fintech space is extremely crowded. The Fintech Festival in Singapore, held in November 2019, attracted more than 60,000 participants. Brunei had only one exhibition booth and no country pavilion.[3]

Brunei's particular advantage in the fintech space may be a focus on MSMEs, which could be less interesting or attractive to others in the region that are likely to target the needs of larger firms. Brunei may want to think about how to harness fintech tools to meet the needs of MSMEs. Such offerings, if designed from the beginning for ASEAN markets, would be highly useful and desirable. Given the overwhelming numbers of MSMEs across the region, aggregating smaller firms into specific services products could be end with quite substantial categories and give Brunei the market size it currently lacks to create competitive scale.

3 See https://www.fintechfestival.sg/list-of-exhibitors/?title=&name=&industry=&country=BN

7. A Framework for Reforming Brunei's Services Sectors

As seen in the assessment above, Brunei must address some fundamental issues before it can create globally competitive logistics and financial services sectors. Because of limitations in the size and potential of its domestic market, the country needs to work extra hard to ensure sufficient growth in industrial development and trade flows for the most efficient and effective development of its logistics and financial services sectors.

To do so, Brunei must put in place reforms that will allow it to attract global interest by establishing a national direction for market development, and improve the domestic market's attractiveness relative to global markets. By increasing exposure in the global emerging market portfolio and being better positioned to serve as a financial and/or logistics centre, Brunei will be able to improve MSME industry and services participation in GVCs.

The following are recommendations that would allow Brunei to begin to move in a direction that enables the growth and integration of its industries into global financial flows and supply chains.

7.1. Ratify the Comprehensive and Progressive Trans-Pacific Partnership

The first order of business for the Brunei government should be to ratify and swiftly and effectively implement the CPTPP trade agreement. Ratifying the CPTPP will help convince investors and trade partners that Brunei is willing to undertake domestic reforms that will guarantee better investment and trade flows in and out of the country.

Brunei's domestic economy lacks competitiveness. Firms are not currently connected to GVCs. Investors are not willing to pour FDI into the economy. Until the overall trade environment within Brunei's economy improves, logistics and financial services will not take off in the planned directions.

The CPTPP helpfully takes Brunei's business climate in the right direction. The high-quality, comprehensive trade agreement tackles a wide range of challenges – from goods and services to investment and e-commerce. It more effectively integrates Brunei with dynamic economies across the Pacific region, providing a convenient platform for building future growth opportunities.

While the agreement appears daunting for smaller firms, with nearly 600 pages of dense legal text and thousands of pages of country-specific commitments, the deal is actually surprisingly helpful for MSMEs to use. The CPTPP drops tariffs to zero on nearly every single good and does so for nearly all products within the next three years. The agreement allows cumulation across the current membership, letting Brunei companies 'add up' raw materials, parts or components from Singapore or Malaysia or Australia before shipping finished goods to Japan or Canada. For smaller firms, the combination of zero tariffs and cumulation means that companies can more easily create products in Brunei and be competitive in markets like Japan. Zero tariffs are easy for small firms to understand. Given the high costs of logistics into and out of Brunei, it is critically important that all other costs are as low as possible to make MSMEs competitive in foreign markets.

Services suppliers are also better off under the CPTPP, as there are no requirements for local presence, meaning that Brunei's services firms can stay in Brunei and deliver services across CPTPP countries. All services sectors are opened as well, making it possible for Brunei's skilled staff to remain at home.

The agreement also includes a wide variety of commitments designed to help reassure foreign investors that CPTPP member countries will allow, encourage and protect their investments. Given the relatively low state of inbound FDI into Brunei, anything the government can do to encourage investment should be welcomed.

The specific investment protections, of course, apply only to CPTPP member firms. However, the broader commitments made by the government of Brunei regarding investment may also go a long way towards reassuring potentially nervous investors from any economy. Hence, non-CPTPP investment could also pick up in the wake of CPTPP ratification. The agreement is a signal of the government's intentions. An agreement like the CPTPP that contains commitments not to expropriate assets without fair compensation is an important message to investors that the government is serious about protecting foreign investors.

Thus far, seven of the 11 signatories have had the agreement enter into force: Australia, Canada, Japan, Mexico, New Zealand, Singapore and Vietnam. Chile has very nearly completed its internal procedures.[1]

The agreement takes effect 60 days after domestic ratification procedures are completed. Hence, as soon as Brunei informs New Zealand (the official repository country) that it is ready to begin, the CPTPP will become active for Brunei in 60 days.

Brunei's government should, as part of the implementation process for CPTPP, prepare materials and engage in extensive training sessions for MSMEs to ensure Brunei's firms are prepared to take advantage of the agreement. After all, while it is a useful signal to foreign markets to see Brunei ratify the deal, it also matters that local firms are prepared to actually use the provisions and concessions granted in the agreement to help power new sources of economic growth for the local market.

Another suggestion for Brunei is to send out delegations of businesses and government officials to other CPTPP member governments to engage in outreach. As an example, Canada has been busy bringing together Canadian firms and regional and local officials with their counterparts across Vietnam. As a result, Canada/Vietnam trade has exploded since entry into force of the CPTPP. Investors in Canada should be similarly encouraged to think of Brunei and the reverse.

One key element of the CPTPP is the elimination of tariffs on all agricultural products. This is a highly unusual feature of the trade agreement, since most trade deals continue to shelter agriculture from tariff reductions. It opens up important new opportunities for agriculture, aquaculture and fisheries exports for Brunei firms since existing tariffs for these sectors can be 40 per cent or more. Once inside the CPTPP, Brunei's exports to key markets like Japan for such products will be tariff- or duty-free, making them much more competitive relative to similar items from non-CPTPP markets.

7.2. Implement ASEAN commitments

Since much of the challenge in driving competitiveness in logistics and financial services in Brunei relates to difficulties in growing the domestic market, it makes sense to do everything possible to better connect Brunei's businesses with the wider regional market. Brunei business should be 'born regional' instead of 'born domestic'. By raising the level and quality of existing MSMEs, it may be possible to help unleash a virtuous circle of growth in markets driving demand for improved logistics and financial services, which should drive greater competitiveness for domestic firms.

Brunei is part of a regional economic community designed explicitly for doing exactly this: the AEC. Brunei needs to cultivate and strengthen economic and social linkages within the ASEAN bloc to ensure it better leverages the growth potential of the region. The AEC and the AEC Blueprint 2025 contain a wide range of helpful commitments that should strengthen the domestic business environment for Brunei-based firms.

Specifically, for the logistics sector, Brunei should operationalise and drive trade facilitation and logistics-related agreements and commitments contained within ASEAN's various entities.

As part of ASEAN's ongoing efforts to integrate its logistics sector, Brunei should drive implementation of the ASEAN Framework Agreement on the Facilitation of Goods in Transit (AFAFGIT), the ASEAN Framework Agreement on the Facilitation of Inter-State Transport (AFAFIST), the ASEAN Framework Agreement on Multimodal Transport (AFAMT) and the ASEAN Framework Agreement on Facilitation of Cross-Border Transport Passengers by Road Vehicles (CBTP) (Irzanto, 2015).

Furthermore, as part of the implementation of AFAFGIT, Brunei should support the regional development of an automated customs transit system. The ASEAN Customs Transit System (ACTS) would act as a catalyst for the implementation of AFAFGIT and provide full end-to-end computerisation of transit operations with single electronic customs transit declaration (Irzanto, 2015).

1 Peru is unlikely to ratify prior to the end of 2019 as the government has collapsed. Malaysia's path is uncertain.

While trade facilitation and customs work has been underway at the ASEAN level for decades, financial services integration has been much less developed. Even in the AEC, free movement of capital was not promised, only 'freer' movement, as the deadline was kept for 2020 for financial services integration. However, this also means there is greater scope for Brunei to help drive the overall regional agenda in this space and encourage the development of truly cross-border financial services across a range of potential products.

Given the relatively limited development thus far in Brunei's domestic markets for many financial services products, it may make sense to consider the creation of ASEAN-wide concepts instead. Rather than just focusing on Islamic financing products, Brunei might also think harder about how to create ASEAN-wide MSME offerings that would not only benefit local firms but also create market demand for Brunei-based financial services products. At present, MSME financial services products are in short supply across the region, despite strong demand for such products. Brunei could usefully take a leadership role in ASEAN in creating the frameworks for MSME-friendly or MSME-facilitating insurance schemes, financing products, cross-border loans and so forth. Many of these products could be offered using innovative fintech products and delivered at low cost across ASEAN.

Under the existing frameworks at the ASEAN level, Brunei should implement commitments made under the ASEAN Framework for Cross-Border Offerings of Collective Investment Schemes (CIS) and ASEAN trading link, which aims to enhance the capital markets of the region by developing closer relationships between ASEAN's various securities exchanges (ASEAN, n.d.).

Brunei should also promote the financial sector integration agenda under the AEC 2025 Blueprint, which is focused on financial integration, financial inclusion and financial stability. Key commitments for financial services include the following (ASEAN Secretariat, 2015):

- Liberalise the financial services sector through the ASEAN Trade in Services Agreement, which will serve as a platform to link financial markets within the region and with Dialogue Partners;
- Provide greater market access and operational flexibility for Qualified ASEAN Banks through the ASEAN Banking Integration Framework;
- Promote deeper penetration in insurance markets through the ASEAN Insurance Integration Framework;
- Deepen and interlink capital markets by progressing towards more connectivity in clearing settlement and custody linkages to facilitate investment in the region and allow investors and issuers to tap cross-border ASEAN capital markets efficiently, in line with the objective of ASEAN Capital Market Infrastructure Blueprint;
- Promote the development of sovereign bond markets as well as corporate issuances that will diversify risks from the banking system and provide savers with greater opportunities to invest;
- Promote the expansion of distribution channels, which improve access to and reduce cost of financial services, including mobile technology and micro-insurance;
- Promote standardisation and develop settlement infrastructure for cross-border trade, remittance, retail payment systems and capital markets including harmonisation of standards and market practices based on international best practices (such as ISO 20022) to foster stability and efficiency.

Overall, ASEAN can be a platform to drive the type of logistics and financial market integration required to facilitate Brunei's industrial and financial growth.

7.3. Drive investment to increase trade and financial flows

Basically, one key challenge in building logistics and financial services sectors that are more competitive is the lack of scale in the domestic market overall. Without things to trade (beyond oil and gas), the backbone services of logistics and financial services have never quite had the incentives to develop efficient and effective product offerings. Inefficient backbone services, in turn, make it harder to build competitive marketplaces. Rather than building to a virtuous circle, Brunei has been stuck.

Brunei needs to drive industrial development in strategic sectors to increase the demand for logistics services and, potentially, financial services. Higher cargo volumes will reduce freight and transhipment prices, encourage the development of specialised logistics facilities and benefit services.

Such opportunities have the most potential in the halal industry and the petrochemical and downstream oil sectors.

The Brunei government has already identified the halal industry as a significant industry for growth and is employing foreign joint ventures with logistics firms to expand its halal market.

To address the increasing halal needs of Muslim consumers worldwide, local halal foods and beverages companies have employed the help of foreign logistics firms to improve the transportation and packaging of their products. For example, Ghanim International Corporation Sdn Bhd, a government-linked company for marketing and branding halal food products, was established in 2010 in a joint venture with Kerry Logistics and the Brunei government. Services provided by Kerry Logistics include sourcing, distribution and marketing of Brunei halal food products, international freight forwarding and integrated logistics management to uphold Brunei's strict halal standards (3PL News, 2010).

According to representatives from BEDB, halal-related sectors like aquaculture could also turn into viable sources of investment and export (BEDB, n.d.a). The aquaculture sector has the potential to provide Brunei with sufficient production to export competitively into other regional and global markets. The development of domestic or foreign-owned aquaculture firms would increase demand for specialised logistics services as well as corporate finance and insurance solutions.

Recent official forecasts of the aquaculture sector have shown that it can turn into a US$1.4 billion industry (Oxford Business Group, 2017). Brunei's aquaculture sector is projected to see a volume increase of almost 3,000 metric tonnes by 2020, following the signing of two agreements between the Ministry of Primary Resources and Tourism and Singapore-Based Barramundi Asia (B) Sdn Bhd. Barramundi Asia will be developing 6,613 hectares at Nankivell Offshore Aquaculture Site and an area of 25.1 hectares located in Kampung Meragang for high-quality hatchery and fish nursery for the production of sea bass juveniles to be supplied to the offshore fish cages (BEDB, n.d.a).

Aquaculture would not only enable the growth of the food processing industry but also strengthen Brunei's halal logistics and halal certification programmes, which could attract agri-food businesses from around the world to invest in local processing facilities.

It is worth noting that the CPTPP contains significant benefits for seafood and aquaculture products, particularly into Japan. Brunei's exports could be tariff-free into Japan (and all other CPTPP market), providing an additional incentive for exploring these markets.

Brunei wants to join GVCs. It actually already has extensive experience as a GVC player in oil and gas. Unfortunately, however, it provides the raw material inputs to the chain and its own participation largely ends. Brunei has never developed significant value added capabilities in downstream sectors that would allow it to participate across all aspects of the sector GVCs. Hence, it makes sense as part of a broader diversification plan to build on Brunei's experience in the oil and gas sector and developed expertise and strength particularly in upstream and liquefied natural gas (BEDB, n.d.b).

The construction of a 3,900 metric tonnes per year fertiliser (urea) plant and the development an integrated refinery and petrochemical complex at Pulau Muara Besar in partnership with Chinese private company Zhejiang Hengyi Group both show there are opportunities for Brunei to incorporate more value-added services to its oil and gas exports (Xinhua, 2019b).

Brunei's current target for downstream economic output is to achieve US$3.62 billion per year by 2035 (AMBD, 2015). To do so, Brunei may need to explore the development or expansion of the petrochemicals chain, by developing chemicals beneficial to or further down the streaming processes.

The development of downstream oil and gas and petrochemicals industry could be a good opportunity for Brunei to put in place reforms that would increase demand for specialised logistics services and stronger capital markets. This will not only raise the level of foreign value added but also increase demand for the logistics services and specifications required to promote a more developed oil downstream services industry.

Overall, increased volumes from industrial development in these and other sectors will allow Brunei to increase cargo volumes and investment flows and position itself as a viable partner for future opportunities that would enable its participation in GVCs. Such opportunities include Brunei's development into an air cargo or transhipment hub or a regional hub for Islamic finance.

7.4. Closing the circle

For Brunei's successful integration into more GVCs and the diversification of the economy away from traditional sources of growth, the country needs to harness the innovation of its smaller firms in new ways. This includes building more efficient and effective backbone services in both logistics and financial services to support these firms in their regional and global journey. It also means creating an enabling environment to support smaller firms with a regional and global mindset from the very beginning.

Brunei should leverage its membership in ASEAN. A variety of ambitious trade agendas provide ready-made platforms, giving Brunei businesses a competitive edge over many other potential rival firms. There may be further opportunities to use this knowledge to deepen business engagement and improve market penetration.

Policies need to be smart and targeted, to best deliver scarce resources to avenues that are most likely to deliver returns on investment in the near term. This means focusing on areas like halal, aquaculture and digital services and working closely with firms to ensure these are, indeed, areas of interest and competitive advantage in the region.

Brunei should also work on creating the conditions for better integration of MSMEs into GVCs for services. Given the overwhelming dominance of smaller firms in Brunei's economy, getting these companies engaged in trade is critical. Bottlenecks and high costs of logistics can be problematic for goods trade but such obstacles are not present for services delivery. Hence, it is important to think harder about building up services firms for regional and international competitiveness.

As the WTO 2019 World Trade Report notes, the global economy is increasingly services-based. Brunei should take heed of this trend and work with its own MSMEs to plug into the opportunities presented by the digital economy to foster integration into GVCs directly from Brunei.

The conditions are solid for new growth in Brunei. The country has excellent infrastructure, a highly skilled workforce, a committed and stable government, a network of trade agreements that give firms built-in advantages over potential competitors and a roadmap for action. It is time to move beyond discussing diversification and make improved participation in GVCs a reality.

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