The Investment Policy Review of Viet Nam is the latest in a series of investment policy reviews undertaken by UNCTAD at the request of countries interested in improving their investment framework and climate. The countries included in this series are:

- Egypt (1999)
- Uzbekistan (1999)
- Uganda (2000)
- Peru (2000)
- Mauritius (2001)
- Ecuador (2001)
- Ethiopia (2002)
- United Republic of Tanzania (2002)
- Algeria (2004)
- Benin (2005)
- Kenya (2005)
- Colombia (2006)
- Rwanda (2006)
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NOTE

UNCTAD serves as the focal point within the United Nations Secretariat for all matters related to foreign direct investment. This function was formerly carried out by the United Nations Centre on Transnational Corporations (1975-1992). UNCTAD’s work is carried out through intergovernmental deliberations, research and analysis, technical assistance activities, seminars, workshops and conferences.

The term “country” as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that date are not available or not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row.

A dash (-) indicates that the item is equal to zero or its value is negligible.

A blank in a table indicates that the item is not applicable.

A slash (/) between dates representing years – for example, 2004/05, indicates a financial year.

Use of a dash (–) between dates representing years – for example 2004–2005 signifies the full period involved, including the beginning and end years.

Reference to the “dollars” ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

The material contained in this study may be freely quoted with appropriate acknowledgement.
The UNCTAD Investment Policy Reviews are intended to help countries improve their investment policies and to familiarize Governments and the international private sector with an individual country’s investment environment. The reviews are considered by the UNCTAD Commission on Investment, Technology and Related Financial Issues.

The Investment Policy Review of Viet Nam, initiated at the request of the Vietnamese Government, was carried out through a fact-finding mission in March–April 2007, and is based on information current at that date. The mission received the full cooperation of the relevant ministries and agencies, in particular the Ministry of Planning and Investment and the Foreign Investment Agency. The mission also had the benefit of the views of the private sector, foreign and domestic, and the resident international community, particularly bilateral donors and development agencies. A preliminary version of this report was discussed with stakeholders at a national workshop in Hanoi on 18 December 2007. Comments were also gathered during a workshop organized by the Ministry of Planning and Investment on 12 March 2008. The final report reflects written comments from various Ministries of the Government of Viet Nam, as collected by the Ministry of Planning and Investment.

The suitability and effectiveness of the regulatory regime is assessed against several related criteria: (a) whether regulations adequately promote and protect the public interest; (b) whether regulations adequately promote investment and sustainable socio-economic development; and (c) whether the methods employed are effective and well-administered, given their public interest and development objectives and the legitimate concerns of investors that rules and procedures do not unduly burden their competitiveness. International practices are taken into account in making the assessment and recommendations in this report.

Chapter III of this review concentrates on attracting foreign direct investment (FDI) in the electricity sector. This follows a specific request from the Government of Viet Nam to focus on this issue, rather than on proposing a general strategy on how to position Viet Nam in terms of FDI attraction and how to derive maximum benefits from foreign investment.

This report was prepared by Quentin Dupriez, Rory Allan, Neil Pinto (consultant – Power Planning Associates) and Paige Griffin, under the supervision of Chantal Dupasquier. James Zhan provided overall guidance. The report benefited from comments and suggestions from UNCTAD colleagues under a peer review process. It was funded by the Government of Ireland, which also provided financing for follow-up activities.

It is hoped that the analysis and recommendations of this review will help Viet Nam achieve its development goals, contribute to improved policies, promote dialogue among stakeholders and catalyze investment and the beneficial impact of FDI.

Geneva, September 2008
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AFTA</td>
<td>ASEAN free trade area</td>
</tr>
<tr>
<td>APEC</td>
<td>Asia–Pacific Economic Cooperation</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of South-East Asian Nations</td>
</tr>
<tr>
<td>bcm</td>
<td>billion cubic meters</td>
</tr>
<tr>
<td>BIT</td>
<td>bilateral investment treaty</td>
</tr>
<tr>
<td>BoM</td>
<td>Board of Management</td>
</tr>
<tr>
<td>BOO</td>
<td>build-own-operate</td>
</tr>
<tr>
<td>BOT</td>
<td>build-operate-transfer</td>
</tr>
<tr>
<td>BTA</td>
<td>bilateral trade agreement</td>
</tr>
<tr>
<td>CCGT</td>
<td>combined cycle gas turbine</td>
</tr>
<tr>
<td>CIF</td>
<td>cost insurance and freight</td>
</tr>
<tr>
<td>DPI</td>
<td>Department of Planning and Investment</td>
</tr>
<tr>
<td>DTT</td>
<td>double taxation treaty</td>
</tr>
<tr>
<td>EIA</td>
<td>environmental impact assessment</td>
</tr>
<tr>
<td>EPZ</td>
<td>export processing zone</td>
</tr>
<tr>
<td>ERAV</td>
<td>Electricity Regulatory Authority of Viet Nam</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>EVN</td>
<td>Viet Nam Electricity Group</td>
</tr>
<tr>
<td>FDI</td>
<td>foreign direct investment</td>
</tr>
<tr>
<td>FIE</td>
<td>foreign-invested enterprise</td>
</tr>
<tr>
<td>FOB</td>
<td>free on board</td>
</tr>
<tr>
<td>GATS</td>
<td>General Agreement on Trade and Services</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>GDT</td>
<td>General Department of Taxation</td>
</tr>
<tr>
<td>GSP</td>
<td>Generalized System of Preferences</td>
</tr>
<tr>
<td>GW</td>
<td>gigawatt</td>
</tr>
<tr>
<td>ICSID</td>
<td>International Centre for Settlement of Investment Disputes</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IOE</td>
<td>Institute of Energy</td>
</tr>
<tr>
<td>IPP</td>
<td>independent power producer</td>
</tr>
<tr>
<td>IPRs</td>
<td>intellectual property rights</td>
</tr>
<tr>
<td>ISP</td>
<td>internet service provider</td>
</tr>
<tr>
<td>kV</td>
<td>kilovolt</td>
</tr>
<tr>
<td>kWh</td>
<td>kilowatt hour</td>
</tr>
<tr>
<td>LLC</td>
<td>limited liability company</td>
</tr>
<tr>
<td>LURs</td>
<td>land use rights</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>merger and acquisition</td>
</tr>
<tr>
<td>MFN</td>
<td>most favoured nation</td>
</tr>
<tr>
<td>MOI</td>
<td>Ministry of Industry</td>
</tr>
<tr>
<td>MOLISA</td>
<td>Ministry of Labour, War Invalids and Social Affairs</td>
</tr>
<tr>
<td>MONRE</td>
<td>Ministry of Natural Resources and Environment</td>
</tr>
<tr>
<td>MPI</td>
<td>Ministry of Planning and Industry</td>
</tr>
<tr>
<td>MW</td>
<td>megawatt</td>
</tr>
<tr>
<td>NLDC</td>
<td>National Load Dispatch Centre</td>
</tr>
<tr>
<td>NOIP</td>
<td>National Office of Intellectual Property</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>PC</td>
<td>People’s Committee</td>
</tr>
<tr>
<td>PPA</td>
<td>power purchase agreement</td>
</tr>
<tr>
<td>PPP</td>
<td>purchasing power parity</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>research and development</td>
</tr>
<tr>
<td>SBV</td>
<td>State Bank of Viet Nam</td>
</tr>
<tr>
<td>SCIC</td>
<td>State Capital Investment Corporation</td>
</tr>
<tr>
<td>SME</td>
<td>small and medium-sized enterprise</td>
</tr>
<tr>
<td>SOE</td>
<td>State-owned enterprise</td>
</tr>
<tr>
<td>SPS</td>
<td>sanitary and phytosanitary standards</td>
</tr>
<tr>
<td>TNC</td>
<td>transnational corporations</td>
</tr>
<tr>
<td>TRIMS</td>
<td>Agreement on Trade-Related Investment Measures</td>
</tr>
<tr>
<td>TRIPS</td>
<td>Trade-Related Aspects of Intellectual Property Rights</td>
</tr>
<tr>
<td>UNCITRAL</td>
<td>United Nations Commission on International Trade Law</td>
</tr>
<tr>
<td>VAT</td>
<td>value added tax</td>
</tr>
<tr>
<td>VCAD</td>
<td>Viet Nam Competition Administration Department</td>
</tr>
<tr>
<td>VCC</td>
<td>Viet Nam Competition Council</td>
</tr>
<tr>
<td>VGCL</td>
<td>Viet Nam General Confederation of Labour</td>
</tr>
<tr>
<td>VNPT</td>
<td>Viet Nam Posts and Telecommunications</td>
</tr>
<tr>
<td>WIPO</td>
<td>World Intellectual Property Organization</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Key economic and social indicators

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<th>1997-06 average</th>
<th>2006</th>
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<td>35.5</td>
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<td>GDP per capita (dollars)</td>
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<td>725.2</td>
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<td>7.1</td>
<td>8.2</td>
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<td>GDP by sector (%)</td>
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<td>Agriculture</td>
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<td>23.3</td>
<td>20.4</td>
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<td>Industry</td>
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<td>Trade (billion dollars):</td>
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<td>Net FDI flows</td>
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<td>31.6</td>
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<td>1.7</td>
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<td>FDI to GDP ratio</td>
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<td>4.9</td>
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<td>Life expectancy at birth (years)</td>
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<td>Literacy rate, adult (%)</td>
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<td>90.0</td>
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<td>94.0</td>
<td>94.0</td>
<td>91.0</td>
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1 Based on most recent year available.

Sources: UNCTAD, FDI/TNC database; World Bank, World Development Indicators; World Bank, Global Development Finance.

Key investment climate indicators (2008)

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<th>Indicator</th>
<th>Viet Nam</th>
<th>China</th>
<th>Malaysia</th>
<th>ASEAN</th>
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<td>Starting a business (No. of days)</td>
<td>50.0</td>
<td>35.0</td>
<td>24.0</td>
<td>63.8</td>
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<td>Cost of registering property (%)</td>
<td>1.2</td>
<td>3.6</td>
<td>2.4</td>
<td>4.5</td>
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<tr>
<td>Investor protection index</td>
<td>2.7</td>
<td>5.0</td>
<td>8.7</td>
<td>5.3</td>
</tr>
<tr>
<td>Rigidity of employment index (%)</td>
<td>27.0</td>
<td>24.0</td>
<td>10.0</td>
<td>24.8</td>
</tr>
<tr>
<td>Cost of hiring (% salary)</td>
<td>17.0</td>
<td>30.0</td>
<td>5.0</td>
<td>9.1</td>
</tr>
<tr>
<td>Cost of firing (weeks of wage) (%)</td>
<td>87.0</td>
<td>91.0</td>
<td>75.0</td>
<td>53.4</td>
</tr>
<tr>
<td>Cost of enforcing contracts (%)</td>
<td>31.0</td>
<td>8.8</td>
<td>27.5</td>
<td>45.6</td>
</tr>
<tr>
<td>Intl. telecom cost ($/3 min. call to United States)</td>
<td>1.9</td>
<td>2.9</td>
<td>0.7</td>
<td>1.2</td>
</tr>
<tr>
<td>Time for exports (days)</td>
<td>24.0</td>
<td>21.0</td>
<td>18.0</td>
<td>24.1</td>
</tr>
<tr>
<td>Time for imports (days)</td>
<td>23.0</td>
<td>24.0</td>
<td>14.0</td>
<td>23.8</td>
</tr>
<tr>
<td>Domestic investment (% GDP)</td>
<td>35.4</td>
<td>43.5</td>
<td>31.7</td>
<td>23.0</td>
</tr>
</tbody>
</table>

Sources: World Bank, Doing Business and UNCTAD.
INTRODUCTION

Viet Nam is a relative newcomer in the world of FDI. It opened to foreign investors in the late 1980s under the Doi Moi policy of renovation and economic reforms. Although the opening has been decidedly gradual, Viet Nam managed to attract significant inflows of FDI quickly. The impact of these inflows has been very strong, and foreign investors have been a major force in the economic transformation during the past two decades and in Viet Nam’s integration into the world economy.

While FDI inflows have been notable so far, Viet Nam has considerable potential to attract significantly more foreign investment, which could further boost the economy and reduce poverty. The Government has pursued a strong agenda of reforms in recent years, which made accession to the World Trade Organization (WTO) possible, sealing the integration of Viet Nam into the world economy. But further reforms are needed to put in place effective regulatory mechanisms under a market economy framework, promote innovation and sustainable development, and further reduce poverty. Underpinned by such policies, FDI could contribute to turning Viet Nam into a middle-income Asian Tiger in the near future. Foreign investment could also play a more important role in the future in developing new and dynamic services activities, and in enhancing the position of Viet Nam as a business and logistics hub for the Greater Mekong subregion.

Chapter I analyzes past trends in FDI and its impact on the economy. It notes that Viet Nam has undergone an impressive process of transformation from an isolated, poor and collectivized agriculture-based economy into a booming nation with a dynamic and diversified private sector coexisting with a large public sector, fully integrated into the world economy. It underscores that poverty has been reduced at one of the fastest rates in history. Foreign investors have played a major role in these outcomes, generating employment, wealth, diversification, and exports. A large part of FDI inflows has been focused on manufacturing for exports, but Viet Nam has considerable potential in other sectors, some of which have been largely closed to FDI so far, but are starting to be opened.

Chapter II examines the investment framework. It takes note of and commends the vast programme of legal and regulatory reforms that has been accomplished so far. It highlights a number of areas where Viet Nam could focus its attention for further reforms and makes concrete recommendations. A “Doi Moi 2” in investment policy and oversight should be considered to unleash the forces of innovation. A policy to ensure that the economy has the skills it needs as it evolves and develops is suggested, using foreign workers where necessary. Measures to separate clearly the State’s ownership and regulatory functions are also proposed, together with a rationalization and simplification of fiscal incentives on corporate taxes. It is also suggested to lift certain FDI entry restrictions selectively in order to allow the realization of the FDI potential in areas that could become bottlenecks for growth in the future and in areas with high dynamic potential.

Chapter III proposes a strategy to attract FDI in electricity, at the request of the Government. Electricity could become a bottleneck for growth if supply issues are not addressed properly, and the ongoing structural reforms in Viet Nam’s electricity sector are analyzed. A number of measures are suggested to enable Viet Nam to attract FDI in power generation and meet the rapid increase in electricity demand. Recommendations are provided with the view of minimizing the Government’s exposure to the risks involved in attracting independent power producers. Certain structural requirements needed to put in place a fully competitive power market by 2025 – as planned by the Government – are also underscored.

Chapter IV highlights the main findings and recommendations of the review.
I. FDI TRENDS AND IMPACT

A. Economic background

Viet Nam has undergone an extraordinary economic transformation over the past 20 years. Much of the country’s infrastructure was destroyed during the war with the United States in the 1960s and 1970s, and the Government of Viet Nam put in place a centrally planned economy immediately after reunification in 1976. This implied the collectivization of farms and public ownership of all productive assets. Economic performance under the centrally planned system was poor, with widespread shortages of food and other staple goods, very limited industrial development, poor infrastructure and poverty levels well above 70 per cent. In addition, Viet Nam was by and large isolated from the world economy, with very limited trade relations, mainly with countries from the former Communist bloc.

Confronted with the failure of the centrally planned system and in view of the success of the reform process in China, the Government of Viet Nam launched the “Doi Moi” (“renovation”) initiative in 1986. Doi Moi sought to revive economic growth and development by starting a gradual transition from central planning to a market-based economy and by progressively integrating into the world economy. Reforms under Doi Moi have gradually removed the stranglehold of the public sector on the economy and allowed private investment and initiative. Key measures include the transfer of agricultural land from large State-owned farms to household farms, price liberalization and private ownership in industry and commerce. Viet Nam also started reforming its State-owned enterprises (SOEs) and gradually opened to foreign direct investment (FDI).

Helped by a strong culture of entrepreneurship and high literacy rates, the economy responded strongly and rapidly to Doi Moi. The private sector took off at once from a virtually non-existing base. By 2006, there were about 124,000 registered national private companies. The Vietnamese non-State sector represented 47.3 per cent of total output in 2006, compared with 40 per cent for the State sector and 12.7 per cent for the foreign-invested sector.

Despite the development of the private sector and initial efforts aimed at reforming and equitizing the State-sector, SOEs still represent a very large share of domestic output and employment (chapter II, section C.13). Although no comprehensive census of SOEs exists, there remain about 4,000 of them, active throughout the economy, sometimes in a commanding position. Foreign investors, in turn, responded favourably to Doi Moi and played an important role in economic transformation and poverty reduction. While foreign-invested enterprises (FIEs) were banned before Doi Moi, there were more than 4,200 of them in 2006, and their impact on the economy has been significant, in terms of output, employment and integration into the world economy (see below).

As a result of Doi Moi and the development of the private sector, annual real gross domestic product (GDP) growth averaged 6.8 per cent in the period 1986–2006, with relatively little volatility and moderate inflation. In nominal terms, the economy was 10 times its late-1980s size in 2006, at $61 billion, making

1 The United States-supported Republic of Viet Nam was reunified with North Viet Nam as the Socialist Republic of Viet Nam in July 1976, following the end of the war with the United States in 1975.
2 The adult literacy rate for men and women aged 15–24 was 94 per cent in 1999. The gross enrolment ratio in secondary education was 76 per cent in 2005, with gross enrolment in tertiary education at 16 per cent.
3 Source: General Statistics Office.
4 Including 100 per cent foreign-owned companies and joint ventures.
5 Equitization means the process of selling some or all of the capital of an SOE to its employees, the public or a strategic investor. Viet Nam does not use the term “privatization”.
Viet Nam the 58th largest economy in the world in 2006, up from 76th in 1986. In addition to growing rapidly, the economy also diversified significantly. In 1990, agriculture represented over 30 per cent of GDP; by 2006 it had declined to under 19 per cent. In contrast, industry increased from 25 per cent to 41 per cent over the same period, creating a large number of jobs in the industrial sector (figure I.1). Another sign of good economic fundamentals was the ability to weather the East Asian financial crisis in 1997 and expand, when most other East Asian economies were contracting.

Figure I.1. Sectoral composition of GDP, 1990–2006
(Percentage of total)

Doi Moi also brought about the integration of Viet Nam into the world economy. In addition to building the country’s export capacity through private sector development, the Government pursued a strategy to join various economic and trade agreements. Viet Nam became a member of the Association of South East-Asian Nations (ASEAN) in 1995 and joined the Asia–Pacific Economic Cooperation (APEC) in 1998. Viet Nam also became a member of WTO in 2007, cementing its commitment to integration into the world economy (box I.1). In addition, various bilateral trade agreements have been ratified, including the bilateral trade agreement with the United States in 2001.

The economic transformation and high growth rates have been accompanied by unprecedented progress in poverty reduction. The poverty rate plunged from 58 per cent in 1993 to 37.4 per cent in 1998 and 19.5 per cent in 2004. Similarly, the World Bank estimates that the population living with less than $1 a day was only 2 per cent of the total in 2002. It also estimates per capita GDP on a purchasing power parity (PPP) basis at $3,384 in 2006, up from $941 in 1990. This compares with $7,660 in China, $11,675 in Malaysia and $9,331 in Thailand in 2006.

Source: General Statistics Office.


Source: Government Statistics Office.

On a purchasing power parity basis.
Box I.1. Viet Nam’s membership in multilateral economic agreements

Viet Nam joined ASEAN in July 1995. In addition to the founding members of 1967 (Indonesia, Malaysia, the Philippines, Singapore and Thailand), ASEAN includes Brunei Darussalam (1984), Viet Nam (1995), the Lao People’s Democratic Republic (1997), Myanmar (1997) and Cambodia (1999). The overarching purposes of ASEAN are to accelerate economic growth, social progress and cultural development, and to promote regional peace and stability.

The ASEAN Free Trade Area (AFTA) is only one component of a wider project of establishment of an ASEAN Economic Community, which aims to create a single market and production base with free flow of goods, services and investment (box II.3). Although it seeks the complete elimination of tariff and non-tariff barriers among member countries, that goal has not been achieved yet. The five founding members and Brunei Darussalam have reduced their intra-ASEAN tariffs on goods on the Inclusion List to less than 5 per cent, with more than 60 per cent of these goods subject to zero tariffs. The other members were given more time to reduce tariffs on goods on the Inclusion List to a 0–5 per cent range. Viet Nam was given until 2006 to do so. The elimination and reduction of intra-ASEAN tariffs are also constrained by the Highly Sensitive List and General Exception List, to which commitments to liberalization do not apply.

APEC started in 1989 as an informal ministerial-level dialogue group with 12 member countries, before extending to 21 members. The objective of “free and open trade and investment in the Asia–Pacific by 2010 for developed economies and 2020 for developing economies” was set in the APEC leaders’ declaration of Bogor in 1994. APEC operates as a cooperative multilateral economic and trade forum, and it seeks to advance its objectives of free trade and investment without requiring its members to agree to legally binding obligations. The policy agenda is advanced through annual leaders’ meetings, in addition to ministerial meetings and the work of special committees and working groups. The 14th leaders’ meeting was held in Hanoi in November 2006.

Viet Nam became a member of the WTO in January 2007, after a 12-year accession process. As such, it is a signatory to the General Agreement on Trade and Services (GATS), WTO’s Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Trade-Related Investment Measures (TRIMS) agreements. Viet Nam did not sign up to WTO’s optional Agreement on Government Procurement.

Source: ASEAN, APEC and WTO websites.

B. FDI trends

1. FDI size and growth

The effects of Doi Moi on FDI materialized rapidly after the opening of the economy to foreign investors in 1987. From a complete ban prior to 1987, FDI inflows picked up to $180 million in 1990, before surging to $2.6 billion in 1997, on the back of the overall dynamism in the region and optimism over the pace of reforms in Viet Nam (figure I.2). This surge in FDI coincided with and reinforced the strong increase in economic activity as Doi Moi started to unleash market forces and private initiative. While some of the initial foreign investments took place in oil and gas, manufacturing rapidly became the primary driver of FDI (section 2).
Although the initial response by investors was strong, the rise in investment abated starting in 1995, despite a one-off peak in 1997.\(^9\) The number of FDI projects declined between 1995 and 1998 (table I.1), while FDI flows fell from their 1997 peak for five consecutive years to $1.2 billion in 2002. The decline in project registrations started before the financial crisis that shook East Asia in July 1997 and produced a collapse in output in Hong Kong (China), Indonesia, Singapore, the Republic of Korea, Malaysia, the Philippines and Thailand, with limited effects in China, India and Taiwan, Province of China.

The slowdown in FDI growth starting in 1995 can be partly attributed to the relatively slow pace of reforms after the groundbreaking opening of 1987. Investors’ interest and expectations were high, but somewhat toned down, as they confronted difficulties in running their businesses, including as a result of a difficult regulatory environment, discriminatory pricing and trading restrictions.

The real turning point, however, was the East Asian financial crisis. As output collapsed around the region and as the risk of global contagion was real, foreign investors put projects on hold. During the 1990s East Asian boom, many investors from the region had started turning to Viet Nam as a new location to expand export facilities, as well as to access a new emerging market for their goods. With over 60 per cent of FDI in Viet Nam originating from countries in the region, inflows were cut sharply as the main corporations in the Republic of Korea, Singapore, Thailand or Hong Kong (China) were caught in a wave of restructuring, liquidation or mergers and acquisitions (M&As).\(^10\) These circumstances left little room for companies in the region to focus on investments abroad. In addition, Asian exports to

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\(^9\) The 1997 peak was not determined by inflows under one or a few big projects, but by contemporaneous disbursements on a larger number of projects in a variety of sectors.

\(^10\) In 1997, the top three sources of FDI as a percentage of total FDI were Japan (17 per cent), the Republic of Korea (14 per cent), and Singapore (11 per cent). Other regional investors included Thailand (7 per cent), Taiwan Province of China (6 per cent), Hong Kong (China) (5 per cent), and Malaysia (3 per cent).
the world contracted by about 5 per cent after more than a decade of very fast growth, which reduced the need for and attractiveness of Viet Nam as an export platform.

Table I.1. FDI project registrations and average size, 1990–2006
(Million dollars and number of projects)\(^1\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of projects</th>
<th>Registered capital</th>
<th>Average registered capital per project</th>
<th>Implemented capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>107</td>
<td>735</td>
<td>6.9</td>
<td>..</td>
</tr>
<tr>
<td>1991</td>
<td>152</td>
<td>1291</td>
<td>8.5</td>
<td>329</td>
</tr>
<tr>
<td>1992</td>
<td>196</td>
<td>2208</td>
<td>11.3</td>
<td>575</td>
</tr>
<tr>
<td>1993</td>
<td>274</td>
<td>3037</td>
<td>11.1</td>
<td>1017</td>
</tr>
<tr>
<td>1994</td>
<td>372</td>
<td>4188</td>
<td>11.3</td>
<td>2041</td>
</tr>
<tr>
<td>1995</td>
<td>415</td>
<td>6937</td>
<td>16.7</td>
<td>2556</td>
</tr>
<tr>
<td>1996</td>
<td>372</td>
<td>10 164</td>
<td>27.3</td>
<td>2714</td>
</tr>
<tr>
<td>1997</td>
<td>349</td>
<td>5591</td>
<td>16.0</td>
<td>3115</td>
</tr>
<tr>
<td>1998</td>
<td>285</td>
<td>5100</td>
<td>17.9</td>
<td>2367</td>
</tr>
<tr>
<td>1999</td>
<td>327</td>
<td>2565</td>
<td>7.8</td>
<td>2335</td>
</tr>
<tr>
<td>2000</td>
<td>391</td>
<td>2839</td>
<td>7.3</td>
<td>2413</td>
</tr>
<tr>
<td>2001</td>
<td>555</td>
<td>3143</td>
<td>5.7</td>
<td>2450</td>
</tr>
<tr>
<td>2002</td>
<td>808</td>
<td>2999</td>
<td>3.7</td>
<td>2591</td>
</tr>
<tr>
<td>2003</td>
<td>791</td>
<td>3191</td>
<td>4.0</td>
<td>2650</td>
</tr>
<tr>
<td>2004</td>
<td>811</td>
<td>4548</td>
<td>5.6</td>
<td>2852</td>
</tr>
<tr>
<td>2005</td>
<td>970</td>
<td>6840</td>
<td>7.1</td>
<td>3309</td>
</tr>
<tr>
<td>2006</td>
<td>987</td>
<td>12 004</td>
<td>12.2</td>
<td>3956</td>
</tr>
<tr>
<td>2007</td>
<td>1544</td>
<td>21 348</td>
<td>13.8</td>
<td>..</td>
</tr>
</tbody>
</table>

\(^1\)Registrations are on the basis of total project cost over the whole duration of the investment, including the part financed by third-party debt. Numbers as reported on this basis therefore do not match FDI inflows as reported on a balance of payments basis. Some registered projects may also never materialize.

Sources: General Statistics Office and Ministry of Planning and Investment.

The sharp decline in FDI inflows between 1997 and 2002 had a negative impact on GDP growth, given the importance of the foreign-invested sector in the economy, but it must be noted that real GDP growth fell only marginally below 5 per cent in 1999, before picking up again to more than 7 per cent per annum. Given that Viet Nam was not open to the short-term capital flows whose volatility so affected other East Asian economies, it was able to weather the East Asian financial crisis much better than other countries.

FDI inflows to Viet Nam were relatively slow to recover; however, and they did not increase as a result of the wave of consolidation and M&As that occurred in other countries in the region as part of the post-crisis recovery (figure I.3). In the Republic of Korea, M&As soared from about $300 million per year on average in 1993–1997 to almost $6 billion per annum in the subsequent five years. M&As also picked up significantly after the financial crisis in Hong Kong (China), Singapore and Thailand. In contrast, Viet Nam’s regulations against M&As precluded it from participating in the rebound in FDI through this channel. More importantly, it also took time for corporations in the region to complete their restructuring at home and start looking again for investment opportunities abroad.
FDI inflows started increasing again at a strong pace in 2003, reaching $2.3 billion in 2006. Several factors are underpinning this new wave of growth in foreign investors’ interest in Viet Nam. First and foremost, Viet Nam is increasingly establishing itself as a platform for the production of manufactured goods for the global economy. It is increasingly seen as one of the alternatives to China, with similarly low labour costs, reasonably efficient and competitive infrastructure services and an increasingly welcoming environment. Foreign investors also took notice of the acceleration in structural reforms in the early 2000s and the improvements in the investment framework (chapter II). In addition, the ratification of the bilateral trade agreement (BTA) with the United States in 2001 opened up large export opportunities and was a clear sign that reforms were going to be sustained and that accession to WTO was firming up.

**Figure 1.3. FDI inflows to Viet Nam, India, Malaysia and Thailand, 1986–2006**

*(Million dollars)*

![Figure 1.3. FDI inflows to Viet Nam, India, Malaysia and Thailand, 1986–2006](image)

Source: UNCTAD FDI/TNC database.

The rapid recovery from the East Asian financial crisis across the region and the strengthening of Asia as a global manufacturing centre also contributed to the renewed attractiveness of Viet Nam as an investment destination. At the same time, sustained output growth and the emergence of a middle class are increasing the appeal to invest in Viet Nam in order to supply the local market. Although this “access to market” type of FDI is still relatively limited, as most foreign investors continue to look at Viet Nam as an export platform, it is likely to rise in importance in the future, particularly as services open to FDI.

A comparative analysis of relative FDI flows points to two main conclusions: (a) FDI has played an important role in driving economic activity so far – more so than in other countries in the region; and (b) FDI has significant growth potential in Viet Nam. FDI inflows as a proportion of GDP were particularly high in the 1990s, averaging $70 per $1,000 of GDP (table I.2). This is higher than in most other countries in the region, including China. As the economy developed, the ratio has come more in line with the ASEAN average in the period 2001–2006.
### Table I.2. Comparative FDI flows with selected countries, 1986–2006

(Dollars and per cent)

<table>
<thead>
<tr>
<th>Country</th>
<th>FDI inflows</th>
<th>% GDP</th>
<th>As % of GFCF</th>
<th>Per capita (Dollars)</th>
<th>FDI inflows</th>
<th>% GDP</th>
<th>As % of GFCF</th>
<th>Per capita (Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vietnam</td>
<td>40.4</td>
<td>54.8</td>
<td>11.7</td>
<td>39.2</td>
<td>34.1</td>
<td>18.4</td>
<td>22.4</td>
<td>11.6</td>
</tr>
<tr>
<td>Angola</td>
<td>913.2</td>
<td>55.4</td>
<td>12.5</td>
<td>497.5</td>
<td>38.1</td>
<td>13.0</td>
<td>13.0</td>
<td>9.1</td>
</tr>
<tr>
<td>Cambodia</td>
<td>786.0</td>
<td>41.6</td>
<td>21.9</td>
<td>229.0</td>
<td>9.2</td>
<td>11.1</td>
<td>11.1</td>
<td>5.7</td>
</tr>
<tr>
<td>Chile</td>
<td>2 936.1</td>
<td>55.4</td>
<td>13.9</td>
<td>4 903.1</td>
<td>55.4</td>
<td>13.9</td>
<td>13.9</td>
<td>55.4</td>
</tr>
<tr>
<td>China</td>
<td>454.4</td>
<td>33.1</td>
<td>11.2</td>
<td>221.0</td>
<td>11.2</td>
<td>11.2</td>
<td>11.1</td>
<td>11.2</td>
</tr>
<tr>
<td>Colombia</td>
<td>1 820.7</td>
<td>33.9</td>
<td>3.4</td>
<td>261.5</td>
<td>3.4</td>
<td>3.4</td>
<td>3.4</td>
<td>3.4</td>
</tr>
<tr>
<td>India</td>
<td>508.6</td>
<td>5.7</td>
<td>1.0</td>
<td>453</td>
<td>4.8</td>
<td>4.8</td>
<td>4.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2 341.8</td>
<td>5.2</td>
<td>2.0</td>
<td>845</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1 820.7</td>
<td>36.0</td>
<td>12.2</td>
<td>2 076.8</td>
<td>12.2</td>
<td>12.2</td>
<td>12.2</td>
<td>12.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>3 322.5</td>
<td>159.0</td>
<td>39.9</td>
<td>47 969</td>
<td>39.9</td>
<td>39.9</td>
<td>39.9</td>
<td>39.9</td>
</tr>
<tr>
<td>Thailand</td>
<td>1 236.8</td>
<td>33.0</td>
<td>15.4</td>
<td>1 050.9</td>
<td>15.4</td>
<td>15.4</td>
<td>15.4</td>
<td>15.4</td>
</tr>
<tr>
<td>ASEAN</td>
<td>6 970.8</td>
<td>39.5</td>
<td>17.5</td>
<td>747.3</td>
<td>17.5</td>
<td>17.5</td>
<td>17.5</td>
<td>17.5</td>
</tr>
<tr>
<td>South, East and South-East Asia</td>
<td>15 750.5</td>
<td>26.8</td>
<td>10.1</td>
<td>481.4</td>
<td>10.1</td>
<td>10.1</td>
<td>10.1</td>
<td>10.1</td>
</tr>
<tr>
<td>Developing economies</td>
<td>26 776.0</td>
<td>26.7</td>
<td>12.2</td>
<td>599.9</td>
<td>12.2</td>
<td>12.2</td>
<td>12.2</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Source: UNCTAD FDI/TNC database.
Similarly, FDI represented a very high proportion of gross fixed capital formation at 30 per cent of the total in the 1990s, compared with an ASEAN average of 14 per cent. As investment by private Vietnamese investors developed, the ratio declined in 2001–2006 to be in line with developing economies. On a per capita basis, however, FDI inflows remain well below other countries in the region, including China.

2. Distribution by sector and industry

As illustrated briefly in section A, Viet Nam’s economic landscape has altered radically over the past 20 years, moving from an agriculture-based to an industry- and services-based economy. FDI has been one of the engines behind this transformation and it continues to be a driving force of industrial growth and economic diversification. Although the first foreign investments were directed in the oil and gas sector, the industrial sector rapidly became the main magnet for FDI, as foreign investors used Viet Nam as an export platform. By the late 1990s, the manufacturing sector accounted for almost 45 per cent of registered foreign investments. Other sectors that attracted significant FDI inflows included construction, real estate and tourism-related investments (table I.3).

(Million dollars and percentage of total)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Registered capital (million dollars)</th>
<th>Share of total registered capital (percentage of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>14 871</td>
<td>33 698</td>
</tr>
<tr>
<td>Real estate, renting business activities</td>
<td>3477</td>
<td>9068</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>2524</td>
<td>3090</td>
</tr>
<tr>
<td>Construction</td>
<td>4152</td>
<td>2209</td>
</tr>
<tr>
<td>Transport, storage and communications</td>
<td>2706</td>
<td>1493</td>
</tr>
<tr>
<td>Electricity, gas and water supply</td>
<td>716</td>
<td>994</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>1541</td>
<td>716</td>
</tr>
<tr>
<td>Agriculture and forestry</td>
<td>1852</td>
<td>637</td>
</tr>
<tr>
<td>Other</td>
<td>1342</td>
<td>2296</td>
</tr>
</tbody>
</table>

Sources: General Statistics Office and Ministry of Planning and Investment.

The predominance of manufacturing FDI further increased in the past few years, as the sector attracted more than 60 per cent of all registered capital in 2001–2007. Real estate is a very distant second with 17 per cent of the total, followed by hotels, construction and transport with less than 6 per cent each. This predominance of the manufacturing sector highlights that foreign investors have chosen Viet Nam mainly as a centre of production for globally traded goods. Early investments had a relatively low technological content, including in textile and garment and footwear.

The ratification of the BTA with the United States, for example, allowed Viet Nam to export garments without quotas. Asian investors, including from China, were attracted as a result. The surge in apparel and footwear exports to the United States immediately after ratification of the BTA in 2001 indicates that investors had established factories in anticipation of the ratification.

More recently, manufacturing investments have progressively become more technologically advanced and with higher domestic value added, even if Viet Nam remains sought after for its low labour costs.
Goods manufactured for exports in Viet Nam are no longer restricted to apparel and footwear, and increasingly include consumer electronics and electronic assembly (section C.5). The decision by Intel to establish a $1 billion semiconductor assembly and test facility in the country is not only a landmark for Viet Nam, but also a clear indication of a growing trend (box I.2). In the same sector, Hon Hai–Foxconn (Taiwan Province of China) indicated that it had plans to invest up to $5 billion over the next five years in several sites to manufacture electronic goods and computer products, from digital cameras to music players, motherboards and other computer components. The company indicated that it would also build urban developments for its workers, who could number up to 300,000 in the future.

**Box I.2. Intel selects Viet Nam for a $1 billion investment**

In February 2006, Intel announced that it would invest $300 million to build a semiconductor assembly and test facility in the Saigon Hi-Tech Park in Ho Chi Minh City. Eight months later, it announced that the investment would be increased to $1 billion in order to build a larger complex (13,935m², later increased to 46,452m²). This is the first such investment by the semiconductor industry in Viet Nam and will be the largest factory in Intel’s global network of assembly and test facilities. The factory is expected to begin production in 2009 and will produce 600 million chipsets annually at full capacity.

Intel’s selection of Viet Nam is a significant landmark and image-building event for the country. Investor confidence could be boosted by Intel’s selection of Viet Nam over other regional contenders such as India. The decision will give a significant boost to the Saigon Hi-Tech Park and could generate further interest by other investors in the same sector, and be at the basis of the development of an electronics cluster in Viet Nam.

The assembly and test facility should employ about 4,000 people at full capacity, most of whom will be relatively high-skilled. The investment is likely to generate significant skills transfer and development opportunities. Given the needs of this type of facility, Intel faces a skill shortage, particularly at the engineer and senior management levels. Intel has instituted a three-fold solution. First it began hiring personnel earlier than normal and training them at other Intel facilities in Asia. Second, it has worked with universities to develop curricula. Lastly, Intel is engaging American universities to open a new engineering college in the high-tech park.

Source: Intel website.

With such a predominance of FDI in the export-oriented manufacturing sector, Viet Nam has attracted little market-seeking FDI or foreign investment in the non-tradable and services sectors. The exceptions are real estate, tourism and construction. It is particularly notable that Viet Nam has not attracted significant levels of FDI in telecommunications, finance, media or other services, whether for exports or for domestic consumption. This is in sharp contrast with most developing countries, including in the region, where there is a clear trend of services FDI overtaking manufacturing FDI. UNCTAD’s World Investment Report 2004 points out that services FDI accounted for two thirds of global FDI flows in 2001–2002, and that services FDI has diversified from the initial focus on trade and finance to other sectors such as telecommunications, business services, electricity and water.

The main reason underlying the lack of services FDI in Viet Nam is that the Government had chosen to keep most services sectors closed to foreign investors. Much of this is going to change in the next
few years as Viet Nam is committed to opening up many of the services sectors to FDI as part of its accession to WTO.

FDI in telecommunications has been limited so far because it has only been partially open to foreign investors, mainly as suppliers/builders of equipment and under business cooperation contracts (chapter II) with national investors. Private sector participation in the telecommunications sector in general is very limited, as the three network operators (mobile and fixed lines) are State-owned. Viet Nam's position on the telecommunication sector has become atypical, as the global trend is for the divestiture of the national operator and the entry of private investors, both domestic and foreign.

Viet Nam is committed under WTO to a partial liberalization of FDI entry in the telecommunication sector, but foreign ownership of network operators will remain capped at 49 per cent. In addition, network operators must be at least 51 per cent State-owned (chapter II). These restrictions mean Viet Nam is missing out on significant inflows of FDI, which may have consequences on the quality and cost of telecommunication services, as well as on innovation in the sector.

Representing less than 1 per cent of FDI over the past decade, finance is another sector where the role of FDI has been very limited so far. Similarly to the telecommunication sector, the reason is not the lack of interest from foreign investors, but restrictions on FDI entry. The banking sector is currently dominated by four State-owned banks, which accounted for 62 per cent of credits to the economy\(^\text{11}\) as of March 2007. Although a number of foreign banks have set up branches in Viet Nam, they face important restrictions on taking deposits and on the services they are allowed to offer. The main clients of foreign banks are other foreign investors, and they have ventured into retail banking on a very limited base only.

In the context of its accession to WTO, Viet Nam has agreed to lift the restrictions on FDI entry in the financial sector (banking, insurance and other financial services) by 2011. The restrictions will be phased out gradually, which implies that the potential for foreign investments in financial services will be realizable in the coming years. There have been clear indications of interest by foreign investors recently, and the potential for FDI in the sector is likely to be very large.\(^\text{12}\)

In 2005, ANZ Bank (Australia) purchased shares in Sacombank and Standard Chartered (United Kingdom) purchased shares in ACB bank. Kookmin Bank, the biggest Korean retail bank, has also shown interest in the Vietnamese market. Citibank has also gained ground by signing a partnership deal with State-owned Viet Nam Postal Saving Service Co. (VPSC) in September 2007 that will enable millions of Vietnamese using the VPSC network in more than 3,000 district-level post offices to make payments to firms that are banking with Citibank.

FDI in business and professional services has also been very limited so far, and Viet Nam has not been a player in the global trend towards outsourcing and delocalization of back-office operations. This is due not only to the legal and regulatory framework, but also to the availability of skills and infrastructure.

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11 Excluding net credits to the Government.
12 Other countries in the region and elsewhere have attracted large inflows of FDI in the financial sector. UNCTAD’s World Investment Report 2004 estimates that the financial sector represented 22 per cent of the stock of services FDI in developing countries in 2002. In 2005, China attracted an estimated $12 billion of FDI in the financial sector alone.
There has been limited foreign investment in infrastructure, most of which in power generation under build-operate-transfer (BOT) projects. Two large power plants were financed by foreign investors in the Phu My complex, using gas from the Nam Con Son Basin. Phu My 2.2 is a $400 million joint venture between Electricité de France, Sumitomo Corporation and the Tokyo Electric Power Company. It has a 20-year power purchase agreement (PPA) with the national power company. Phu My 3 is a $400 million joint venture between British Petroleum, Nissho Iwai Corporation (Sojitz) and SemboCorp Industries, which operates under similar terms as those of the Phu My 2.2 plant. In turn, the gas field of the Nam Con Son basin was developed by British Petroleum and Korean National Oil Corporation, in association with PetroVietnam. Together, the Phu My 2.2 and Phu My 3 power plants account for about 12 per cent of the total generating capacity of Viet Nam.

3. Provincial distribution of FDI

Virtually all of Viet Nam’s 64 provinces have attracted some level of FDI in the past couple of decades. The distribution across provinces has been very unequal, however, with the regions with the most developed infrastructure and highest availability of relatively skilled labour attracting the lion’s share of total FDI in the country. About 26 per cent of registered foreign investments in 1988–2006 were located in the Red River Delta region around Hanoi and Hai Phong, with the capital city alone attracting 16 per cent of the total (table I.4). In turn, the South-East attracted 54 per cent of total registered FDI in 1988–2006, with Ho Chi Minh City alone accounting for one quarter.

<table>
<thead>
<tr>
<th>Province</th>
<th>Number of projects</th>
<th>Percentage of total</th>
<th>Registered capital (million dollars)</th>
<th>Percentage of total</th>
<th>Registered capital per capita (dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Red River Delta</td>
<td>1781</td>
<td>21.5</td>
<td>20241</td>
<td>25.9</td>
<td>1.11</td>
</tr>
<tr>
<td>(Hanoi)</td>
<td>(949)</td>
<td>(11.5)</td>
<td>(12 561)</td>
<td>(16.1)</td>
<td>(3.90)</td>
</tr>
<tr>
<td>(Hai Phong)</td>
<td>(266)</td>
<td>(3.2)</td>
<td>(2648)</td>
<td>(3.4)</td>
<td>(1.47)</td>
</tr>
<tr>
<td>(Other)</td>
<td>(566)</td>
<td>(6.9)</td>
<td>(5031)</td>
<td>(6.4)</td>
<td>(0.38)</td>
</tr>
<tr>
<td>North-East</td>
<td>358</td>
<td>4.3</td>
<td>2445</td>
<td>3.1</td>
<td>0.26</td>
</tr>
<tr>
<td>North-West</td>
<td>27</td>
<td>0.3</td>
<td>115</td>
<td>0.2</td>
<td>0.04</td>
</tr>
<tr>
<td>North Central Coast</td>
<td>125</td>
<td>1.5</td>
<td>1473</td>
<td>1.9</td>
<td>0.14</td>
</tr>
<tr>
<td>South Central Coast</td>
<td>349</td>
<td>4.2</td>
<td>5276</td>
<td>6.7</td>
<td>0.74</td>
</tr>
<tr>
<td>Central Highlands</td>
<td>113</td>
<td>1.4</td>
<td>1041</td>
<td>1.3</td>
<td>0.21</td>
</tr>
<tr>
<td>South-East</td>
<td>5126</td>
<td>62.0</td>
<td>42 337</td>
<td>54.1</td>
<td>3.07</td>
</tr>
<tr>
<td>(Binh Duong)</td>
<td>(1315)</td>
<td>(15.9)</td>
<td>(6700)</td>
<td>(8.6)</td>
<td>(6.95)</td>
</tr>
<tr>
<td>(Dong Nai)</td>
<td>(870)</td>
<td>(10.5)</td>
<td>(10 410)</td>
<td>(13.3)</td>
<td>(4.70)</td>
</tr>
<tr>
<td>(Ho Chi Minh City)</td>
<td>(2504)</td>
<td>(30.3)</td>
<td>(17 896)</td>
<td>(22.9)</td>
<td>(2.93)</td>
</tr>
<tr>
<td>(Other)</td>
<td>(437)</td>
<td>(5.3)</td>
<td>(7332)</td>
<td>(9.4)</td>
<td>(1.62)</td>
</tr>
<tr>
<td>Mekong River Delta</td>
<td>334</td>
<td>4.0</td>
<td>2315</td>
<td>3.0</td>
<td>0.13</td>
</tr>
</tbody>
</table>

Source: General Statistics Office.
The disparity in FDI distribution across provinces is similarly strong when measured on a per capita basis. While the province of Binh Duong close to Ho Chi Minh City attracted the highest relative level of registered FDI at almost $7 per capita, the mountainous North-East and North-West regions at the border with China and Lao People’s Democratic Republic attracted only $0.26 and $0.04 per capita, respectively.

As could be expected, foreign investors have established production centres in areas with the best infrastructure already in place, and where skilled labour is most likely to be available. This trend in localization is natural and common in all countries. The predominance of export-oriented manufacturing FDI in Viet Nam has also reinforced this trend, as foreign investors in search of globally competitive production sites are least likely to locate in remote or less-developed areas. The Government’s policy to promote first and foremost FDI in export-oriented manufacturing has thus reinforced a natural trend.

More recently, the large number of FDI projects in Hanoi and Ho Chi Minh City has increased operating costs and created constraints in terms of availability of land. This pushed investors to look for production sites in the surrounding provinces. This trend has been particularly noticeable around Ho Chi Minh City, in the provinces of Binh Duong and Dong Nai. More remote provinces, however, have not benefited.

While the provincial distribution of FDI across provinces is very uneven, it does not seem to have further reinforced existing regional disparities. The output of State-owned enterprises and the Vietnamese private sector is similarly concentrated around a small number of major regional production centres in the North, centre and South.

The uneven distribution of FDI across provinces indicates that the Government needs to put in place specific measures if it wishes FDI to contribute to reducing regional inequalities. The experience so far indicates that fiscal incentives provided to investors who choose to locate in remote or less-developed areas have been ineffective. Other tools could be more effective, including the development of transport infrastructure in more remote areas, increased diversification of the types of FDI – i.e. widening the focus from export-oriented manufacturing to other sectors, including agriculture and food processing – and the strengthening of investment promotion efforts in underdeveloped provinces (annex I).

4. Countries of origin

Early investors came primarily from Australia and Europe, and include Unilever, British Petroleum and Shell. Asian firms were somewhat slower to join, but as FDI increased in the region as a whole, Viet Nam became a natural investment destination, especially for investors expanding their sites for the garment assembly. Firms from the United States were the latest entrants, limited by a United States embargo that was not lifted until 1994. United States firms that arrived in a third wave of investors include Procter and Gamble, Coca-Cola, Nike and General Electric.

Viet Nam has been unusual in its evolution of FDI attraction compared to other developing countries in that historically there have been relatively low proportions of FDI from European and North American investors (table I.5). In 1988–2006, five Asian countries were the source of almost 60 per cent of registered FDI: Singapore (12.8 per cent), Taiwan Province of China (12.1 per cent), the Republic of Korea (11.8 per cent), Japan (10.7 per cent) and China (including Hong Kong (China), 9.8 per cent). These numbers suggest that the large TNCs from Europe and the United States are not very active in Viet Nam when, in fact,
they do have a sizeable presence. This is largely because many firms – such as Coca-Cola, Procter and Gamble, Unocal and Conoco Phillips – license their investments in Viet Nam through third-party countries, predominantly Hong Kong (China), Singapore and the British Virgin Islands. As such, these investments are not counted as originating from Europe or the United States.\textsuperscript{13}

The ratification of the BTA with the United States in 2001 significantly increased the interest in Viet Nam on the part of United States investors. The BTA not only regularized the trade relationship between the two countries, but also includes an investment chapter that seeks to promote and protect United States investments in Viet Nam. Registered investments from the United States more than doubled in the five-year period after the ratification of the BTA (2002–2006) relative to the previous five years (1997–2001), steadily rising from about $100 million in 2001 to nearly $1 billion in 2006. At the same time, Vietnamese exports to the United States surged (box I.3).

<table>
<thead>
<tr>
<th>Home economy</th>
<th>Number of projects</th>
<th>Share of total number of projects (per cent)</th>
<th>Registered capital (million dollars)</th>
<th>Share of total registered capital (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>727</td>
<td>8.8</td>
<td>10 935</td>
<td>14.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>543</td>
<td>6.6</td>
<td>10 003</td>
<td>12.8</td>
</tr>
<tr>
<td>Taiwan Province of China \textsuperscript{1}</td>
<td>1743</td>
<td>21.2</td>
<td>9502</td>
<td>12.1</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>1438</td>
<td>17.5</td>
<td>9252</td>
<td>11.8</td>
</tr>
<tr>
<td>Japan</td>
<td>838</td>
<td>10.2</td>
<td>8398</td>
<td>10.7</td>
</tr>
<tr>
<td>China (including Hong Kong, China)</td>
<td>1056</td>
<td>12.8</td>
<td>7643</td>
<td>9.8</td>
</tr>
<tr>
<td>(Hong Kong, China)</td>
<td>(548)</td>
<td>(6.7)</td>
<td>(6400)</td>
<td>(8.2)</td>
</tr>
<tr>
<td>ASEAN (excl. Singapore)</td>
<td>540</td>
<td>6.6</td>
<td>4397</td>
<td>5.6</td>
</tr>
<tr>
<td>United States and Canada</td>
<td>459</td>
<td>5.6</td>
<td>3630</td>
<td>4.6</td>
</tr>
<tr>
<td>Other</td>
<td>893</td>
<td>10.8</td>
<td>14 385</td>
<td>18.4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>8237</td>
<td>100.0</td>
<td>78 248</td>
<td>100.0</td>
</tr>
</tbody>
</table>

\textsuperscript{1} FDI from Taiwan Province of China may also be greater than reported. In 2004, over half of the investments originating in the British Virgin Islands were Taiwanese.

Source: General Statistics Office.

Taiwanese investors were early entrants in the Viet Nam market, largely in apparel and textiles. Recent trends in Taiwanese investment in Viet Nam suggest a shift toward electronics and computers. One example is the recent arrival of Foxconn, a maker of outsourced electronics, which started operations in Viet Nam in 2007 and reportedly plans to invest up to $5 billion in the next five years. Japanese investors also have built a strong presence in Viet Nam in recent years. Many see Viet Nam as an attractive alternative to China and are keen to diversify their very high exposure to the latter for economic and political reasons.

\textsuperscript{13} According to MPI statistics, by the end of November 2006, United States firms had invested in 305 projects with the total investment capital of $2.1 billion ($730 million disbursed). Approximately 74 additional United States-sourced investment projects have been implemented through third-party countries, totalling $2.4 billion. If United States-invested projects carried out through third countries are included, total United States FDI capital in Viet Nam may be closer to $4.4 billion.
Republic of Korea investors have invested in many areas, including textiles and garments, footwear, electronics, real estate and infrastructure. Kumho Asiana Group is an example of one of the large Republic of Korea corporations investing in Viet Nam. Its projects include the development of the Giang Vo Cultural and Trade Centre and Me Tri Exhibition Centre, both in Hanoi, with a combined investment of $2.5 billion. The recent signing of the Republic of Korea–ASEAN free trade agreement should further boost investment from the Republic of Korea to Viet Nam.14

**Box I.3. United States–Viet Nam bilateral trade agreement**

Viet Nam and the United States ratified a BTA in December 2001. It includes a commitment from both sides to grant each other most favoured nation (MFN) status for all trade in goods, as well as provisions on trade in services. Viet Nam committed itself to be fully TRIPS-compliant within 18 months. The BTA also includes an investment chapter, with provisions on protection against expropriation, on dispute settlement, national treatment and discriminatory pricing.

Within one year of ratifying the BTA, Vietnamese exports to the United States had more than doubled, demonstrating that manufacturers were prepared for the increased demand once the agreement was in place. In 2007, Vietnamese exports were more than 10 times the 2001 level. The composition of exports also fundamentally changed. In 1996, tea and coffee represented 36 per cent of total exports to the United States. By 2007, the share had declined to 3 per cent. In contrast, the share of apparel and footwear, which was nearly nonexistent in the mid-1990s, has grown to just over half of total exports. In the six years from 2001 to 2007, apparel and footwear exports increased from $180 million to over $5 billion.

**Figure I.4. United States imports from Viet Nam, 1996–2007**

(Million dollars)


14 Effective June 2007.
5. **Types of FDI and the role of export processing and industrial zones**

From their inception in 1991, Viet Nam’s industrial and export processing zones have attracted a significant share of total FDI, and they continue to play a key role. There are currently 179 industrial and export processing zones in Viet Nam, 110 of which are operational, with the remaining 69 under construction. Nineteen of the operational zones have been developed jointly by the Vietnamese Government and foreign investors. The majority of investment has been in the manufacturing sector, initially in textile and garment, but increasingly also in other higher value added sectors such as consumer electronics, as the recent investments from Intel, Foxconn and Nidec show.

Total investment by foreign companies located in zones amounted to $13 billion as of end-2007. In addition, national companies had invested close to $6.5 billion. The total land area available for industrial development in the zones amounted to close to 26,000 hectares, with a further 17,000 hectares in zones currently under development. The average occupancy ratio is quite high at 74 per cent, with a number of zones operating at full capacity. Over 1 million workers were employed in the zones as of end-2007, almost one sixth of total formal employment.

**Box I.4. The Tan Thuan export processing zone and Hiep Phuoc power plant**

The Central Trading and Development Group (Taiwan Province of China) established the first export processing zone in Viet Nam in 1991. The Tan Thuan export processing zone is adjacent to the Ho Chi Minh City port area. By end-2006, total FDI in Tan Thuan amounted to more than $500 million. About 55,000 people were employed in the zone, and 81 per cent of the area was leased. FDI has flowed into the zone, primarily from Taiwan Province of China and Japan, and also from Australia, Germany, Hong Kong (China), Malaysia, Singapore, the Republic of Korea and the United States. Investments range from food processing to semiconductors, with textiles and garment representing a quarter of total investment. Illustrating the changing landscape of FDI in Viet Nam, electrical appliances and electronics are now the second largest sector at 20 per cent.

Several key factors have underpinned the success of Tan Thuan. First and foremost, infrastructure is among the best in Viet Nam. The Taiwanese zone developer provides, among other things, a 2-Mbps dedicated internet connection, on-site private postal services (DHL and Federal Express), wastewater and solid waste treatment facilities, and a direct pipeline to a water plant. Most importantly, Tan Thuan obtains its electricity directly from the dedicated 375-MW Hiep Phuoc power plant, which was also built by the zone developer. Hiep Phuoc is connected to the zone via a dedicated transmission line, and excess capacity is sold through the national grid.

The management board of Tan Thuan also facilitates installation procedures by working with the Ho Chi Minh City Export Processing Zone Authority (HEPZA). Support is provided to obtain investment certificates, construction permits, business licenses, import and export licenses, and certificates of origin. This agency not only facilitates the process, but also helps investors prepare their applications (including translation) through the Tan Thuan and HEPZA Joint Service Centre.

**Sources:** Investor interview and company website.
Zones are located throughout the country, even though there is a large concentration in and around Hanoi and Ho Chi Minh City. About 19 per cent of total FDI in the Red River Delta is in the zones, while in the South-East, the ratio is up to 45 per cent. There is also evidence that zones play an important role in the regions with low levels of foreign investment. The Mekong River Delta receives only 3 per cent of total FDI in the country, but 30 per cent of that FDI is in the zones. The South Central Coast region receives 5.7 per cent of FDI, 20 per cent of which is in the zones.

Several factors contribute to the success of the zones. An important one is the higher quality of infrastructure. A number of zones are given priority in power supply in case of brown-outs, and the developers of the Tan Thuan export processing zone went as far as building a dedicated power plant (box I.4). In addition, transport and telecommunications infrastructure has also been improved in and around the zones.

Another key factor in the success of industrial and export processing zones is the availability of land. Access to industrial land remains a complex issue for most foreign investors, and zones offer an attractive solution, as the land has already been cleared and registered for industrial use by the time the investor is ready to build its factory. The Government has not only made the zones easily accessible to investors, but it also offers fiscal incentives to zone investors. Certain zones also offer a somewhat more expedited licensing process and consultative services that help investors prepare applications. In addition, zones are used to promote the development of clusters of industrial activities (box I.5).

Box I.5. Saigon Hi-Tech Park and cluster development

The Saigon Hi-Tech Park (SHTP) is one example of a zone built to promote the development of a cluster of high-technology activities and higher value added foreign investments. It also illustrates the evolving nature of manufacturing FDI in Viet Nam. Another example of cluster-based zones is the Quang Trung Software City.

Built in 2002, SHTP is located just outside Ho Chi Minh City and is adjacent to HCMC National University. The park’s stated vision is to “develop a technopolis that will greatly enhance the economic, technological, and intellectual base of Ho Chi Minh City and the Southern Economic Region of Viet Nam, and that will ultimately serve as a model for Viet Nam technological innovation, intellectual capital development and innovation economy.” The goals and objectives explicitly include the development and transfer of technologies to national companies through linkages and fostering collaboration between tenants and with human resource development institutions outside the park, as part of a cluster development strategy.

SHTP is open to a wide range of high-technology projects, including microelectronics, information and communications technology, automation, precision mechanics, bio-technologies and new and advanced materials. It has granted investment licences to 25 projects so far. Key tenants include Intel (United States), Jabil (Singapore), Nidec (Japan), Sonion (Denmark) and FPT (Viet Nam). The park provides above-average infrastructure. Although power is supplied from the national grid, SHTP plans to build a dedicated backup gas-powered system. On-site waste water treatment facilities are available, as well as a wide range of information and communication technology facilities. In addition, the park authorities provide assistance to investors to obtain the required permits and licences.

Sources: interview and SHTP website.
As illustrated by the Tan Thuan export processing zone, foreign investors have also been involved in zone development. Cumulative FDI in zone development amounted to almost $600 million by end-2007, with foreign developers involved in 19 zones. All investments involved joint ventures between one or several foreign partners and the national or local authorities. The last typically provide land as their capital contribution to the project, while the infrastructure is developed by the foreign partner(s). Foreign investors in zone development originate mostly from Asia (Japan, Taiwan Province of China, Singapore, Thailand, China and Malaysia – by size of investment), with United States and Belgian investors also involved in two zones.

C. Impact of FDI

1. Economic activity

Foreign investors have played a major role in the transformation and growth of the Vietnamese economy since the start of Doi Moi. They have been at the forefront of the diversification of the economy from agriculture to manufacturing, but have been significantly less involved in the services sector, mostly because of restrictions on FDI entry. Far from abating in recent years, the impact of foreign investors on industrial development has remained very strong. Real industrial output from foreign invested enterprises\(^\text{15}\) (FIEs) was multiplied by a factor of seven between 1995 and 2006, far outpacing the increase in industrial output of SOEs and the national private sector.\(^\text{16}\) As a result, FIEs represented 38 per cent of total industrial output in 2006, up from 25 per cent in 1995.

**Figure I.5. Output growth by type of companies and share of FIEs in output growth, 1996–2006**

*(Percentage growth and percentage of total)*

Source: General Statistics Office.

\(^{15}\) Foreign invested enterprises include those that are 100 per cent foreign owned as well as joint ventures between a foreign and Vietnamese partner.

\(^{16}\) Real industrial output of SOEs was multiplied by a factor of three between 1995 and 2006, while that of the national private sector was multiplied by a factor of almost six.
The foreign-invested sector has consistently exhibited an even stronger dynamism than the national-invested sector over the past decade (figure I.5). Real output growth of FIEs averaged almost 14 per cent in the decade 1996–2006, compared with 6.7 per cent for the national sector. During the East Asian financial crisis, the foreign sector led economy was also a main stabilizing factor. While the growth rate of the national-led economy fell significantly in 1997–1999, foreign sector led output continued to grow at more than 15 per cent per annum.

As a result of its size and dynamism, the foreign-invested sector has accounted for almost one fifth of the annual real output growth of Viet Nam in the decade 1996–2005. By 2006, FIEs represented almost 13 per cent of the entire Vietnamese economy, double the percentage ten years earlier.

2. Investment and capital

Foreign investment has played a significant role in capital accumulation since Doi Moi. FDI as a proportion of gross fixed capital formation peaked in 1991–1995 at 36 per cent, before tapering off to about 12 per cent in 2001–2006. Rather than an indication of declining FDI flows, however, the fall in the ratio highlights the dynamism of national investors, both private and public, which pushed the ratio of gross fixed capital formation to GDP from 27.2 per cent in 1995 to 36.8 per cent in 2006.

A general trend is also that foreign investments have been significantly larger than investments from the Vietnamese private sector, both in capital invested and in employment per enterprise. Although it has flourished in recent years, the Vietnamese private sector consists mainly of a large number of small and medium-sized enterprises (SMEs), with few well-established large private corporations. Among all national private companies, 90 per cent had fewer than 50 employees in 2006 (table I.6). In contrast, 30 per cent of all FIEs in Viet Nam had more than 200 employees.

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Fewer than 9</th>
<th>10-49</th>
<th>50-199</th>
<th>200-299</th>
<th>300-499</th>
<th>500-999</th>
<th>1000 and over</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>1.2</td>
<td>17.7</td>
<td>36.6</td>
<td>10.7</td>
<td>12.3</td>
<td>10.7</td>
<td>10.8</td>
</tr>
<tr>
<td>Non-state enterprises</td>
<td>60.3</td>
<td>30.4</td>
<td>7.3</td>
<td>0.8</td>
<td>0.6</td>
<td>0.4</td>
<td>0.2</td>
</tr>
<tr>
<td>Foreign-invested enterprises</td>
<td>9.2</td>
<td>28.6</td>
<td>31.8</td>
<td>7.6</td>
<td>7.8</td>
<td>7.9</td>
<td>7.0</td>
</tr>
</tbody>
</table>

Table I.6. Distribution of companies by number of employees and capital, 2006

(Percentage of total within group)

<table>
<thead>
<tr>
<th>Invested capital</th>
<th>Under 0.5 billion dongs</th>
<th>0.5 to 1 billion dongs</th>
<th>1 to 5 billion dongs</th>
<th>5 to 10 billion dongs</th>
<th>10 to 50 billion dongs</th>
<th>50 to 200 billion dongs</th>
<th>200 billion dongs and over</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>0.8</td>
<td>0.7</td>
<td>8.6</td>
<td>9.8</td>
<td>32.1</td>
<td>28.7</td>
<td>19.3</td>
</tr>
<tr>
<td>Non-state enterprises</td>
<td>12.8</td>
<td>17.6</td>
<td>51.1</td>
<td>9.6</td>
<td>7.1</td>
<td>1.5</td>
<td>0.3</td>
</tr>
<tr>
<td>Foreign-invested enterprises</td>
<td>2.5</td>
<td>2.2</td>
<td>14.0</td>
<td>11.7</td>
<td>35.6</td>
<td>21.9</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Source: General Statistics Office.

The contrast in sizes is similarly striking when national private companies are compared with FIEs in terms of capital invested. This is not to say that there are no large Vietnamese companies, but the vast majority of them remain State-owned.

In addition to being larger in terms of capital and employment, FIEs also tend to mobilize more capital per employee than their counterparts from the Vietnamese private sector. Average capital per employee amounted to about $25,000 in 2005 in FIEs, compared with only $11,000 in the Vietnamese private sector. It is thus likely that labour productivity is significantly higher in FIEs than in the rest of
the economy, as is corroborated by average earnings figures in FIEs and the Vietnamese private sector (section C.4).

3. Technology and skills

As mentioned above, FDI has played a central role in the transformation of the Vietnamese economy. The increased demand for relatively skilled labour resulting from the industrialization process has been met relatively easily so far by a fairly literate population. As more technologically advanced and skills-intensive sectors develop, however, one of the key challenges will be to build human capital in order to meet the increasing demand for more highly educated workers. According to the Department of Labour, Invalids and Social Affairs of Ho Chi Minh City, demand for unskilled labour will shrink from 32 per cent of the total to 17 per cent by 2010, while the demand for highly-skilled labour in the electricity-electronics sector will increase from 5 per cent to 7 per cent, information technology from 7 per cent to 9 per cent, and trading services from 6 per cent to 10 per cent.

Foreign investors are already starting to feel some pressure from the increasing demand for skilled labour, and some have begun to address the issue by instituting their own training programs. According to a 2005 study, FIEs have trained approximately 300,000 workers and 25,000 technicians. In addition, 6,000 managers have been trained partially abroad. Similarly, the World Bank’s Investment Climate Assessment Survey of 2005 shows that 60 per cent of FIEs in Viet Nam provide formal training programmes to their employees.

Intel has been sending Vietnamese employees to other facilities in Asia as part of their hiring strategy, in order to give them training in a fully operational facility from experienced managers. In turn, Foxconn recently recruited 500 university graduates in Viet Nam and sent them to China to prepare them for key staff positions. The foreign investors involved in the Phu My 3 power plant have put in place a “localization plan” in which most positions in the company will be turned over to local staff by 2008. In addition to being trained to use the computer system to run the plant, nationals are trained to address environmental issues, safety awareness and health issues affecting people working at the plant and also living in the surrounding community areas. In agro-processing, Nestlé, one of the largest foreign investors in agriculture, has sent experts to Viet Nam and developed a programme to work with Vietnamese coffee organizations and growers to improve coffee quality, with a focus on processing.

Formal training programmes by foreign investors are an important channel to build skills and generate transfers of competencies, but they will never be sufficient to generate the amount and levels of skills needed by the economy. Foreign investors in need of highly qualified workers will only be in a position to deepen and adapt the skills of already trained people. One important channel for the transfer of skills and competences on a larger scale is FDI in the training and higher education sector. Such investments have been very limited so far, partly as a result of entry restrictions.

The Royal Melbourne Institute of Technology (RMIT) nevertheless recently established a fully foreign-owned university in Viet Nam with campuses in Hanoi and Ho Chi Minh City (box I.6). Intel has also begun to address the issue of availability of skilled graduates proactively by engaging in talks with American universities about plans to establish campuses in Viet Nam.

17 Le Thanh Thuy (2005).

18 This compares well with an average of 45 per cent in East Asia and the Pacific and 42 per cent in Malaysia, but remains significantly lower than in China (85 per cent) and Thailand (76 per cent).
Viet Nam has not yet reached the stage of development where it starts becoming a centre for research and development (R&D) by global TNCs. A number of FIEs are conducting R&D activities in Viet Nam, however, most likely in terms of product and technological adaptation more than with the intent of generating fundamental innovations. Data from the Government Statistics Office indicate that FIEs accounted for about 25 per cent of all R&D spending in Viet Nam in 2002.

Box I.6. The Royal Melbourne Institute of Technology

A relatively large number of Vietnamese students study in Australia every year, including at RMIT. The cost of such studies abroad is very high, and in 1998 the Government invited RMIT to establish a fully foreign-owned university in Viet Nam so as to provide more affordable education of international quality. A campus was established in Ho Chi Minh City in 2001, followed by another in Hanoi in 2004.

Teaching at RMIT is in English only, and the university offers undergraduate programmes in commerce, business, design and applied sciences and a Masters in Business and Management. At the moment, regulations allow foreign-owned education institutions to offer programmes only in sciences and technology, business administration, economics, accounting, international law and foreign languages.

The student body is currently about 3,800, including foreign students from Australia, neighbouring countries and Europe. The degrees are recognized nationally and are audited by the Australian Universities Quality Audit Agency. Through the RMIT campuses in Hanoi and Ho Chi Minh City, Vietnamese students are in a position to obtain high-quality education at a fraction of what it would cost in Australia. RMIT indicates that the tuition costs for a Bachelor of Commerce are about $16,000 in Viet Nam, as opposed to $39,000 in Australia. In addition, the high costs of living in Australia are eliminated.

Source: RMIT Viet Nam website.

4. Employment and linkages

FDI has generated a very large number of jobs in Viet Nam in the past decade. In 2006, FIEs employed close to 1.5 million workers, representing more than 20 per cent of total formal employment (table I.7). The number of employees in FIEs has also increased rapidly over the past few years, more than tripling between 2000 and 2006.

Table I.7. Employment by type of enterprise, 2002–2006
(Thousands and percentage of total employment)

<table>
<thead>
<tr>
<th>Employees (thousands)</th>
<th>Percentage of total employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned enterprises</td>
<td>2260</td>
</tr>
<tr>
<td>Non-state enterprises</td>
<td>1707</td>
</tr>
<tr>
<td>FIEs</td>
<td>691</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>4658</strong></td>
</tr>
</tbody>
</table>

Source: General Statistics Office.
Average earnings in FIEs are much higher than in the Vietnamese private sector and in SOEs. Average compensation in FIEs in 2002 was double the level in Vietnamese private companies, and almost 50 per cent higher than in SOEs. FIEs also employ a higher percentage of women than do national companies, partly as a result of the high level of employment in apparel and footwear.\footnote{Female employment in FIEs represented 67 per cent of the total in 2006, compared with around 36 per cent in SOEs and Vietnamese private companies.}

Although the impact of FDI on the economy has been wide and profound, as demonstrated above, FIEs continue to a large extent to operate in somewhat of an enclave. This is partly due to Viet Nam’s strategy to seek FDI mostly in the export-oriented manufacturing sector, with important restrictions to FDI entry in the services sectors. Many export-oriented manufacturing firms import much of their inputs, as they are unable to source them domestically. As mentioned above, the vast majority of Vietnamese private firms are small and not in a position to be integrated into the global value chains of the TNCs established in Viet Nam, even as third-tier suppliers. In turn, Viet Nam’s larger national firms are mostly State-owned, and FIEs may be reluctant to engage in supplier contracts with them.

\begin{box}
\textbf{Box I.7. Unilever Viet Nam business linkage centre}

Unilever started operations in Viet Nam in 1995. Recognizing that small local manufacturers would need to make significant changes to work with a large multinational, Unilever began a Manufacturing Sustainability Improvement Programme. Elements of Unilever’s programme include a transfer of technology through supplying modern equipment and providing full time technical support, and education on quality, safety and management systems.

Supplier upgrading has evolved into a business linkages programme through a joint partnership with RMIT, UNCTAD, the Investment Promotion Centre of North Viet Nam and the Ministry of Planning and Investment (MPI). The programme has been expanded to include “Kaizen” — total productive maintenance — and the upgrading of local businesses to meet international standards. Unilever Viet Nam reports that the groundwork laid by the earlier programme and the recent additions to training will increase its domestic sourcing by 59 per cent, an increase that will account for 86 per cent of its entire operation. Moreover, in addition to becoming preferred suppliers for Unilever, local suppliers have also been able to expand their export capacity and they now export 20 per cent of their output to 20 different countries.

UNCTAD is working with its partners to expand the programme further. Next steps include replicating with other TNCs that want to upgrade their suppliers. The majority of the current training is not dependent upon the type of manufacturing, so other TNCs in Viet Nam and various suppliers would be able to benefit from the programme. The involvement of all the partners, including MPI, has also served to increase exposure of the programme at a policy level and will help direct more funding towards the development of SMEs in Viet Nam. RMIT is also an important partner in helping develop a curriculum not just in the Business Linkage Centre but also complimentary curricula in the university.

Source: UNCTAD
\end{box}

An ancillary issue that has affected FIEs and their ability to create linkages is the openness of certain sectors. Sectors where linkages could be formed with limited regard to size and business type include banking, retail, insurance, telecommunications and other services. If or when these sectors become open
to foreign investors, impact and linkages could be increased. Despite these limitations, there have been some efforts by certain FIEs to establish stronger linkages with domestic suppliers. This is particularly the case with FIEs whose focus is less on exports and more on serving the local market. Examples include IBM and its suppliers upgrading programme, as well as Unilever (box 1.7).

5. Trade integration and diversification of exports

In 1986, Viet Nam was virtually a closed economy, aside from limited trade with members of the former communist bloc. Twenty years later, Viet Nam has fully integrated into the world trading system and become a significant exporter in a variety of goods. From virtually nothing, merchandise exports grew to $7.3 billion in 1996 and $48.6 billion in 2007. This lifted the merchandise exports to GDP ratio to 66 per cent and placed Viet Nam as the 48th largest exporter in the world in 2006.\(^\text{20}\) While Viet Nam’s integration into the world economy is the result of government policies,\(^\text{21}\) FDI has been a driving force in making it a reality.

As mentioned above, a very large proportion of FDI has been directed in the export-oriented manufacturing sector. This trend already prevailed in the first wave of FDI in the early 1990s, and it has been further reinforced recently. In 1995, FIEs generated $1.5 billion in exports, representing 27 per cent of the total. A significant part of this was oil and gas, however. By 2007, FIEs exports had surged to $27.8 billion, representing almost 60 per cent of the total (figure 1.6).

**Figure 1.6. Exports by nationality of exporting firms, 1995–2007**

\((\text{Billion dollars and percentage of total})\)

![Figure 1.6. Exports by nationality of exporting firms, 1995–2007](image)

Sources: Foreign Investment Agency, Ministry of Planning and Investment.

\(^{20}\) Based on merchandise exports as reported by the IMF’s International Financial Statistics.

\(^{21}\) In addition to encouraging FDI in export-manufacturing sectors and joining bilateral and multilateral trade agreements, the Government implemented extensive changes to trade policy, including lifting export quotas and reducing export taxes.
FIEs have not only been at the basis of the surge in export values, but they have also driven product and market diversification. In 1990, exports were almost exclusively agricultural. By 2003, manufactured goods represented nearly half of the total. Export diversification started initially with the establishment of foreign investors in apparel and footwear in the mid-1990s. By 2003, textile, apparel and footwear represented 32 per cent of total exports (table I.8).

More recently, Viet Nam has further diversified its export base into consumer electronics, electrical equipment and others. Although these exports are just beginning to gain ground in the overall structure of exports, recent foreign investments by large electronic firms and the increasing share of FIE manufacturing output in these categories suggest that the FDI-led diversification should continue. The increase and diversification in exports led by FIEs also mean that Viet Nam is rapidly positioning itself into the global value chains of the world’s large TNCs. Much as China has become the “factory of the world”, Viet Nam has succeeded in positioning itself as a viable and competitive alternative and an opportunity for diversification in the outsourcing of production in global value chains.

**Table I.8. Composition of exports, 1997–2003**

(Billion dollars and percentage of total)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>%</td>
<td>$</td>
<td>%</td>
<td>$</td>
<td>%</td>
<td>$</td>
</tr>
<tr>
<td>Textiles¹</td>
<td>2.7</td>
<td>28.9</td>
<td>2.6</td>
<td>27.3</td>
<td>3.5</td>
<td>30.2</td>
<td>3.8</td>
</tr>
<tr>
<td>Manufacturing²</td>
<td>0.9</td>
<td>9.8</td>
<td>0.9</td>
<td>9.7</td>
<td>1.3</td>
<td>11.5</td>
<td>1.7</td>
</tr>
<tr>
<td>Petroleum</td>
<td>1.5</td>
<td>16.7</td>
<td>1.3</td>
<td>14.3</td>
<td>2.3</td>
<td>19.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Agriculture³</td>
<td>1.7</td>
<td>19.2</td>
<td>1.9</td>
<td>20.5</td>
<td>2.1</td>
<td>17.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Fish &amp; Shellfish</td>
<td>0.8</td>
<td>8.4</td>
<td>0.8</td>
<td>8.4</td>
<td>1.0</td>
<td>8.4</td>
<td>1.5</td>
</tr>
<tr>
<td>Other Exports</td>
<td>1.6</td>
<td>17.0</td>
<td>1.8</td>
<td>19.7</td>
<td>1.4</td>
<td>12.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Total Exports</td>
<td>9.2</td>
<td>9.3</td>
<td>11.5</td>
<td>14.4</td>
<td>15.0</td>
<td>16.7</td>
<td>20.1</td>
</tr>
</tbody>
</table>


¹ Apparel, clothing, footwear and textile.
² Electrical equipment, furniture, miscellaneous manufacturing, office/data processing machines and wood manufacturing.
³ Cereals, coffee, tea, vegetables and fruits.

The conclusion of bilateral and multilateral trade agreements and the dynamism of exporting FIEs have also greatly diversified the destination countries of exports. In the late 1980s, the former Soviet Union and Eastern bloc countries accounted for about 40 per cent of Viet Nam’s exports. With the collapse of those economies, exports shifted to Asia, the destination for 76 per cent of total exports in 1995. Ten years later, Asia continues to be the primary destination but its share in exports has declined to just under half of the total. In contrast, exports to the United States boomed after the conclusion of the bilateral trade agreement to represent 20 per cent of the total in 2005 (figure I.7).

In addition to diversifying its main export markets, Viet Nam is also exporting to a larger number of countries. In 1995, it exported to only 44 countries. By 2005, Vietnamese goods were sold to 74 countries around the world.
6. Other impacts

In addition to their widespread direct impact on the economy, FIEs have made a major contribution to the Government budget. Although they account for less than 4 per cent of all enterprises in Viet Nam, they account for more than a third of the Government’s collection of taxes and fees (table I.9). In 2002, total taxes paid by FIEs (including value added tax) amounted to $5.3 billion, compared with only $1.5 billion paid by the Vietnamese private sector.

The contribution of FIEs in total corporate taxes is very high even in relative terms, as their share of total output is only about 13 per cent. This may be explained by several factors. To begin with, FIEs tend to be more profitable than private or public Vietnamese firms. It is also likely that FIEs are subject to stricter oversight by the tax authorities and that they tend to be quite tax-compliant.

Table I.9. Tax paid by category of company
(Billion dong and percentage of total)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th></th>
<th>2001</th>
<th></th>
<th>2002</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Billion</td>
<td>Percentage</td>
<td>Billion</td>
<td>Percentage</td>
<td>Billion</td>
<td>Percentage</td>
</tr>
<tr>
<td></td>
<td>dong</td>
<td>of total</td>
<td>dong</td>
<td>of total</td>
<td>dong</td>
<td>of total</td>
</tr>
<tr>
<td>State-owned enterprises</td>
<td>79 907</td>
<td>55.8</td>
<td>103 989</td>
<td>60.2</td>
<td>117 824</td>
<td>52.1</td>
</tr>
<tr>
<td>Non-state enterprises</td>
<td>12 297</td>
<td>8.6</td>
<td>14 915</td>
<td>8.6</td>
<td>24 194</td>
<td>10.7</td>
</tr>
<tr>
<td>FIEs</td>
<td>51 045</td>
<td>35.6</td>
<td>53 797</td>
<td>31.2</td>
<td>84 207</td>
<td>37.2</td>
</tr>
<tr>
<td>Total</td>
<td>143 250</td>
<td>100.0</td>
<td>172 702</td>
<td>100.0</td>
<td>226 224</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: General Statistics Office.
The presence of foreign investors in Viet Nam has also had non-quantifiable and intangible effects, which have been nonetheless important for the transformation of the Vietnamese economy. In recent years, the Government increased its efforts to consult the business community (domestic and foreign) when preparing new legislation and regulations. Draft legislation is now regularly circulated for comments. Foreign investors have made a strong point to participate actively in this consultation process and to provide valuable inputs to the Government. While this is driven out of self-interest, it is also helping Viet Nam to improve its investment framework (chapter II) as it benefits from the perspective and comments of investors with operations around the globe. Foreign investors have been active not only on a firm-level basis, but also through structured efforts organized by the various chambers of commerce.

7. Some pitfalls

Foreign direct investment is not without potential negative or undesired effects. Partly as a result of its cautious and gradual policy to open to FDI, Viet Nam has not had to suffer from significant negative effects. Child labour and other labour standards issues arose mostly in the 1990s, but the Government has addressed them properly by enforcing national standards, and FIEs currently offer significantly higher wages than their national counterparts. Foreign firms also addressed the issue by raising their own standards, as international campaigns by civil society threatened their global image.

Viet Nam has become increasingly aware that FDI, like any other form of investment, may generate negative impacts on its environment. Except in a few cases where particularly harmful industries are consciously “exported” from a source country, the environmental impact of FDI is not related to its “foreign” aspect, but to its “investment” aspect, irrespective of ownership. Environmental rules and regulations have been put in place recently, which should allow Viet Nam to protect its environment from the adverse effects of investments, regardless of the nature of its ownership (chapter II).

A recurrent concern linked to FDI is the extent to which TNCs are able to shift taxable income from the host country to another location with lower taxes. As indicated above, the contribution of FIEs to corporate taxes is very high in Viet Nam, which indicates that their impact on Government revenue is positive overall, even if some income shifting may have occurred. In addition, Viet Nam recently put in place provisions on transfer pricing, which should help it ensure that the income of TNCs generated in the country is taxed fairly.

Probably the biggest concern that policymakers around the world have about the impact of FDI relates to competition issues and the loss of national control over “strategic” sectors. Viet Nam has adopted a strategy of gradually opening its economy to FDI over the past 20 years, allowing and encouraging foreign investment mostly in export-oriented sectors at first. As a result, competition with national firms (private and public) has been relatively limited so far, particularly on the domestic market. The Government also decided to restrict FDI entry – or foreign control – in a number of sectors considered as strategic.

While this strategy has provided some protection to national businesses, it has also resulted in more limited benefits in terms of linkages between FIEs and national firms, more limited benefits to consumers...

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22 Including translations in English, which are usually prepared by Allens Arthur Robinson, an Australian law-firm with offices in Hanoi and Ho Chi Minh City (www.vietnamlaws.com).
23 The American Chamber of Commerce, Australian Chamber of Commerce and Japanese Business Association have been particularly active in this respect.
24 This was the case, for example, of Nike, which came under intense pressure from human rights groups in the 1990s. In reaction, the company increased the minimum age for new recruits to 18 in its shoe factories and tightened air quality controls. It also pledged to allow outsiders to join independent auditors who inspect factories.
in terms of increased competition and availability of products, and more limited productivity gains across
the economy. As the opening of the Vietnamese economy increases in the future as per the Government’s
policy choices and its commitments under WTO, competition in the domestic market will increase with
the entry of FIEs in new sectors that have been closed or strictly restricted until now. This increased
level of competition from FIEs is likely to produce the failure of some private and public enterprises,
which some may consider as a negative impact of FDI. Overall, increased and more diversified flows of
FDI should nevertheless encourage a Schumpeterian process of “creative destruction”,\(^{25}\) which should
sustain long-term growth and poverty reduction in Viet Nam.

D. Assessment

Twenty years on from Doi Moi, the economy of Viet Nam has radically changed. From an isolated,
poor and collectivized agriculture-based economy, Viet Nam has transformed itself into a booming nation
on the verge of becoming a new Asian Tiger, with a dynamic private sector coexisting with a large public
sector. The industrial sector has become the main driver of growth, and it is diversifying at a very rapid
pace. Viet Nam has also become an active member of the world trading system. This staggering pace of
transformation and wealth creation has allowed Viet Nam to reduce poverty at some of the fastest rates
in history.

Without minimizing the role of the Vietnamese private and public sectors, this pace of economic
transformation and poverty reduction would not have been possible without FDI. As evidenced in this
chapter, foreign investors have played a key role in boosting industrial output and diversifying the economy
away from agriculture (table I.10). They were among the lead players in the production of apparel and
footwear and are now venturing into new and more technologically advanced industries, including consumer
electronics. Foreign investors have played a predominant role in making the treaty-based integration of
Viet Nam into the world economy a reality. As a result of their presence in Viet Nam, the country is now
part of the global value chains of some of the world’s largest TNCs.

<table>
<thead>
<tr>
<th></th>
<th>% of total number of enterprises 2006</th>
<th>% of GDP 2006</th>
<th>% of industrial output 2006</th>
<th>% of gross capital formation 2006</th>
<th>% of exports 2007</th>
<th>% of taxes 2002</th>
<th>% of total employment 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIEs</td>
<td>3.2</td>
<td>12.7</td>
<td>37.8</td>
<td>17.6</td>
<td>57.2</td>
<td>37.2</td>
<td>21.5</td>
</tr>
<tr>
<td>State-owned enterprises</td>
<td>2.8</td>
<td>40.0</td>
<td>31.6</td>
<td>52.3</td>
<td>42.8</td>
<td>52.1</td>
<td>28.4</td>
</tr>
<tr>
<td>Non-state enterprises</td>
<td>94.0</td>
<td>47.3</td>
<td>30.5</td>
<td>30.1</td>
<td></td>
<td>10.7</td>
<td>50.1</td>
</tr>
</tbody>
</table>

Sources: General Statistics Office and Ministry of Planning and Investment.

Foreign investors have created a very large number of jobs – including for women – that provide
significantly higher pay than in national firms. They have also trained a large number of people and
contributed to the development of skills and know-how. In addition, FDI has been a stabilizing factor for
the economy as a whole, particularly during the East Asian financial crisis.

\(^{25}\) Schumpeter (1942) introduced the idea of “creative destruction” to describe the process of transformation that is generated by technological
innovation in the economy. Technological changes and innovation in production processes, in turn, are at the basis of long-term growth. His ideas are
at the basis of the literature on endogenous growth, which seeks to explain why and how economies can grow in the long run.
Partly as a result of Government policies that have sought to steer FDI towards manufacturing for exports, the foreign-invested sector still operates somewhat as an enclave in the economy of Viet Nam. There are relatively few linkages with national firms through suppliers or buyers contracts, including because there are few large Vietnamese private companies. Restrictions on FDI entry, particularly in services sectors, have also limited the potential benefits of FDI for local consumers and private companies.

In spite of its success in attracting FDI so far and the positive impact on the economy, Viet Nam has a vast potential to attract much higher levels of beneficial FDI. This is illustrated in UNCTAD’s World Investment Prospects Survey 2007–2009, in which Viet Nam ranks sixth among the most attractive economies for the location of FDI.26 This potential could be relatively easily realized if the Government wishes to give more room to foreign investors to diversify into sectors that have been mostly off-limits until now. There are clear indications that Viet Nam is already moving in that direction, including as part of its commitments to liberalize entry in the services sectors under the WTO accession agreement.

Careful consideration should be given as to which sectors the Government wishes to liberalize further in the near future – and how – in order to further unleash innovation, growth and wealth creation. In particular, infrastructure and higher education could benefit from a larger degree of openness to FDI. The development of high-quality physical infrastructure (electricity, transport, telecommunications) and human capital will be among Viet Nam’s key constraints to address in the future in order to ensure that economic development and poverty reduction can be sustained at the pace of the past two decades. As has been the case in the past 20 years in terms of industrial development, FDI could make a significant contribution to infrastructure and human capital development, if appropriate frameworks and policies are put in place. The latter will be particularly important also to ensure that the potentially adverse effects of FDI – in terms of the environment, labour standards or competition – are avoided as much as possible.

26 UNCTAD (2007b). The results are based on a questionnaire sent in March 2007 to 1,500 non-financial TNCs selected from among the world’s 5,000 largest TNCs on the basis of foreign assets. The response rate was about 13 per cent.
II. THE INVESTMENT FRAMEWORK

A. Introduction

Viet Nam has embarked on a vast programme to reform its legal and regulatory framework for investment and make it consistent with a market economy. The reform process started with Doi Moi in 1986, but it was not until Viet Nam formally started accession negotiations with WTO in early 1995 that reforms got into full gear. Remarkable progress has been achieved already, and the legal and regulatory framework for investment has been much strengthened in the past decade. This has not only contributed to turning Viet Nam into an attractive destination for investors, but also allowed the country to better protect its national interest.

A number of reforms were undertaken as prerequisite conditions to Viet Nam’s formal accession to WTO, which took place on 11 January 2007 after 12 years of preparation. Recent improvements in the legal and regulatory framework have affected numerous areas, including taxation, intellectual property, trading, price controls, accounting and foreign exchange controls. As far as foreign investors are concerned, a fundamental shift occurred in 2005, when Viet Nam adopted the Law on Investment and a new Law on Enterprises. One of the key purposes of these two laws is to put all investors (domestic and foreign, public and private) on a more equal footing. Breaking away from past practice, all investors are now subject to the same key laws, even though in practice differences in treatment remain.

Despite great progress in improving the legal and regulatory framework for investment, reforms are far from complete. Viet Nam still faces a number of challenges in putting in place the legal and regulatory mechanisms required to establish and manage a market economy. In many cases, not the least of which investment entry and establishment, the framework still contains elements of a planned-economy approach. The legal system tends to be excessively burdensome and complex, and the regulatory bias is to “steer and control” rather than “regulate, monitor and enforce”, as in all long-established market economies. A number of additional reforms will thus be required to allow Viet Nam to operate not just according to the letter of a regulated market economy, but also in its spirit.

One of Viet Nam’s greatest challenges will also be to ensure that legal reforms are properly implemented. As laws and regulations grow more complex, they also become less readily understood by those who must administer them and are susceptible to uneven implementation across provinces. Training of civil servants will be key to the successful implementation of the reformed system.

B. Entry, establishment, treatment and protection of FDI

1. FDI entry

Viet Nam has progressively opened its economy to foreign investors over the past two decades, but it maintains a sizeable number of hurdles, restrictions, limitations or prohibitions to FDI entry. The Government has decided to accelerate the opening of the economy to foreign investment, even though it will maintain a gradual approach. It is also adopting policies that aim to steer FDI into sectors, regions,

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27 The analysis of this chapter is based on legal documents as translated from Vietnamese to English by the law firm Allens Arthur Robinson (www.vietnamlaws.com).

28 The term “market economy” in this report is used in a very comprehensive manner to include everything that characterizes long-established market economies, including laws and regulations, regulatory institutions and competitive markets. References to Viet Nam’s progress in establishing a market economy should not be understood as a statement on UNCTAD’s position regarding Viet Nam’s status as a “market economy” under the WTO accession agreement. Such status as granted by partner countries is to a large extent a political decision, with strong legal and economic implications for Viet Nam, and it is not the role of this report to take position on the issue one way or another.
or even projects that are seen as particularly beneficial. In spite of the policy breakthrough of 1986 (Doi Moi) and more recent policy reforms, Viet Nam still does not have a liberal FDI entry regime when compared with other developing countries. Where it is clearly open to FDI, however, the response from foreign investors has been very high (chapter I).

There are currently four main legal sources that define restrictions to FDI entry: (a) the 2005 Law on Investment and its associated decrees; (b) sectoral laws and regulations; (c) the schedule of specific commitments in services under the WTO accession agreement; and (d) legal restrictions on mergers and acquisitions (M&As) of domestic companies.

The Law on Investment defines three types of sectors:

- **Prohibited sectors**: investment is prohibited for both domestic and foreign investors;
- **Conditional sectors**: investment is conditional for both domestic and foreign investors;
- **Conditional sectors for foreign investors**: investment is conditional only for foreign investors.

Sectors that are not listed in the prohibited or conditional lists are considered by default as being “non-conditional”. It is crucial to note that the Law on Investment assimilates joint ventures where Vietnamese nationals own more than 51 per cent of the capital of an enterprise to “domestic investors”. It stipulates clearly that “the same investment conditions which are applicable to domestic investors shall be applied to foreign investors where Vietnamese investors hold more than 51 per cent of the charter capital of an enterprise.”

The classification of a sector as “conditional” as per the Law on Investment determines the extent to which projects are screened through an investment certification procedure upon establishment (section B.2). It is distinct from the conditionality linked to the necessity to hold sectoral licences, even though the two concepts are interrelated. Table II.1 provides the list of sectors classified as prohibited, conditional for all investors, and conditional for foreign investors only.

The Law on Investment itself does not fully specify the nature and extent of the conditionality, and most of the conditional sectors are sectors that are subject to stringent licensing conditions in most countries. The precise nature and extent of FDI entry restrictions in conditional sectors is also to be found in sectoral laws and regulations. Typical restrictions include ceilings on foreign ownership, joint venture requirements, and restraints on operations (e.g. permission to provide certain services only to other FIEs, restrictions on taking bank deposits in dongs and restrictions on fields that can be taught in foreign-owned education institutions).

Although it is not possible to be exhaustive in listing FDI entry restrictions, table II.1 indicates that sectors where entry remains restricted in one way or another are wide-ranging. In particular, FDI entry restrictions affect the following sectors: (a) telecommunications; (b) banking and finance; (c) import, export and distribution; (d) river and sea ports; (e) education; (f) media; (g) air terminals and airports; (h) goods and passenger transport; and (i) real estate. Other sectors may also be subject to restrictions as per Viet Nam’s commitment under international treaties. In contrast, other sectors where Viet Nam has sought to attract FDI and developed a comparative advantage – in particular manufacturing for export – have been open without entry restrictions.
Table II.1. Sectoral classifications in the 2005 Law on Investment

<table>
<thead>
<tr>
<th>Prohibited for all investors (5 sectors)</th>
<th>Conditional for all investors (9 sectors)</th>
<th>Conditional for foreign investors only (14 sectors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projects detrimental to national defence, security and public interest</td>
<td>Sectors impacting national defence, security and social order</td>
<td>Radio and television broadcasting</td>
</tr>
<tr>
<td>Projects detrimental to historical and cultural traditions and ethics</td>
<td>Banking and finance</td>
<td>Production, publishing and distribution of cultural products</td>
</tr>
<tr>
<td>Projects detrimental to people’s health or that destroy natural resources and the environment</td>
<td>Sectors impacting public health</td>
<td>Mining and processing of minerals</td>
</tr>
<tr>
<td>Projects for treatment of imported toxic wastes</td>
<td>Culture, information, press and publishing</td>
<td>Telecommunications and Internet services</td>
</tr>
<tr>
<td>Other projects banned by law</td>
<td>Entertainment services</td>
<td>Public postal networks, postal and delivery services</td>
</tr>
<tr>
<td></td>
<td>Real estate</td>
<td>Construction and operation of ports and airports</td>
</tr>
<tr>
<td></td>
<td>Mining and exploitation of natural resources</td>
<td>Transport of goods and passengers</td>
</tr>
<tr>
<td></td>
<td>Education and training</td>
<td>Fishing</td>
</tr>
<tr>
<td></td>
<td>Other sectors in accordance with law</td>
<td>Production of tobacco</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Real estate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Import, export and distribution</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Education and training</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hospitals and clinics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other sectors as per international treaties</td>
</tr>
</tbody>
</table>


In addition to the conditionality defined in the Law on Investment and the FDI entry-restrictions specified in sectoral laws, Viet Nam negotiated specific commitments on trade in services under mode 3 (commercial presence) with WTO.\(^{29}\) Viet Nam’s accession to WTO in 2007 has thus codified a number of restrictions and commitments to liberalize FDI entry in the services sectors into an international treaty. The schedule of specific commitments requires Viet Nam to ease or lift FDI entry restrictions in most services sectors under a pre-determined time-frame.

The main restrictions to FDI entry in the services sector as per the WTO schedule of specific commitments and the time-frame for their easing or lifting are summarized in table II.2. Clearly, many restrictions remain, including in very important services sectors such as telecommunications, transport.

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\(^{29}\) WTO’s schedule of specific commitments in services lists the services sectors to which a member country will apply the market access and national treatment obligations of GATS, as well as the exceptions to these obligations it wishes to preserve. Commitments are made for each of the four modes of supply of services (cross-border supply, consumption abroad, commercial presence and presence of natural persons). Services that are not listed in the schedule are not subject to any commitment, leaving the country free to impose restrictions on market access under any of the four modes of supply.
and distribution. It must also be noted, however, that Viet Nam is committed to liberalizing FDI entry in the majority of services sectors within a period of typically three to five years after accession. Viet Nam has made commitments to liberalization in each of the 11 broad categories of services sectors defined by WTO, and in 74 of the 116 more detailed subcategories. The Government has drafted a decree to guide the implementation of conditional investments in accordance with the WTO commitments, which should be promulgated in the second half of 2008.

Viet Nam’s accession to WTO will significantly liberalize FDI entry in services, if not immediately at least in the next few years. The sectors most subject to liberalization include business services, financial services and construction and engineering. In contrast, the most important areas where Viet Nam is not committed to full liberalization include:

- Telecommunications: see section C.12.
- Distribution: foreign-owned retail outlets beyond the first one will be subject to an economic needs test. Although the Government is committed to establishing publicly available procedures for approval based on objective criteria (number of existing outlets in a particular geographic area, stability and size of the market), this is likely to be a major hurdle to FDI in the retail sector.
- Transport: liberalization will affect maritime and internal waterways transport, air transport, as well as road and rail transport. Maritime operations under the Vietnamese flag will be open to foreign investors only as joint ventures with a maximum of 49 per cent ownership of capital, but foreign companies will be allowed to establish fully-owned shipping subsidiaries. Container handing services companies will be allowed only under joint venture agreements with foreign ownership not exceeding 50 per cent. Commitments to liberalization for air transport services touch mainly upon sales and marketing, computer reservation and maintenance and repair of aircrafts. Significant restrictions will remain for road services, with freight transport open to foreign investors only through joint ventures with a maximum foreign ownership of 51 per cent of capital.

The 2005 Law on Investment widens the permissible forms of investment, which now include:
(a) 100 per cent foreign or domestic owned private companies; (b) joint ventures between domestic and foreign investors; (c) business cooperation contracts, build-operate-transfer (BOT) and other contractual forms of investment; (d) purchase of shares or capital contributions in view of participating in the management of the company; and (e) mergers and acquisitions (M&As). Various forms of FDI entry are thus formally allowed, not just greenfield projects. This is a significant change from the regime that applied under the former Law on Foreign Investment, which allowed only three forms of foreign investment: enterprises with 100 per cent foreign owned capital, joint ventures and business cooperation contracts.

The decision under the Law on Investment to allow FDI inflows through M&As is very important, and Decree 139–2007 on the Law on Enterprises – issued in September 2007 – further clarifies and liberalizes the provisions on M&As. Until then, foreign investors (or foreign-owned companies in Viet Nam) were allowed to acquire a maximum of 49 per cent of the capital of companies listed on the stock exchange, and a maximum of 30 per cent of the capital of unlisted Vietnamese (domestic) companies.

A business cooperation contract is a contract between investors to cooperate in business and share profits or products without creating a new legal entity.
## Table II.2. Summary of restrictions to FDI entry in services under WTO accession agreement

<table>
<thead>
<tr>
<th>Sector</th>
<th>Current restrictions</th>
<th>Commitments to liberalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Business services</td>
<td>For many types of business services, foreign firms are temporarily restricted to providing services to other FIEs.</td>
<td>After 1-3 years from accession, most restrictions will be lifted.</td>
</tr>
<tr>
<td>2. Communication</td>
<td>Postal services closed to FDI. Temporary restriction for express delivery services. Significant restrictions in telecommunication sector (section 12.b). Only joint ventures are allowed in audiovisual services and no opening of radio and television.</td>
<td>Opening of courier services 5 years after accession. Only partial opening of telecommunications services. Long-term restrictions to remain, including joint venture requirement for facilities-based operators, with 49 per cent maximum foreign ownership. Liberalization of non-facilities based services allows foreign ownership of up to 65 per cent by 2010.</td>
</tr>
<tr>
<td>3. Construction and engineering</td>
<td>For most types of construction and engineering services, foreign firms are temporarily restricted to providing services to other FIEs.</td>
<td>After 2-3 years from accession, most restrictions will be lifted.</td>
</tr>
<tr>
<td>5. Education</td>
<td>FDI permitted only in higher education and in technical fields, sciences and technology, business studies, economics, international law and languages. Joint venture requirement with cap on foreign participation until 2009.</td>
<td>100 per cent foreign-owned investments allowed from 2009. Restrictions on fields of study to remain.</td>
</tr>
<tr>
<td>7. Financial services</td>
<td>Significant restrictions in insurance, banking and other financial services.</td>
<td>Most restrictions will be lifted by 2011, with some opening to FDI immediately upon accession.</td>
</tr>
<tr>
<td>8. Health</td>
<td>Few restrictions for hospitals, but social services closed to FDI.</td>
<td>None.</td>
</tr>
<tr>
<td>9. Tourism and travel</td>
<td>FDI not permitted in guide services. FDI in travel agencies and tour operators requires joint-venture, without cap on foreign share.</td>
<td>None.</td>
</tr>
<tr>
<td>10. Recreation, cultural, sporting</td>
<td>FDI not permitted in news agencies, libraries and museums.</td>
<td>FDI in entertainment services will be permitted from 2012, but only through joint venture with maximum foreign participation of 49 per cent.</td>
</tr>
<tr>
<td>11. Transport</td>
<td>Important restrictions apply, many in the form of requiring joint ventures with cap on foreign participation.</td>
<td>Increase in cap on foreign participation in joint ventures or lifting of joint venture requirement in certain cases.</td>
</tr>
</tbody>
</table>

1 This table provides a brief summary of the restrictions and commitments to liberalization, most of which are more detailed and complex than presented here.

Source: WTO, Schedule CLX – Viet Nam, Schedule of Specific Commitments in Services.
Decree 139–2007 stipulates that foreign investors are allowed to acquire shares in domestic companies without limitation, subject to four exceptions: (a) the 49 per cent cap for listed companies remains, as per the Law on Securities; (b) general foreign ownership restrictions as per sectoral laws and regulations remain; (c) restrictions may be imposed on foreign acquisition of SOEs under the equitization process; and (d) maximum ownership ratios in the services sector will follow the WTO schedule of specific commitments on trade in services.

Given the restrictions on M&As so far, FDI inflows to Viet Nam have been of a “greenfield” nature. The restrictions on M&As have not acted as a brake on foreign investment, partly because there are few sizeable private domestic companies that could be the target for acquisition by foreign investors (chapter I). This is likely to change rapidly, however, as domestic private companies expand with the growing economy, and as more of the large SOEs are equitized (section C.13).

Cross-border M&As are an important channel of FDI in a number of countries, with a value of worldwide deals of $880 billion in 2006, up from $151 billion in 1990. Although most of these deals are between developed countries, cross-border M&As in developing Asia reached $79 billion in 2006. While M&As do not generate a direct increase in productive capital, they typically involve changes in management and possibly a company restructuring, and may generate transfers of skills, know-how or technology.

The new M&As provisions are thus likely to open a significant new channel for FDI in the coming years. In order to promote this channel, however, the Government may wish to reconsider the 49 per cent cap on foreign ownership of listed companies in the future. At a time when sizeable public sector assets could be equitized, Viet Nam may also wish to be flexible in imposing foreign ownership restrictions on equitized SOEs so as to allow the participation of strategic foreign investors in the process.

2. FDI establishment

The 2005 Law on Investment and Law on Enterprises represented a major breakthrough, as they introduced a unified legal and regulatory framework for all forms of investors and enterprises, regardless of nationality (foreign vs. domestic) and form of ownership (private vs. public). Prior to the introduction of these two laws, foreign investors operated under a special framework both for investment and company laws.

One central aspect of FDI establishment has not changed, however. As before, all foreign investment projects must be formally approved by the administration under a certification procedure. The certification process entails judging whether a proposed investment is in Viet Nam’s interest, even if it falls within the parameters of sector, size and permitted level of foreign ownership. In this respect, Viet Nam’s certification regime remains influenced by a planned economy approach rather than reflecting common practice in market economies. While a number of changes in certification procedures and requirements have been introduced by the 2005 Law on Investment, they will not be touched upon unless they raise a particularly relevant issue for foreign investors.

31 These restrictions apply to greenfield FDI as well.
32 As of 11 January 2008, the limit on foreign acquisition of domestic companies will be lifted for all sectors listed on the WTO schedule of specific commitments on trade in services, except for joint-stock commercial banks. This is subject to the sectoral caps on foreign ownership of companies as defined elsewhere.
33 Cross-border M&As reached an all-time high of $1.144 trillion in 2000 at the height of the “Internet bubble”.
34 The previous regime required foreign investors to obtain a “licence”. Under the 2005 Law on Investment, the term used is “certificate”, which tends to suggest a lighter procedure. There are no major differences between “licences” and “certificates”, however.
There are currently three degrees of certification requirements which depend upon three key criteria: (a) the nationality of the investor (domestic or foreign); (b) the size of the investment; and (c) the sector (conditional or non-conditional). Based upon these three criteria, investments can proceed without formality (small domestic investments only), be subject to a registration requirement, or be subject to a stricter evaluation procedure. As illustrated in figure II.1, foreign investments are either subject to a registration requirement (“small” projects in non-conditional sectors) or to an evaluation procedure (“large” projects and all those in conditional sectors). In all cases, an investment certificate must be obtained for any foreign-led project to proceed.

The procedure to obtain an investment certificate is complex and may involve a number of agencies at various levels of Government. A novelty in the 2005 Law on Investment is that the authority to issue investment certificates has been decentralized to the provincial level. Investment certificates are now issued either by the province’s People’s Committee or by the Management Committee of a zone, if the investment is located in a zone. As a result, the initial and primary interlocutor for foreign investors with respect to investment certification is either the People’s Committee or the Management Committee.

As illustrated in figure II.2, the procedures to obtain investment certification vary according to three criteria: size and sector of investment, as well as ownership (foreign or domestic). The sectoral conditionality closely mirrors the list of conditional sectors mentioned above (section B.1), but does not exactly match it. A number of additional sectors are listed for which foreign investors must undergo special certification procedures (type 5 projects).

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35 Viet Nam has 64 provinces, each one with a local Government called the “People’s Committee”. Each People’s Committee is composed of a number of departments, including a Department of Planning and Investment. Under the previous law, the decentralization to provinces was only applicable to “small” projects.

36 Each industrial zone, export processing zone, high-tech zone or economic zone is managed by its own Management Committee, which is appointed by the People’s Committee.
Figure II.2 Procedure for investment certification

1. Projects in 8 sectors, irrespective of ownership or size
   - line ministries approval required
   - PC or MC issue the certificate. Relevant Ministries are consulted. Conformity with Master Plans. 43 working days EVALUATION.
   - People's Committee or Management Committee register the project. 15 working days REGISTRATION.

2. Projects in 3 sectors, irrespective of ownership and x>1500 billion dong
   - People's Committee or Management Committee register the project. 15 working days REGISTRATION.
   - Line Ministries approval required
   - PC or MC issue the certificate. Relevant Ministries are consulted. Conformity with Master Plans. 43 working days EVALUATION.

3. Projects in 8 sectors, irrespective of ownership or size
   - Line Ministries approval required
   - People's Committee or Management Committee register the project. 15 working days REGISTRATION.
   - PC or MC issue the certificate. Relevant Ministries are consulted. Conformity with Master Plans. 43 working days EVALUATION.

4. FDI projects in 4 sectors, irrespective of size
   - Line Ministries approval required
   - People's Committee or Management Committee register the project. 15 working days REGISTRATION.
   - PC or MC issue the certificate. Relevant Ministries and Prime Minister are consulted. Conformity with Master Plans. 55 working days EVALUATION.

Notes:
1. Including construction and operation of airports, seaports, industrial parks, and oil and gas.
2. Including electricity, railway, roads and alcohol.
3. Including shipping, telecom, Internet services, publishing and scientific research.
Type 1 projects:
- Require a somewhat simplified registration procedure instead of a full evaluation of project;
- People’s Committee or Management Committee can issue the certificate autonomously.

Type 2 projects:
- Full evaluation is required;
- Conformity with Master Plans is assessed;
- People’s Committee or Management Committee can issue the certificate autonomously.

Type 3 projects:
- Full evaluation is required;
- People’s Committee or Management Committee coordinates inputs/comments from line Ministries;
- People’s Committee or Management Committee issues the investment certificate.

Type 4 projects:
- Full evaluation is required;
- Conformity with Master Plans is assessed;
- People’s Committee or Management Committee coordinates inputs/comments from line ministries;
- People’s Committee or Management Committee issues the investment certificate.

Type 5 projects:
- Full evaluation is required;
- Conformity with Master Plans is assessed;
- People’s Committee or Management Committee coordinates inputs/comments from line ministries;
- Decision to grant the certificate is taken by the Prime Minister;
- People’s Committee or Management Committee issues the investment certificate.

The stringent investment certification system and the desire to steer investments in particular areas or sectors reflects an attitude towards private investment that remains influenced by the former planned economy system. Whether their project requires registration or full evaluation, investors must submit very detailed information to the issuing body, including:

- Company details (legal representative, charter, list of founding members);
- Structure of capital contributions;
- Report on financial capacity of the investor;
- Type of goods or services to be produced and scale of the project;
- Precise schedule for construction of the project and commencement of operations;
- List of imported capital goods.

The information is requested partly for legitimate statistical purposes, but largely to allow the authorities to make a full evaluation of the investment and whether it fits into the regional or national development policy, i.e. the Master Plans. The requirement for projects to conform with the relevant Master Plans is quite open-ended and potentially a hurdle or barrier to private investors (foreign or domestic). Master Plans are detailed and numerous (box II.1) and could potentially be used to refuse the issuance of an investment certificate for otherwise valid projects, even though this appears not to have
been the case so far. Yet, the grounds to assess conformity with Master Plans are not sufficiently defined at the moment. More importantly still, in most sectors, conformity should not need to be assessed at all in a market economy, and Master Plans should be limited to an industrial policy aimed at encouraging – not cherry-picking – investment.

Investment certificates are entirely project-specific. For example, an established foreign company wishing to expand into new product lines, or even to make a significant expansion to an existing production plan, would need to obtain a new investment certificate or an amendment to its investment certificate. In addition, investment certificates are granted for a limited period, usually capped at 50 years.

Viet Nam’s approach to investment certification illustrates that it still has some way to go to adopt a full market-economy attitude towards investment, whereby investors are free to invest in whatever project they wish, as long as they comply with existing laws and regulations designed to protect the public interest.

**Box II.1. Viet Nam’s Master Plans**

Viet Nam’s economic and industrial policy is framed by its Master Plans. A large number of Master Plans are prepared at the national and provincial levels and for a wide range of sectors. In some aspects, Master Plans are similar to sectoral strategies and policy papers used in most countries, as they call for policy initiatives to promote sectoral development. Viet Nam also has sectoral development strategies, however, which are distinct from Master Plans and focus on wider policy issues. In other aspects, Master Plans are reminiscent of planned economies’ annual or five-year plans as they enumerate lists of specific projects calling for investment, even in purely commercially-oriented activities (not related to infrastructure).

The Ministry of Industry alone has 15 Master Plans at the national level (e.g. automobile, plastic, steel, textile and garment or power industries) and 34 Master Plans at the provincial level (e.g. Hanoi’s food processing, Da Nang’s socio-economic development). Other ministries and provincial authorities (People’s Committees) similarly have a large number of Master Plans of their own.

Master Plans vary in content and depth, but they are typically quite detailed in their planning and forecast of sectoral development. They may suggest policy measures, include forecasts in terms of output growth and provide a list of priority investment projects/areas. The inclusion of specific projects in Master Plans is an integral part of any Government’s role in certain key sectors such as power, ports, airports or road development, where planning at the national or regional level is essential. In contrast, Master Planning in purely commercial activities (e.g. footwear, tourism, electronic industry or textile and garments) is usually not a function for the Government when market forces are allowed to play their role – even if an industrial policy is in place.

Sources: Ministry of Industry and other Ministries and UNCTAD.

While the stringent approach to investment certification has made FDI establishment slower and more bureaucratic, it must also be noted that certificates have provided some comfort and safety to investors. Investment certificates have provided a high degree of stability and predictability to investors in Viet Nam. In particular, certificates specify the incentives to which an investor may be entitled, including (a) corporate income tax rate reductions or exemptions; (b) import duties exemptions; (c) exemptions or
reductions on land use fees; and (d) other fiscal or non-fiscal incentives. Although the matter has never gone to court, the law appears to give contractual value to investment certificates and their related incentives.

3. FDI treatment and protection

The 2005 Law on Investment and Law on Enterprises have brought Viet Nam a long way towards providing national treatment to foreign investors, post-establishment. One of the key purposes of the laws was to provide a unified operational framework for foreign and domestic investors as well as for private and public enterprises. Until then, foreign investors were subject to a specific Law on Foreign Investment. In contrast, the 2005 laws unify the legal and regulatory framework for investment and corporate structure for all types of investors. Article 4 of the Law on Investment provides that “the State shall provide equal treatment before the law to all investors from all economic sectors, and as between domestic and foreign investment.”

Until recently, a number of special provisions applied to FIEs, including in terms of corporate taxation, dual pricing, local content requirement or foreign exchange balancing. As part of its accession to WTO, Viet Nam ratified the Agreement on Trade-Related Investment Measures (TRIMS). In order to comply with the TRIMS requirements, the 2005 Law on Investment specifies that the State will not impose any of the following requirements on foreign investors: (a) priority purchase of domestic goods or services; (b) export requirements or export limitations; (c) foreign exchange balancing; (d) localization ratios; (e) minimum level of R&D; and (f) obligation to supply goods or services in a particular location. In addition, Viet Nam eliminated most dual prices, which used to apply to a number of areas, including airport and seaport charges, customs and utilities.

Articles 22 and 23 of the Constitution stipulate that the State protects the legal capital and property of business establishments. Property may be nationalized only for reasons of security, national defence or for the national interest, with compensation at market prices and according to procedures as defined by law. Article 25, in turn, specifies that the State encourages foreign organizations and individuals to invest capital and technology in Viet Nam, and that “enterprises with foreign invested capital shall not be nationalized”. Article 25 is not subject to the proviso of security, national defence or the national interest, which could imply that FIEs cannot be nationalized under any circumstances.

The 2005 Law on Investment provides that disputes involving a foreign investor can be referred to Vietnamese courts or arbitration procedures as well as to international arbitration (section C.8 on investor–investor disputes settlement and arbitration). Where the dispute involves a foreign investor and the State, the case is referred by default to a Vietnamese court, unless provided otherwise in a contract between the investor and the State or in an international treaty to which Viet Nam and the investor’s home State are parties. This dispute-related contract is separate from the investment certificate, which does not include provisions on dispute resolution. Foreign investors located in countries that do not have a bilateral investment treaty (BIT) with Viet Nam thus also have the possibility to obtain guaranteed access to international arbitration in case of dispute with the State.

Although it started negotiating BITs only in the 1990s, Viet Nam had signed them with 48 countries by mid-2007, including most of its important trade and investment partners. Of the 48 agreements, 9 – with small trade and investment partners – are not yet in force. Agreements with major partners include Australia, China, France, Germany, Japan, the Republic of Korea, Singapore, Taiwan Province of China, Thailand and the United Kingdom.
negotiated recently and concurrently, they tend to follow a reasonably standard pattern, including in terms of definition of what an “investment” is and who an “investor” is. They typically provide for:

- National treatment (post-establishment), with some exceptions;
- Fair and equitable treatment;
- Most-favoured nation (MFN) treatment;
- Protection against nationalization or expropriation (allowed for a public purpose only in a non-arbitrary and non-discriminatory basis) and the obligation to provide prompt (without undue delay and including interests), adequate (typically the market value before the expropriation decision was made public) and effective compensation (realizable and freely transferable);
- The right to repatriate returns and assets;
- Recourse to international arbitration.

Recourse to international arbitration as provided in BITs is available at the initiative of either party to the dispute after a period of usually three to six months, during which an amicable settlement must be sought. The outcome of the arbitration procedure is final and binding. Viet Nam is not currently a member of the International Centre for Settlement of Investment Disputes (ICSID), although it has applied for membership. Short of Viet Nam being a member of ICSID, most BITs provide for international arbitration to take place under the United Nations Commission on International Trade Law (UNCITRAL), or under ICSID once Viet Nam becomes a member.38

Although it does not currently have a BIT with the United States per se, the United States–Viet Nam bilateral trade agreement of 2001 provides similar types of protection to United States investors, in addition to provisions to liberalize FDI entry for United States investors in a number of sectors. In addition, Viet Nam is a party to the ASEAN Investment Area, which seeks to coordinate efforts in FDI promotion and facilitation, allow free flows of FDI among member States in all industrial sectors and provide full national treatment (section C.14, box II.3).

4. Recommendations on FDI entry, establishment, treatment and protection

The current approach adopted by the Government of Viet Nam in regulating FDI entry and establishment reflects four partly contradictory purposes: (a) attracting high levels of FDI inflows and promoting private investment; (b) keeping a close administrative oversight over private investments; (c) steering private investments to what public administrators consider as most valuable projects; and (d) keeping a number of "strategic" sectors closed to or largely protected from FDI.

The current FDI entry and investment certification approach raises a number of issues:

- It is unnecessarily intrusive and does not sufficiently reflect the market-economy approach that the Government is putting in place.
- It is insufficiently clear and predictable in terms of FDI entry restrictions.
- It is needlessly burdensome for both investors and public administrators.
- It is complex and administratively intricate, which makes it more difficult to comprehend both for investors and the administrators of the law.

38 One case was brought to international arbitration under UNCITRAL in 2003. Mr. Trinh Vinh Binh (Binh Chau joint stock company) brought a case for violation of the Netherlands–Viet Nam BIT after being jailed and having assets confiscated for bribery and violation of land administration rules. The case was settled in 2007 on confidential terms on the eve of the court hearing.
● It is likely to be subject to inconsistent administration across Viet Nam’s 64 provinces.
● It fails to recognize the dynamic nature of investment and modern corporations: investors should not be straight-jacketed by rigid investment certificates, but should be given sufficient flexibility to adapt and respond to new business conditions and opportunities, both in terms of expanding and diversifying production.

UNCTAD has started helping the Government of Viet Nam improve efficiency, transparency and predictability in investment certification procedures through the e-regulations system (box II.2). This review proposes a number of additional measures for immediate implementation to improve the workings of the current system. It also suggests a more fundamental review of the approach to regulating (foreign) investment entry and establishment, which the Government should envisage under a “Doi Moi 2” plan aimed at further increasing the role of the private sector in economic and social development, and promoting innovation.

a. Make the current system work efficiently

It is unlikely that the Vietnamese authorities would want to make fundamental changes to the 2005 Law on Investment in the short term as it has been adopted very recently and results from a long consultation process. As noted above, the Law on Investment also introduced a positive policy paradigm shift in that it subjects foreign and domestic investors to a common body of laws and regulations. While a further fundamental step in adapting the approach to regulating investment may not be achievable in the short term, a number of steps could be taken quickly to ensure that the certification procedure for investors is as simple and unobtrusive as possible, and applied consistently throughout Viet Nam.

● Strengthen facilitation services at the provincial level, establish one-stop shops: The provincial Departments of Planning and Investment (DPIs) and the Boards of Management (BoMs) of economic zones have become the main interface between investors and the State. As such, they also provide limited facilitation services to investors. It is recommended that these services be significantly strengthened, including through the creation of full one-stop-shop facilities where appropriate. The proposal to establish one-stop-shop facilities and progressively shift the focus of provincial DPIs from regulation and oversight towards promotion and facilitation is further discussed in annex I of this review.

● Ensure consistency in regulatory oversight across provinces: The decentralization of the investment certification process to the DPIs and BoMs poses potential issues regarding the consistent application of laws and regulations across the country. Administrative capacity and expertise differ widely from province to province. Attitudes towards private investors may vary as well. In such circumstances, it will be essential for the central Government to ensure that laws and regulations are applied consistently and with a common understanding of the spirit of the law. The UNDP is providing technical assistance to support a Government task force on the implementation of the Investment and Enterprise Laws already. In addition, consistent application of the laws could be supported by:
  ● Preparing procedural manuals to guide the implementation of laws and regulations by the DPIs and BoM: These manuals should provide information on the spirit of the law and guidance on the implications of Viet Nam’s accession to WTO, in particular regarding the schedule of specific commitments in services. These procedural manuals could be issued under a ministerial circular or decision so that they be referable in court if necessary.
- **Building “precedents”:** Administrative decisions taken in the larger and more developed provinces could be used to build a series of “precedents” that could be used for guidance by smaller and less developed provinces.

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### Box II.2. UNCTAD’s e-regulations in Viet Nam

UNCTAD’s e-regulations system is an online step-by-step guide on investment procedures seen from the investor’s point of view. It provides detailed information on rules and procedures applicable to various investment operations. Information is organized per investment objective. For each objective, the system lists all necessary administrative steps and ensures quick access to all aspects of a step, including (a) contact details of ministries and officials in charge; (b) information on requirements and conditions; (c) costs, timeframe and necessary forms; and (d) legal sources. Each step is validated by the administrative office directly overseeing its application, securing a high level of confidence in the information.

The e-regulations system in Viet Nam ([vietnam.investway.info](http://vietnam.investway.info)) provides step-by-step information on a limited number of procedures for first-time and existing investors, including company creation in non-conditional sectors, conversion and re-registration of existing companies, adjustment of investment certificate, land lease and recruitment of personnel. Additional procedures will be included in the future.

The system should help increase transparency and predictability in investment procedures. The precise identification of each step investors are required to go through before starting operations could also be used to detect redundant or unnecessary procedures and streamline processes.

*Source: UNCTAD.*

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- **Clarify and list FDI entry restrictions:** The legal grounds for FDI entry restrictions are currently dispersed in a large number of sources. Their nature and extent should be clearer, more transparent and non-arbitrary.

- **Remove the time limit on investment projects:** The Law on Investment specifies that foreign invested projects may have an operational duration of up to 50 years.\(^{39}\) This has not been an obstacle to foreign investment so far, but it is unusual and appears to serve no public purpose. Based on international practice, time limits are usually only applied in the special case of BOT projects in which ownership of the asset reverts to the State after an agreed time in private ownership. Licences that give exclusive rights (e.g. mining or telecommunication licences) typically have renewal periods so that rights and obligations can be rebalanced over time. But these considerations do not apply to most kinds of projects. The time cap also does not apply to domestic projects, and to the lifetime of the foreign invested company. It is recommended that the time cap be removed altogether. The joint project certification – with time limit – and company registration – without time limit – in the investment certificate under the 2005 Law on Investment may also create legal issues later on.\(^{40}\)

- **Separate company registration from FDI certification:** Company registration should be a separate process from investment certification for both foreign and domestic investors. Although it adds one step to the procedure, it is best to keep company registration separate from the FDI registration/certification. The procedure could still be facilitated through the services of one-stop shops, however.

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\(^{39}\) Or up to 70 years in exceptional circumstances.

\(^{40}\) This does not apply to domestic companies, which must register separately.
b. Plan for a “Doi Moi 2” in investment policy

The recommendations above aim to make the current framework operate as smoothly as possible. However, more fundamental changes will be required in order to address the structural problems highlighted above, including the need to (a) introduce a less intrusive and planned approach to private investment regulation, better adapted to a blossoming market economy; (b) reduce the complexity and administrative burden of the framework and make it more transparent; and (c) reflect the dynamic nature of private investment and corporations.

A fundamental principle that allows market economies to flourish and develop is that private agents are given the freedom to identify business opportunities and to innovate – under a set of well-defined and enforced rules aimed at protecting consumers and the national interest. The potential for innovation, creativity and ultimately prosperity in Viet Nam could be increased by adopting a less intrusive approach to investment regulation. It is suggested that the regulatory framework for foreign and domestic investment be underpinned by the following key principles, under a “Doi Moi 2” in investment policy:

- **Maximize flexibility in investors’ decisions within the framework of the law**: Investors should be free to invest in projects as they see fit, as long as they comply with all laws and regulations, including sectoral regulations and/or restrictions, labour, health and environmental standards, and competition rules. Civil servants are usually not in a good position to assess the extent to which a project is valuable for the country or for consumers. Restricting flexibility in investment decisions by private agents is likely to stifle innovation, the single most important element to sustainable growth and development.

- **Regulate investment and protect the national interest through specific laws and regulations**: Sectoral laws and regulations, together with the labour code, environmental law, health and safety regulations and others should be the main conduit to protect the national interest and regulate investments.

- **Simplify registration and certification procedures**: Clear and streamlined certification regulations are likely to further promote and facilitate investment. They would also lighten the burden on the public administration and make it easier to implement consistent rules across all provinces.

Concretely, the implementation of a “Doi Moi 2” in investment policy would mean putting in place an investment oversight mechanism as depicted in figure II.3:

- **Draw up a full list of FDI entry restrictions in the implementation decrees of the Law on Investment**: The nature of the FDI entry restrictions should be precisely determined and kept separate from sectoral licensing requirements. The nature and extent of FDI entry prohibitions, limitations and restrictions should be clearly defined, transparent and non-arbitrary. The list of restrictions will obviously need to conform with Viet Nam’s international engagements.

- **Update the list of FDI entry restrictions to meet Viet Nam’s investment and development strategy**: Current and future restrictions should be considered in the light of the overall development strategy. Liberalization should be phased in so as to ensure a smooth process and allow the development of a competitive Vietnamese private sector. Restrictions should be maintained only if they serve the national interest, and back-tracking on liberalization should be avoided so as to provide predictability and stability for investors.
- **Unleash (foreign) investors:** The current registration/certification system puts many restrictions on investors by requiring that all projects or project modifications/extensions be authorized by the Government. This approach limits innovation and is unnecessary as long as general and sectoral oversights are conducted properly.

**Figure II.3 Suggested investment oversight procedures**

- **Remove registration and certification requirements for domestic investors:** Domestic investors should not have to register or obtain an investment certificate, as sector-specific regulations are enforced by dedicated agencies.
- **Restrict foreign investment registration/certification procedures to an FDI entry compliance check:** The registration and certification procedure for foreign investments should be limited to checking that projects comply with FDI entry restrictions and are permitted by law or not.\(^4^1\) Once established, foreign investors should be subject to the same general and sectoral oversight as domestic investors – as already stipulated in article 4 of the Law on Investment. Under “Doi Moi 2”, Viet Nam should no longer use investment certificates to check the conformity with Master Plans and steer investments in preferred sectors or areas. Procedures should be simplified, but the DPI and BoM should continue to operate as the interface with investors and conduct investor registration and certification.

\(^{41}\) In addition to being useful for statistical purposes.
- **Make foreign direct investment registration the rule**: Foreign investments in sectors that are not subject to FDI entry restrictions should be subject to a simple and streamlined registration requirement, regardless of the amount invested. Registration should be limited to the provision of general information about the investment and there should be no legal grounds provided for rejecting investments that are not subject to entry restrictions.

- **Make foreign direct investment certification the exception**: Foreign investments in sectors that are subject to FDI entry restrictions should be subject to a simplified certification procedure, regardless of the amount invested. The certificate would not include any sectoral licence (say in banking, telecommunications or electricity) and would thus not necessarily imply that the investment per se has received government approval. The legal grounds for rejecting certification should be restricted to cases where the investment does not comply with FDI entry restrictions.

- **Keep sectoral licences and company registration separate from FDI registration/certification**: As indicated above, the FDI certificate would merely confirm that a project complies with FDI entry restrictions. In order to proceed with the project, the investor would need to secure sectoral licences separately with the relevant authorities.

- **Subject all investors to a common system of general and sectoral oversight**: Monitoring and enforcement of general and sectoral laws and regulations should be exercised uniformly on all investors by dedicated agencies and various ministries (competition, labour, environment, banking, telecommunications, etc.).

- **Collect data on an annual basis through enterprise surveys**: The current registration/certification requirement also serves the purpose of collecting statistics on investment. Such data are essential to policymaking and should continue to be collected. This is already done to a large extent by the enterprise survey conducted annually under the Statistical Law. Any gap that may arise from removing or simplifying the registration/certification requirement could thus easily be filled by some minor adjustments to the enterprise survey.

c. **Allow the realization of FDI potential in key sectors and promote new and dynamic types of FDI**

   In addition to the measures highlighted above, the Government may wish to reconsider some of the restrictions it currently imposes on FDI entry so as to allow the full deployment of the country’s FDI potential. It may also wish to broaden its FDI promotion strategy to include new and dynamic sectors – including services – in addition to traditional export-oriented manufacturing investments.

   Although it is a matter of national policy choice, this review considers that it would be in Viet Nam's national interest to provide a more open framework in sectors that used to be considered in many countries as too “strategic” to be opened to private investors, or as natural public monopolies. Experience elsewhere has shown that such conceptions were mostly mistaken and that private sector participation under a well-regulated framework is beneficial, even if it takes place in parallel with significant involvement from public sector enterprises. This review considers that it would be beneficial for Viet Nam to allow a larger degree of (foreign) private sector participation in the following sectors:

   - **Telecommunications**: High-quality and internationally price-competitive telecommunication services will be increasingly important to Viet Nam as its economy grows and diversifies, and will be required by foreign investors in high value added and technologically complex sectors.
- **Electricity and water**: Responding to the surge in electricity demand will be one of Viet Nam’s major infrastructure challenges in the coming decades. Electricity is already open to a significant extent to foreign investors, but Viet Nam still needs to put in place some of the conditions to attract FDI in the sector. This is the subject of chapter III of this review.

- **Transport infrastructure (ports, airports, roads and rail)**: Upgrading infrastructure will be crucial to Viet Nam’s competitiveness in the future, particularly as it seeks to increase its integration into the world economy and further expand and diversify exports. FDI in the transport sector is already taking place to some extent, but restrictions remain significant.

- **Higher education**: Although Viet Nam has a reasonably well-educated labour force, the skills requirements of the economy and foreign investors are increasing rapidly. Raising the general skills level and planning to supply the type of skills that future investors will need is essential to Viet Nam’s continued development in the long term. Foreign investment in higher education and vocational training can make a significant contribution to developing skills, but FDI flows are currently restricted and not actively promoted by the Government.

The potential for beneficial FDI in these sectors is large, and it is recommended that Viet Nam liberalize FDI entry conditions in order to allow the realization of its potential. Similarly to the policy of gradually opening to FDI applied in the past two decades, a gradual approach could be adopted to ensure that the benefits of opening to FDI in these sectors are maximized, while the potential costs or disruptions are avoided or minimized. By request from the Government, a strategy to attract and benefit from FDI in the electricity sector is proposed in chapter III of this review. It is recommended that Viet Nam undertake similar strategic reviews and put in place “policy packages” in the sectors mentioned above.

Keeping up with the rising demand for core infrastructure services is a necessity to sustain the rapid pace of economic development of the past two decades. Increasing the quality of services in telecommunications, electricity and transport through private (domestic and foreign) investment would also better position Viet Nam to attract FDI in new and dynamic sectors. To date, FDI flows to Viet Nam have been directed mostly into the export-oriented manufacturing sector (chapter I). This is the result of a number of factors: (a) a strategic choice by the Government to promote FDI in export-oriented manufacturing; (b) Viet Nam’s comparative advantage; and (c) FDI entry restrictions.

Viet Nam’s commitment to liberalize FDI entry in a number of services sectors in the coming years means that significant new opportunities will open to foreign investors. In order to build a comparative advantage in new fields and fully avail of the new opportunities, Viet Nam will need to strengthen the quality of services in the areas of infrastructure mentioned above. It will also need to further increase the skills level of its workforce, including in terms of languages and managerial talent.

It is thus recommended that, in addition to the strategic reviews and “policy packages” mentioned above, the Government start elaborating and putting in place a broadened strategy of FDI promotion and attraction. As per the Government’s request, this review focuses on FDI in electricity and does not consider such a strategy. Some of the elements to consider, however, include:

- How can Viet Nam become an attractive destination for FDI in services sectors?
- How can Viet Nam participate in the global trend of outsourcing of back-office operations?
- How can Viet Nam position itself as a logistics centre in the Greater Mekong subregion?
- How can Viet Nam become a business hub for TNCs operations in the ASEAN region?
C. General measures for regulating business

1. Enterprise law and corporate governance

Viet Nam adopted a new Law on Enterprises in 2005 to work hand-in-hand with the new Law on Investment. The 2005 Law on Enterprises unifies the legal and regulatory framework for all business entities, regardless of ownership (foreign vs. domestic and private vs. public). Article 5 specifies that the law “ensures the equality of enterprises before the law, regardless of their form of ownership and economic sector and recognizes the lawful profit-making nature of business activities”. In contrast, the previous regulatory regime was based on three laws: the 1996 Law on Foreign Investment, the 1999 Law on Enterprises and the 2003 Law on State-Owned Enterprises.

The 2005 Law on Enterprises represents a major step forward in the modernization of Viet Nam’s legal framework for investment and is particularly welcome in that it subjects all forms of businesses to a single set of rules. Corporate governance and transparency are also strengthened as the new law imposes modern rules for the management structure of enterprises. In addition to partnerships and private enterprises – which are not very relevant for foreign investors – two main types of enterprise structures are permitted:

- **Limited liability companies (LLCs)** can have a single or multiple owners (up to a maximum of 50) whose liability is limited to their capital contribution. Simplified procedures are in place for one-member LLCs, with distinct rules depending on whether the owner is an individual or an organization.

- **Shareholding companies** must have a minimum of three shareholders whose liability is limited to their capital contribution. The company is allowed to issue ordinary shares as well as preference shares.\(^{42}\) The management structure follows international standards and is based on a general meeting of shareholders, a board of management, a director general and an inspection committee.

A number of elements introduced by the 2005 Law on Enterprises should be particularly welcomed by foreign investors:

- **Capital contributions** may occur in a variety of forms, including the value of intellectual property rights, technology and technical know-how. The valuation of these assets is left to the discretion of shareholders.

- **Minority shareholders** are given additional protection. In LLCs, minority shareholders are entitled to call for an extraordinary meeting of the Members’ Council if they hold more than 25 per cent of the charter capital.\(^{43}\) In shareholding companies, minority shareholders representing 10 per cent of total ordinary shares are entitled to call for an extraordinary general meeting of shareholders in specified circumstances\(^{44}\) or to request for an item to be put on the agenda, to nominate candidates to the Board of Management and Inspection Committee and to request the Inspection Committee to review a particular issue.

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42 Voting preference shares, dividend preference shares, redeemable preference shares or other as stipulated in the company charter.
43 If one member holds more than 75 per cent of the capital, the limit is the residual percentage of capital.
44 This includes breaches of shareholders rights by the Board of Management or if the latter takes decisions that fall outside its mandate, as well as other cases as specified in the company charter.
One aspect of the 2005 Law on Enterprises is likely to create concerns for a number of foreign investors, however, and particularly to those engaged in joint ventures with local partners. Under the new regulations for LLCs and shareholding companies, resolutions of the members’ council or the general meeting of shareholders require a 65 per cent majority of the aggregate capital of attending members to be passed.\(^{45}\) Major decisions require a 75 per cent majority.\(^{46}\) Decisions of the Board of Management in shareholding companies, in turn, require a simple majority of the attending members.

While the provisions to protect minority shareholders are welcome, the 65 per cent majority rule is excessive and not in line with common practice in other countries with well-established corporate traditions. It is likely to create significant rigidities in the management of both LLCs and shareholding companies. It may also create problems for existing foreign investors who engaged in joint ventures prior to the new laws, as the previous majority rule was 50 per cent. Some of them may thus lose management control as a result of the new regulations. However, foreign investors with minority stakes in new joint-ventures may find that the 65 per cent majority rule gives them additional protection against unilateral decisions from the partner in the joint venture.

In addition, resolution 71–2006 of the National Assembly specifies that “commitments of Viet Nam to the WTO which are stipulated fully, clearly and in detail in the WTO accession documents are to be directly applied.” The accession document states that investors under joint ventures have the right to determine voting procedures in the company charter, including quorum and majority rules. As a result, Resolution 71 should give investors under joint ventures the right to determine their own majority rules, but this has not been tested in court yet.

Still, this review recommends that Viet Nam adopt a simple majority rule of 50 per cent for most decisions by the members council and general meeting of shareholders (as currently applies for board decisions in shareholding companies) and to keep the current 75 per cent majority rule for major decisions only. This is in line with international practice and would give a good balance between protecting shareholders rights and allowing sufficient flexibility in management decisions.

The 2005 Law on Investment and Law on Enterprises repealed the 1996 Law on Foreign Investment. The latter, however, was the legal underpinning for the organization of FIEs as well as for the investment licences. Under such circumstances, FIEs that were established before the 2005 laws became effective\(^{47}\) have been given two options:

- **Do nothing:** The FIE can continue to operate under the investment licence and business registration granted under the 1996 Law on Foreign Investment.
- **Re-register:** The FIE is re-registered under the 2005 Law on Enterprises and is re-issued an investment certificate under the 2005 Law on Investment. The FIE also has the option to convert concurrently, i.e. to change the form of the enterprise.

FIEs have been given until 1 July 2008 to re-register if they wish to do so. Re-registration is clearly the Government’s preferred option, and the procedures to do so have been kept simple. FIEs have a

\(^{45}\) In the case of LLCs, attendees must represent a legal quorum of 75 per cent of charter capital in the first meeting, 50 per cent of charter capital in the second meeting, and the legal minimum is lifted in the third meeting. The percentages for shareholding companies are 65 per cent, 51 per cent and none, respectively.

\(^{46}\) Major decisions include amendments to the company charter, reorganization of the company and the sale of assets representing more than 50 per cent of the total value of assets recorded in the latest financial statement.

\(^{47}\) The 2005 Law on Investment and Law on Enterprises became effective on 1 July 2006.
definite advantage in re-registering as it allows them to operate under a modern corporate structure. In contrast, not doing so creates a number of problems. In particular, the company will be strictly confined to the lines of business and duration of operation as stipulated under the original investment licence, and it is likely to become more and more difficult to operate under the old Charter as new laws are passed in the future.

All SOEs, which were previously regulated under the Law on State-Owned Enterprises, will be converted into LLCs or shareholding companies under the 2005 Law on Enterprises within a period of four years (section C.13).

2. Taxation

As in the area of general investment and company regulation, Viet Nam has embarked on a process to harmonize taxation for domestic and foreign companies as well as foreign individuals. It has also initiated a number of institutional and administrative reforms in order to improve the administration of taxation. As also reflected in the administratively heavy and intrusive regulations on FDI entry and establishment, Viet Nam has instituted a complex web of fiscal incentives aimed at promoting investment in favoured sectors or geographic areas. However, no assessment of the effectiveness of such a complex scheme of incentives has been conducted so far.

a. Value added tax

Viet Nam introduced a value added tax (VAT) in 1999 to replace the turnover tax. The system reflects international practice and has quickly been competently administered by the General Department of Taxation (GDT). All business establishments are subject to VAT, regardless of size or sales of taxable goods. Most sizeable companies – and all foreign investors – compute their VAT payments following the input–output tax credit method. Small domestic businesses, in contrast, compute VAT payments directly on the basis of value added. VAT applies to goods and services as follows:

- 28 categories of goods and services are VAT-exempt, including medical services, education, goods in transit or under temporary admission, life insurance or capital goods that cannot be produced locally.
- Exports of goods and services are the only ones taxed at 0 per cent. This includes goods and services to export processing zones, with the exception of those that do not go directly into the production process, such as insurance, consultancy, telecommunications or consumer goods.
- 21 categories of goods and services are taxed at a rate of 5 per cent, including medical equipment, basic chemicals, fresh foodstuff and metallurgical products.
- All other goods and service are taxed at a rate of 10 per cent.

Companies are required to file VAT returns and payments on a monthly basis. Excess input tax over output tax is usually credited to the following month. VAT refunds are possible in three cases: (a) exporters of goods and services can obtain refunds on a monthly basis when their credit due exceeds 200 million dong ($12,500); (b) newly established businesses can obtain refunds on an annual basis, or on a quarterly basis if the input VAT paid on the capital investment exceeds 200 million dong; and (c) expanding businesses can obtain refunds on a quarterly basis if the input VAT paid on the capital investment exceeds 200 million dong.

\[48 \text{ Sale price minus input price (value added) is multiplied by the tax rate.}\]
b. Corporate income taxation

The 2003 Law on Corporate Income Tax unified the tax regime for domestic and foreign companies, effective 1 January 2004. It imposes a single corporate income tax rate of 28 per cent for all business establishments, regardless of structure and ownership.\(^{49}\) Under the 1997 Law on Corporate Income Tax, domestic investors were taxed at 32 per cent, while foreign investors subject to the 1999 Law on Foreign Investment\(^{50}\) were taxed at 25 per cent. In addition, however, profits remitted overseas were subject to a 3 to 7 per cent tax, which was repealed by the 2003 Law on Corporate Income Tax.

Viet Nam has adopted a modern approach to determine taxable income and allows companies to deduct the standard business-related expenses, including depreciation of fixed assets, research and development (R&D) costs, training, advertisement and marketing costs. Losses may be carried forward for a maximum of five years.

Fixed assets may be depreciated at rates that closely mirror actual economic life.\(^{51}\) Regulations set a minimum and maximum duration for the purpose of depreciation. Companies are thus given a certain degree of flexibility to apply faster rates of depreciation. Depending on the type of asset, they may apply a straight-line or a declining balance method.\(^{52}\) Companies that achieve “high economic efficiency” are entitled to apply accelerated depreciation if they renew their equipment and technology at a faster rate than that of the economic life of the assets. Accelerated depreciation must be applied under the straight-line method and may not exceed twice the normal rates. Despite these provisions, depreciation allowances are likely to be less favourable than is common in many other countries where tax depreciation of fixed assets is typically faster than economic depreciation.

Viet Nam has developed a technically competent and relatively efficient tax administration in the GDT, which falls under the supervision of the Ministry of Finance. The GDT is currently organized around 14 divisions, including ones that deal with State-owned enterprises, FIEs and Vietnamese private enterprises. It is supported by tax departments at the provincial and district levels. In conformity with the general reform to bring all investors under a common regulatory framework, the GDT will soon be re-organized around a smaller set of functional divisions, including tax-return processing, tax audit and taxpayer services.

Companies are required to self-assess their turnover, expenses, taxable income and corporate income tax due for the year ahead. Provisional tax payments are due every quarter in accordance with self-declarations, and the final tax statement is due within 90 days after the end of the fiscal year. Excess payments, if any, are not refunded but credited against the tax liability of the following period.

In keeping with the strengthening of the GDT and the introduction of a modern tax regime, Viet Nam introduced detailed regulations and guidelines on transfer pricing in 2005. The regulations build on the Organization for Economic Cooperation and Development (OECD) guidelines and stipulate that transactions between affiliates must be based on “market prices”. Five methods of calculation of market prices are defined: (a) comparable uncontrolled price; (b) resale price; (c) prime cost plus profits; (d) profit comparison; and (e) profit split.

\(^{49}\) A rate between 28 per cent and 50 per cent applies to companies in prospecting, exploration and exploitation of oil and gas and other precious natural resources. The actual rate is determined on a case-by-case basis.

\(^{50}\) Repealed by the 2005 Law on Investment.

\(^{51}\) For example, cars and trucks are depreciated in 6 to 10 years, permanent buildings in 25 to 50 years and electronic equipment in 3 to 8 years.

\(^{52}\) A third method based on the quantity or volume of goods produced may also be applied in certain cases.
The core of Viet Nam’s corporate taxation is thus relatively sound and well administered. The authorities have nevertheless superimposed a complex web of incentives on the baseline corporate income tax rate. The incentives are based on two main criteria:

- **Two lists of “incentive sectors” and “special incentives sectors”:** The list of incentive sectors includes 53 more or less precisely defined sectors ranging from production of bottled or canned fruit juices to private hospitals and production of electronic appliances. It also encompasses all labour intensive industries, i.e. projects employing between 500 and 5,000 people, as well as all projects established in industrial parks. The list of special incentives sectors includes another 26 more or less precisely defined sectors ranging from afforestation to the production of computers and ITC equipment, or R&D projects. It also encompasses all projects employing more than 5000 people.

- **Two lists of “difficult socio-economic regions” and “specially difficult socio-economic regions”:** The list of difficult socio-economic zones includes districts and towns in 42 of Viet Nam’s 64 provinces and also includes all industrial parks. The list of specially difficult socio-economic regions includes districts and towns in 48 of Viet Nam’s 64 provinces and also includes all high-tech parks and economic zones.53

The incentives are threefold and summarized in Table II.3:

- A full exemption on corporate income tax for the first 1 to 4 years of operations;
- A 50 per cent reduction on the corporate income tax rate for the subsequent 2 to 9 years;
- A reduction in the baseline corporate income tax rate from 28 per cent to 20, 15 or 10 per cent, respectively, for a duration of 10 to 15 years.

The extent of the incentives depends on the combination of the sector and region where it takes place. Incentives apply only to newly established businesses, i.e. to companies that incorporate for the first time in Viet Nam. A separate regime applies to existing businesses that relocate or those that expand into new production lines or renew their technology (Table II.3). Existing businesses are granted much less favourable incentives than new ones if they set up a new production line in a promoted sector or region. Expanding businesses would thus be likely to create 100 per cent owned affiliates to benefit from the more generous incentives.

As indicated above, all new businesses in economic zones and high-tech parks benefit from the incentives of specially difficult socio-economic regions, while all new businesses in industrial parks benefit from the incentives of incentive sector cum difficult socio-economic regions. Companies that employ more than a threshold number of people also qualify for incentives. In addition, exemptions are available to promote employment of women and vocational training for ethnic-minorities.

The Government also provides exemptions on land rent to investors in incentive sectors and/or in encouraged regions. The exemption varies from three years to the whole duration of the project, depending on the combination of sector and region.

53 Not all districts and towns within a province necessarily qualify as a difficult socio-economic region or specially difficult socio-economic region. The provinces entirely excluded from the lists include Can Tho City, Da Nang City, Hai Phong City, Hanoi City and Ho Chi Minh City.
Table II.3. Summary of incentives on corporate income tax rate and land rent

<table>
<thead>
<tr>
<th>Conditions</th>
<th>Reduced tax rate¹</th>
<th>Total duration for reduced rate²</th>
<th>Full exemption³</th>
<th>50 per cent reduction on tax rate⁴</th>
<th>Land rent exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Newly established businesses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Incentive sector</td>
<td>20%</td>
<td>10 years</td>
<td>2 years</td>
<td>3 years</td>
<td>3 years</td>
</tr>
<tr>
<td>* Difficult socio-economic region</td>
<td>20%</td>
<td>10 years</td>
<td>2 years</td>
<td>6 years</td>
<td>7 years</td>
</tr>
<tr>
<td>* Incentive sector and difficult socio-economic region (includes industrial parks)</td>
<td>15%</td>
<td>12 years</td>
<td>3 years</td>
<td>7 years</td>
<td>11 years</td>
</tr>
<tr>
<td>* Special incentive sector or specially difficult socio-economic region (includes economic zones and high-tech parks)</td>
<td>10%</td>
<td>15 years</td>
<td>4 years</td>
<td>9 years</td>
<td>7 years, 11 years, 15 years full exemption⁵</td>
</tr>
<tr>
<td><strong>Relocating existing businesses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Outside of urban area following a Master Plan</td>
<td>..</td>
<td></td>
<td>2 years</td>
<td>2 years</td>
<td>..</td>
</tr>
<tr>
<td>* Into difficult or specially difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>2 years</td>
<td>6 years</td>
<td>..</td>
</tr>
<tr>
<td><strong>Expanding businesses and technology renewal</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Non-incentive sector or region</td>
<td>..</td>
<td></td>
<td>1 year</td>
<td>2 years</td>
<td>..</td>
</tr>
<tr>
<td>* Incentive sector or difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>1 year</td>
<td>4 years</td>
<td>..</td>
</tr>
<tr>
<td>* Special incentive sector or specially difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>2 years</td>
<td>3 years</td>
<td>..</td>
</tr>
<tr>
<td>* Incentive sector and difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>3 years</td>
<td>5 years</td>
<td>..</td>
</tr>
<tr>
<td>* Special incentive sector and difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>3 years</td>
<td>7 years</td>
<td>..</td>
</tr>
<tr>
<td>* (Special) incentive sector and specially difficult socio-economic region</td>
<td>..</td>
<td></td>
<td>4 years</td>
<td>7 years</td>
<td>..</td>
</tr>
<tr>
<td><strong>Other cases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>* 10 to 100 female employees (min. 50% of total employees)</td>
<td></td>
<td></td>
<td></td>
<td>Tax payable is reduced by the amount of salaries paid to female employees</td>
<td></td>
</tr>
<tr>
<td>* Over 100 female employees (min. 30% of total employees)</td>
<td></td>
<td></td>
<td></td>
<td>Tax payable is reduced by the amount of salaries paid to female employees</td>
<td></td>
</tr>
<tr>
<td>* Vocational training for ethnic minority people</td>
<td></td>
<td></td>
<td></td>
<td>Full exemption from corporate income tax</td>
<td></td>
</tr>
</tbody>
</table>

¹ Standard corporate income tax rate is 28 per cent.
² Total duration starts from commencement of operations and includes years with exemption and 50 per cent reduction.
³ Exemption applies to the years from commencement of operations.
⁴ 50 per cent reduction applies to subsequent number of years.
⁵ Number of years of exemption depends on the combination of special incentive sector and/or specially difficult socio-economic region. Projects in special incentive sectors and specially difficult socio-economic regions receive full exemption on land rent for the entire duration of the project.
⁶ Includes new production lines, expansion of scale and technology renewal. Tax incentives apply to the income generated from the expansion only.

The incentives that a project is entitled to are itemized in the investment certificate. This was also the case under the 1996 Law on Foreign Investment, and it appears that investment certificates/licences have contractual value. As specifically stated in article 31 of the 2003 Law on Corporate Income Tax, investors are thus entitled to benefit from the incentives as provided in their certificate or licence, regardless of posterior changes in tax laws. If changes in the tax laws give a more favourable treatment than that provided for in the licence or certificate, however, the most beneficial conditions apply. This provision implies that foreign investors registered before the 2003 Law on Corporate Income tax continue to benefit from the 25 per cent tax rate for the remaining duration of their licence.

Viet Nam has thus put in place a very complex structure of incentives that seeks to achieve more than it probably can in steering investments into a number of favoured sectors or regions. The structure of incentives implies that companies go through a number of “steps” in corporate income tax rates as the project evolves (figure II.4).

**Figure II.4. Incentives-based corporate tax rates for newly established businesses**

![Incentives-based corporate tax rates for newly established businesses](image)

*Source: 2007 Decree on Corporate Income Tax.*

Although the GDT appears capable of administering the incentives, their complex structure imposes a very high administrative burden both on investors and the tax authorities. Viet Nam finds itself in a position where projects may be subject to corporate income tax rates of 0 per cent, 5 per cent, 7.5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent or 28 per cent, depending on when the project has been approved, the district it is located in and the sector of operation. For a given project, the tax rate will also vary from year to year.

As stated by the GDT, the incentives provided to new businesses cover such a wide range of situations that nearly all new projects are likely to benefit from one kind of incentive or another. Yet, the Government has so far not properly assessed the effectiveness of the incentives in achieving their two main goals: (a) promoting investment in general; and (b) steering investment towards Government-favoured sectors and regions.
Assessing the effectiveness of tax incentives to channel investments in desired sectors or regions is a complicated undertaking. But the Government should undertake such an assessment urgently, as the cost of ineffective incentives can be high as a result of (a) unnecessarily providing tax rebates; (b) an excessive administrative burden on tax authorities, which may divert resources from tax compliance efforts; and (c) additional room for tax engineering and tax evasion. In addition, such a targeted system is likely to lead to misallocations of scarce resources, as priorities chosen by the Government may not match the country’s comparative advantage.

The recommendations of this review are thus for the Government to:

- Conduct a full assessment of the effectiveness of fiscal incentives. This will require a comprehensive cost-benefit analysis of the complex set of incentives and the extent to which they do promote investments that would not otherwise take place.
- Put in place a regionally and globally competitive general tax regime instead of an excessively targeted incentives regime where most investors end up receiving one type of incentive or another.
- Rationalize and simplify the current system of incentives. Incentives should be geared towards a small number of specific objectives, and their effectiveness should be measurable through a cost–benefit analysis. Under a generally attractive and competitive regime, incentives could be limited, for example, to temporary rebates on the corporate income tax rate and accelerated depreciation for a small number of particularly disadvantaged regions and to a small number of strategic sectors.
- Simplify the tax system and reduce the administrative burden on investors and the tax authorities.

It appears that the Government is willing to move in the directions recommended above, and amendments to the Law on Corporate Income Tax are under consideration. Even though no details have been made available thus far, the Government indicated that it could consider a lower base-line corporate income tax rate, simplifying the regime of preferential rates and providing incentives through accelerated depreciation.

Viet Nam has quickly recognized the importance for foreign investors in concluding double taxation treaties (DTTs). The Government initiated negotiations with major FDI source countries in the early 1990s. By 2007, Viet Nam had signed DTTs with 46 countries and territories, including Canada, China, Japan, the Republic of Korea, Singapore, Taiwan Province of China and a number of countries from the European Union (EU).

As stated above, Viet Nam does not currently tax dividends paid to non-residents. All the DTTs it has signed, however, allow the Government to put in place a dividend withholding tax in the future if it so wishes. The maximum rates allowed under existing DTTs typically range from 10 to 15 per cent. Somewhat unusually, the DTT with Australia allows the latter to apply a dividend withholding tax rate of 15 per cent while Viet Nam may only apply a rate of 10 per cent. In turn, the DTT with the United Kingdom provides for withholding rates of 7, 10 and 15 per cent, depending on the degree of control over the dividend paying company. The withholding tax rates on interest payments, royalties and other incomes are typically capped at 10 per cent in most DTTs.

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54 All DTTs are in force, except for five with relatively minor trade and investment partners such as Algeria, Egypt and Sri Lanka.
Although Viet Nam has put in place an impressive network of DTTs in a relatively short period, one important gap remains as there is no DTT with the United States. Negotiations should be started rapidly, as United States investors are becoming increasingly important, particularly in some of the high value added industries and in services.

c. Personal income taxation

The current personal income tax system is discriminatory in favour of foreigners, but the relatively high marginal tax rate compared with some neighbouring countries or those at a similar level of development raises the cost of hiring high-earning skilled workers, particularly internationally mobile individuals. This situation will change as of 1 January 2009 when Law 04-2007 on Personal Income Tax comes into force.55

Under the current regime, expatriates’ income is taxed according to five brackets at rates of 0, 10, 20, 30 and 40 per cent. The top marginal rate of 40 per cent applies from a monthly income of 80 million dong ($5,000). Vietnamese citizens and permanent residents, in turn, are taxed at the same five rates, but the income brackets are lower, with the top rate applying from a monthly income of 40 million dong ($2,500). Taxable income includes wages, salaries, bonuses and allowances, as well as almost all fringe benefits (with the exception of training fees, school fees and annual leave air fares for expatriates).

The top marginal rate that applies currently makes it more expensive for employers to recruit skilled workers in Viet Nam than in some key regional competitors (table II.4). Yet, if Viet Nam wishes to promote skills-intensive sectors, it needs to ensure that skilled workers are available (section C.5 deals with the issue of attracting expatriates with skills in short supply locally), but also that skilled labour costs are competitive internationally.

Law 04-2007 will put Viet Nam more in line with its neighbours when it comes into effect in 2009, even though the level of personal income taxes will remain at the upper end in the region. The new law provides a more modern framework for personal income taxation than defined under the current Ordinance on Income Tax of High Income Earners. Taxable income is defined more precisely and encompasses all sources of income, including salaries and wages, income from capital investments and income from transfers. A number of important exemptions are also provided, including excess income from overtime work and remittances from overseas Vietnamese. Deductions are also provided for dependents.

The 2007 Law removes the discrimination between expatriates and citizens or permanent residents. The tax brackets have been unified and increased to seven, which apply at the rates of 5, 10, 15, 20, 25, 30 and 35 per cent. As before, the top bracket of 35 per cent applies from a monthly income of 80 million dong ($5,000). Different rates apply on income from capital investment (5 per cent), income from inheritance (10 per cent) or income from royalties (5 per cent).

55 As defined in Ordinance 35-2001 on Income Tax of High Income Earners.
### Table II.4. Personal income tax rates

(Percentage)

<table>
<thead>
<tr>
<th>Country</th>
<th>Bracket 1</th>
<th>Bracket 2</th>
<th>Bracket 3</th>
<th>Bracket 4</th>
<th>Bracket 5</th>
<th>Bracket 6</th>
<th>Top bracket</th>
</tr>
</thead>
<tbody>
<tr>
<td>Viet Nam (current)</td>
<td>0</td>
<td>10</td>
<td>20</td>
<td>30</td>
<td>40</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Viet Nam (2009)</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
<td>30</td>
<td>35</td>
</tr>
<tr>
<td>China</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
<td>(…)</td>
<td>45</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0</td>
<td>19</td>
<td>24</td>
<td>27</td>
<td>28</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Philippines</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
<td>(…)</td>
<td>32</td>
</tr>
<tr>
<td>Singapore</td>
<td>0</td>
<td>3.5</td>
<td>5.5</td>
<td>8.5</td>
<td>14</td>
<td>(…)</td>
<td>20</td>
</tr>
<tr>
<td>The Republic of Korea</td>
<td>8</td>
<td>17</td>
<td>26</td>
<td>35</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Thailand</td>
<td>0</td>
<td>10</td>
<td>20</td>
<td>30</td>
<td>37</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>


### d. Economic zones, high-tech parks, industrial zones and export processing zones

Viet Nam has relied heavily on special economic zones to promote the manufacturing sector and attract FDI (chapter I). It has established four types of zones that benefit from a number of fiscal and non-fiscal incentives:

- **Economic zones** are economic areas with defined geographical boundaries, separated from the general investment and business environment and with specially favourable conditions for investors.
- **High-tech parks** are areas with defined geographical boundaries that specialize in research, development and application of high technologies.
- **Industrial zones** are areas with defined geographical boundaries that specialize in the manufacture of industrial products and the provision of services for industrial manufacture.
- **Export processing zones** are industrial zones that specialize in the manufacture of export products and the provision of services for the manufacture of export products and export activities.\(^{56}\)

As per the 2005 Law on Investment and Decree 29–2008, zones can be set up only by decision of the Prime Minister and in accordance with Master Plans. Provinces have generally been eager to establish zones, as they are one of the main conduits for investment promotion in Viet Nam. A total of 110 industrial and export processing zones had been set up by end-2007, representing a total area of 26,000 hectares, of which about 74 per cent had been leased to investors. Another 69 industrial and export processing zones were under construction, representing a total of 17,000 hectares.\(^ {57}\)

The vast majority of industrial and export processing zones have been developed by provincial Governments, sometimes with the financial support of the central Government. A small number of the most successful zones, however, have been set up under joint venture agreements with private foreign developers, mostly from the region (China, Japan, Singapore or Taiwan Province of China). The construction and commercial operation of zones infrastructure qualifies as a “special incentives sector” and is thus eligible for tax incentives (section 2.b).

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\(^{56}\) As defined under the 2005 Law on Investment.

\(^{57}\) This does not include economic zones and high-tech parks.
The regime of fiscal incentives for investors establishing operations in one of Viet Nam’s four types of zones has been modified with the introduction of the 2005 Law on Investment, Decree 24-2007 on Corporate Income Tax, and Decree 29-2008 on zones. Under the current regime, industrial and export processing zones are assimilated to “difficult socio-economic regions” and qualify for fiscal incentives as such. Economic zones and high-tech parks, in turn, are assimilated to “specially difficult socio-economic regions” and qualify for fiscal incentives as such.

Investors who were established before the new laws and decrees took effect will continue to benefit from the fiscal incentives as stipulated in their investment licence. In order to comply with its WTO obligations, Viet Nam has eliminated the export requirement for companies in export processing zones. Under the current regime, companies seeking to establish in export processing zones are thus no longer compelled to export any given proportion of their output. Under the previous regime, incentives were conditional upon exporting a minimum of 80 per cent of output. Decree 24-2007 on Corporate Income Tax specifies that companies enjoying fiscal incentives conditional upon export ratios will continue to benefit from them until the end of 2011, in conformity with the WTO commitment.

In order to comply with WTO regulations, Viet Nam has repealed a number of the decrees that established industrial and export processing zones and high-tech parks. A new decree was issued to regulate high-tech parks in 2003, and Decree 29-2008, Issuing Regulations on Industrial Zones, Export Processing Zones and Economic Zones, was promulgated in March 2008. This new decree clarifies the situation of industrial, economic and export processing zones. It reasserts the fiscal incentives that investors are entitled to, regulates the conditions under which zones can be established or expanded, and defines the respective powers and responsibilities of the ministries, people’s committees and management committees.

As illustrated in chapter I, a significant part of Viet Nam’s industrial and manufacturing investment has taken place in one of the four types of zones. In turn, various degrees of fiscal incentives have been granted to all investments in the zones. Under these circumstances, the vast majority of investors benefit from one type of fiscal incentive or another. As stated in section 2.b, it would be more rational and transparent to put in place a regionally and globally competitive general tax regime, rather than a system where almost everyone benefits from some incentives. This review recommends:

- Setting up a generally competitive tax regime that applies throughout the country, including in zones.
- Focus the zones development policy on providing first-class hard and soft infrastructure, including:
  - Transport, telecommunications and utilities (hard infrastructure);
  - Investment certification, customs, work permits and other regulatory services (soft infrastructure).
- Increase efforts to attract private zones developers capable of providing first-class hard infrastructure to investors. This could include providing zones developers with limited fiscal incentives.

58 In particular Decree 36-CP issuing regulations on industrial zones, export processing zones and high-tech zones (1997).
e. Customs duties, inspection and trading rights

One of the key requirements for WTO accession was to grant trading rights to any natural or legal person, domestic or foreign. The Commercial Law of 2005 and its associated decrees do indeed provide for the right to import and export, without any minimum investment in Viet Nam required. Significant restrictions do prevail, however, in terms of distribution to the domestic market (section B.1).

Viet Nam’s accession to WTO also means that imports from most countries will be granted MFN status. MFN tariffs range from 0 to 60 per cent, with a limited number of goods subject to special duties of up to 150 per cent. The trade-weighted average MFN import duty declined moderately over the past decade – from 21.1 per cent in 1994 to 14.7 per cent in 2005 – but remains relatively high by international standards (figure II.5).\(^5\) Viet Nam also maintains tariff escalation, even though agricultural goods are granted higher-than-average protection, while machinery benefits from lower-than-average duties.

**Figure II.5. Trade-weighted MFN import duties, 1994–2005**

(Percentage)

![Trade-weighted MFN import duties](image)

Source: UNCTAD, TRAINS database.

Import duties exemptions are provided in a number of cases, including (a) temporary imports of machinery; (b) goods imported for export processing; (c) goods imported as fixed assets for eligible investment projects in encouraged sectors or regions; (d) raw materials and supplies for eligible investment projects in encouraged sectors or regions, for a maximum of five years; and (e) capital goods imported by BOT enterprises. Viet Nam also has a duty-drawback scheme for exporters, and it allows them to operate bonded warehouses.

\(^5\) The average MFN import duty for China, India, Indonesia, the Lao People’s Democratic Republic, Malaysia, the Philippines, Sri Lanka and Thailand was 7.5 per cent in 2005. Only India and the Lao People’s Democratic Republic impose import duties at a level similar to Viet Nam, while all other countries have trade-weighted MFN tariffs between 3.8 and 7.5 per cent.
The Government is currently seeking to improve the operation of customs procedures. The 2001 Law on Customs (as amended in 2005), establishes ambitious clearance time targets. Customs is required to perform all procedures within eight hours (after the declarant has performed all the requirements) with respect to consignments subject to random inspection, and within two working days with respect to consignments subject to full inspection. These time limits are targets rather than the current actual performance, however.

The General Department of Viet Nam Customs has designed a strategy for the period to 2010 to improve customs administration, with the help of the World Bank. A number of procedures have been streamlined, including cutting the number of documents required for clearance. An electronic customs system is also being phased in, with pilot projects in Ho Chi Minh City and Hai Phong currently under way. Viet Nam has decided to design its own e-customs software. It may wish to reconsider that position, however, and adopt UNCTAD’s Asycuda++ platform, which is used in about 80 countries around the world, including Latvia, Lithuania, the Philippines or Slovakia, and has proved to be efficient and reliable.\textsuperscript{60}

As part of the 2010 strategy, Viet Nam seeks to establish random inspection on a maximum of 5 per cent of all customs declarations. It is also profiling traders with respect to their compliance in order to apply targeted inspections. In addition, the 2001 Law on Customs introduced the possibility for owners of intellectual property rights to request the temporary suspension of customs procedures for imported or exported goods that infringe their rights.

3. Foreign exchange arrangements and fund transfers

Viet Nam took a major step at the end of 2005 by accepting the obligations of International Monetary Fund (IMF) article VIII, which bans foreign exchange restrictions for current international transactions, as well as multiple or discriminatory currency arrangements. The 2005 Ordinance on Foreign Exchange Control clearly stipulates that “all transactions being payments and remittances of money relating to current transactions between residents and non-residents shall be conducted freely.”

The State Bank of Viet Nam (SBV) publishes daily average exchange rates against the dollar and allows foreign exchange traders to quote spot rates that vary at most by 1 per cent on either side. SBV has maintained a very stable exchange rate against the dollar, as the annual nominal depreciation of the dong against the dollar has not exceeded 1 per cent per year since 2004. This led the IMF to re-classify Viet Nam’s exchange rate regime in the category of “conventional pegged arrangement” from “managed floating with no predetermined path.”

The Government indicated to IMF that it planned to make the dong fully convertible by 2010. At the conclusion of the article IV consultations in November 2006, the IMF Board encouraged the Government to avail of the strength of the external position to move towards greater exchange rate flexibility, which would “serve to cushion the economy from external shocks and foster better management of exchange rate risks”.\textsuperscript{61} In the medium term, SBV will need to strengthen its capacity in exchange rate management as capital flows are further liberalized and full convertibility is introduced.

Residents are allowed to open foreign currency accounts. Exporters, in turn, are required to remit all foreign currency earnings into a foreign currency account with an authorized credit institution in Viet Nam. Retaining foreign currency earnings overseas is possible only upon approval from SBV.

\textsuperscript{60} Viet Nam used the older Asycuda v2.7 until 2000, mostly as a trade statistics gathering tool, but has since stopped using it.

\textsuperscript{61} IMF (2006e).
Capital transactions remain more strictly regulated, and the 2005 ordinance deals separately with FDI, portfolio investment, Vietnamese FDI, and external borrowing. The ordinance specifies that lawful revenues in Vietnamese dong related to FDI operations can be converted into foreign currency and freely remitted abroad. The Law on Investment is more specific, in that it allows the remittance abroad — after the investor has fully discharged its financial obligations to the State — of the following:

- Profits;
- Fees received from the provision of technology and services and intellectual property;
- Principal and interest on external debt;
- Capital and capital gains arising from the sale of assets;
- Other assets and proceeds lawfully owned by the investor.

Foreign investors are nevertheless required to open a dedicated direct investment capital foreign currency account. A number of transactions between Viet Nam and the rest of the world must transit through this account, including:

- Capital contributions;
- Principal and interest payments on external debt;
- Dividend payments or capital repayments;
- Other revenue and disbursements relating to the investment.

This capital account is distinct from the company’s operational account. Transfers between the two accounts must be declared to SBV before they can proceed. Although the transfer notification does not constitute a requirement for authorization, the separation of capital and operating accounts and the declaration of transfers add an unnecessary administrative burden on companies. It is thus recommended that it be removed.

4. Labour regulation

The Labour Code of 1994, as amended in 2002, 2006 and 2007, provides a reasonably well-balanced regulatory framework that takes into account the need to protect workers’ interests and to promote employment creation. It applies to all workers, regardless of whether they are employed in SOEs or private companies (domestic and foreign). It also applies uniformly throughout the country, including in export processing zones and economic zones. Viet Nam should nevertheless consider a number of changes to its Labour Code in order to reduce certain rigidities in hiring and firing procedures, improve the implementation of the right to strike and protect workers’ rights.

Some of the key provisions and regulations of the Labour Code are as follows:

- Employees must be at least 15 years old.
- Discrimination on the basis of gender, race, social class, belief or religion is illegal.
- Three types of contracts are defined: (i) indefinite term contracts; (ii) definite term contracts, with a minimum term of 12 months and a maximum term of 36 months and renewable only once; (iii) labour contracts for a specific or seasonal job of less than 12 months.
- The trial period on labour contracts is limited to 30 days for most workers, 60 days for positions that require “specialized or highly technical skills”. Workers may be offered a reduced pay during the trial period, which must represent at least 70 per cent of the wage for the relevant position.
Notice of 45 days are required from employees or employers in case of resignation or firing.
Each employee is provided with a “labour book” that records a person’s employment history.
The normal work-day consists of eight hours, with a normal workweek of six days.
Overtime is capped at four hours per day and 200 hours annually.
Employers must contribute 15 per cent of gross wages to a social insurance fund, and employees contribute 5 per cent of their wage.

Viet Nam has instituted two minimum wage scales: one that applies to employees working in FIEs and one that applies to employees working in Vietnamese companies. Minimum wages in FIEs are 800,000 dong ($50), 900,000 dong ($56) or 1,000,000 dong ($62) per month, depending on where the company is established. The minimum wage in Vietnamese companies, in turn, is 540,000 ($34), 580,000 dong ($36) or 620,000 dong ($39) per month, depending on location. The Government indicates that it will put in place a single minimum wage by 2010. Based on evidence gathered through interviews with foreign investors in Viet Nam, the level of minimum wage does not appear to be a constraint to FDI. The majority of FIEs offer wages above the minimum level, and average monthly earnings in FIEs was close to 2 million dong ($120) in 2002.62

While hiring is left fully in the hands of the parties in the labour contract, redundancies and firing procedures are significantly more rigid, including in comparison with some other countries in the region or in OECD countries (table II.5). Firing costs are also on the upper limit of regional comparators.

<table>
<thead>
<tr>
<th>Table II.5. Labour market rigidity index, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>(0 to 100, 100 = highest rigidity)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Rigidity of employment</th>
<th>Difficulty of hiring</th>
<th>Rigidity of hours</th>
<th>Difficulty of firing</th>
<th>Non-wage labour cost1</th>
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1 Percentage of salary.
2 Weeks of wage.

Redundancies are authorized only after consultation and agreement with the executive committee of the trade union and after notification with the local body in charge of State administration of labour, regardless of the number of workers to be retrenched. Formal approval by the local body in charge of State administration of labour is required when a larger number of employees are made redundant. Compensation amounts to one month of salary per year worked, with a minimum of two months. Seniority, skills, family conditions and other factors must be taken into account in selecting the workers.

62 This average includes positions at all level of qualification, including skilled and unskilled. The average is more than twice the highest level of minimum wage, however. In the Vietnamese private sector, in contrast, the average monthly wage was below 1 million dong ($60) in 2002.
to be retrenched. Firings, in turn, are possible if a worker repeatedly fails to perform in accordance with the terms of the contract or in the case of serious misconduct, and after reaching an agreement with the trade union. A notice of 45 days must then be given to the employee.

Trade union representatives must be constituted in all companies with 10 employees or more. At present, all trade unions must be affiliated with the Viet Nam General Confederation of Labour (VGCL) and operate under its umbrella. The 2006 and 2007 amendments to the Labour Code principally seek to improve the mechanisms to resolve collective labour disputes. The law now distinguishes collective labour disputes about rights (as specified by law or collective labour agreements and internal labour rules that have been registered officially) and collective labour disputes about benefits.

The resolution mechanism for disputes about rights is based on three levels: (a) direct negotiation and conciliation through the labour conciliation council of the enterprise or a labour conciliator; (b) failing agreement at the first level within three days, the case is referred to the Chairman of the People’s Committee at the District level; and (c) failing resolution at the second level within five days, the case is then referred to the People’s Court (provincial level).

The resolution mechanism for collective labour disputes about benefits is based on two levels: (a) direct negotiation and conciliation through the labour council of the enterprise or a labour conciliator; and (b) failing agreement at the first level within three days, the case is referred for conciliation to the labour arbitration council of the province, which must hold a session within seven days. Failing agreement at the second level, workers may engage a procedure to strike.

The right to strike is strictly regulated by law. Strikes may only result from unresolved collective labour disputes (about rights or about benefits). Prior exhaustion of the first two levels of recourse mentioned above is required, as well as the consent of more than 50 or 75 per cent of the employees. Notification must be given at least five days prior to the strike to the employer, the provincial labour office and the provincial trade unions federation. Strikers are also not allowed to force other employees to stop work by any means. Although the amendments of 2006 and 2007 improved the mechanisms to resolve collective labour disputes, including by setting time limits for the first two levels of recourse that need to be exhausted before a strike can be called, “legal” strikes remain difficult to organize and most of them take place outside the legal framework.

The International Labour Organization (ILO) is providing technical assistance to strengthen capacity in the provincial labour arbitration councils. ILO is also working jointly with the International Finance Corporation (IFC) on the “Better Work” programme, which supports companies that are part of global supply chains to improve their labour standards, based on core ILO standards and national law. In addition to protecting workers’ rights, the programme helps enterprises compete in global markets where buyers demand compliance with labour standards from their suppliers.

In addition to the ongoing work aimed at improving labour relations, this review suggests a number of amendments to the Labour Code that would:

63 Every enterprise with a trade union is required to set up a labour conciliation council composed in equal numbers from representatives of the employees and the employer.

64 50 per cent in an enterprise (or section of an enterprise) with fewer than 300 employees and 75 per cent otherwise.

65 A number of provinces do not even have labour arbitration councils.

Ease the procedures to retrench small numbers of workers, including by removing the required approval of the executive committee of the trade union and by giving more freedom to enterprises as to which employees should be made redundant.

Lengthen the trial period to three to six months – depending on the nature of the job – but provide full pay. This would provide employers with a more reasonable amount of time to ensure that new recruits have the required qualifications, while at the same time protect workers’ rights by providing them full pay.

Soften the restrictions on the right to strike to make regulations enforceable and create a more balanced protection of the interests of employers and employees. This would avoid illegal “wild” strikes and could improve labour relations.

Allow independent trade unions, aside from the VGCL.

In addition, the Government should consider whether the labour book is really necessary and whether it could actually be detrimental to employees. Employers should not need the labour book in their recruitment procedures as they should be able to test qualifications themselves. In turn, workers may be subject to pressure from their employers if their whole employment history and performance can be recorded and available to all future employers.

5. Employment of foreigners

Viet Nam operates a relatively rigid and restrictive system of allocation of work permits for foreigners that is ill-suited to its economic needs and interest, even though some important provisions were improved in March 2008 under Decree 34-2008. The system remains more the reflection of past practices still common around the world than the result of a carefully-thought strategy to optimize the contribution of foreign skills to the economy and the building-up of local skills. Although Viet Nam has rapidly built its human capital over the past decades through its general education policy, skills shortages remain. This review proposes a complete overhaul of the work permits allocation system in order to turn it into an effective tool to reinforce human capital and respond to the rapidly changing set of skills needed by the economy.

The underlying principles of the current system are that:

- Expatriates should be recruited only if the employer can demonstrate that it could not find a suitably qualified Vietnamese (labour market testing condition).
- Expatriates can only be recruited for managerial or “expert” positions, mostly related to higher-education training.
- The employer should train a Vietnamese worker to replace the expatriate as quickly as possible (understudy requirement).

Viet Nam applies these principles relatively strictly. Employers are required to advertise vacancies in a national or local newspaper to attempt to identify a suitably qualified Vietnamese worker. The Labour Code, in turn, stipulates that an expatriate may be recruited “where a Vietnamese is unable to satisfy the requirements for work which requires highly technical or management skills (…) provided that training plans and programmes are established in order to enable Vietnamese workers to do such works within a short period of time and to replace foreign employees”. The understudy requirement is strictly defined by law as employers are required to propose a detailed skills-transfer plan. The Ministry of Labour, War Invalids and Social Affairs (MOLISA), however, recognizes that it is difficult to monitor the transfer of skills and that the programme does not work to the desired effect.
Decree 34-2008 on Employment and Administration of Foreigners Working in Viet Nam defines more precisely the conditions of attribution of work permits to foreigners. Managerial positions are defined as those subject only to “general supervision or direction by the board of management or shareholders of the enterprise”. They are thus limited to top managers in the firm. An “expert” is defined as a person with “specialist and highly technical qualifications”, “technical knowledge or management of equipment” (which includes engineers, artisans and trades-people), or someone with “considerable experience in an occupation or trade, in operating production and business and in managerial work”. A wider range of expatriates can thus be recruited as “experts”, even though the definition remains relatively narrow and restrictive.

Until the new decree was adopted in March 2008, Viet Nam used to enforce a quantitative restriction that prevented firms to employ more than 3 per cent of their staff as expatriates (subject to exceptions). An important step towards the liberalization of entry of expatriates was taken with the lifting of this quantitative restriction under the new decree. In addition, the new regulations provide that certain types of foreigners may work in Viet Nam without work permit. These include members of a limited liability company with two or more members, the owner of a one-member limited liability company, a member of the board of management of a shareholding company, and foreign lawyers who have received a certificate to practice law in Viet Nam. It is also particularly welcome that Viet Nam set up a “key positions” programme under Decree 34-2008, which entitles all FIEs to three work permits for managers or experts.

Under the schedule of specific commitments in services of WTO, Viet Nam negotiated a horizontal limitation on intra-corporate transferees that requires that a minimum of 20 per cent of the total number of managers, executives and specialists be Vietnamese nationals. This applies to companies in the services sector as well as in industry. Decree 34-2008 nevertheless also specifies that all foreign enterprises are permitted to have at least three managers, executive directors and experts who are not Vietnamese.

Work permits are valid for the duration of the foreign worker’s contract, for a maximum of three years. They are renewable if it is demonstrated that the Vietnamese understudy is not capable of replacing the expatriate worker and upon explaining why it is so in spite of the compulsory skills transfer programme. Subsequent renewals are possible under the same conditions. Work permits are kept separate from residence permits.

Viet Nam is increasingly seeking to promote foreign investment in more technologically advanced manufactured goods and services. Although it is making significant efforts to build human capital through its education policy, it still suffers from a shortage of qualified labour in a variety of fields, and the shortage is likely to become more acute as more advanced technology and services sectors develop. As indicated above, the current system of allocation of work permits to foreigners does not suit Viet Nam’s needs and interest. It is thus recommended that Viet Nam consider a proactive skills attraction programme whose two key objectives would be to:

- Selectively attract the type of skills that Viet Nam and its economy need, thereby contributing to its development objectives; and
- Promote skills transfer and complement the education-based skills development policy.

The programme should be both proactive in attracting desired skills and smooth in terms of process. Employing foreigners should be open equally to FIEs and Vietnamese companies, under the same conditions and procedures. The programme would be structured along the lines depicted in figure II.6 and as explained below.
Figure II.6. Recommended skills attraction programme

**a. Skills audit and migration occupations in demand list**

Viet Nam should conduct a comprehensive audit of its skills base in order to assess the gaps and the needs of the labour market. The skills audit would provide the basis for the establishment of a migration occupations in demand list (MODL). The MODL would consist of a detailed list of specific occupations where there are insufficient workers in Viet Nam at the level of qualification required by the employers. It would not be restricted ex-ante to any specific type of qualification (say those requiring university degrees, as is currently the case), but should properly assess the needs of the economy and be inclusive regardless of the type of education that is required by the occupation. The MODL would then underpin the process of allocation of work permits to foreigners, with special treatment provided to those who have skills that match Viet Nam’s needs (see below).

The construction of the MODL should involve wide consultations with stakeholders and be based on a number of tools. Experience elsewhere has showed that a single survey cannot give a full and accurate picture of need. Australia – one of the pioneers in using such an approach to labour immigration – draws on a number of sources to establish its MODL, including information from employers, surveys of job advertisements, surveys of job vacancies, consultations with key industry and employer groups and assessments of outputs of educational and training institutions.
The MODL should be forward-looking in assessing the needs of the labour market. It should thus also draw on sectoral strategies. In addition, the MODL should be updated on a regular basis – probably annually – to reflect changes in local skills and in labour market conditions. The list is likely to remain relatively stable from year to year, however.

b. Work permits policy

Under the proposed scheme, Viet Nam would operate a dual-track approach to allocating work permits to foreigners:

- **Deemed approved track:** Employers wishing to recruit expatriates for occupations included on the MODL should be allowed to do so following a simplified procedure. Given that the MODL establishes that skilled people capable of filling the position are in short supply in Viet Nam, the work permit should be deemed approved and the employer should not have to demonstrate that it could not identify a suitably qualified Vietnamese worker. It would only be “deemed approved” as the expatriate (or their employer) would still have to demonstrate that he/she possesses the appropriate skills, in addition to being of good character.

- **Labour market testing track:** It should remain possible for employers to recruit expatriates for positions that are not included on the MODL, as the latter may not cater for all circumstances. In such instances, employers would have to demonstrate – as is currently the case – that no suitably qualified Vietnamese worker could be identified.

There should be no ex-ante limit on the proportion of foreign employees in a company. The current 3 per cent cap should be removed, as the allocation of work permits under the “deemed approval track” would be based on a nationwide assessment of skills needs. The very legitimate concern to protect Vietnamese workers’ rights and interest would be addressed at the country level through the MODL and its regular updating.

At the moment, work permits are granted for a maximum period of three years and are, in principle, renewable only once, subject to condition. While the three year period is appropriate, it is suggested that renewals be “deemed approved” for occupations that remain on the MODL at the time of renewal. It is also suggested that Viet Nam establish a path to permanent residence for skilled workers, as it is in its interest to retain skilled people who can make a long-term contribution to the country’s development. In addition, Viet Nam should carefully review its policy vis-à-vis the partner and dependants of migrant workers. In particular, it should consider granting work permits for partners as not doing so is a significant deterrent for many of the most qualified potential migrants. Moreover, partners of highly qualified individuals tend to be qualified as well and are likely to be productively employed.

In addition to the dual-track policy recommended above, Viet Nam could consider relaxing some of the restrictions on intra-corporate transferees, as per its WTO commitments. In particular, it could adopt a less restrictive definition of “specialist” so as to allow a higher degree of intra-corporate movements at various levels in the company. Doing so would give corporations more flexibility in assessing where foreign staff may be needed, and it could encourage higher skills transfers at various levels in the company.

67 “Specialists” are defined under the WTO commitments as “natural persons working within an organization who possess knowledge at an advanced level of expertise and with knowledge of the organization’s services, research equipment, techniques or management (…) a high level of skills or qualification referring to a type of work or trade requiring specific technical knowledge.”
c. Administrative issues

A number of measures are proposed to improve the allocation and administration of work permits:

- Work and residence permits should be unified into a single permit in order to put in place a smooth and investor-friendly administrative process. This approach is adopted, for example, in Australia, Canada or the United States.
- Employers who demonstrate a good track record of complying with work permit and labour regulations should see their applications for work permits fast tracked. This would allow the immigration and labour authorities to focus their oversight on potentially more problematic cases.
- Viet Nam will need to put in place a more elaborate mechanism to evaluate skills. This will be particularly important as skills should not be understood narrowly to include only those related to university degrees. Viet Nam will thus need to establish criteria to evaluate qualifications from education as well as on-the-job training and work experience. It will also need to identify institutions to evaluate skills and experience based on the established criteria. Other countries frequently work with professional associations, higher-learning institutions and vocational training bodies in that respect.
- In addition to the qualifications checks, Viet Nam will continue to operate security and character checks before issuing unified work and residence permits, as is currently the case.

d. Skills transfers and integration

It is legitimate that Viet Nam should seek to maximize the transfer of skills from expatriates to nationals and that in many cases migrant workers be seen as a temporary solution to skills shortages. A number of issues should be considered, however, in determining the skills transfer policy and in viewing the role of migrant workers:

- Understudy programmes have not functioned well to generate broad transfers of skills, and they are difficult to monitor. This is the experience of Viet Nam, and a number of countries that used to enforce such requirements have removed them. Some countries – such Australia, Canada or the United States – have no formal skills transfer requirements, while Singapore put in place industrial and vocational training programmes at the national level, financed in part by a special levy on companies.
- Migrant workers should not be seen only as a solution to fill temporary skills gaps. The experience of many countries – including Australia, Canada, Singapore or the United States – is that immigrants can provide long-term benefits to their host country by providing increased dynamism, skills and initiative. There are thus benefits in allowing certain temporary migrants to become permanent residents, or even citizens.
- The contribution of immigrants to the economy and the country as a whole is a function of their degree of integration. Policies to facilitate the integration of immigrants into the host country generate significant benefits for both parties.

Considering these factors, it is recommended that Viet Nam eliminate the understudy requirement linked to all work permits and replace it with a more flexible and broad-based programme of skills transfers. In principle, market forces will encourage employers to minimize the number of expatriate employees, as skilled expatriates are significantly more expensive to hire than nationals. Employers have a strong incentive to limit the number of expatriates and to restrict them to positions where they genuinely
make a contribution that no Vietnamese can. They should also have an incentive to train nationals to replace them.

Such market forces could be supplemented with a number of measures to encourage skills transfer and development. Companies that employ a significant number of expatriates could be required to establish company-wide training programmes. Such programmes should be flexible and not linked to the occupations of the expatriates, however. What matters is that the employer make an effort to transfer skills to nationals through specific skills development programmes. Employers of expatriates could, for example, be required to spend a certain percentage of turnover or expatriates payroll on training for nationals. Such training programmes could also be encouraged by allowing companies to deduct expenses above cost from their taxable income.

Some countries, including Singapore, have also established nationwide industrial training programmes and vocational institutes to train nationals to work in foreign companies. This option could also be used in Viet Nam to replace the understudy programme and promote skills development. It could be funded by employer contributions to a national fund. It would be sensible to seek the involvement of private companies in running the training institutions or in providing part-time teachers. This would maximize the chance that training programmes correspond to employers’ needs.

In addition to the skills transfer requirements, Viet Nam would benefit from establishing programmes to facilitate the integration of expatriates into the local community. Countries such as Australia, Canada and Singapore have set up such programmes with great success. The “services” offered range from help in identifying housing, schooling or health care to support with administrative issues and community development initiatives. These three countries have found that these programmes have greatly enhanced migrant workers’ contributions to society.

6. Land

Viet Nam adopted a new Law on Land in 2003 to replace the 1993 Law on Land and the 1994 Ordinance on Rights and Obligations of Foreign Organizations and Individuals Leasing Land. While the 2003 law unifies the legal underpinnings for land use by nationals and foreigners, the latter are still subject to specific restrictions.

All land in Viet Nam belongs to the people as a whole, with the State as the representative owner. The Government first introduced land use rights (LURs) in 1988 when agricultural land was decollectivized. The nature of the LURs and the associated rights and obligations differ according to the user (e.g. national vs. foreigner, households vs. communities) and to the type of land. There are three main types of legal underpinnings for LURs:

- **Allocation**: The State can grant LURs by way of an administrative decision to national entities only. Allocated LURs can be subject to a land use fee or not, depending on the cases.
- **Recognition**: The State can “recognize” LURs to national entities only, in which case no fee is applicable.
- **Leasing**: The State can grant LURs on the basis of a contract to both national and foreign entities. LURs leases are subject to a land use rent and are the only form of land right available to foreigners.

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68 The World Bank’s Investment Climate Assessment survey of 2005 shows that 62 per cent of foreign enterprises offer formal training programmes to their employees.
LURs are provided either on a “stable and long-term basis” or for a defined period. Investors are allowed to lease LURs only for the duration of their licensed investment project, up to a maximum of 50 years. The law stipulates that “the State shall consider extension of the duration of land use if (...) the user has strictly observed the laws on land during the period of use (...).” The precise conditions under which LURs will be extended are not defined under the law or its implementation decrees, however, which creates significant uncertainty for investors.

LURs can be exchanged, assigned, leased, subleased, bequeathed, donated, mortgaged or used as capital contributions in investment projects. Not all of these transactions are allowed in all cases, however. It must be noted also that LURs are registered separately from the property developed on the land. As a result, fixed assets attached to the land can be mortgaged or used as guarantee separately, even in cases where the LURs cannot be mortgaged.

Foreign investors have two main options in order to secure land for investment projects:

- **Transact directly with the State:** LURs can be leased directly from the State for a maximum duration of 50 years. Foreign investors have the option to make either annual rent payments or a one-off payment for the entire term of the lease. Investors are allowed to assign, sublease or mortgage the LURs only under the one-off rent payment option. This option is particularly relevant for property or zones developers, and a number of FIEs have been active in developing export processing zones or industrial parks.

- **Transact with national or foreign organizations:** LURs can be subleased from national or foreign organizations, including zones developers. LURs have frequently been used as capital contributions by the local partner in joint ventures as well. Foreign investors are not allowed to sub-lease land from family households, individuals or communities.

Land use rents or the value of LURs are negotiated freely when foreign investors sublease land from national or foreign organizations or when LURs are used as capital contributions to an investment project. All transactions with the State – including for the payment of taxes and fees – are based on land prices as determined by decree. Investors leasing LURs from the State are charged an annual rent of 0.5 per cent of the land price. As of 2007, the land price for urban areas ranged from a maximum of 47,810 dong ($3) to a minimum of 15 dong ($0.01) per square meter. In addition, the Government provides land rent exemptions to certain types of projects (section C.2).

As evidenced in chapter I, the national and provincial authorities have established a large number of industrial parks, economic zones, high-tech parks and export processing zones throughout the county. Most of these are under public management, while a smaller number have been developed by private investors or under public–private partnerships. Parks and zones are clearly the most favoured locations for foreign investors, particularly in the manufacturing sector.

LURs in parks and zones appear quite secure, and there has been no major expropriation dispute involving foreign investors so far. The grounds for recovery of LURs by the State are quite wide, however, and include the following circumstances:

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69 The duration can be extended to 70 years in exceptional circumstances, including projects with large capital costs and slow recovery rate, or projects in specially difficult socio-economic regions.

70 Or up to 70 years in exceptional circumstances.
● The State needs the land for objectives of national defence and security, national interest, public interest or economic development purposes;

● The organization holding the LURs is dissolved or declared bankrupt;

● The land is used for the incorrect purpose or inefficiently;

● The land is being intentionally damaged.

The decree providing for implementation of the Law on Land provides a wide definition of permissible recovery of LURs for economic development, which includes (a) the development of zones and parks; (b) investments funded by official development assistance; (c) investments in special incentives sectors that cannot locate in zones or parks; and (d) 100 per cent foreign-invested projects that cannot locate in zones or parks.

These provisions are particularly favourable to (foreign) investors, at the expense of previous holders of LURs, in particular household businesses and individuals. The authorities should be particularly careful in implementing the land recovery provisions of the law and provide due protection and respect for the interest of holders of LURs. Failure to do so could create a backlash against foreign investors and zone developers. Particular attention should also be paid not to expropriate unnecessarily to develop large number of zones and parks. This is a genuine risk as provinces compete to develop such facilities to attract investors.

The recovery of LURs requires a notification period of 90 days for agricultural land and 180 days for non-agricultural land. Compensation must be paid for the residual value of the LURs and the residual value of the assets invested on the land. Residual values are established by an Evaluation Committee, based on Government-determined land prices and market value. Compensation can be monetary or take the form of allocation of new land for the same purpose. Holders of LURs are entitled to bring complaints about LURs issues to the Chair of the People’s Committee or to a People’s Court.

Viet Nam has a reasonably well established land cadastre. Provincial registries on land use and encumbrances are still paper-based, but the Government intends to computerize all registries by around 2011. It is currently negotiating support from the World Bank under an $80 million Land Administration Project and the initial phase, including cadastres for Hanoi and Ho Chi Minh City should start in 2008.

7. Environmental regulations

Environmental regulations were overhauled and enhanced under the 2005 Law on Protection of the Environment, which replaced Viet Nam’s first-ever environmental protection rules in 1993. The 2005 Law is quite progressive inasmuch as it seeks to promote environmentally-responsible behaviour from consumers and producers and as it takes account of regional and global issues such as global warming. As is often the case in Vietnamese laws, it is also quite detailed and comprehensive and it provides for – on paper at least – a significant level of environmental protection. In line with the decentralization of other regulatory issues relating to investment (section B), it also implements the principle of decentralization of functions to local authorities.

The 2005 Law establishes a number of general principles, including:

● The objective of sustainable development;\(^{71}\)

● Prevention;

\(^{71}\) The law adapts the definition of sustainable development as first put forward in the 1987 Brundtland Report, Our Common Future.
Polluter pays;
The promotion of environmentally friendly technologies;
The promotion of environmentally friendly consumer behaviour.

The principle of prevention is firmly entrenched in the law, which defines three levels of environmental assessments. At the government level, strategic environmental assessments must be formulated as part of all the strategies and Master Plans defined by the authorities at the national or provincial level. They are also required for all zoning decisions for land use.

At the investment level, environmental impact assessments (EIAs) are required for all projects that may have a significant environmental impact. A list of 102 such projects is defined by the implementation decrees. They range from telecommunications to power generation, textile, electronics or coffee processing. The content of EIAs is precisely defined by law and includes potential impact during construction and operation, as well as specific mitigation measures and contingency plans.

An environmental protection undertaking must be registered with the local authorities for all projects not subject to EIAs. The undertaking must provide basic information on the form and scale of the project, raw materials and fuel used, type of waste produced and planned measures to minimize and treat waste to comply with the law. This is a simple registration requirement that does not require authorization from the local authorities.

The authority to assess and approve EIAs used to be centralized under the State Environmental Protection Authority. Under the 2005 Law, that responsibility has been delegated to appraisal councils set up at various levels of government. Inter-industry and inter-provincial projects, as well as those that require approval by the National Assembly or the Prime Minister fall under the responsibility of the Ministry of Natural Resources and Environment (MONRE). Ministries and People’s Committees at the provincial levels are responsible for establishing appraisal committees for investment projects, the approval of which falls under their authority.

Appraisal councils under the responsibility of MONRE have 45 days to issue a decision, while those under the responsibility of other ministries or People’s Committees have only 30 days to do so. For a number of complex projects, these requirements are probably excessively short and could be lengthened. At the same time, however, the law does not stipulate mechanisms for investors to deal with cases where EIAs have been rejected. A clear appeal procedure should be considered.

In addition to the EIAs and environmental protection undertakings, the 2005 law defines specific environmental protection requirements in respect to a number of broad activities such as manufacturing, services, hospitals, transport, mining, tourism or agriculture. The requirements typically deal with waste collection and treatment, water and air pollution and toxic substances.\textsuperscript{72} The law also establishes an environment tax and an environment fee. The former applies to projects that exert a “long-term adverse impact” on the environment, while the latter applies to projects that have an “adverse impact” or discharge waste into the environment.

\textsuperscript{72} For example, manufacturers of batteries, electric equipment or tires are responsible for recovering expired and discarded products, similarly to what is being done in many OECD countries nowadays.
The 2005 law established strict penalties and fines for cases of breaches of environmental protection rules. Offenders are required to clean up, rehabilitate and pay compensation for losses incurred by third parties. In addition, heads of organizations may be liable for criminal charges in cases of serious environmental damage. Similar rules apply to public servants who abuse their position to cover up offences.

Viet Nam has adopted a strong and modern set of environmental regulations that should allow it to promote sustainable development. The decentralization of EIA appraisals will test the capacity of local authorities, however. It will thus be particularly important to ensure that the proper technical capacity is available at all levels in order to:

- Professionally assess EIAs in a timely way in order not to unduly delay or discourage investment projects and protect Viet Nam’s interest;
- Apply the law and regulations consistently across the country;
- Monitor compliance with environmental standards.

8. Governance and judiciary system

Issues of governance do not appear to be at the top of the list of investors’ concerns or to be an insurmountable impediment to investment. Yet, like many countries at a similar stage of development, Viet Nam continues to suffer from widespread corruption at various levels of Government and from low confidence in the fairness of the judicial system. Investors frequently report that various forms of petty corruption are commonly required to “ease processes”. Viet Nam ranked 123rd out of 179 countries on the Transparency International Corruption Perception Index 2007, far behind Thailand (84th), Malaysia (43rd) and China (72nd).

The Government has stepped up its efforts to tackle high-level corruption and to improve the quality of the court system. Viet Nam adopted the first Law on Anti-Corruption in 2005, which strengthened the provisions of the 1998 Ordinance on Anti-Corruption. One of the key aspects of the law is to require not only government officials to declare their assets, but also those of their close relatives. The law also establishes a National Anti-Corruption Steering Committee to coordinate the fight against corruption, which remains under the responsibility of a number of agencies, including the Government Inspectorate, the State Audit and the People’s Procurary.

Although the nature of corruption in Viet Nam has not been sufficiently investigated to provide a clear assessment of its impact on the economy, it does seem to be dominated by relatively low-level graft required to advance administrative procedures. Some of the agencies most often cited for issues of corruption include customs, land administration and the tax department.

The generally complex and heavy nature of administrative and investment licensing procedures means that there is structurally significant room for low-level corruption. In addition to its efforts to combat high-level corruption through “regular” channels, the Government should thus strive to eliminate purposeless or redundant administrative procedures, business licences or other authorizations (see previous sections). This would not only promote and facilitate investment, but would also reduce room for corruption.

Foreign investors have little trust in the fairness of the judicial system, and court procedures are lengthy. Until recently, arbitration was also not very popular among investors as there was no legal basis to compel the enforcement of arbitration awards. The Viet Nam International Arbitration Centre, which is
part of the Viet Nam Chamber of Commerce and Industry, reports relatively small numbers of arbitration cases with foreign investors between 1993 and 2005.\textsuperscript{73}

The scope for arbitration is likely to increase in the coming years, however, as Viet Nam adopted a much improved legal framework with the 2003 Ordinance on Arbitration. Arbitration is available for disputes relating to commercial activities\textsuperscript{74} between business entities. Recourse to arbitration may be agreed upon as a contractual clause or in a separate document, and it can also be agreed upon after a dispute. Courts may not accept jurisdiction over disputes that are expressly subject to a preliminary arbitration agreement.

The 2003 ordinance also significantly improved the provisions on arbitrators, who are selected with much more freedom by the disputing parties, without interference from the Ministry of Justice. Significantly, foreign citizens may arbitrate in Viet Nam if the dispute involves at least one foreign party and if the person is eligible to arbitrate in their country of origin. Foreign investors are also entitled to choose the substantive law used to resolve the dispute (Vietnamese or foreign law), to conduct the arbitration abroad, and to agree on the language to be used in the proceedings. Most importantly, the 2003 Ordinance provides for the enforcement of arbitration awards, which are final and binding.

9. Competition regulations

Viet Nam adopted a modern and comprehensive Law on Competition in 2004, and it has been working to make the framework operational since then, including by establishing regulatory institutions. The 2004 law represented a major breakthrough, as Viet Nam did not have a proper regulatory framework for competition until then, with only a few general provisions on illegal competition included in the 1997 Commercial Law.\textsuperscript{75} The challenge for Viet Nam is now to implement the new legal framework with strong, impartial and competent regulatory institutions and through education efforts among investors and consumers.

The Law on Competition has a comprehensive scope of application as it applies to all enterprises, including SOEs in competitive sectors and those operating as public monopolies. It also applies to all sectors, including those under the general supervision of sectoral bodies such as electricity, banking or telecommunications. In addition, it clearly specifies that the law on competition prevails over any provision on competition included in other laws.

Two main classes of prohibited practices are defined by law: (a) practices in restraint of competition; and (b) unfair competitive practices. Practices in restraint of competition are precisely and comprehensively defined in the law and its associated decrees. They are defined as follows:

- **Agreements in restraint of competition:** These include price fixing, market sharing, quantity controls, collusion in tenders, and agreement to prevent or impede the entry of new participants. Some of these agreements are prohibited in all circumstances, but others — including price fixing, market sharing and quantity controls — are illegal only if the parties to the agreement together control a minimum of 30 per cent of the relevant market.\textsuperscript{76}

\textsuperscript{73} An average of 21 cases were arbitrated annually between 2000 and 2005, as opposed to 17 between 1993 and 1999.

\textsuperscript{74} The ordinance defines commercial activities widely and in accordance with the UNCITRAL model law.

\textsuperscript{75} The 1997 Commercial Law was replaced by the 2005 Commercial Law, which does not cover competition issues.

\textsuperscript{76} The law provides a clear definition of the “relevant market”, which includes the relevant product market and the relevant geographical market. Methodologies to determine the latter two are defined in details in implementation decrees.
Abuse of dominant market position and monopoly position: A single company is deemed to be in a dominant market position if it controls 30 per cent of the relevant market. Groups of two, three or four companies are deemed in such a position if they control 50 per cent, 65 per cent and 75 per cent, respectively, of the relevant market. Prohibited practices include selling below cost, restraining production or distribution or applying different conditions to the same type of transactions.

Economic concentration: This includes mergers, acquisitions, consolidations and joint ventures. Transactions are prohibited if they lead to the control of a combined market share of more than 50 per cent of the relevant market, even though exemptions are possible. In addition, all transactions leading to a combined market share of 30 per cent to 50 per cent must be notified to the regulator before taking place. The regulator has 45 days to pronounce itself on the legality of the transaction.

A comprehensive list of prohibited unfair competitive practices is also provided in the law. It includes (a) infringement of business secrets; (b) discrimination by an association; (c) illegal multi-level selling; (d) defamation; and (e) coercion in business.

Viet Nam established a twin institutional system to enforce the Law on Competition with the creation in 2006 of the Viet Nam Competition Administration Department (VCAD) and the Viet Nam Competition Council (VCC). VCAD is mandated to assist the Minister of Trade in carrying out State administration of the competition, anti-dumping, anti-subsidy and consumer protection policies. It is part of the Ministry of Trade and has limited power of its own right. The main duties and powers of VCAD include:

- Investigate and deal with unfair competitive practices;
- Control the process of economic concentration;
- Conduct investigations concerning practices in restraint of competition in order for the VCC to deal with them;
- Establish a system of information on enterprises in a dominant market or monopolistic position.

All cases of practices in restraint of competition – with the exception of economic concentration – are handled by the VCC. In such instances, VCAD is charged to conduct investigations and to provide a full report to the VCC. The VCC consists of 11 members appointed directly by the Prime Minister for five-year terms. The current members are all serving officials of ministries, and include three Deputy Ministers. Appointees come, among others, from the Ministry of Trade, Ministry of Industry, Ministry of Transport, Ministry of Justice and Ministry of Planning and Investment. There is no legal requirement that members of the VCC be public officials, however.

Competition cases referred to the VCC are handled by ad hoc Competition Council Hearing Committees composed of five members from the VCC. All cases – whether they refer to practices in restraint of competition or unfair competition – are subject to a preliminary investigation from VCAD. It can either suspend the case or decide to conduct a full official investigation before arbitrating it or referring it the VCC. Cases can either be raised on VCAD’s own initiative or by any interested party.

77 Exemptions may be granted if one of the parties is at risk of going bankrupt or if the concentration can promote exports, or contribute to socio-economic development or technological progress.

78 The law stipulates that the VCC is composed of 11 to 15 members, and only 11 were appointed in 2006.

79 Raising a case with VCAD is subject to the advance payment of a fee of 10 million dong ($625) or 100 million dong ($6,250). Ultimately, the party which is concluded to be in breach of the Law on Competition must pay the entire fee for dealing with competition cases.
Parties to a competition case dealt with by VCAD may appeal the initial decision with the Minister of Trade, and ultimately in court. Appeals for cases dealt with by an ad hoc Competition Council Hearing Committee are made directly to the VCC and ultimately to court.

The law provides for significant sanctions for violations of competition regulations, which should be an efficient deterrent tool if properly enforced. Possible sanctions include:

- Warnings;
- Revocation of business registration certificates;
- Remedial measures, including enterprise restructuring or division, sale of assets or removing provisions from business contracts;
- Monetary fines for practices in restraint of competition, which are typically set at 0-5 per cent or 5-10 per cent of total revenue in the financial year prior to the year in which the breach was committed, depending on the type of breach;
- Monetary fines for unfair competition, which vary between 5 million dong ($312) and 100 million dong ($6,250).

The adoption of the Law on Competition and its implementation Decrees in 2004 and 2006 has put in place a modern and potentially effective tool to promote sound competition in Viet Nam. Insufficient time has elapsed to assess the impact of the law and the effectiveness of the institutional mechanism established to enforce it. Given that the competition framework is sound on paper, Viet Nam will need to concentrate its efforts in the coming years on building capacity at VCAD and the VCC, establishing their credibility as independent regulators, and educating the public – particularly SOEs and private companies.

A number of measures are recommended to achieve these goals:

- Appoint four recognized independent competition experts from outside Government to the VCC;
- Replace Ministry appointees at the VCC with independent competition experts when their first term comes to an end;
- Increase the number of staff at VCAD and pursue further capacity-building with donors support.

Although it may be premature, Viet Nam should also consider making VCAD a fully independent competition authority with its own enforcement powers, as is being done in most OECD countries. This is likely to be the only measure susceptible to make private investors confident that competition rules will be enforced fairly and equally on SOEs as well as on other investors.

There is an inherent incompatibility in keeping competition regulatory oversight under the same roof – the Ministry of Trade and other Ministries through their appointees in the VCC – as direct ownership of SOEs (many of which are still under the responsibility of line Ministries). This incompatibility should eventually be resolved by making VCAD and the VCC independent, and by removing direct ownership of SOEs from line Ministries (section C.12).

### 10. Intellectual property law

The legal and regulatory framework for intellectual property rights (IPRs) was overhauled and greatly improved in preparation for WTO accession, but enforcement remains extremely weak and infringements are widespread. The International Intellectual Property Alliance – a coalition of private United States
companies – estimates that piracy levels for business software were as high as 88 per cent in 2006, down from 95 per cent in 2002. Sales of pirated CDs, DVDs and books are also widespread and overt in all major cities. Yet the issue of IPRs and their enforcement is becoming an increasingly important element of Viet Nam’s investment environment as it seeks to attract FDI in IP-sensitive sectors.

Viet Nam appears committed to improve its IPRs framework, however. The Government took highly symbolic steps in 2006 to ensure that its agencies use legitimate software. Most importantly, it adopted the first Law on Intellectual Property in 2005. The Law is comprehensive in coverage and raises the legal IP framework to modern standards. It also consolidates IP-related provisions that were previously scattered in numerous legal documents. While some issues – mostly related to enforcement – continue to be dealt with in the civil and criminal codes, all essential IP matters are covered in the Law on Intellectual Property, and the latter applies if there are differences between its provisions on intellectual property and those of other laws.

The adoption of the Law on Intellectual Property was necessary in order to make Viet Nam compliant with the WTO’s TRIPS agreement, to which it is party. It was also needed for Viet Nam to fulfill its commitments under the bilateral trade agreement with the United States. The law provides international standards of protection, as well as the traditional limitations on IPRs:

- **Copyright and copyright related rights** protect literary, artistic and scientific works, including music, motion pictures, photography, books, stage works, computer programmes, lectures or textbooks. Moral rights are protected for an indefinite term, while economic rights are protected for 50 years from publication, or for the whole life of the author plus 50 years after his/her death. Copyrights and related rights may be assigned or licensed freely and conducts constituting infringements are clearly defined by law.

- **Industrial property rights** cover inventions, industrial designs, layout designs of integrated circuits, marks, trade names, geographical indications and trade secrets. Patents are delivered by the National Office of Intellectual Property (NOIP), pending the usual requirements of novelty, inventiveness, susceptibility to industrial application, commercial novelty, not being common knowledge or distinctiveness. Precise definitions of each of these requirements are provided in associated Decrees. Viet Nam usually applies the “first to file” principle, but priority can be invoked in a certain number of cases. Invention patents are granted for 20 years, utility solution patents for 10 years, industrial design patents for 5 years (renewable twice), and registered designs for semi-conducting closed circuits are valid for 10 to 15 years. Registered trade marks are valid for 10 years but renewable indefinitely.

- **Plant varieties** may also be registered for protection on the condition that they are new, distinct, uniform, stable and designated by proper denominations. Viet Nam became a member of the International Union for the Protection of New Varieties of Plants at the end of 2006.

The law imposes two general limitations on IPRs: (a) the exercise of intellectual property rights must not infringe the interests of the State, the public interest or the legitimate rights and interests of other organizations and individuals; and (b) the State may prohibit or restrict the exercise of IPRs, or compel the holder to license to other organizations or individuals on appropriate terms for reasons of national defence, security, the people’s livelihood and other interests of the State and society.
Compulsory licensing of inventions is possible in four circumstances:

- The invention is used for public and non-commercial purposes or in the service of national defence, security, disease prevention and treatment or other urgent needs of society;
- The holder of the exclusive right fails to fulfill the obligation to use certain specified inventions within four years from application for registration or three years from granting of the patent;
- The holder of the exclusive rights fails to reach a licensing agreement with an interested party despite efforts made within a reasonable time for negotiating satisfactory commercial price and conditions;
- The holder of the exclusive rights engages in illegal anti-competitive practices.

In turn, the State must comply with a number of conditions when it requires compulsory licensing: (a) the licensed use right must be non-exclusive; (b) the licensed use right is limited in scope and duration, and mostly for the domestic market; (c) the licensee must neither assign nor sub-license the right to others; and (d) the licensee must pay satisfactory compensation to the holder of the exclusive right.

As mentioned above, enforcement is extremely weak and is the main problem in a modernized IP framework. The Law on Intellectual Property nevertheless provides a number of tools for the authorities to deal with infringements and to protect IPRs:

- **Administrative measures** can be applied in four main situations, including acts that cause loss or damage to consumers and production, import, transport or trading in counterfeit goods. Administrative measures are the most practical for IPR holders, but they do not provide significant compensation. Sanctions can include a warning, fine, confiscation and destruction of counterfeit goods or suspension of business activity. They can be imposed by inspectorates, market management offices, customs offices, police offices and People’s Committees.
- **Civil remedies** include compulsory termination of the infringing acts, payment of damage for loss, compulsory destruction of goods and public apology and rectification. Losses are defined as both material and moral, and the extent of the compensation is determined on the basis of actual losses suffered. The plaintiff may request damages to be assessed either on the basis of total amount of money plus profit derived by the defendant or on the basis of the would-be price of the licensing of the intellectual property right. Moral losses are capped at 50 million dong ($3,125). Very few disputes have been brought to civil courts so far as the process is very long and plaintiffs feel that compensation awards do not reflect actual losses incurred.\(^{80}\)
- **Criminal procedures** are regulated under the Criminal Procedure Code. They are applicable to cases involving manufacturing and/or trading of counterfeit goods in significant quantities or values.

Viet Nam has been a member of the World Intellectual Property Organization (WIPO) since 1976. It is a contracting party in 8 of WIPO-related treaties or conventions, including the Berne, Brussels and Paris Conventions, the Madrid Protocol and the Patent Cooperation Treaty. It joined 5 of these agreements after 2004.

The recent legislative changes have significantly improved Viet Nam’s legal framework for intellectual property protection.

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\(^{80}\) A Vietnamese judge reported at a workshop organized in 2005 by the United States–Viet Nam Trade Council that only 12 cases on copyright and 10 cases on industrial property rights had been filed in civil court between 2000 and 2005. A trademark infringement dispute was discussed. The plaintiff was awarded – after a four-year procedure – $182 in compensation for damage to reputation (against a petition by the plaintiff for $15,000), and $136 for legal fees (against a duly justified request for $18,000).
property, on paper at least, and brought it mostly in compliance with its international obligations. Significant efforts are required to translate the legal framework from paper to practice, however. A number of concrete measures could be considered by the Government, which would give investors more confidence that their IPRs will be respected and enforced. This will be particularly important if Viet Nam wishes to attract FDI in industries that are IPR-sensitive or with high technology content, and in a number of services sectors. It is recommended to:

- Provide training to judges, including to help them properly assess reasonable compensation for material losses.
- Put in place the legal underpinnings for the effective criminalization of infringements of copyrights on a commercial scale and enforce them. Viet Nam is committed to do so under the bilateral trade agreement with the United States, and it is also a TRIPS requirement.
- Mandate the NOIP or another administrative body to lead the enforcement of IPRs through administrative procedures. Administrative procedures are currently handled by a number of agencies. Although it will not be possible to bring all enforcement functions under one roof, one agency should be clearly and visibly identified as the leader and coordinator of administrative enforcement.
- Give stronger powers of seizure, forfeiture and destruction to IP enforcement agencies;
- Increase the maximum authorized levels of administrative fines.
- Join some of the important WIPO-related agreements that Viet Nam is still not party to, including the Patent Law Treaty, the Washington Treaty, the WIPO Copyright Treaty and the Hague Agreement.81

11. Transfers of technology

Viet Nam adopted a Law on Technology Transfer in 2006 to regulate transfers between Viet Nam and the rest of the world, as well as transfers within Viet Nam. The main purposes of the law are to promote a number of types of technology transfers, restrict or prohibit some and provide a general framework for technology transfer contracts and dispute resolutions.

“Encouraged” transfers of technology include those that (a) create new and highly competitive products; (b) create new industries or services; (c) save energy or raw materials; and (d) protect human health, among others. “Restricted” transfers of technology must be authorized by the State if they aim to protect (a) the national interest; (b) human health; (c) national cultural values; and (d) animals and plants, natural resources and the environment. “Prohibited” transfers of technology include those that (a) fail to satisfy the requirements on safety, labour hygiene and human and environmental protection; (b) cause harm to socio-economic development; (c) are contrary to international treaties; and (d) constitute State secrets.

In the absence of a decree of implementation, which remains to be drafted, it is difficult to assess the extent and precise nature of these restrictions and prohibitions. It is important for the Government to rapidly issue a decree to provide detailed regulations and guidelines on this and other issues. Restricted and prohibited transfers of technology should be precisely and narrowly defined so as not to discourage other transfers. The new decree should also replace Decree 11-2005 on Technology Transfer, which is still in force but contains many provisions that contradict the new Law.

81 The detailed content of these agreements can be found at www.wipo.int/treaties/en.
The 2006 Law on Technology allows private contracting parties to freely negotiate the terms and conditions of the technology transfer. Registration of technology transfer contracts is optional (except as mentioned above for “restricted” cases), but it is required in order to enjoy the fiscal incentives provided by Law. These incentives include:

- Income tax exemption for an entity contributing capital by an invention patent or technology licence;
- Import duty and VAT exemptions on goods imported for direct use in scientific and technological development;
- Income tax exemption and a 50 per cent reduction on corporate income tax for up to 9 years for investments in technological fields.

12. Selected sectoral regulations

a. Electricity

The legal and regulatory framework for the electricity sector is being fundamentally overhauled under the 2004 Law on Electricity. The purpose is to move from the current vertically integrated public-sector dominated structure to a competitive electricity market. The law and the sector as a whole are discussed in details in chapter IV of this review.

b. Telecommunications

The telecommunications sector has developed extremely rapidly over the past few years. Tele-density rates increased from 9 per cent at the end of 2003 to 45 per cent in June 2007, with the number of subscribers of fixed and mobile phones booming from 7.2 million to 38 million in the same period. The sector remains essentially controlled by SOEs, however, and Viet Nam still lags behind some of its regional competitors in terms of quality, cost and diversity of services (table II.6). FDI into the telecommunications sector is severely restricted, even though Viet Nam recently made concessions in terms of access as part of its commitments with WTO. A higher degree of liberalization would be beneficial to Viet Nam’s telecommunications service users – and to its economy as a whole – and could attract significant levels of FDI.

The 2002 Ordinance on Posts and Telecommunications dismantled the monopoly of Viet Nam Posts and Telecommunications (VNPT) over the telecommunication network infrastructure. At the same time, however, the ordinance established a distinction between network infrastructure providers and telecommunications services providers.

Network infrastructure providers are facilities-based operators with a full licence to build and operate telecommunication equipment. The ordinance stipulates that they must be SOEs or enterprises in which the State holds controlling shares or special shares. Telecommunications services providers, in turn, are non facilities-based operators in the sense that they cannot own or build their own transmission capacity but are allowed to contract with facilities-based operators on a long-term basis in order to offer telecommunication services to their own clients.

The facilities-based vs. non-facilities-based distinction forms the basis of Viet Nam’s commitments under WTO to liberalize its telecommunications market. As of accession, foreign investors are allowed to own up to 51 per cent of the legal capital of joint ventures with non facilities-based operators, a share that is to increase to 65 per cent by 2010. Foreign ownership of facilities-based operators, in turn, is capped at 49 per cent as of accession and Viet Nam is not committed to increase that threshold.
Table II.6. Telecommunications costs
(Dollar per minute)

<table>
<thead>
<tr>
<th>Country (Operator)</th>
<th>Mobile-mobile</th>
<th>Fixed-United States</th>
<th>Fixed-Japan</th>
<th>Fixed-United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Viet Nam (VNPT)</td>
<td>0.11</td>
<td>0.78</td>
<td>0.78</td>
<td>0.78</td>
</tr>
<tr>
<td>China (China Telecom)</td>
<td>0.07</td>
<td>2.0</td>
<td>1.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Malaysia (Digi)</td>
<td>0.14</td>
<td>0.26</td>
<td>0.53</td>
<td>0.26</td>
</tr>
<tr>
<td>Singapore (Singtel)</td>
<td>0.1</td>
<td>0.026</td>
<td>0.6</td>
<td>0.04</td>
</tr>
<tr>
<td>Thailand (True)</td>
<td>0.05</td>
<td>0.3</td>
<td>0.6</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Source: Company websites.

The 2002 ordinance did not establish an independent telecommunications regulator, and the supervisory functions – including licensing – are under the responsibility of the Ministry of Posts and Telematics, which also has direct ownership of VNPT. VNPT remains the largest player in the telecommunications market, but a number of SOEs have been granted full telecom licences in the past few years. This has introduced some competition in the sector and there are currently a number of significant players in fixed line, mobile phone, international gateway, internet services providers (ISPs) and internet exchange providers. The three main players are VNPT, EVN Telecom (owned by Electricity of Viet Nam) and Viettel (owned by the Ministry of Defence), with smaller regional companies (Saigon Post and Telecommunications, Hanoi Telecom) and a number of ISPs.

The Government seems determined to keep control of facilities-based operators and it has no further long-term commitments under WTO than allowing a 49 per cent ownership by foreign investors in duly licensed operators. The potential for FDI in the telecommunications sector is large, however, as are the potential benefits in terms of increased competition, cost and quality of services. Restricting the involvement of foreign investors to non-controlling joint venture agreements with SOEs and to non-facilities based services means that the potential benefits are unlikely to materialize, however.

It is recommended that Viet Nam reconsider these restrictions in the medium term and that majority foreign ownership be allowed in at least one facilities-based operator in the short term. As is the case in a number of other regulated sectors, Viet Nam should also separate ownership of assets from regulatory functions. This would imply transferring the ownership of SOEs to the State Capital Investment Corporation (SCIC), whether they are expected to be equitized or not (section C.13).

13. Equitization of State-owned enterprises

Viet Nam started reforming its SOEs under the Doi Moi in 1986, but the process is far from complete and SOEs continue to play a prominent role in the economy. The reform process has involved a number of steps, including consolidation, liquidation and sale. A big step was also accomplished under the 2005 Law on Enterprise, which requires SOEs to operate under a unified legal and regulatory framework for all business entities. Yet, the ubiquity of SOEs and the blurred distinction between the ownership and regulatory functions of the State mean that much remains to be done to put the private sector on a level competitive field with the public sector and to achieve the Government’s vision of a private sector-led economy with sound, well governed and efficient SOEs in strategic sectors.

The SOE sector accounted for 40 per cent of GDP in 2006, similar to the level a decade earlier. There is no comprehensive list of SOEs, however, and sources differ on their number and on how many have been affected by the reform process. It is generally estimated that there were around 12,000 SOEs in...
1990. The General Statistics Office reports that there were 3,720 SOEs in 2006, down from 5,759 in 2000. These enterprises had 1.91 million employees, compared with 6.72 million formal jobs in the economy as a whole (table II.7).

SOEs operate across all sectors of the economy, and many of them are small enterprises under the ownership of local authorities. The majority of large companies in Viet Nam are also SOEs, however. There were 400 SOEs with more than 1,000 employees in 2006, as opposed to only 249 national private companies.82

### Table II.7. SOE indicators

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of SOEs</td>
<td>4597</td>
<td>4086</td>
<td>3720</td>
</tr>
<tr>
<td>Share in total GDP</td>
<td>41.1</td>
<td>40.7</td>
<td>40.0</td>
</tr>
<tr>
<td>Number of employees</td>
<td>2 250 372</td>
<td>2 037 660</td>
<td>1 906 994</td>
</tr>
<tr>
<td>(percentage of total in the economy)</td>
<td>39.0</td>
<td>32.7</td>
<td>28.4</td>
</tr>
<tr>
<td>Number of SOEs with 1-49 employees</td>
<td>753</td>
<td>721</td>
<td>704</td>
</tr>
<tr>
<td>(Private companies with 1-49 employees)</td>
<td>(75 018)</td>
<td>(94656)</td>
<td>(1 11881)</td>
</tr>
<tr>
<td>Number of SOEs with 50-199 employees</td>
<td>1688</td>
<td>1507</td>
<td>1362</td>
</tr>
<tr>
<td>(Private companies with 50-199 employees)</td>
<td>(7079)</td>
<td>(8254)</td>
<td>(8977)</td>
</tr>
<tr>
<td>Number of SOEs with 200-999 employees</td>
<td>1702</td>
<td>1431</td>
<td>1254</td>
</tr>
<tr>
<td>(Private companies with 200-999 employees)</td>
<td>(1740)</td>
<td>(2048)</td>
<td>(2285)</td>
</tr>
<tr>
<td>Number of SOEs with 1000+ employees</td>
<td>454</td>
<td>427</td>
<td>400</td>
</tr>
<tr>
<td>(Private companies with 1000+ employees)</td>
<td>(166)</td>
<td>(209)</td>
<td>(249)</td>
</tr>
</tbody>
</table>

1 Excluding FIEs and joint ventures with foreign partners.

Source: General Statistics Office.

The Government started the SOE reform process in 1986, when it introduced profit-based accounting and replaced output targets with profit targets, while at the same time encouraging national private investment and progressively opening the economy to foreign investors. The equitization process, which consists of transforming SOEs into shareholding companies and selling part or all of the capital to employees and/or private investors, was initiated in 1991. A significant number of small SOEs were liquidated or consolidated at first. New equitization decrees were issued in 1996, 1998, 2002, 2004 and 2007 to reflect the Government’s evolving thinking on the process.

Under Decree 109-2007, foreign investors are explicitly allowed to participate in the equitization process. They are put on an equal footing with national investors, but they remain subject to the provisions of other laws that may restrict their participation in the process, such as ceilings on capital ownership and others. A certain proportion of shares may also be reserved to the employees of the equitized enterprises at a discount. Three methods of sales are allowed: public auction, underwriting and direct agreement. Direct agreement is to be used only when part of the capital is sold to strategic investors after the public auction. Strategic investors can be either Vietnamese or foreign and must have financial and enterprise management capability, know-how and long-term interests closely connected with the enterprise.

The transformation of SOEs into shareholding companies and the sale of assets have experienced ups and downs over the past 15 years. As of mid-2007, the sale of assets has been mostly limited to

82 This excludes FIEs and joint ventures.
SMEs and to minority stakes in larger SOEs. The 2004 Decree on Conversion of SOEs into Shareholding Companies stipulates that equitization will apply to all companies for which the State does not need to maintain 100 per cent ownership on account of their strategic nature. It also defines the valuation methods of enterprises and allows the sale of a percentage of shares on preferential terms to employees or a strategic investor.

The list of SOEs that should remain under full public ownership has evolved over time. A Prime Ministerial Decision in 2007 defines a list of 19 sectors in which existing SOEs will remain under 100 per cent Government ownership. This includes:

- Explosives, toxic chemicals, weapons and ammunition;
- Electricity transmission and large-scale electricity production with special socio-economic importance;
- Management and operation of national and urban railways, airports and large-scale seaports;
- Radio, television, publishing and press;
- Credit institutions serving socio-economic development.

In addition, the Decision defines a list of 27 sectors in which the State will continue to hold more than 50 per cent of the capital of SOEs, including:

- Maintenance of the national railway system;
- Management and operations of seaports (other than large-scale);
- Electricity production with output capacity of 100 megawatts (MW) or more;
- Mining of various minerals, petroleum and natural gas;
- Supply of ICT network infrastructure;
- Wholesale of food;
- Currency trading;
- Insurance.

In addition to its policy of transforming a large number of SOEs into shareholding companies, the Government unified the legal framework for all enterprises – regardless of ownership – under the 2005 Law on Enterprises (section C.1). SOEs, which were subject to the Law on State-Owned Enterprises until then, have been given a maximum period of four years to convert to a form under the 2005 Law on Enterprises. The majority of SOEs will be converted into shareholding companies, while those that will remain under full government ownership will be converted into one-member limited liability companies.

Until recently, all SOEs were under the direct ownership of line ministries or local authorities. The Government seems to be aware of the problem of conflict of interest that this conjunction of ownership and regulatory power generate. Article 168 of the 2005 Law on Enterprises stipulates that the State shall exercise its ownership of SOEs on the principle of “separating the function of exercise of owner’s rights from the function of State administrative management”.

The State Capital Investment Corporation (SCIC) was created in June 2005 with the mission to “manage, invest and trade in state capital”. The stated objective is to create a distinct separation between regulatory and ownership functions, give complete business autonomy and remove all State subsidies and

83 Until 1 July 2010, i.e. four years after the Law on Enterprises became effective.
preferential capital grants to SOEs. In principle, SCIC should act as the State representative of ownership in all SOEs. Its other objectives are to speed up SOE reforms and improve management in companies in its portfolio, and to prepare SOEs for equitization.

In practice, however, State ownership in only 805 companies had been transferred to SCIC by end-2007, sometimes even only partly. In addition, none of the very large SOEs have been transferred so far. Much remains to be done to separate ownership and regulatory functions, let alone to set up a proper ring-fence between the two aspects.

Viet Nam has come a long way in its efforts to establish a market economy with proper regulatory mechanisms and to level the playing field between the different types of investors. Yet, the size and significance of SOEs – including in purely commercial activities – associated with the continued blur between regulatory and ownership functions are one of the most important issues Viet Nam needs to address in the short and medium term.

In addition, the policy and attitude that the Government will adopt as SOEs come under increasing competitive pressure from FIEs and emerging Vietnamese private enterprises will be key determinants of the investment climate in the near future. A significant number of SOEs are likely to face bankruptcy when confronted with hard budget constraints (i.e. when they are cut off from State subsidies and no longer have access to loans from State-owned commercial terms on special terms) and competition from the private sector. Although the speed at which this is likely to happen is very uncertain, Viet Nam needs to have a strong mechanism in place to allow an orderly work out of bankruptcies and the settlement of bad debts. This mechanism needs to be applicable to SOEs.

The extent to which Viet Nam wishes to preserve State ownership in key companies and sectors is a matter of sovereign policy choice. This review nevertheless stresses that significant benefits could be derived from allowing private – domestic and foreign – investors to take over the ownership and management of a larger number of SOEs – including some of the larger ones, particularly in purely commercial activities. It also stresses that a properly level playing field will require a strong ring-fencing between ownership and regulation, which is absent at the moment. It is thus recommended to:

- Establish and publish a comprehensive census of all SOEs, and conduct a full audit of assets and liabilities.
- Transfer ownership of all SOEs to SCIC, if not at once, at least under a clearly defined timetable. This should include EVN, PetroVietnam, VNPT, State-owned commercial banks and other large groups.
- Mandate SCIC to enforce hard-budget constraints on SOEs and put in place a transparent system of State subsidies to SOEs where these remain necessary.
- Provide clear guidelines to SCIC for the appointment of SOEs Board Members, and grant operational autonomy to SOEs managers, subject to reporting and transparency requirements as per the Law on Enterprises.
- Draw up a list of SOEs operating in purely commercial and non-strategic activities and equitize them fully or at least for 65 per cent of capital to give management control to private investors. In a number of cases, strategic investors should be attracted, allowing them to gain full management control of the assets.
- Narrow down the list of SOEs in which the State will maintain 100 and 50 per cent ownership to companies operating in genuinely strategic or socially sensitive sectors.
14. International trade and economic agreements

Viet Nam’s accession to the Association of South East Asian Nations (ASEAN) and the ASEAN Free Trade Area (AFTA) in 1995 marked its re-entry into the multilateral trade agreements arena. Under AFTA, Viet Nam was committed to reduce its tariffs on imports from ASEAN countries to 0 to 5 per cent by 2006 (box II.3). The second breakthrough was the ratification of the United States–Viet Nam Bilateral Trade Agreement in 2001. The agreement covered not only trade in goods, but also trade in services, IPRs and other investment-related issues. It committed Viet Nam to a number of trade-related reforms,

Box II.3. International cooperation under the ASEAN agreement

The Bangkok Declaration of 1967 gives a twin goal to ASEAN: (a) accelerate economic growth, social progress and cultural development in the region; and (b) promote regional peace and stability. In 2003, ASEAN leaders instituted three pillars of cooperation: (a) the ASEAN Economic Community; (b) the ASEAN Socio-Cultural Community; and (c) the ASEAN Security Community.

The ASEAN Economic Community seeks to establish a single market and production area by 2020, based on free trade in goods and services, free flows of direct investment and freer flow of capital. A number of mechanisms have been put in place in order to achieve that goal, including:

- AFTA: Launched in 1992, AFTA seeks the elimination of tariff and non-tariff barriers among ASEAN countries. This has not yet been achieved, even though intra-ASEAN trade is subject to a common effective preferential tariff – applicable to goods that meet a 40 per cent ASEAN content requirement – 0 to 5 per cent in most instances. Certain goods on a General Exception List and Highly Sensitive List are excluded from the tariff elimination schedule, however.
- The ASEAN Framework Agreement on Services (AFAS): Signed in 1995, AFAS seeks to reduce the restrictions on trade in services among member countries. It also seeks to put in place mutual recognition arrangements for the qualifications of professionals.
- The ASEAN Agreement for the Promotion and Protection of Investments: Signed in 1987, the agreement provides for MFN treatment, protects against arbitrary expropriation or nationalization, guarantees repatriation of capital and earnings, and gives access to international arbitration under UNCITRAL and ICSID.
- The ASEAN Investment Area (AIA): signed in 1998, the AIA seeks to put in place a coordinated approach to FDI promotion and facilitation. Most importantly, it calls for ASEAN members to open up all industries to FDI originating from within the group by 2010, with some exceptions specified in a temporary exclusion list, a sensitive list and a general exclusion list. It also calls for full national treatment for ASEAN investors by 2010 in the industrial sector.
- Measures to facilitate the movement of business people and skilled workers.
- Cooperation on customs issues (valuation, electronic processing, harmonized nomenclature).
- Institutional framework for the protection of intellectual property rights.
- Harmonized standards of quality with the purpose of putting in place a “one standard, one test, accepted everywhere” policy.

Source: ASEAN website.
while the United States granted MFN status to Vietnamese imports, which soared as a result of greater market access and lower duties (chapter I, box I.3).

The full integration of Viet Nam in the multilateral trade system was finalized with the accession to WTO on 11 January 2007, 12 years after application. Viet Nam is now party to all the major WTO agreements, including GATS, TRIPS and TRIMS. Under the bilateral negotiations, however, Viet Nam had to concede to be treated as a non-market economy for up to 12 years after accession. The non-market economy status means that the methodology used to assess whether Viet Nam is engaged in dumping practices is based on the surrogate market principle rather than on the general rules and standards of the WTO Agreement on Anti-Dumping.

The surrogate market methodology can be particularly disadvantageous to the country subject to anti-dumping investigation, and the Vietnamese authorities are keen to be recognized as a market economy as quickly as possible. A number of countries have done so already – including China, South Africa and the Republic of Korea – but the European Union and the United States continue to treat Viet Nam as a non-market economy. Although a methodology to assess status has been developed, the decision to grant market economy status is eminently political. It is not the purpose of this review to evaluate whether Viet Nam should qualify as a market economy under that methodology. As the analysis throughout this chapter shows, however, it is evident that Viet Nam has made enormous progress in the past decade to modernize its investment framework and build the legislation and institutions of a market economy, even if the approach to certain policies continues to be influenced by practices that the Government is now leaving behind.

**D. Assessment and recommendations**

Viet Nam has achieved vast reforms to improve its legal and regulatory framework for investment over the past two decades. This has allowed it to formally seal its integration into the world economy by joining WTO in 2007. The continuous process of reforms and the perspectives it opened to foreign investors have also allowed Viet Nam to attract significant levels of FDI in the past two decades despite relatively restrictive entry conditions and a heavy administrative burden imposed on investors. As a result, Viet Nam has also succeeded in deriving important benefits from the involvement of foreign investors in its economic development (chapter I).

Twenty years on, the accession to the WTO in 2007 represents a landmark in Viet Nam’s economic development that is likely to be as important as Doi Moi in 1986. The reforms required to join WTO have put Viet Nam firmly on the track towards developing a full-fledged market economy. They have also resulted in a significantly improved investment environment and a further opening of the economy to foreign investors. This will make Viet Nam even more attractive to foreign investors and increase the potential developmental benefits of increased FDI flows.

The reforms to the legal and regulatory framework for investment are not complete, however, and Viet Nam – as any other country – should continuously seek improvements to its framework, taking inspiration from what works elsewhere in similar circumstances. In addition, many of the recent reforms need to be “absorbed” and put into practice. Some important elements of the framework should also be adapted in order for Viet Nam to realize its full potential of FDI attraction and gain the full developmental benefits of FDI. This review recommends six mains axes of further reforms to the legal and regulatory framework for investment.
1. **Move from “steer and control” to “regulate, monitor and enforce”**

Investment policy and regulations continue to reflect a “steer and control” approach, in spite of the recent changes to the investment and enterprise laws. The authorities still see their role as one of steering private investments where they see the most need, as illustrated in the preparation of comprehensive “lists of projects calling for investment” by most provinces and in the numerous national and provincial Master Plans. The desire to control tightly what investors are allowed to do is also prevalent, as illustrated in the heavily regulated investment certification system.

As Viet Nam further develops as a market economy, this “steer and control” approach should be replaced with a “regulate, monitor and enforce” policy stance. This should be based on the presumption that investors – the market – are best informed of valuable business opportunities, and that the role of the Government is to (a) set rules (regulations) in order to protect the people and the national interest; (b) monitor whether market participants obey these rules; and (c) enforce the rules. This philosophy of economic policy is at the basis of a market economy, and does not preclude a strong role for the State, including protecting the national and consumers’ interests.

The implementation of such an approach would require fundamental changes in the Law on Investment and the current certification system, which are described in details in section B.4. Some of the concrete reforms recommended under a “Doi Moi 2” in investment policy are to:

- Unleash (foreign) investors to promote innovation and growth: investors should not be straight-jacketed by rigid investment certificates, but should be given sufficient flexibility to adapt and respond to new business conditions and opportunities, both in terms of expanding and diversifying production.
- Draw up and maintain a full list of FDI entry restrictions: FDI entry restrictions should be clarified and precisely defined in order that they be enforced transparently and in a predictable and non-arbitrary manner.
- Restrict foreign investment registration and certification procedures to an FDI entry compliance check.
- Subject all investors to a common system of regulatory oversight.
- Refocus investment promotion agencies on promotion, facilitation and aftercare instead of administration of certification and control.

As the shift to “regulate, monitor and enforce” from “steer and control” is likely to take time, this Review recommends that a number of measures be taken in the short term in order to make the current framework operate as well as possible. This would include measures to:

- Clarify the list of FDI entry restrictions;
- Establish full one-stop shop services and strengthen the facilitation and aftercare departments of investment promotion agencies;
- Ensure consistency in regulatory oversight across provinces;
- Remove the time limit from investment certificates.

The shift in approach should be reflected not only in the Law on Investment, but in other legal documents that affect business operations. This includes, in particular, sectoral laws and tax laws.
2. **Allow the realization of the FDI potential in key sectors, promote new and dynamic FDI**

Viet Nam will open a number of services sectors to FDI as a result of its WTO commitments. In addition to these, the country would gain from lifting some restrictions or limitations on FDI entry in the near future. In particular, the Government should consider further opening the following sectors: (a) telecommunications; (b) electricity; (c) transport; and (d) higher education. It should also consider allowing a greater participation of foreign investors in the equitization of SOEs, including large ones.

There is great potential for beneficial FDI in all of these sectors, and foreign investors are in a position to make significant contributions to the development of higher-quality backbone infrastructure (e.g. telecommunications and electricity) and to the development of skills (education). Attracting foreign investors in these sectors, however, will require coherent and properly planned strategies of market liberalization. Similarly to the policy of gradually opening to FDI applied in the past two decades, a gradual approach could be adopted to ensure that the benefits of opening to FDI are maximized, while the potential costs or disruptions are avoided or minimized. At the request of the Government, chapter III of this review proposes a strategy of FDI attraction in electricity. It is recommended that similar strategies and “policy packages” be prepared for telecommunications, transport and higher education.

Keeping up with the rising demand for core infrastructure services is a necessity to sustain the rapid pace of economic development of the past two decades. Increasing the quality of services in telecommunications, electricity and transport, and further raising the skills level of the labour force would also better position Viet Nam to attract FDI in new and dynamic sectors. Although it is not the mandate of this review to propose an overall FDI strategy, it is suggested that Viet Nam should start elaborating and putting in place a broadened strategy of FDI promotion and attraction. Such a strategy would no longer focus mostly on FDI in export-oriented manufacturing activities, but would be broadened to FDI in new and dynamic sectors, including in services. It would also seek to enhance the role of Viet Nam as a logistics centre in the Greater Mekong subregion and as a business hub for TNCs operations in the ASEAN area.

3. **Facilitate the entry of skills needed by a rapidly evolving economy**

One of Viet Nam’s key assets in attracting foreign investors is its relatively low labour costs, combined with a productive, industrious and trainable workforce. This has allowed the country to attract a large number of foreign investors in labour-intensive sectors that require either relatively low skills (textile and garments) or intermediate skills (consumer electronics and basic manufactured goods). More recently, Viet Nam has also sought – and succeeded – to attract foreign investors in need of more highly skilled workers, although on a much more limited scale.

As it continues to develop, Viet Nam will require more and more skilled workers in a wide variety of fields. While education policy will underpin the development of such skills, Viet Nam would greatly benefit from setting up a proactive immigration policy to facilitate the entry of foreign skills that are in short supply but needed by its economy. Such a policy would seek to achieve the twin purpose of selectively attracting skills in short supply locally and to promote skills transfer, thereby complementing the education-based skills development policy. It would replace the current restrictive regime of entry of foreign workers and would be articulated along the following principles:
Conduct a comprehensive skills and labour market audit and update it on a regular basis.

Establish a migration occupations in demand list (MODL) on the basis of the skills and labour market audit. The MODL would identify a detailed list of specific occupations where there are insufficient workers in Viet Nam at the level of qualification required by employers. The MODL should be forward looking in assessing the needs of the labour market and updated regularly.

Facilitate and promote the entry of foreign workers who possess qualification on the MODL. This would require policy initiatives to allow the entry of workers, as well as administrative measures to facilitate processes.

Promote the transfer of skills to Vietnamese workers through targeted programmes that would replace the current understudy requirement.

4. **Ring-fence the State’s ownership and regulatory functions**

SOEs continue to represent a sizeable share of output and most are involved in essentially commercial activities where they compete with private investors, domestic and foreign. The definition of what constitutes “strategic areas” where the State needs to be involved is a matter of sovereign policy choice, and it varies both across time and across countries. A number of areas that were deemed “strategic” in Viet Nam in the past have now been liberalized and opened to the private sector, and this evolution is likely to continue in the future.

Regardless of the extent to which the authorities wish SOEs to be involved in economic activity, it is important – for efficiency purposes and to avoid conflicts of interest – that the ownership and regulatory functions of the State be properly ring-fenced. Viet Nam recognizes this, as illustrated in a number of legal provisions and in the creation of the SCIC. It also recognizes that ring-fencing is necessary to provide a level playing field between public and private investors.

While some steps have been taken in the right direction, much remains to be done in that area. This review recommends a number of measures, including to:

- Establish and publish a comprehensive census of all SOEs, together with a full audit of their assets and liabilities and ownership structure.
- Transfer the ownership of all SOEs to SCIC and mandate it to enforce hard-budget constraints on all of them, with a transparent system of State subsidies to SOEs where these remain.
- Equitize SOEs in purely commercial and non-strategic activities, with the State selling all or the majority of its shares.
- Narrow down the list of SOEs in which the State will maintain 100 and 50 per cent ownership to companies operating in genuinely strategic or socially sensitive sectors.

Viet Nam has greatly improved the legal framework for heavily regulated sectors (e.g. telecommunications, electricity, banking, transport, education) and for competition in recent years. It has also started to put in place an institutional framework for the enforcement of regulations. In most cases, the enforcement institutions are a department within the parent ministry. While this kind of arrangement may be suitable for the moment in many instances, Viet Nam should aim at creating independent regulatory institutions with their own enforcement powers in the medium term. Such an arrangement is likely to be the only one susceptible to guarantee the impartial enforcement of the rules of the game to public and private investors alike. The aim should be for the Government to turn the key regulatory departments within various Ministries into independent institutions soon after they have built up and demonstrated their capacity to enforce the laws and regulations.
5. **Simplify the tax system, rationalize the incentives structure**

Viet Nam has established a very complex system of tax incentives aimed at promoting investment in general and in encouraged regions, sectors or activities. This system is such that the majority of investors benefit from one type of incentive or another. Yet, the authorities have not conducted a cost/benefit analysis of the incentives or an overall assessment of its effectiveness in promoting desired outcomes.

It is recommended that the Government conduct a comprehensive assessment of fiscal incentives and reform the current system with the aim to:

- Make the general tax system attractive and competitive by further reducing the standard corporate income tax rate to 25 per cent, providing unlimited loss carry-forward and allowing faster depreciation rates on fixed assets.
- Streamline and simplify the number of incentives and restrict them to a small number of specific objectives. Under a generally attractive and competitive system, incentives could be limited, for example, to temporary rebates on the corporate income tax rate for a small number of particularly disadvantaged regions and to a small number of strategic sectors.
- Simplify the tax system and reduce the administrative burden on investors and the tax authorities.

In addition, the Government should ratify the DTT with the Republic of Korea and initiate negotiations on a DTT with the United States.

6. **Absorb and enforce recent regulatory changes**

Viet Nam has undergone major legislative changes in the past decade. It is crucial now that these changes be “absorbed” and properly enforced. Significant efforts are needed to inform, educate and train administrators and judges. Investors also need to be fully informed about legal and regulatory requirements. The dissemination efforts undertaken by VCAD for the new competition law should be replicated with other key laws, including the Law on Investment, Law on Enterprises and Law on Intellectual Property.

A structured effort to educate and train the administrators of the law should be put in place. This effort could involve setting up a “training academy” for civil servants. The academy would be run by the central Government and would provide training on the key laws and regulations affecting investors. It could be an effective tool to ensure consistency in administration of the law across provinces, which is currently an important issue as capacity differs widely across provinces.

Absorption and enforcement efforts should initially focus on: (a) the Law on Investment; (b) the Law on Enterprises; (c) the Law on Competition; (d) the Law on Intellectual Property; and (e) the Law on Protection of the Environment. In a number of cases, enforcement will go hand-in-hand with the strengthening of the regulatory institutions (VCAD, ERAV and others).
III. ATTRACTING FDI IN ELECTRICITY

A. Introduction

The availability of good quality physical infrastructure is an essential element for socio-economic development. It has become impossible to participate effectively in the global economy without a minimum level of infrastructure in transport, telecommunications and utilities. In addition to the well-known digital divide, UNCTAD’s Least Developed Countries Report 2006 emphasized a general infrastructure divide – with a particular focus on electricity – as a major constraint to economic growth, poverty reduction and the development of productive capacities.

Infrastructure services are rarely among the most important production inputs in industrial sectors. Yet good physical infrastructure is essentially a precondition to most modern economic activities. “Good” infrastructure should be understood in terms of quality, quantity, reliability and cost. Each of these elements is important in facilitating the development of the economy as a whole.

Figure III.1 Economic activity and infrastructure usage indicators

Sources: General Statistics Office and EVN.
The range of services offered in electricity, transport and telecommunications is vast. Until recently, most Governments considered that many infrastructure services constituted natural public monopolies. In recent decades, however, technological and regulatory changes have shown that many infrastructure services can in fact operate under a competitive framework and be developed most efficiently by the private sector. The phenomenon has been most obvious and widespread in telecommunications, but it has also affected transport (port and airport functions, railways) and electricity. A key regulatory change has underpinned these changes, i.e. the disaggregation of functions into various operational segments.

Viet Nam has been among the fastest growing countries in the world in the recent past, with real GDP growth averaging 7.4 per cent a year between 1990 and 2006. The increase in industrial output in the same period has been staggering, far outpacing output growth in the primary sector. At the same time, electricity demand grew at an unprecedented pace, tripling in less than a decade. As exports and imports surged, the demand for transport of freight also registered strong growth, while the use of telecommunications services boomed (figure III.1).

Part of Viet Nam’s strong development performance over the past two decades owes to its success in rapidly developing its infrastructure. Most of the infrastructure build-up so far has been led by SOEs or the Government itself, with the support of the donor community. Yet, large investments will be required for many years to come in order to respond to increased demand and to improve the quality of services. The Government realizes that the public sector is unlikely to be in a position to finance all the required infrastructure needs, and that the private sector could make a significant contribution in a number of sectors.

It will be vital for Viet Nam’s infrastructure to keep up with increased demand. Failure to do so could significantly slow economic growth and poverty reduction in the coming decades. Some signs of stress are already appearing, particularly in electricity and transport. This chapter considers what it would take for Viet Nam to attract FDI in the development of its power infrastructure.

In addition, it is recommended (chapter II, section B.4) that Viet Nam undertake similar strategic reviews for other infrastructure sectors, in particular (a) telecommunications; (b) ports, seaports, road and rail transport; and (c) higher education and vocational training, as part of Viet Nam’s “soft” infrastructure development strategy (human capital).

**B. Current structure of Viet Nam’s electricity industry**

1. **Overview**

   The electricity industry in Viet Nam is currently structured around a vertically integrated utility, the Viet Nam Electricity Group (EVN), but the Government is planning to introduce competition progressively in a number of segments of the industry (section E). EVN currently operates as a public monopoly in most segments of the industry. It owns the majority of assets in power generation, and has full monopoly over transmission and distribution. The Government has nevertheless sought to attract independent power producers (IPPs) over the past few years to complement EVN’s generation capacity and meet fast growing demand.

   As is the case for most large SOEs in Viet Nam, EVN’s ownership functions rest with the supervisory ministry, the Ministry of Industry. EVN is organized as a corporate group with full ownership or control
in over 60 subsidiaries (box III.1), a number of which are currently being equitized. Shares in five power generation subsidiaries were recently sold on the stock exchange, even though EVN retains between 60 per cent and 78 per cent of equity.\footnote{Pha Lai Power (78 per cent EVN-owned) has a total coal-fired capacity of 1040 MW, Thac Ba Power (75 per cent EVN-owned) is a hydro plant of 120 MW, Vinh Son-Song Hinh Power (60 per cent EVN-owned) operates two hydro plants with a total capacity of 136 MW, Thac Mo Power is a hydro plant of 150 MW and Baria Vung Tau Power has a gas-fired plant of 389 MW.}

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**Box III.1. Viet Nam Electricity Group (EVN)**

The Viet Nam Electricity Group (EVN) was established in 2006 on the basis of the reorganization of the Electricity of Viet Nam Corporation. EVN now operates as a corporate group as defined in the 2005 Law on Enterprises and is subject to the provisions of the law that regulate relationships between parents and subsidiaries which require, among others, that (a) contracts, transactions and other relations between the parent and the subsidiary be performed independently as if between two fully independent legal entities; and (b) separate and consolidated accounting be prepared.

The parent company includes (a) three large hydro power plants; (b) the national load dispatch centre; (c) the power project management units; and (d) the power information centre. The parent company holds 100 per cent equity in a number of companies, including several power plants, the largest distribution companies, the consolidated transmission company and EVN Telecom. EVN holds at least 50 per cent of equity in the other subsidiaries. It also controls a number of professional units, including the Institute of Energy and education institutions.

As it currently stands, EVN is a fully integrated electricity company that controls generation, transmission, distribution and retail. It also integrates quasi-regulatory units such as the Institute of Energy, and it has a number of assets in electrical engineering, consultancy and education. EVN also owns EVN Telecom, which holds a full telecommunication services licence, and An Binh Bank. EVN could become even more diversified as the Prime Minister’s decision that established the group provides an impressive list of EVN’s lines of business. The list includes all possible functions in the electricity industry, in addition to hotels and tourism, production of consumer goods, telecommunications, finance and banking, road and water transportation or exploitation of non-ore raw materials.

As of end-2005, EVN Corporation had total assets of $7.2 billion. Total revenue rose 18 per cent in 2005 to $2.4 billion, generating gross profits before tax of $200 million. It employs around 80 000 employees and it produced 41 billion kWh in 2005 out of a national total of 52 billion kWh. As of end-2005, EVN had an installed power generation capacity of 8 822 MW out of a national total of 11 340 MW.

*Source: EVN interview, website and annual reports.*

EVN has operated efficiently so far and is likely to be profitable and financially sound. It has accumulated a strong expertise and competence in all areas of the electricity industry, and has stood up well in facing the challenge of meeting the rapid increase in demand while at the same time expanding coverage across the country. In 2006, 98 per cent of districts and communes had access to electricity, while household electrification reached 93 per cent, up from 73 per cent in 2000.
Anecdotal evidence and some hard facts also suggest that the quality of supply has improved significantly over the recent past. Transmission and distribution losses have fallen steadily over the past decade from 21.4 per cent in 1995 to 11.8 per cent in 2005. The operators of the Phu My 2.2 power station, a private venture, advised that they had only experienced one outage due to low system frequency over two years of operation. At the same time, however, supply constraints remain an issue for many customers due to the high growth rate for electricity demand, delays in the commissioning of new power stations and below-average output from hydro stations due to poor rainfall. The World Bank’s Investment Climate Assessment 2005 survey of enterprises shows that about one third of them own a generator, significantly more than in China, South Africa or Thailand. The average number of outages was also higher at about 10 days per year.

The separation between operational, regulatory and ownership functions in the electricity sector is currently quite loose. EVN is actively involved in policy issues through its ownership of the Institute of Energy, which is the main body in charge of preparing the electricity Master Plan. Master Plans are drafted every five years. They provide planning for a 10-year period, with provisional forecasts for another 10 years. Demand forecasts provide the basis for the preparation of a list of required investments in generation, transmission and distribution. A detailed list of projects is prepared, with expected commissioning dates.

The general policy direction is set by the Ministry of Industry, which also exercises ownership over EVN. The Electricity Regulatory Authority of Viet Nam (ERAV) was established in 2005 (section B.2). Its regulatory powers are very limited, however, as it is charged to assist the Minister of Industry in enforcing regulations and it is not an independent body. The regulatory environment as it currently stands provides little comfort to private investors that conflicts of interests can be avoided. Several recommendations will be made on this issue.

The Government has decided to move away gradually from the vertically integrated model and replace it with a disaggregated model akin to what many OECD countries have put in place over the past few decades. The planned changes are elaborated upon in section E.

2. Generation

Viet Nam’s total installed generation capacity is around 12,000 MW, split between generators as follows: (a) 7,300 MW by EVN; (b) 1,800 MW by equitized power units of EVN; (c) 2,600 MW by BOTs, and (d) 210 MW by IPPs. In the North of the country, the generation mix comprises hydro and coal fired steam plants, in the centre it is predominantly hydro and in the South it is mainly a mixture of hydro and gas fired plants. Hydro power is the dominant source of generation and Viet Nam is highly exposed to hydrological risk. Recently, poor rainfall in the catchment areas has restricted the output of hydro plants, resulting in failure to meet the full level of electricity demand in the country.

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85 Most OECD countries introduced competition in electricity in the 1980s as they progressively dismantled vertically integrated public monopolies. As of today, countries vary in the degree of vertical and horizontal integration, but all have introduced a certain degree of competition and separated functions of generation, transmission and distribution.
86 The Vietnamese typically use the term BOT to mean independent power projects in which foreign investors have a stake.
87 The Vietnamese typically use the term IPP to mean independent power projects developed by local investors, including SOEs other than EVN.
The overall split of generation between the different technologies is illustrated in figure III.2. Combined cycled gas turbine (CCGT) power plants based at the Phu My complex near Ho Chi Minh City now represents some 31 per cent of total capacity. A significant proportion of this gas-fired capacity is provided by two plants owned by foreign investors in the form of BOT projects. The gas is supplied from fields contracted mainly with British Petroleum (BP) and Korean National Oil Corporation (KNOC) in the Nam Con Son Basin who on-sell to PetroVietnam. The existing pipeline is understood to be near capacity. These plants are:

- **Phu My 2.2**, which is a joint venture between Electricité de France (56.3 per cent), Sumitomo Corporation (28.1 per cent) and the Tokyo Electric Power Company (15.6 per cent). It started commercial operation in 2005, and has a capacity of 715 MW. Output from the plant is sold to EVN under a 20 year Power Purchase Agreement (PPA).
- **Phu My 3**, which started operation in March 2004. It is an equal share joint venture between British Petroleum, Nissho Iwal Corporation of Japan and SemboCorp Industries of Japan. It has a similar capacity to Phu My 2.2 and output is also sold to EVN under a 20 year PPA. As with Phu My 2.2, gas supplied to the plant is purchased from PetroVietnam. The cost of this gas is directly passed through to EVN under the PPA.

By the end of 2006, Viet Nam had 17 independently run IPPs that have a combined capacity of 210 MW. These are all small projects but even so have been subject to delays or have not been built as originally proposed. Other than hydro generation, there is currently no significant source of renewable electricity in Viet Nam. A renewable energy development programme is growing, however, with emphasis being placed in off-grid supplies to isolated areas. In addition, Viet Nam is interconnected with the South of China and currently imports up to approximately 500 MW.
Power plants are dispatched by the National Load Dispatch Centre (NLDC), which is part of EVN. NLDC is responsible for determining the least cost way of meeting demand from the available portfolio of power plant.

3. Transmission

The backbone of the transmission system is a 500 kV grid, which connects the main generation sources and demand centres. In 2005, there was over of 3,000 kilometres of 500 kV lines with a total of 11 500 kV substations. The ability to make optimal use of the generation sources between the different areas of the country was, however, limited by the capacity of the lines. A second 500 kV line, paralleling the existing line was built recently, which should help address these constraints and allow optimal use of the generation mix. Reinforcement of the transmission networks around the main urban areas of Hanoi and Ho Chi Minh City will strengthen the integrity of the network in these areas.

In addition to the 500 kV system, there were over 5,000 km of 220 kV lines and nearly 11,000 km of 110 kV lines in 2005. NLDC is responsible for the operation of the whole transmission system from 500 kV to 100 kV.

4. Distribution and retail

The main distribution network is organized around nine regional distribution companies, all under the ownership of EVN. In the countryside, some local communities own and operate low voltage networks. Major industrial customers in economic zones may be supplied directly by an IPP or BOT plant. The tariffs for such supplies are restricted to within 25 per cent of the comparable EVN tariffs. The largest such plant is the Hiep Phuoc plant that supplies the Tan Thuan export processing zone near Ho Chi Minh City.

Tariffs were increased by 8.8 per cent in 2006 to average of 852 dong per kWh ($0.053/kWh). The increase was the first in four years, and was intended to allay investor fears as to the likely profit levels in the industry. Further increases are planned for 2008 (4.5 per cent) and 2010. In real terms, however, prices have fallen, and electricity prices in Viet Nam are similar or lower than in neighbouring countries.

C. Supply/demand projections and investment requirements

Electricity sales have grown at a rapid rate in recent years, averaging nearly 14.5 per cent per annum over the period from 1997 to 2006, with a minimum increase of 10 per cent (figure III.3). This is a very high rate of sustained growth, and was achieved despite the limitations in supply experienced in some years.

These increases are forecast to continue in the future, underpinned by the high level of economic growth, sustained industrialization and enhanced electrification. The Sixth Power Master Plan anticipates that electricity demand will increase by 17 per cent per annum over the period to 2010, corresponding to a required increase in capacity of more than 2,000 MW in 2007, rising to more than 3,200 MW by 2010. At an assumed typical average cost for new generation of between $700/kW and $1,500/kW, depending upon the generation technology adopted, this increase in capacity represents a funding requirement of approximately $2 billion in 2007 and $3.2 billion in 2010, assuming a typical cost of $1,000/kW.89

88 Electricity prices vary according to the category or user (types of businesses, resident users), voltage level and peak/off-peak hours.
89 Capital costs for new generation vary with technology and plant size. The figure adopted is considered to be a reasonable proxy covering new hydro, coal and gas fired plants.
In addition to this, further expansion of the transmission and distribution networks will be required to meet the increases in demand. The Fifth Power Master Plan projected average annual capital expenditure of around $125 million for transmission and $400 million for distribution over the period 2007–2010. This brings the total funding requirement over 2007–2010 to approximately $13 billion, or an average of $3.3 billion per annum.

Responsibility for the determination of the least cost programme for the development of the electricity sector in Viet Nam rests with the Institute of Energy. The most recent published programme is the 5th Power Master Development Plan, which covers the period 2000–2010. The Sixth Master Plan was scheduled for publication in 2006, but it is still awaiting Prime Ministerial approval and will cover the period from 2006 to 2015.

EVN plans to develop a significant number of generation projects over the period to 2015. While some of the later projects may vary both in size and timing, projects proposed over the period to 2010 should be at an advanced stage of development/construction, and therefore details should be firm. The power generation programme for the next few years puts significant emphasis on the development of hydro resources. It projects to complete 16 hydro power plants with a total capacity of 3,440 MW by 2010, with initial development work on the 2,400 MW Son La plant also being carried out during the period. Nine thermal power plants with a total capacity of 4,400 MW are also projected for completion by 2010.
Aside from EVN plants, a number of independent power projects are in the planning or realization phases. The Viet Nam Oil and Gas Corporation (PetroVietnam) is becoming one of the biggest IPP investors and is participating in the construction of the Ca Mau 1&2 power stations, which are scheduled to be commissioned in 2007 and 2008, respectively, with a total capacity of 1,500 MW. It has been reported that work has started on 40 other IPPs, including a gas/power/fertilizer complex at Nhon Trach with an ultimate capacity of 1,950 MW, owned by PetroVietnam. Construction on this plant began in March 2007, but has been subject to delays. The first unit, with an output of 450 MW will be commissioned in 2008. The second plant is not scheduled until 2011.

A joint venture between the Viet Nam Coal and Minerals Industries Group and the AES Group for the 1,400 MW Mong Duong 2 coal fired plant BOT project does not seem to have made tangible progress though it has been under discussion for some time. It would now seem unlikely that the plant could be commissioned before 2011 at the earliest. A memorandum of understanding between AES and the Viet Nam Coal and Minerals Industries Group was signed in 2005 and in its 2006 annual report, AES stated that the project is in the “early stages of development”.

Offshore gas fields in the South of Viet Nam have been earmarked for use in power generation and fertilizer production. Supplies from these fields are expected to grow from 6.6 billion cubic metres (bcm) in 2005 to 10–12 bcm in 2010 and at least 14 bcm in 2015. Gas is well suited as a fuel for electricity generation as it can be used in combined cycle plants which have the merits of high efficiency (typically in excess of 55 per cent for modern installations) and relatively short construction periods.

The lack of progress in the development of the O Mon power projects, which are planned to utilize gas from the South West basin, nevertheless illustrates some of the difficulties facing developers before the gas is brought onshore. The possible development of power projects using this gas was considered by Unocal, which was subsequently taken over by Chevron. The supply potential, based on proven reserves, is assessed to be some 4 bcm per annum, but negotiations have been delayed by disputes on pipeline ownership and capacity, and on the fiscal terms associated with the gas sales.

PetroVietnam is pushing for majority ownership of the pipeline as is the case for the supply to the Phu My plants. Chevron wishes to mirror the terms of PetroVietnam’s holding in the Nam Con Son gas field. It also wants to develop an initial pipeline sized for the first phase of development of the gas field, which is proven to be over 100 bcm, with a second pipeline built to exploit the second phase reserves, estimated to be of a similar size to the initial phase. PetroVietnam proposes the construction of a single pipeline sized to meet the capacity of both phases. Chevron also wants the project to attract a preferential tax regime applicable to disadvantaged areas which would reduce the sector tax rate to below 50 per cent. It is now unlikely that gas could be available for power generation at O Mon before 2011 or 2012 – some five years later than was originally envisaged.

Based on the above expectations of power plant development and an assumed annual growth in demand of 17 per cent, figure III.4 shows the annual shortfall in capacity in the period 2007–2010. In the short term, part of this deficit can and will be met by increasing supplies from neighbouring countries, China in particular. However, the shortfall may also turn out to be bigger than illustrated in figure III.4 if delays in commissioning some new plants continue or become more widespread.

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90 Gas fields in the Cuu Long basin, Nam Con Son basin and South West basin are developed and exploited by PetroVietnam, either by itself or in joint ventures with foreign partners, including British Petroleum and Chevron.
The funding requirements in the electricity industry – generation in particular – are larger than could be met from EVN resources unless it sharply increases its borrowings and raises tariffs. EVN has been profitable since it was created in 1995, but the borrowing requirements to finance all the power capacity additions needed in the coming years are substantially larger than could be justified by the balance sheet of the company. The Government has eliminated subsidies to the sector, and is not prepared to underwrite any borrowings. It is therefore important that both local and foreign investors be attracted to complement EVN’s investments in power generation.

Recently, there has been criticism at a high level in Viet Nam regarding the delays in implementing new projects. It has been reported that nine power plants in the North have fallen between 6 and 12 months behind schedule. The projects include four coal fired plants and five hydro plants. The delays have been blamed on slow land clearance, delayed supply of equipment, poor level of contractor performance and technical differences in engineering and procurement standards between Vietnamese and Chinese contractors. These delays in the construction have affected both EVN and local IPPs, and in the case of the latter will compound the pre-financial close delays.

Of particular concern is the lead time for foreign-led investments in the power sector. Evidence to date shows that prolonged negotiations have been necessary before projects can reach financial close. This means that projections as to new generation capacity which could be provided by 2010 could seriously prejudiced.

Figure III.4. Generating plant capacity additions and expected generation shortfall, 2007–2010

(Megawatts)


91 Haiphong (1,200 MW), Quang Hinh (1,200 MW), Cha Pha (300 MW) and Uong Bi (600 MW).
92 Tuyen Quang (342 MW), Bac Ha (90 MW), Ban Chat (220 MW), Huoi Quang (520 MW) and Nam Chien (200 MW).
D. Private investment and FDI in electricity – experiences from other countries

The importance of foreign investment in the electricity sector in developing countries began to be recognized in the late 1980s, when it became clear that neither lending agencies nor national utilities would be in a position to fund the capital expenditure necessary to meet the increasing levels of electricity demand. In many countries, tariffs for electricity sales were substantially below long-run marginal costs and failed to generate sufficient cash to ensure the sustainability of the sector or to provide the basis for additional borrowing on commercial terms.

At the same time, most OECD countries started breaking up their previously vertically integrated State-owned electricity monopolies. The European Union has required member countries to split previously vertically integrated utilities and allow for competition in electricity retail. Some countries have entirely liberalized their markets, allowing free entry of private investors in the sector. Sophisticated markets for the trading of electricity have developed in recent years, including complex financial instruments for the hedging of risks.

The breakup of vertically integrated state-owned electricity monopolies has also occurred in a number of newly industrialized countries, but it has not been adopted widely in developing countries. The concept of independent power producers selling their output to the national utilities was born to introduce some degree of private participation in the power sector without dismantling vertically integrated public monopolies. These plants – funded by a mixture of debt and equity – sign long-term power purchase agreements (often running for 20 years). In many instances, the utilities with whom the PPAs are signed are in fragile financial situations and private investors require sovereign guarantees in order to engage in long-term and capital-intensive investments. Sovereign guarantees are usually required by commercial banks providing financing to investors to ensure that the repayment terms can be met. Typically, PPAs in developing countries have included:

- Sovereign guarantees on dollar-denominated power prices;
- Sovereign guarantees on the availability of foreign exchange;
- Sovereign guarantees on capacity payments and power offtakes.

As a result, Governments in developing countries have had to accept significant contingent liabilities, the nature of which was not always well understood in the early phases of development of IPPs. The risks include:

- Exposure to foreign-exchange risk: Power purchases are dollar-denominated for the public utility, while power sales are in local currency. When and if currency depreciation occurs, Governments may find it politically difficult to pass on the effects in the local currency-based power charges, even though this would simply reflect economic costs. A number of countries have been caught in this dilemma, such as the Philippines during the Asian financial crisis of 1997.
- Exposure to erroneous demand projections and excess capacity: most IPPs have requested sovereign guarantees on capacity charges and power offtakes. Overly optimistic demand forecasts or slower-than-expected economic growth due to external shocks have exposed public utilities to high costs under take-or-pay contracts. This was again the case of the Philippines following the Asian financial crisis.
India has the sixth-largest electricity industry in the world, and in common with Viet Nam has a high rate of growth. The sector suffers, however, from a historic legacy of under-recovery of costs through tariffs, poor operational efficiency and strong central control. Many of the State Electricity Boards which are responsible for generation, transmission, distribution and retail have questionable levels of financial viability and the record of system reliability is poor. The Government has recognized the need for greater involvement by the private sector, and foreign investors are being encouraged to assist in the development of new projects, with competitive tendering increasing transparency in the procurement process. Actual progress, however, has been slow. Bureaucratic delays and cumbersome processes have resulted in few projects reaching financial close, despite a large number of memoranda of intent and bids from developers. Continued delays in addressing structural problems, however, are likely to inhibit the appetite of foreign investors for a prolonged period.

FDI in the electricity sector in China began in the 1980s with the involvement of the China Light and Power Co. Ltd. in the Guangdong region. The establishment of special economic zones in the 1990s was the catalyst for a marked acceleration in activity and more than 100 memoranda of understanding were signed with private sector parties. From 1994 to 1997 there was a boom in the development of the industry, helped by important commitments made by the Chinese Government and the perception of high rates of return. More than 50 medium to large generation projects reached financial close over this period. By 2002, FDI represented 13 per cent of the total investment in the sector. After the initial surge in activity, however, there was a huge drop in new projects as the initial enthusiasm was tempered by the reality as to the returns which were achievable, with none reaching closing in 2000 and only one closing in 2001. In October 2002, China introduced new legislation to make the sector more competitive and to attract investment. This included the breakup of the former State Power Corporation separating generation, transmission and distribution assets, and the creation of regional transmission and distribution companies. Implementation of the policy, however, has been mixed. China maintains a rigid approach to planning and a high degree of regulation which delay the approval of project applications.

The Philippines attracted large amounts of FDI in power generation in the early 1990s, with the Government providing sovereign guarantees to foreign IPPs. The Asian financial crisis of 1997 wreaked havoc in the sector, as the vertically integrated power utility – Napocor – could not service its obligations under the PPAs following the depreciation of the Peso and a sharp reduction in electricity demand. The Government restructured the electricity industry in 2001 with the establishment of the Power Sector Assets and Liabilities Management Corporation (PSALM), a special Government body created to take over and manage the assets and liabilities of Napocor. The contractual terms of a number of PPAs were also re-negotiated. PSALM is currently engaged in a process of selling its assets through a competitive tendering process, but progress has been slow. It has also appointed IPP administrators who bid the output of IPPs into the market and seek to ensure that PSALM payments under PPAs are minimized.

The examples above illustrate some of the pitfalls that can affect countries seeking to liberalize their power sector and attract private investment electricity. They highlight the need for clarity in setting policy for the development of the power sector, and for a high degree of stability in the application of this policy. In Brazil and China, both of whom have seen substantial amounts of FDI, policy changes have resulted in significant variations in foreign investment with consequential impact on the development of the sector. The experience of the Philippines highlights the need to conduct careful assessments of the possible consequences of foreign exchange exposure, contingent Government liabilities under PPAs and the vulnerability to errors in demand forecasts.
E. Planned structural changes in the electricity industry of Viet Nam

1. Market framework

As mentioned above, Viet Nam has launched a process to overhaul the structure of the electricity industry in the coming decades. The key objective is to move from the current vertically integrated public-sector dominated structure to a competitive electricity market that combines private sector players and strategic public sector investors. The Government is putting in place a consciously gradual approach to the transition process as it is aware that many pitfalls could be present along the road to establishing a competitive electricity market.

The overhaul of the electricity industry is underpinned and regulated by the Electricity Law of 2004, which became effective 1 July 2005 and is Viet Nam’s first electricity law. The law clearly stipulates that a competitive electricity market shall be established and based on the principles of transparency, equality, fair competition and non-discrimination between participants. Participants are to be free to make their own choice of parties to engage with, under freely negotiated forms of transactions. One of the key roles of the State is to regulate activities so as to ensure the sustainable development of electricity infrastructure and meet the requirement of a “safe, stable and efficient electricity supply”.

The law determines that the electricity market will be established by introducing competition in three segments of the market in three sequential phases: (a) power generation; (b) wholesale; and (c) retail sales. The law does not provide for a schedule of implementation or for detailed regulations, which are to be determined by the Prime Minister. A preliminary electricity market roadmap was prepared in 2005, which provides further indications as to how the transition will operate (figure III.5).

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**Figure III.5. Electricity market roadmap**

<table>
<thead>
<tr>
<th>2005</th>
<th>2009</th>
<th>2014</th>
<th>2022</th>
<th>2025</th>
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<tbody>
<tr>
<td>pilot phase</td>
<td>pilot phase</td>
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**Phase 1: competitive generation market**

Competition in generation is to be introduced progressively during phase 1 of the transition. This should involve a number of measures, including:

- Increasing the number of independent power producers and raising their share in total supply capacity;
- Equitizing some of the power plants that currently belong to EVN;
- Turning the national load dispatch centre into the system operator;
One of the most crucial elements in introducing effective competition in power generation will be the establishment of a “single buyer” in 2009. Under the current regime, IPPs sell their power to EVN, the vertically integrated electric utility. By 2009, all generators will have to sell their electricity to the single buyer, who will then supply distributors and end-users.

At this stage, it remains unclear who the single buyer will be and – most importantly – what its relationship with EVN will be. A number of crucial operational issues are yet to be resolved in the creation of a competitive market for power generation. These are discussed below.

**Phase 2: competitive wholesale market**

The single buyer function will be eliminated in 2014 under phase 2 of the transition. Power sales will take place under a competitive framework where wholesale buyers are free to purchase electricity directly from generators. Sales will take place under negotiated long-term purchase agreements and on the spot market. Wholesale buyers will include distribution companies, large electricity users or dedicated wholesalers. Phase 2 is expected to include a pilot period of about three years.

One of the keys to the success of phase 2 will be to ensure that credible and creditworthy wholesale buyers are created as offtakers for the power generation companies. Large commercial users are likely to be among the most creditworthy offtakers, but it will be essential that retailers also be financially sound. Competition will also require that dedicated wholesale buyers emerge. These issues are addressed in further details below.

**Phase 3: competitive retail market**

Phase 3 is expected to lead to a fully competitive electricity market, including at the retail level. At that stage, retail customers should have access to a choice of suppliers, who would then be dissociated from distribution companies. A pilot phase of three years starting in 2022 is expected to be concluded by 2025, at which time the transition should be complete.

2. Market players and pricing

The 2004 Electricity Law clearly defines the market players and their respective rights and obligations:

- **Power generators** can either be public or private. The Electricity Law nevertheless stipulates that the State will retain the monopoly in the construction and operation of large electricity plants of particular socio-economic and national security importance.93 Power generators are free to sell their output to all electricity purchasers on the wholesale market, either under the form of long-term purchase agreements or through spot dealings.

- **Transmission** will remain a State monopoly, and the previous four regional transmission entities of EVN have been integrated into a single company. The transmission company will charge a transmission fee whose level will be approved by the regulatory authorities.

- **Distribution companies** will operate as regulated monopolies. They will charge a distribution fee whose level will be approved by the regulatory authorities and will have the obligation to give access to their network to licensed retailers. It is unclear at this stage whether and under what conditions distribution companies could combine as retailers. This will be an important issue to address to ensure that competition is effective at the retail level.

93 These are defined as nuclear power plants and a number of hydroelectric plants (essentially large ones).
• **Wholesalers** can be either public or private and have the right to use the transmission and distribution networks. Such operators do not currently exist.

• **Retailers** can be either public or private and have the right to use the transmission and distribution networks. Although they do not currently exist as such, they will become the main suppliers of electricity to end-users, in particular households and smaller commercial users.

• **Large electricity users** are explicitly given the right to purchase electricity directly from generators and to connect to the transmission grid.

The law defines a clear policy on electricity prices, which will also be implemented in a phased process. It states that a “reasonable price subsidy regime among various groups of customers” will remain in place in the future, even though the nature of this regime is not defined in the law. The current tariff structure is such that industrial and commercial users subsidize small urban residential users (under 150kWh per month) and rural users. Peak and off-peak prices are differentiated only for industrial and commercial users. In contrast, all cross-subsidies between electricity production costs (generation, transmission, distribution) must be gradually reduced and eventually eliminated by law.

Although one of the stated objectives of the electricity policy is to create a competitive market, the law does not give full freedom to market operators to determine prices:

• **Retail prices** may only vary within a given range from a pre-determined price list. The electricity price list is approved by the Prime Minister based upon the recommendation of the Ministry of Industry, assisted by the Electricity Regulatory Authority of Viet Nam (ERAV). The list will determine retail prices at the household, commercial and industrial levels. The extent of the allowable range has not been defined yet.

• **Wholesale prices** will similarly have to remain within a bracket as determined by the Minister of Industry.

3. **Regulatory institutions and planning**

Regulatory powers remain the prerogative of the Ministry of Industry despite the creation of ERAV in 2005. As stated in the 2004 Law on Electricity, the function of ERAV is to assist the Minister of Industry to implement the law and its associated regulations. Although it was created as a separate legal entity, ERAV works under the supervision of the Ministry of Industry and it does not have enforcement powers of its own. Its role in supporting the Minister is wide, however, and includes assistance in:

• Formulating the Master Plan and publishing a list of projects calling for investment;

• Restructuring the electricity industry in conformity with the roadmap to create a competitive electricity market;

• Formulating electricity prices;

• Preparing regulations;

• Evaluating application for electricity operating licences;

• Monitoring the observance of rules and regulations;

• Implementing regulations on competition.

The principle of Master Planning in electricity, which Viet Nam has applied for several decades, is confirmed and instituted in the 2004 Law on Electricity. The Master Plan must be approved by the Prime Minister upon submission of the Minister of Industry. In principle, all investments in electricity
development must comply with the Master Plan, even though projects that are not included may be authorized by the Prime Minister. As of mid-2007, the Prime Minister was about to approve the Sixth Master Plan, about one year behind schedule.

The Master Plans include a detailed list of projects that are deemed necessary to ensure an adequate, stable and reliable supply of electricity to respond to projected demand. They include projects in generation, transmission and distribution. As it currently stands, the roadmap towards the competitive electricity market does not envision the elimination of Master Plans beyond the 2024 horizon. Although the Government wishes to introduce competition in generation, it does not seem prepared to allow market forces to determine which power plants should be built and according to what schedule. Under the 2004 Law on Electricity and the current roadmap, all investments (subject to exceptions approved by the Prime Minister) will have to fit into the Master Plan.

4. Other laws and regulations affecting the power sector

A number of other laws and regulations have been adopted or modified in recent years that will affect investments in the power sector. Key among these is a 2002 Decision on the management of investment and construction of independent power projects. The Decision has two key requirements:

- Investments in IPPs must be in the form of build-operate-transfer (BOT), build-transfer-operate (BTO), build-transfer (BT) or build-operate-own (BOO);
- The selection of an investor to implement an IPP must be conducted by tender.

The legal framework for BOT-type contracts was fully updated by a new decree in 2007, and a new Law on Tendering was adopted in 2005. The BOT Decree enforces thin-capitalization rules, as equity must represent no less than 30 per cent, 20 per cent or 10 per cent of total capital investment, depending on the size of the project. The decree also requires all BOT-type projects (regardless of sector) to undergo open domestic or international tendering and for projects to fall within a sectoral Master Plan. As in other laws and regulations, however, the decree allows investors to propose projects on their own initiative. If the competent authority decides to approve the addition of such projects to the sectoral Master Plan, bilateral contract negotiations are thus initiated with the investor and tendering is not required.

5. Equitization in the power sector and reforms at EVN

The equitization process is affecting enterprises in the power sector, as well as all other SOEs (chapter II). As per a Prime Minister Decision of 2007, however, many assets in the power sector will remain either 100 per cent or 50 per cent publicly owned. Transmission, nuclear power plants and large-scale hydro plants are to remain under full government ownership. In turn, the government is to retain at least 50 per cent of capital in all existing publicly-owned power plants with a capacity of 100 MW or more.

A Prime Minister Decision in June 2006 re-organized EVN into a corporate group. The parent company comprises a limited number of assets, including three large hydro plants, the national load dispatch centre and a newly established electricity trading arm. The decision states that the parent company will retain 100 per cent ownership in a number of subsidiaries, including the main distribution companies and largest power plants. It also lists the companies that will be equitized, but in which the

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94 Thresholds are for projects below 75 billion dong ($4.7 million), between 75 billion dong and 1.5 trillion dong ($94 million) and above 1.5 trillion, respectively.
parent company will retain at least 50 per cent ownership. These include a number of power plants, smaller distribution companies and power services companies. Five power plants have been equitized so far, and another three are to be equitized in the near future.

F. Market framework requirements for private investment attraction

The structure and organization of Viet Nam’s electricity industry are going to change radically over the next two decades as the sector transitions from a vertically integrated public monopoly to a competitive market (section E). The transition should bring significant benefits to Viet Nam in terms of efficiency, quality and availability of services, as well as significant opportunities for foreign investors. However, past experiences from other countries highlight the difficulties in managing the transition process and the numerous traps to avoid along the way.

Viet Nam still has to clarify and address a number of policy issues regarding the transition to an electricity market. Yet – as stated above – a consistent and transparent policy needs to be adopted if Viet Nam is to attract significant investments from private (foreign) investors on a mutually beneficial basis. These market framework requirements for FDI in electricity relate mostly to the following issues, which are elaborated upon in this section and the next:

- The vertical disaggregation of the industry into generation, transmission and distribution;
- The nature of the single buyer during the transition to a competitive wholesale market;
- Sovereign guarantees in PPAs and their gradual phasing out;
- The role and structure of EVN;
- The Ministry of Industry’s combination of ownership and regulatory functions;
- The role and independence of ERAV;
- The financial strength of forthcoming wholesalers and retailers.

1. Vertical disaggregation

Viet Nam should clearly state that its policy will be to fully separate generation, transmission and distribution. The three functions should be operated independently, and cross-ownership across them should not be allowed in the long run. This is necessary to ensure that no conflicts of interest occur, particularly as far as monopolistic operators are concerned.

The Government has clearly stated that transmission will remain a 100 per cent publicly-owned monopoly, which is a suitable arrangement. It is not as clear what arrangement will prevail for distribution, however. Distribution will clearly remain a monopoly, but it has not been determined whether companies will be state-owned or privately-owned. It is unlikely that foreign investors will show significant interest in distribution, and the benefits for Viet Nam of FDI in distribution would be limited. Yet, in order to allow market forces to operate at the retail level, the Government will need to determine whether distribution companies can combine as retailers or whether they will be restricted to carriers, like the transmission company.

2. The nature of the single buyer

The EVN group is currently the sole buyer and seller of power in Viet Nam. Under the Electricity Roadmap, a single buyer will be introduced in 2009 that will purchase power from all generating companies, whether owned by EVN or by foreign and domestic IPPs. This arrangement will be the first step to introduce competition in generation.
A number of fundamental issues relating to the single buyer remain unclear, however. It is crucial for the Government to clarify them rapidly in order to attract (foreign) private investors in generation.

**Who will be the single buyer?**

The single buyer should not be EVN and not be part of the EVN group, as this would pose insurmountable conflicts of interest. Independent power producers need to be sure that the single buyer will treat all generators impartially and not favour its own generation arm. It is clearly not workable for one part of EVN to be responsible for the purchase of electricity from other parts of EVN that will be in competition with other generators. The best alternative would be for the transmission company to remain under State ownership as planned but legally separated from the EVN group, and for the single buyer to be a ring fenced entity within the transmission company. A clear ruling needs to be made on this issue as soon as possible so that investors can be assured of transparency and impartiality in the operation of the electricity generation market.

**On what contractual basis will the existing IPPs sell electricity to the single buyer?**

It is presently envisaged that much of the electricity traded will be through long-term contracts and accessorially via a spot market. While Vietnamese IPPs typically have short-term PPAs, the foreign IPPs in Phu My have 20-year contracts, of which 18 still have to run. These contracts are with EVN and would need to be re-assigned unless they continue to sell to EVN. At present the contracts are backed by the Government of Viet Nam, and such a sovereign guarantee will endure. The contracts also remove foreign currency risk from the developer, with an indexation of the tariffs to the dollar/dong exchange rate. It is highly improbable that the existing investors will relinquish these rights.

**On what contractual basis will new private investment projects sell to the single buyer?**

It is very probable that new investors will seek similar terms to those enjoyed by existing investors. In particular, they will seek sovereign guarantees on the PPA undertakings of the single buyer. The Government has indicated that it no longer wishes to offer such guarantees and will require new investors to rely on the financial strength and probity of the single buyer. This is a perfectly reasonable objective of the Government as it does not wish to be burdened by large contingent liabilities. However, at this stage of development of the power market, refusing to grant sovereign guarantees would stall large investments from mainstream foreign investors. The forthcoming single buyer will not have any track record in meeting large-scale commercial obligations with foreign power developers. Moreover, the single buyer's role and financial strength will be affected by market deregulation. The Government has several options:

- Decline to provide sovereign guarantees and accept that foreign investor interest will be much reduced. This means a larger investment commitment by EVN which may not be able to cope without either tariff increases or government loan guarantees.
- Continue to provide sovereign guarantees but for a limited period (say five years) and then review the policy for new projects in the light of the performance and financial strength of the single buyer.
- Privatize the single buyer to a large strategic investor (e.g., a major foreign transmission operator) of sufficient strength to be a creditworthy off-taker without the need for sovereign guarantees. Quite apart from the political and security issues involved, this could be commercially premature until the wholesale market is well-developed.
It is recommended that the policy of providing sovereign guarantees should continue. This should be done for private investment projects reaching financial close in the next five years. The policy could then be reviewed. In the long term, the best way for Viet Nam to escape from sovereign guarantees is to ensure that wholesalers operating in the next phase (the wholesale market) are strong and financially sound players (section F.6).

3. The role and structure of EVN

One of the most crucial elements in the transition to a competitive power market and in Viet Nam’s ability to attract (foreign) private investors in the electricity industry will be the role and structure of EVN in the coming years. As stated above, a competitive market will function all the way to the retail level only if the situations of conflict of interest arising from EVN’s vertical integration and market power are properly addressed.

It is thus essential that a clear mechanism and timeline for the disaggregation of EVN be published. The ongoing reorganization of EVN as a corporate group with ownership in a large number of daughter companies does not satisfactorily address the issues of conflicts of interest, even if the 2005 Law on Enterprises requires parent and daughter companies to operate at arms length. The EVN group should be disaggregated around a small number of strategic poles. Each pole should be legally separated, even though the State could retain full or majority ownership for the near future:

- **Generation companies**: One large power generation company – referred here as Viet Nam Power Company (VPC) – should be created on the basis of the key EVN power plants. This company would remain 100 per cent state-owned. Two or three other power generation companies could be constituted on the basis of the remaining EVN power plants, building on the equitization that has already taken place (section B.1). These companies would be fully independent of each other and not have cross ownership in order to foster competition at the generation level. The smaller generation spin-offs of EVN could be partly or fully owned by the private sector under the equitization programme.

- **Transmission company**: The national transmission grid should operate as an independent legal entity, fully owned by the Government. The transmission company should also include the Institute of Energy and the National Load Dispatch Centre, which need to be separated from the current EVN and not included in the proposed VPC. There are conflicts of interest between the Institute of Energy’s role as author of the Master Plan and EVN’s (or VPC) responsibilities as a major generation entity. Integrating the Institute of energy into the transmission company would be an arrangement similar to that adopted in many other countries. The transmission company typically has the best information regarding power needs across the country and is in the best position to produce a statement of future development needs over a 5–10 year period.

- **Distribution companies**: The distribution companies of the current EVN group should be turned into legally separate entities. Consideration will need to be given to the number of distribution companies that should remain, though this is not an urgent issue to address. While these companies would remain under state ownership at first, they could also be subject equitization at a later stage.

- **Electricity services companies**. EVN’s electricity services companies could be grouped under one or a few new poles, which could also be subject to equitization.

Aside from the generation companies, where partial equitization should take place rapidly to promote competition, whether the new companies are state-owned or (partly) privately owned is not all-important
from an FDI perspective. It is suggested that VPC and the transmission and distribution companies remain 100 per cent state-owned initially, and that the other generation companies and services companies be equitized.

4. State ownership and regulatory functions

The Ministry of Industry has conflicting roles at present as both owner of EVN and regulator of the power sector. This review recommends, as a general policy measure, that the State’s ownership and regulatory functions be clearly separated and ring-fenced (chapter II). In the electricity sector, this would require transferring the ownership of EVN (or its disaggregated poles) from the Ministry of Industry to the SCIC. This is needed to give private investors enough confidence that conflicts of interest can be minimized, if not avoided altogether. Separation of ownership from regulatory functions is a cornerstone of good regulatory practice in other countries in both the electricity and other regulated sectors.

The recommended disaggregation of the EVN and the change of ownership from the Ministry of Industry to the SCIC are illustrated in figure III.6.

5. Role and functions of ERAV

ERAV will have a key role in ensuring the transparency of the development process, but is constrained to some extent by its direct responsibility to Ministry of Industry. Both the Minister of Industry and the Prime Minister, for example, have the legal powers to fast track projects that are not in the Master Plan, even though ERAV is responsible for the adherence to it by developers. ERAV is still at an early stage in its development, and it is critical that the skills and capabilities of its staff be developed as quickly as possible so that it becomes able to provide a strong and objective direction in the recommendations it provides to the Ministry of Industry. This may help in its establishment as a key party capable of objective and impartial regulation which will provide an important signal to potential foreign investors in the sector. Eventually, Viet Nam will also have to consider making ERAV independent from the Ministry of Industry and give it its own enforcement powers.

ERAV is currently assisted by an external consultant seconded on a long term basis. ERAV is also seeking technical assistance from consultants for: (1) the development of retail tariffs; (2) the development of market rules for generation and the competitive power market; (3) preparation of the generation and ancillary services pricing methodologies; (4) drafting standard bilateral contracts/PPAs; and (5) the preparation of the procedures and draft regulation for enforcement and dispute resolution. Such assistance is important in the establishment of ERAV’s role and in the setting of appropriate approaches. It is also vital that knowledge transfer and capacity building should form part of such consultancy assignments.

6. Financial strength of wholesalers

The introduction of a wholesale competitive market is scheduled for around 2015. This will involve the elimination of the single buyer as trading will take place between multiple bulk buyers and sellers. This trading will be based on long-term contracts with a small balancing spot market.

It is very unlikely that any developer would be prepared to invest in a merchant plant – selling a significant proportion of the output of the plant on the spot market – in Viet Nam at this stage. Such investments will require the market to be operational for some years to allow investors to gain confidence as to the stability of prices in the market.
As far as plants selling on the basis of long-term contracts are concerned, the elimination of the single buyer around 2015 and its replacement with wholesale buyers will be a crucial issue. The structuring of the market after 2015, in particular the financial integrity of the counterparties to long-term contracts, is a key issue that needs to be addressed. Arrangements will also need to be developed for PPAs concluded between now and 2015, as the initial offtaker (single buyer) will cease to exist part of the way through the duration of the PPAs.
As stated above, one the keys to withdrawing sovereign guarantees will be to develop financially strong wholesalers and retailers within a well-regulated market. The Government should now be considering its policy in this regard, including the role for foreign investors as wholesalers, distributors and retailers.

G. Commercial terms and electricity prices for FDI attraction

Foreign investors will participate in the Vietnamese power sector only if their financial aspirations are met and if they are able to make a return on investment commensurate with their perception of the risk they are taking. The perception and measure of risk will be influenced by a number of factors, including:

- The structural, legal and regulatory frameworks for the electricity industry;
- The transparency and predictability of the legal and structural frameworks;
- The financial soundness of counterparts in the industry;
- The structure and level of electricity prices;
- The commercial terms of long-term contracts.

In the case of Viet Nam and given the ongoing structural changes taking place in the electricity industry, it is unlikely that foreign investors in generation (or the banks providing financing for the projects) will be prepared to take risks in either the offtake price and foreign exchange exposure or in the duration of the contract for the offtake, at least until debt is fully repaid (typically 10 years from project commissioning). As a result, the commercial terms that Viet Nam is willing to offer to new foreign investors in generation and the nature of the future PPAs will be key to its ability to attract first-tier investors in the near future.

Attracting first-tier investors is particularly important for a number of reasons. First-tier investors are likelier to possess and master the most efficient technologies both in terms of fuel-efficiency and in terms of pollution control. The inevitable environmental costs, both locally and globally, are thus likely to be minimized. Long-run electricity costs are also likely to be minimized with the use of the most efficient technologies, even if the initial capital cost is higher. As the recent demolition of heavily polluting coal-fired power plants in China illustrates, the long-run environmental, social and public health costs of using second-tier technology can be extremely high.

The Government has made clear that it wishes to reduce its contingent liability exposure to the sector and that it no longer wants to provide sovereign guarantees on prices, offtakes and foreign exchange exposure, as was the case in the PPA between EVN and the foreign IPPs in Phu My. The desire to escape from the need to provide sovereign guarantees to foreign IPPs is entirely legitimate. As stated above, however, it is unlikely that foreign IPPs would be willing at this stage to invest in Viet Nam without Government-backed PPAs of the same kind as those used in the Phu My projects, and project financing would not be available without sovereign guarantees. This is the consequence of a number of uncertainties that still affect the generation sector, in particular:

- EVN is not a sufficiently credible offtaker without sovereign guarantees as it is undergoing too many changes, the biggest one being its possible disaggregation into smaller parts;
- The nature of the single buyer is still undetermined;
- There is much uncertainty regarding the treatment of long-term PPAs in the transition from EVN as the offtaker to the single buyer (in 2009), and subsequently to the wholesale market.
Rather than an abrupt end to sovereign guarantees, this review consequently proposes a staged strategy to escape from them. The underlying principle is that sovereign guarantees will no longer be needed once the power market is firmly established, with financially sound and credible players at all levels of the industry. In the first phase of the transition to the power market, the only alternative to ensure the credibility of the single buyer is to provide sovereign guarantees. Once the wholesale market is established and after wholesalers have demonstrated their financial soundness, the Government will be in a position not to grant sovereign guarantees on PPAs, as such contracts will take place directly between IPPs and wholesalers (many of which could be private sector companies).

This exit strategy implies that the Government will need to continue to back PPAs with the single buyer at least until around 2018, i.e. towards the end of the pilot phase of the wholesale market. One way to minimize the impact of sovereign guarantees would be to apply sunset clauses in all guarantees granted between now and their phase-out around 2018. The Government policy could be to provide sovereign guarantees only for the duration of the loan repayments of the IPP, instead of the whole duration of the PPA. This would reduce the duration of the sovereign guarantee from about 20 years (typical duration of a PPA) to about 10 years (typical duration of loan financing). It must be noted, however, that this would mean that equity investors are asked to take on a higher risk, and that they would consequently require a higher return on investment, which would affect power prices.

It has been noted above that ERAV is commissioning consultants to draft bilateral PPAs. Viet Nam would significantly benefit from the use of a standard PPA, and it would be important to give due consideration to the sovereign guarantees exit strategy in their drafting. A standard PPA could streamline and accelerate the process leading to financial close, particularly if a pro-forma version of the document is readily available to all parties at an early stage in the development process. It could also reduce the legal costs to Viet Nam and IPPs in reaching an agreement on the PPA.

PPAs typically include payments for plant availability (i.e. the fact that the plant is operational and can produce electricity) and for energy output. These are termed capacity and energy payments, respectively. Capacity payments are linked to a target figure representing the proportion of the year the plant can generate, allowing for scheduled maintenance and forced outages. They allow for interest payments, repayment of loans, return on equity, fixed annual costs such as staffing, annual maintenance or land tax. Energy payments cover the plant variable costs, including fuel and variable operating and maintenance cost. In many cases fuel is considered a pass-through cost with the offtaking making payment based on an agreed level of efficiency for the plant (i.e. how many kJ of fuel energy are required to produce one kWh of electrical output).

The establishment of the power market with financially sound and credible players will be the key to the end of sovereign guarantees on PPAs. Financial soundness will require that electricity prices to end users reflect economic costs and allow for a return on investment to all investors in the sector (generators, transmission company, distributors, wholesalers and retailers). According to the 2004 Electricity Law, electricity prices at the retail and wholesale level will have to fall within a range as determined by the Prime Minister upon recommendation of the Ministry of Industry and ERAV. The level and extent of the range will be crucial in that they will determine: (a) the room for price competition; and (b) the profitability of the industry.

At some point in the future, the Government should consider granting more freedom to operators in determining electricity prices. In line with the disaggregation of the industry, tariffs should be unbundled.
into four components: (a) generation charges; (b) transmission charges; (c) distribution charges; and (d) retail charges. Transmission and distribution charges should remain regulated as they operate under a monopolistic framework. Generation, wholesale and retail charges, in turn, should be determined by the market, as they will, in due course, operate in a competitive environment.

The Electricity Law clearly stipulates that cross-subsidies between generation, transmission and distribution will be eliminated. It also stipulates, however, that a “reasonable price subsidy regime among various groups of customers” will remain in place. Such a policy is not really compatible with a competitive electricity market at the retail level, however. In due course, Viet Nam will need to consider replacing price subsidies with a more transparent levy system aimed at raising funds to guarantee universal access to electricity.

The development of the competitive electricity market will impact electricity prices, but at this stage it is not possible to predict the exact effect. In general liberalization of the electricity market has allowed competitive pressures and the benefit of efficiency savings to be passed on to end-customers, though some of this saving is offset by the higher development costs and returns associated with private sector projects and the costs of operating the market. It is, however, difficult to be precise in predicting the impact of the proposed new arrangements in Viet Nam, particularly when many of the details related to the market have yet to be finalized.

H. Managing the Master Plan and the bidding process

I. Master Plan development

A key aspect to the future development of the power sector and the attraction of foreign investors in generation is a robust Master Plan that is readily available to all parties. The assumptions that underpin the plan should be clear and auditable and the plan should include sensitivity studies reflecting the impact of changes to some of the basic parameters. The plan should be thoroughly updated every five years, with annual revisions to reflect actual demand growth and new developments in the sector. The one year delay in the publication of the Sixth Master Plan is a matter of serious concern as it indicates an unhealthy degree of fine control by the Government. As noted earlier, the responsibility for the production of the Master Plan should not fall within the remit of EVN as it is currently structured, as there is a clear conflict of interest between the generation business of EVN and independent power producers. Instead, the Institute of Energy should form part of an independent transmission company (section F, figure IV.5).

The Master Plan should be based on an economic determination of the least cost development programme, i.e. considering the true value to the country of the goods used. In the case of fuel, for example, internationally traded values should be used after adjustment for transportation to the point of use. This approach ensures that optimal use is made of the national resources. The analysis should be undertaken without consideration as to the potential source of funding for any of the projects. The optimal programme for the future sequencing of new generation and transmission projects, which is the output of the analysis, should be made public on completion.

In order to assess the least cost development programme, it is necessary to have feasibility study level cost data relating to all potential candidate plants. There is obviously an issue as to the funding of such a feasibility study, with potential developers doing such work “at risk” before the project is identified
as part of the recommended development programme. The costs of such studies can also vary widely – in the case of hydro projects, for example, seismic data has to be obtained, which may involve costly drilling. Hydrological data, collected over a prolonged period, is also needed to determine the minimum and probable output of the plant. Ideally cost data used for the Master Plan should be at a common level of accuracy, though in practice this might be difficult.

To address this difficulty, it is recommended that the Institute of Energy have a budget for the commissioning of feasibility studies. These studies can be executed either by the consultancy companies which form part of the current EVN group (but would be separated under the proposed reforms), or by third parties. The completed studies should be made available to all potential developers.

2. Organizing the competitive bidding process

It is recommended that, with the exception of those projects which by law are restricted to state ownership (large power plants of national strategic importance), all new projects should be available for development by either the public or the private sectors. The parameters which will be used in the determination of which projects will be restricted should be made clear by the Government, together with a list of both current and proposed projects which would be so affected. It is recognized that potential future nuclear plants would be covered, but it is not as clear as to which other plants should be included. It is recommended that EVN-VPC\(^\text{95}\) be given responsibility for the development of this restricted category of new projects.

Following the publication of the Master Plan, it is recommended that a competitive bidding process be adopted for all eligible proposed projects under the auspices of ERAV. This should be open to both the public and the private sector, including EVN-VPC. In order to ensure that overall plant requirements are met, EVN-VPC should be declared the developer of last resort. The time for development and construction of all projects will vary, but should be considered in the development of the Master Plan, which should also include details of the bidding programme, including an end date after which time if the project has not been allocated to a developer it is deemed the responsibility of the State. EVN-VPC could be required to bid for all new generation, thereby creating a datum against which other costs can be judged and also minimizing delay if other bids are considered unresponsive. In order to cover the cost of being required to bid for all projects, EVN-VPC could be granted a subsidy earmarked for that purpose.

Bids should be evaluated based on the lifetime costs of electricity output, including environmental and other indirect costs. The analysis should be undertaken from the perspective of the system as a whole, thereby taking account of differences in proposed commissioning programmes between bidders. Differences in efficiency would be captured through potential changes in plant merit order (the order of preference in dispatch, lowest marginal cost plant being dispatched first, etc.) and, if applicable, exchange rate variation.

It is recommended that the Institute of Energy be responsible for the evaluation of the bids as it has the capability to undertake this analysis, being responsible for the production of the Master Plan, on the assumption that it is separated from EVN as soon as possible as previously recommended. This approach does bear some risk of delay to the commissioning of new plant, but if there is a clear understanding as

\(^{95}\) EVN-VPC refers to the proposed strategic generation company to be created on the basis of EVN’s key generation assets, as spelled out in section F.
to the mechanism for the allocation of projects to EVN–VPC as the developer of last resort, this risk can be both managed and minimized.

Viet Nam is already experiencing delays in the development and commissioning period for new plant. While this affects EVN plants, it is even more marked in the case of privately funded projects – particularly when the funding is from foreign investors. In the case of Phu My 2.2, for example, the development phase took approximately six years. The process was slightly easier for Phu My 3, as BP did not need project finance, but the negotiation of the PPA with EVN nonetheless still took three years.

After a developer has been awarded a project in line with the competitive bidding process which has been proposed above, much work still remains before construction can commence. The contractual framework will need to be finalized, more accurate costings determined, and commercial terms negotiated with lenders. Fuel supply arrangements need to be confirmed and any other consents and agreements (including any environmental requirements) concluded. It is therefore vital, if Viet Nam is to rely upon the private sector to meet a substantial element of new build, that this process be streamlined to the maximum extent while still maintaining transparency and auditability of the processes. As has been previously noted, ERAV is already engaged in the drafting of standard PPAs which, if acceptable to all parties, should certainly be of assistance. Of more fundamental concern, however, is the bureaucratic process and complexity which still affects Viet Nam and which has been seen to be an impediment to the rapid development of projects in China.

It is important that a process be adopted to ensure that projects which are not in the Master Plan receive fair and equitable treatment. At present it is within the remit of the Prime Minister or the Minister of Industry to approve such projects. This process does not encourage transparency and creates a suspicion that some developers might be unduly favoured. It is therefore recommended that fast track projects be reviewed by the Institute of Energy, to ensure that they form part of the economically optimal development programme. Other bidders should be invited to participate in the bidding process.

I. Attracting foreign investors and promoting competitive private investment

Viet Nam has been very successful in attracting foreign investment over the past few years, particularly in export-oriented manufacturing. It has not been able so far to mirror this success in the power sector, however, where only two major foreign IPPs projects have been completed. In 2005, the Ministry of Industry published a list of 15 power projects open to foreign investment, with a combined capacity of about 11,500 MW. Few foreign companies responded to this announcement. Reasons for this are understood to include: legal and regulatory issues, low electricity purchase prices by EVN, a lack of a transparent and competitive market, and poor coordination among government agencies.

It is reported that there is a “long list” of private investors wanting to establish wholly foreign-owned thermal power plants in Viet Nam. The list includes companies from the United States, Japan, China, Singapore and Taiwan Province of China, each of whom purportedly wishes to develop projects with capacities in excess of 1,000 MW. Some of these parties, however, do not have an established record in developing major power projects, and others do not appear to have identified proposed sites. It will be important for Viet Nam to concretize preliminary signs of interest and be proactive in accelerating the implementation of new generation projects.

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Given the high demand growth and the long delays in bringing private investments in power generation to the implementation phase, Viet Nam should explore all avenues to attract (foreign) private investment in generation. Three main avenues are possible: (a) standard BOT projects; (b) zone-specific IPP projects; and (c) the equitization programme.

1. **BOT projects**

   BOT projects along the lines of the Phu My projects are likely to be the main avenue for FDI in power generation. A number of general measures will be required to make BOT projects attractive to investors, however, as underscored in the previous sections.

   There are a number of variations to the BOT model, including build-own-operate (BOO) projects, which do not require the transfer of asset ownership at the end of the contract period. Thermal power stations can have engineering lives greater than the 20-year PPAs typical for foreign owned power projects in Viet Nam. Maintenance costs, however, rise with the age of the plant and the operating regime might be expected to change as new, more efficient plants are commissioned. In practice, therefore, it is unlikely that there would be any significant impact of any change to the proposed investment model adopted.

2. **Zone-specific IPP projects**

   The Tan Thuan export processing zone was the first to be developed in Viet Nam in the early 1990s, as a partnership between the Central Trading & Development Group (CT&D, Taiwan Province of China) and the Vietnamese authorities. In addition to the basic zone infrastructure, CT&D built a 375 MW power plant in Hiep Phuoc to provide reliable power to its clients in the zone via a dedicated transmission line. Excess capacity is supplied to “Saigon South” – a new urban development centre also developed in partnership between CT&D and the local authorities – or to EVN.

   At the moment, tariffs for direct supplies from Hiep Phuoc to its clients in the zone are restricted to within 25 per cent of the equivalent EVN tariff. The Government has also indicated that it does not wish to replicate the Hiep Phuoc experience. This review recommends that the Government reconsider that position, but under certain conditions.

   The development of dedicated power plants should be allowed as long as such developments form part of the long-term programme for the electricity sector, in order to ensure their smooth integration into the national power network and to ensure that they are part of the least cost development programme. Such dedicated power plants could also bring a number of benefits:

   - They would fulfill part of the power need from a rapidly growing industrial sector.
   - They would provide reliable power to certain key zones, where power-sensitive industries could choose to locate.
   - Power plants developed under this framework would not require sovereign guarantees on PPAs, as power would be sold directly from the generator to companies established in the zones. This would help the Government reduce its contingent liabilities, which it has indicated it wishes to do.
   - If dedicated plants are allowed to supply excess capacity to the grid, but only on the spot market, they could contribute to the development of the spot market.

   The Government should thus reconsider its position on zone-specific IPP projects, and adopt a suitable regulatory framework. In particular, it should allow parties to freely negotiate tariffs and relax the
current linkage with EVN prices. Enterprises located in zones should have the freedom to choose EVN or the dedicated plant as their supplier of choice, and dedicated power producers should be allowed to charge a premium for reliability of power supply.

3. Equitization Programme

The equitization programme has recently extended to the power sector, with the sale of minority equity participations in five power plants on the stock exchange. Although the five companies are legally independent, the EVN Group retains a minimum of 60 per cent of capital in these companies. As mentioned earlier, a recent Prime Ministerial decision also requires that power plants of a capacity of 100 MW or more that are currently under public ownership will remain at least 50 per cent state-owned.

As part of the structural reforms, this Review recommends the creation of the VPC on the basis of EVN’s strategic power plants (section F.3), and the creation of a small number of power generation companies with the remaining EVN power plants. This would form part of a disaggregation of the EVN Group and the transfer of state-ownership of all assets from the Ministry of Industry and the EVN Group to the SCIC.

While the VPC would remain 100 per cent State-owned through the SCIC, the other power generation companies should be fully independent of each other, without cross-ownership, in order to promote competition and provide a level playing field for new entrants in the market. This would also allow equitized companies to take a more entrepreneurial position in the development of new generation independently of EVN. As long as EVN maintains controlling equity holdings in equitized power plants, the latter will remain reluctant to develop projects in competition with the parent company.

The Government should also consider the full equitization of at least one of the newly created power generation companies to a strategic foreign investor. Although this would not immediately increase generation capacity, it could result in an improvement in the efficiency and availability of existing resources. More importantly, it could accelerate the rate at which new generation projects can be developed by foreign investors, as it would be faster to develop extensions to existing power plants than to develop greenfield projects. It would also allow foreign investors to explore the Vietnamese market and could provide a stepping stone for greenfield projects, which could be partly financed from the cash-flow of existing plants.

4. FDI potential in generation

There is undeniably significant potential for FDI in the electricity industry in the coming years and as the power market develops. The area of most FDI potential and benefits to Viet Nam is power generation. Transmission will remain a 100 per cent state-owned monopoly, and it is unlikely that foreign investors would show much interest in acquiring and developing the distribution network.

The distribution network is monopolistic with no economic rationale for its duplication and the financial returns are therefore strictly regulated. The capital expenditure profile in distribution will be determined by the rate of growth in electricity sales and the replacement of existing assets which have reached the end of their lives. Over a period such as that which might be expected to form the basis of a contract, it is very difficult to assess the proposed level of capital expenditure, and therefore any investor will be dependent upon the approach adopted to tariff formulation. The lack of regulatory independence will inevitably deter foreign investors from the purchase of distribution companies, even if
such an option were open. It is likely also to deter investors from taking any significant positions in the equitized joint stock companies.

A number of first-tier investors have indicated interest in power projects in Viet Nam, but there is no significant project that is at an advanced stage of development. Given the long lead times needed to proceed through contractual negotiations to financial close and plant commissioning, it is unlikely that any major FDI project in power generation could become operational by 2010 at the earliest. It is also unlikely that major first-tier investors would commit to more than one project at a time, at least in the initial phase of development of the electricity market.

If Viet Nam were to adopt the bulk of the measures recommended in this review, one could expect that FDI from first-tier investors could account for up to about one third of the required additional generation capacity per year. This could still translate into very significant flows in excess of $1 billion per year after 2010 to add around 1,000 MW of capacity annually. In turn, failure to adopt some of the major reforms proposed in this Review would likely result in significantly lower interest from first-tier investors, delays in commissioning new plants, and a less competitive electricity market in the medium term.

J. Summary of recommendations

Viet Nam has made significant achievements in the past decades in developing its electricity infrastructure and in supplying the power its industrial development has required. Electricity demand is set to continue growing at an even more sustained pace in the future, and the Government is determined to progressively establish a competitive electricity market in order to provide the highest quality service at the most competitive cost. It follows that private investment is needed to provide competition among participants and that the role of EVN as a vertically integrate monopoly will change.

The development of the competitive power market opens significant opportunities for FDI, which Viet Nam could tap and benefit from. The realization of the potential will require a number of policies to be clarified or put in place in the near future. The key measures centre around the organization of (and transition to) the newly established market, the vertical disaggregation of the industry, the transformation of EVN, the role of regulatory institutions and commercial terms.

The recommended structural organization and ownership structure of the electricity industry are summarized in figure III.7. Such a structure will be necessary to attract FDI in electricity on a significant scale and sustained basis.
Figure III.7. Recommended structure of electricity industry in Viet Nam, phases 1&2

**Phase 1 (single buyer)**

EVN-VPC  Genco X  Genco Y  Genco Z  IPP X  IPP Y  IPP Z

Single buyer  Institute of Energy  Transmission company  National load dispatch centre

Disco X  Disco Y  Disco Z  Lg user X  Lg user Y  Lg user Z

Final user  Final user  Final user

**Phase 2 (competitive retail market)**

EVN-VPC  Genco X  Genco Y  Genco Z  IPP X  IPP Y  IPP Z

Wholesalers

Transmission company

National load dispatch centre  Institute of Energy

Disco X  Disco Y  Disco Z  Lg user X  Lg user Y  Lg user Z

Retailer X  Retailer Y  Retailer Z

Final user  Final user  Final user

Note: Shaded boxes indicate fully or partly State-owned companies. “Genco” stands for generation company, “Disco” for distribution company, and “Lg.” for large.
The key recommendations of this review centre around two issues: the market framework and operations.

1. Market framework recommendations

- **Genuinely disaggregate generation, transmission and distribution**: The three operations should be operated by legally separate companies, without cross-ownership.
- **Disaggregate the EVN group**: EVN should cease to be a vertically integrated power company. This would lead to the creation of a strategic power generation company on the basis of EVN’s key generation assets, the Viet Nam Power Company. A handful of other power companies would be created from the other generation assets. In turn, independent state-owned companies would be created for transmission (nation-wide monopoly), distribution and electricity services.
- **Separate the single buyer from EVN**: The single buyer in the transition to a wholesale market should be part of the proposed transmission monopoly, which would also include the National Load Dispatch Centre.
- **Transfer the ownership of State-owned companies from the Ministry of Industry to the SCIC**: Ownership of SOEs and regulatory functions should be separated. This would require that all State-owned assets be transferred as soon as possible to the SCIC, which has been created with the specific purpose of playing the State’s ownership functions.
- **Transfer the Institute of Energy to the independent transmission company**: The credibility and objectivity of the Master Plan must be as high as possible. This requires that the Institute of Energy be separated from EVN (VPC) in order to avoid conflicts of interest between a generation company and the main drafter of the Master Plan.
- **Strengthen ERAV and gradually increase its powers and independence**.

2. Operational recommendations

- **Seek to attract first-tier investors**: Attracting first-tier investors who possess and master the best and most efficient technologies available is important for a number of reasons, including to protect the local and global environment and public health, and to ensure that long-run electricity costs are minimized with the use of fuel-efficient technologies.
- **Gradually phase out sovereign guarantees**: Viet Nam will need to provide sovereign guarantees to foreign IPPs as it has done in the past if it wishes to attract first-tier investors in generation, at least in the near term. It should put in place a gradual phase-out strategy, underpinned by the establishment of a competitive market at the wholesale level and could provide sunset clauses in the sovereign guarantees provided until the phase-out is complete.
- **Create standard PPAs**: Standard PPAs should be prepared and made readily available to investors. This would not only accelerate the implementation of projects, but also reduce the cost of reaching an agreement for the Government and investors.
- **Establish competitive bidding for all power plants on the Master Plan**: All power plants listed on the Master Plan should be subject to competitive bidding open to private and public sector companies.
- **Make EVN-VPC the developer of last resort**: In order to ensure that overall plant requirements are met, create a datum against which other costs can be judged and minimize delays if other bids are unresponsive, EVN-VPC should be required to bid for all generation projects. In order to cover the cost of being required to bid for all projects, EVN-VPC could be granted a subsidy earmarked for that purpose.
- **Allow zone-specific IPPs**: Zone-specific IPPs should be allowed as long as they are part of the least-cost development programme.

- **Seek strategic investors in equitized power companies**: Equitizing one or two of the smaller power companies created from EVN’s generation assets to strategic foreign investors could be a useful tool to promote FDI, accelerate new greenfield projects and promote a competitive market for generation.
IV. MAIN CONCLUSIONS AND RECOMMENDATIONS

During the 20 years since Doi Moi, Viet Nam has undergone an extraordinary transformation from an isolated, poor and collectivized agriculture-based economy into a booming nation on the verge of becoming a new Asian Tiger. It has achieved an extraordinary reduction in poverty and is becoming a significant player in world trade.

Even though Viet Nam has only gradually opened to FDI, foreign investors have represented a major force in the process of economic transformation. They have underpinned the rapid development of the manufacturing sector and the strong increase in output, created more than one million jobs, offered higher-than-average wages, generated high levels of exports, transferred knowledge and skills, accounted for a significant portion of tax revenue and created employment for women.

The majority of FDI inflows to date has been concentrated in manufacturing for exports, partly as a result of legal restrictions on FDI entry. To a significant extent, foreign enterprises in Viet Nam still operate as enclaves, with relatively few linkages with national firms through supplier or buyer contracts. This is partly due to the predominance of export-oriented manufacturing FDI, the small number of large Vietnamese private firms, and limited structured efforts to promote linkages.

Viet Nam has the potential to attract much higher levels of beneficial FDI and to create more significant linkages with the local economy, as illustrated in UNCTAD’s World Investment Prospects Survey 2007–2009, where it ranks sixth among the most attractive economies for the location of FDI. There are already clear indications that foreign investment is diversifying into new and technologically more complex segments of manufacturing for exports, including consumer electronics and information technologies. The negotiation process for WTO membership has encouraged the Government to press ahead with structural reforms over the past 12 years, and formal accession in early 2007 means that a number of sectors that were previously closed to FDI will open in the near future, even though the Government has decided to maintain a significant number of restrictions to FDI entry. The potential for FDI in services is extremely large, including in banking, telecommunications, insurance, retail, distribution, higher education and infrastructure.

Doi Moi represented a systemic and structural breakthrough in economic policy, allowing private property ownership and encouraging private investment, both national and foreign. It marked the beginning of the transition towards a regulated market economy. Although the transition is extremely well advanced, it is still “work in progress”, and important structural and regulatory issues remain that affect policy towards FDI. These issues include:

- **The regulatory attitude towards private investment:** The current regulatory approach is biased towards “steer and control”, rather than “regulate, monitor and enforce”, as in long-established market economies. An approach that gives more freedom to investors in managing their businesses and a less intrusive regulatory attitude would promote more innovation and dynamism in the private sector.

- **The place of commercially-oriented SOEs in the economy and the nature of their interaction with private investors:** The policy and attitude that the Government will adopt as SOEs come under increasing competitive pressure from FIEs and emerging Vietnamese private enterprises will be key determinants of the investment climate in the near future.
The extent to which the Government will wish to protect the emerging Vietnamese private sector from competition from FIEs: FDI inflows to date have focused on manufacturing for exports and have not significantly competed with Vietnamese private firms in supplying the domestic market. This will change as Viet Nam is committed to lifting some FDI entry restrictions. The policy on the extent to which FDI – including by small-scale foreign investors – will be allowed to compete with Vietnamese private firms for the domestic market will be another important determinant of the investment climate.

The solutions to capacity constraints arising from Viet Nam’s rapid growth: These constraints are easily discernible in electricity and transport infrastructure and less visible, but none the less important, in areas such as human capital development and strengthening local business competitiveness needed to support upgrading and productivity growth.

The recommendations in this review address these key issues. The main recommendations are summarized below. Additional recommendations on the regulatory framework for investment are provided that are not summarized here but can be found in chapter II.

A. Doi Moi 2: unleashing the forces of innovation

The impact of Doi Moi in terms of economic development and poverty reduction has been remarkable, but much remains to be done to alleviate poverty and raise the standards of living to a level comparable to that of Viet Nam’s more developed neighbours, including Malaysia and Thailand. The issue that Viet Nam currently faces is how the legal and regulatory framework for investment should further evolve in the future so as to best bring about sustainable development, wealth creation and poverty reduction.

The Government should now consider a “Doi Moi 2” in investment policy in order to allow companies to become more competitive, innovative, flexible and in tune with the needs of the people and the market. It is timely to consider whether Viet Nam wishes to push all the way the logic and fundamental principle of a market-economy system, which is that agents have the freedom to identify and pursue business opportunities and to innovate – under a set of well defined and enforced rules aimed at protecting consumers and the national interest. The potential for innovation, creativity and ultimately prosperity in Viet Nam could be increased by adopting a less intrusive approach to investment regulation than is the case at the moment.

Concretely, Doi Moi 2 would imply to shift from a “steer and control” attitude to a “regulate, monitor and enforce” attitude in investment policy. This should be based on the presumption that investors – the market – are best informed of valuable business opportunities and that the role of the Government is to:

1. Set rules (regulations) in order to protect the people and the national interest;
2. Monitor whether market participants obey these rules;
3. Enforce the rules.

Concretely, this would mean to:

- Restrict FDI registration/certification procedures for foreign investors to an FDI entry compliance check.
- Draw up a full list of FDI entry restrictions: the nature and extent of FDI entry prohibitions, limitations and restrictions should be clearly defined, transparent and non-arbitrary.
- Remove investment registration and certification requirements for domestic investors.
- Apply regulatory rules to govern the market economy separately from the initial FDI registration/certification process: securing sectoral licences and company registration would be separate
processes from FDI registration/certification, and regulatory rules would apply equally and in a non-discriminatory manner (post-establishment) on both foreign and national investors.

- Cut down the number of Master Plans and redefine their function to policy documents that set out broad policy measures, rather than specifying specific targets and projects that need to be implemented. Remaining Master Plans would focus on the long-term planning of public infrastructure rather than private sector development.

Doi Moi 2 would also mean that investment regulation/promotion institutions take on stronger promotion, facilitation and aftercare role and reduce their regulatory and oversight functions. The latter would be exercised almost exclusively by sectoral oversight institutions, such as the central bank, the competition authorities or the electricity regulatory agency.

In addition, this review recommends that the corporate tax system be simplified and incentives be rationalized in order to promote investment further. A comprehensive assessment of the cost of benefits of fiscal incentives should be conducted and reforms undertaken in order to:

- Make the general corporate tax system attractive and competitive;
- Streamline and simplify the number of incentives and restrict them to a small number of specific objectives;
- Simplify the tax system and reduced the administrative burden on investors and the tax authorities.

B. Allow the FDI potential to be realized in key sectors

Viet Nam has gained tremendously from allowing the entry of foreign investors over the past two decades, even though the opening to FDI has been fairly gradual and partial. Under the WTO accession agreement, a number of services sectors will become open to foreign investors in the near future, including in particular financial services. In the next stage of opening to FDI, the Government should consider key backbone sectors where providing globally competitive services are vital to sustain economic progress, and which risk becoming bottlenecks. Well-orchestrated policies for attracting FDI in such sectors could generate large inflows of beneficial FDI and further promote the development of the economy. These backbone services are:

- Telecommunications;
- Electricity;
- Transport;
- Higher education and vocational training.

Attracting beneficial FDI in these sectors will require a coherent and properly planned strategy of market liberalization. Similarly to the policy of gradually opening to FDI applied in the past two decades, a gradual approach could be adopted to ensure that the benefits of opening to FDI are maximized, while the potential costs or disruptions are avoided or minimized. The Government is putting in place such a strategy in the electricity sector, and this review proposes a number of measures to attract FDI in power generation. It is recommended that similar strategic reviews and policy packages be prepared for telecommunications, transport and higher education.
C. Promote FDI in new and dynamic sectors

Keeping up with the rising demand for core infrastructure services is a necessity to sustain the rapid pace of economic development of the past two decades. Increasing the quality of services in telecommunications, electricity and transport and further raising the skills level of the labour force would also better position Viet Nam to attract FDI in new and dynamic sectors. Although it is not the mandate of this review to propose an overall FDI strategy, it is suggested that Viet Nam should start elaborating and putting in place a broadened strategy of FDI promotion and attraction. Such a strategy would no longer focus mostly on FDI in export-oriented manufacturing activities, but would be broadened to FDI in new and dynamic sectors, including in services. It would also seek to enhance the role of Viet Nam as a logistics centre in the Greater Mekong subregion and as a business hub for TNCs operations in the ASEAN area.

D. Provide necessary skills to the rapidly evolving economy

One of Viet Nam’s key assets in attracting foreign investors is its relatively low labour costs, combined with a productive, industrious and trainable workforce. This has allowed the country to attract a large number of foreign investors in labour-intensive sectors that require either relatively low skills (textile and garments) or intermediate skills (consumer electronics and basic manufactured goods). More recently, Viet Nam has also started to attract foreign investors in need of more highly skilled workers.

As it continues to develop, Viet Nam will require more and more skilled workers in a wide variety of fields. While education policy will underpin the development of such skills, Viet Nam would greatly benefit from setting up a proactive immigration policy to facilitate the entry of foreign skills that are in short supply but needed by its economy. Such a policy would seek to achieve the twin purpose of selectively attracting skills in short supply locally and to promote skills transfer, thereby complementing the education-based skills development policy. It would replace the current restrictive regime of entry of foreign workers and would be articulated along the following principles:

- Conduct a comprehensive skills and labour market audit and update it on a regular basis.
- Establish a migration occupations in demand list on the basis of the skills and labour market audit. The list would identify a detailed set of specific occupations where there are insufficient workers in Viet Nam at the level of qualification required by employers. The list should be forward-looking in assessing the needs of the labour market and updated regularly.
- Facilitate and promote the entry of foreign workers who possess qualification on the migration occupations in demand list.
- Promote the transfer of skills to Vietnamese workers through targeted programmes.

E. State ownership and regulatory functions

State-owned enterprises represent a sizeable share of output and most are involved in essentially commercial activities where they are likely to face increasing competitive pressure in the future from private investors, Vietnamese and foreign. The extent to which the Government may seek to protect fledgling SOEs engaged in commercial activities from competition and possible bankruptcy will be an important determinant of the investment climate. Excessive protection, subsidies or an un-level playing field could have wide repercussions and sour the overall investment climate, thereby discouraging Vietnamese and foreign private investment.
The current approach is to use the SCIC to improve management performance in SOEs and prepare them to face fair competition under a market economy framework. The purpose of the SCIC is also to start putting in place a clearer separation between the State’s ownership and regulatory functions. This approach will be very time consuming, however, and may not prove fast enough in the face of a rapidly evolving economy and investment climate.

In the end, regardless of the extent to which the authorities wish SOEs to remain involved in economic activity, the crucial element in terms of the regulatory framework for investment is that the ownership and regulatory functions of the State be properly ring-fenced in order to provide a level playing field between public and private investors. This will be all the more important as competitive pressures on SOEs increase and as the threat of bankruptcy of some SOEs rises.

While some steps have been taken to separate ownership and regulatory functions, this Review recommends additional steps to ensure a level playing field between private and public companies in commercial activities, including to:

- Transfer the ownership of all SOEs to SCIC and mandate it to enforce hard-budget constraints on all of them.
- Equitize SOEs in purely commercial and non-strategic activities, with the State selling all or the majority of its shares.
- Narrow the list of SOEs in which the State will maintain 100 and 50 per cent ownership to companies operating in genuinely strategic or socially sensitive sectors.
- Establish and publish a comprehensive census of all SOEs, together with a full audit of their assets and liabilities and ownership structure.

Viet Nam has greatly improved the legal framework for heavily regulated sectors (e.g. telecommunications, electricity, banking, transport, higher education) and for competition in recent years. It has also started to put in place an institutional framework for the enforcement of regulations. In most cases, the enforcement institutions are a Department within the parent Ministry. While this kind of arrangement may be suitable for the moment, Viet Nam should aim to create independent regulatory institutions with their own enforcement powers. Such an arrangement is likely to be the only one susceptible to guarantee the impartial enforcement of the rules of the game to public and private investors alike. The aim should be for the Government to turn the key regulatory Departments within various Ministries into independent institutions soon after they have built up and demonstrated their capacity to enforce the laws and regulations.

F. Attracting FDI in electricity

Viet Nam aims to establish a competitive power market at the retail level by around 2025. Concurrently, the Government wishes to attract significant levels of private investment in the sector, in order to ensure that the power market be genuinely competitive and that the large expected increase in electricity demand be met with high-quality and reliable supply. It also wishes that its exposure to commercial risk in the electricity sector be minimized, if not eliminated altogether.

The establishment of such a competitive power market is a very complex undertaking, and the Government has done well to adopt a gradual and stepped approach. This Review suggests market
framework and operational recommendations in order to promote a smooth transition to the competitive power market and create the conditions needed to attract foreign investors in power generation on a significant, sustainable and mutually beneficial basis.

1. Market framework recommendations

- **Genuinely disaggregate generation, transmission and distribution**: The three operations should be operated by legally separate companies, without cross-ownership.
- **Disaggregate the EVN group**: EVN should cease to be a vertically integrated power company. This would lead to the creation of a strategic power generation company on the basis of EVN’s key generation assets, the Viet Nam Power Company. A handful of other power companies would be created from the other generation assets. In turn, independent state-owned companies would be created for transmission (nation-wide monopoly), distribution and electricity services.
- **Separate the single buyer from EVN**: The single buyer in the transition to a wholesale electricity market should be part of the proposed transmission monopoly, which would also include the National Load Dispatch Centre.
- **Transfer the ownership of EVN and other SOEs in the sector from the Ministry of Industry to the SCIC**: Ownership of SOEs and regulatory functions should be separated. This would require that all State-owned assets be transferred as soon as possible to the SCIC.
- **Transfer the Institute of Energy to the independent transmission company**: The credibility and objectivity of the Master Plan must be as high as possible. This requires that the Institute of Energy be separated from EVN (VPC) in order to avoid conflicts of interest between a generation company and the main drafter of the Master Plan.
- **Strengthen ERAV and gradually increase its powers and independence.**

2. Operational recommendations

- **Seek to attract first-tier investors**: Attracting first-tier investors who possess and master the best and most efficient technologies available is important for a number of reasons, including to protect the local and global environment and public health, and to ensure that long-run electricity costs are minimized with the use of fuel-efficient technologies.
- **Gradually phase out sovereign guarantees**: Viet Nam will need to provide sovereign guarantees to foreign IPPs as it has done in the past if it wishes to attract first-tier investors in generation, at least in the near term. It should put in place a gradual phase-out strategy, underpinned by the establishment of a competitive market at the wholesale level and could provide sunset clauses in the sovereign guarantees provided until the phase-out is complete.
- **Create standard PPAs**: Standard PPAs should be prepared and made readily available to investors. This would not only accelerate the implementation of projects, but also reduce the cost of reaching an agreement for the Government and investors.
- **Establish competitive bidding for all power plants on the Master Plan**: All power plants listed on the Master Plan should be subject to competitive bidding open to private and public sector companies.
- **Make EVN–VPC the developer of last resort**: In order to ensure that overall plant requirements are met, create a datum against which other costs can be judged and minimize delays if other bids are unresponsive, EVN–VPC should be required to bid for all generation projects. In order to cover the cost of being required to bid for all projects, EVN–VPC could be granted a subsidy earmarked for that purpose.
• **Allow zone-specific IPPs:** Zone-specific IPPs should be allowed as long as they are part of the least-cost development programme.

• **Seek strategic investors in equitized power companies:** Equitizing one or two of the smaller power companies created from EVN’s generation assets to strategic foreign investors could be a useful tool to promote FDI, accelerate new greenfield projects and promote a competitive market for generation.
ANNEX I: INVESTMENT PROMOTION AND FACILITATION

A.I.1. Background

Viet Nam’s decentralized administrative system raises issues for the conduct of investment promotion. When local levels of government have extensive investment promotion powers it is important that national and provincial levels of Government ensure that there are no gaps, no unnecessary competition or duplication and no confusion in presenting Viet Nam in the best possible way to foreign investors.

The issues raised in this annex reflect comments received from persons interviewed during the fact-finding stage of this report and UNCTAD’s experience of similar issues encountered in other countries. The findings are not based on a detailed or exhaustive survey of provincial investment promotion arrangements. As such they raise considerations and suggestions rather than firm recommendations.

A.I.2. The current investment promotion structure

In Viet Nam, many of the administrative functions that affect investors are devolved to the provinces. These functions include processing and approval of the entry and establishment of foreign investors and some secondary permitting functions such as environmental permitting and land titles. The national government sets the legal framework, which is common to all provinces, and also retains the prerogative of final approval on large or strategically important projects (chapter II).

As part of this devolution, the provinces have wide scope to undertake “investment promotion” (box A.I.1). As used in this annex, the term “investment promotion” includes the range of activities usually coordinated by an investment promotion agency to attract and facilitate FDI. In particular, they include:

- Image building;
- Lead generation;
- Facilitation;
- After-care.

Administrative decentralization raises important issues for investment promotion:

- How can less advantaged provinces ensure that their opportunities for FDI are marketed as professionally and energetically as those in the richer and better-situated provinces?
- How can dynamic investment marketing by provinces be encouraged, but unhealthy competition between provinces be avoided? Unhealthy competition can include relatively mild problems such as multiple approaches by different provinces to the same prospective investor. At worst, it can involve behaviour that is not in the interest of Viet Nam as a whole – such as one province denigrating another or provinces competing with one another to provide incentives that go beyond what is required to induce the investment in Viet Nam.

Broadly speaking, a choice has to be made between a decentralized model and a collaborative model. A decentralized model is where the local level takes the lead in investment promotion (the states in Brazil and the United States are examples of this). In a collaborative model there is an agreed share of responsibilities between the national and local levels. Typically the national level takes the lead in overseas marketing and lead generation while the local level handles investor site visits, facilitation and after-care (Australia and the United Kingdom are examples of this).
Box A.I.1. Viet Nam’s decentralized investment promotion system

At the national level, investment promotion is formally the responsibility of the Ministry of Planning and Investment. MPI has a specialized foreign investment promotion unit, the Foreign Investment Agency (FIA) based in Hanoi. FIA has three regional units – North, South and Centre – which were opened in 2004. The regional units provide training and promotion support to the provincial administrations.

Investment promotion in Viet Nam is decentralized to the provinces as part of the overall decentralization of administration. Each province has a Department of Planning and Investment (DPI), which is its principal investment promotion arm. The DPI reports to the People’s Committee of the province.

In Ho Chi Minh City (which has the status of a province) there is not only a DPI but also a separate trade and investment promotion agency (the Investment and Trade Promotion Centre), which is funded directly by the People’s Committee.

Many provinces have at least one industrial zone, which are key elements in Viet Nam’s FDI offer. Typically, zones are owned wholly or partly by the provincial administration. In joint venture cases, provinces often grant land as their equity contribution. All zones, including those established by provincial administrations, require approval by the Prime Minister.

The provincial zone Management Committee, which reports to the provincial People’s Committee, administers zones. Zones may have their own promotion and facilitation capabilities, especially where there is co-investment with a private zone developer.

Source: UNCTAD.

The decentralized model takes full advantage of local dynamism in investor marketing but risks duplication, confusion and unhealthy competition. Less advantaged States can also be left behind. The collaborative approach can be more efficient in utilizing expensive marketing resources, in providing a coordinated and seamless marketing service and in assisting poorer provinces to get their message across. Viet Nam has adopted most features of a decentralized model. The question is how best to support its good features and to avoid its drawbacks.

A.I.3. The pattern of FDI and regional inequality

As in most countries, Viet Nam has significant disparities in prosperity between provinces. Per capita GDP in or near the major cities of Hanoi, Ho Chi Minh City and Da Nang can be many times higher than in the poorest provinces. The poorest provinces are clustered in the far North bordering China and inland provinces of the Central Highlands and the Mekong River Delta.

In general, the individual provinces’ shares of FDI inflows closely parallel their current state of development, except in the very poorest provinces. Thus FDI is not contributing to further regional inequality within Viet Nam. This is a positive result because FDI inflows elsewhere can be highly skewed.

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96 Viet Nam has 64 provinces, including five municipalities with provincial status. For simplicity, any reference to provinces in this annex includes a reference to these five municipalities.
towards one or two key metropolitan areas. Table A.I.1 compares the share of foreign investment inflows in the richest and poorest provinces with those provinces’ share of GDP. Only in the 10 poorest provinces is there a notably lower share of FDI than the provinces’ share of economic activity.

Table A.I.1. FDI inflows to provinces

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<tbody>
<tr>
<td>10 richest</td>
<td>1099</td>
<td>8.3</td>
<td>5.2</td>
</tr>
<tr>
<td>20 richest</td>
<td>403</td>
<td>0.5</td>
<td>1.4</td>
</tr>
<tr>
<td>20 poorest</td>
<td>233</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>10 poorest</td>
<td>186</td>
<td>0.1</td>
<td>0.4</td>
</tr>
</tbody>
</table>

1 Based on Nguyen Ngoc Anh and Thang Nguyen (2007).
Note: Years do not correspond exactly due to data limitations. Foreign investment is registered foreign investment.
Source: General Statistics Office.

Clearly, certain provinces have intrinsic advantages such as large local markets, proximity to ports or natural resources and will always tend to attract the largest volumes of FDI. But it is important to put in place policies that help all provinces to attract FDI in keeping with their intrinsic potential.

Zones of various kinds have been key instruments in attracting FDI. They account for about 32 per cent of total FDI inflows. Zones can have a particularly important role in attracting FDI to the poorer provinces because they can provide quality infrastructure and services that may not be otherwise available. Thirty-six provinces have at least one zone. However, most zones are clustered in the richer provinces and many of the poorest provinces have no zone (table A.I.2).

Table A.I.2. Zones establishment by province

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Number of zones as of 2006</th>
<th>Number of zones started 2003–2006</th>
</tr>
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<tbody>
<tr>
<td>10 richest</td>
<td>57</td>
<td>13</td>
</tr>
<tr>
<td>20 richest</td>
<td>67</td>
<td>20</td>
</tr>
<tr>
<td>20 poorest</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>10 poorest</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

1 Zones licensed and in operation.
Source: General Statistics Office.

Zones are such an important instrument of FDI attraction in Viet Nam that there is a case for additional national Government assistance to the poorer provinces to establish zones with first-class infrastructure. Consideration could be given to providing additional facilities to zones in poorer provinces such as subsidies for low-cost housing and training for employees. These are currently key constraints for zones in the more advanced provinces.

In Brazil, the South-East region in 2000 attracted nearly 87 per cent of all FDI inflows and had a 58 per cent share of national GDP.
Foreign investment shown in the table is registered foreign investment as defined in Viet Nam. This differs in several ways from the internationally used definition of FDI.
A.I.4. Trends and issues in Viet Nam’s investment promotion effort

A.I.4.1. Image building and promotional material

To date, Viet Nam has not launched a major branding and overseas image-building campaign. Arguably, there has been little need to do so as Viet Nam is a large country in the dynamic South-East Asian region. Events and geography are on Viet Nam’s side. The region will automatically feature in TNCs’ manufacturing location plans and as a large country, Viet Nam is virtually guaranteed to make at least the long list of locations for investment during the site-selection process. The entry of blue chip foreign investors such as Intel and major TNCs from Japan and Taiwan Province of China sends tangible messages about the quality of Viet Nam as a manufacturing location. While this is the case for manufacturing it is not yet the case for export services or for infrastructure.

Promotional literature is produced and provided on websites by the Foreign Investment Agency, by some provincial DPIs, by chambers of commerce and in some cases by individual industrial zones. These publications provide a similar range of information covering economic statistics, incentives, labour, land and utilities costs, applicable laws and application procedures. While most of the information is produced by provincial organizations it generally has both a national and local flavour. Some of this material features lists of “projects calling for investment”. These lists are unlikely to be appealing to foreign investors. They tend to be long “wish lists” of projects, some of which are municipal infrastructure that give the impression of being leftovers from public investment plans. At this level of general promotion it might be preferable to suggest key investment themes at an industry or sectoral level rather than list specific projects calling for investment.

A.I.4.2. Foreign investment lead generation

It is at the level of foreign investment lead generation that Viet Nam’s decentralized investment promotion system will be most tested. There is more scope for collision of interests at this level than in facilitation and after-care, which deals with investors who have already made their location decisions. In particular:

- Will the active provinces confuse investors with multiple approaches or, worse, denigrate other provinces in order to win business?
- Will the less advantaged provinces have an opportunity to attract a share of FDI commensurate with their underlying potential?

The overall lead generation effort is at an embryonic stage. It mostly consists of government-led delegations to important target countries. These delegations include provincial DPI representation and industrial zone representation, most often from the more advanced provinces and chambers of commerce. These appear to be “meet and greet” events rather than highly targeted marketing exercises. But they are likely to be important vehicles for prospective investors to establish contacts with high-level officials and to gain a sense of the political support available. Given that all foreign investment in Viet Nam requires government approval and often assistance in matters such as land acquisition, these contacts are important.

Given Viet Nam’s strong fundamentals in attracting foreign investment, especially in manufacturing, the absence of highly targeted lead generation activity probably has a low opportunity cost in terms of
investment forgone. Viet Nam has been in the right place at the right time and with the right profile of
large volumes of good low cost labour. It has caught a wave of manufacturing diversification from China
and benefits from political sensitivities that certain major regional home countries have with China. For
these reasons it is almost automatically on the long list of possible sites of prospective foreign investors.
FDI in lower-end labour intensive manufacture is now being supplemented by FDI in high-tech but labour
intensive manufacture. The relaxation of restrictions on services FDI agreed as part of Viet Nam’s entry
to WTO will certainly elicit FDI in these activities without the need for active marketing. The domestic
market is large and growing fast; foreign services investors will not ignore it.

Foreign business associations are active and network closely with DPIs (at least in Hanoi, Ho Chi
Minh City and surrounding provinces). They do not generally have a proactive lead generation role. But
they assist by providing information about Viet Nam to newcomers and can be helpful in arranging site
visits.

There is little active one-to-one foreign investor targeting work based on detailed investment
propositions undertaken at any level of government. FIA and DPIs produce general marketing material
with geographical and statistical information and details of investment regulations. In addition, DPIs publish
lists of “projects calling for investment” for which investors are sought. These tend to be property and
infrastructure projects in their locales or solicitations from local business for joint venture partners. They
tend not to be solicitations for manufacturing or services investments that could be located in any part
of Viet Nam. The project lists give the sense that they are projects to be applied for rather than projects
for which DPI will actively solicit investment.

The lack of specific investor targeting and the local nature of the marketing material reduces the
risk of duplication and multiple approaches in overseas marketing. Two future developments will change
this situation. First, more provinces will want to set up overseas representative offices. Da Nang has an
office in Tokyo. Ho Chi Minh City has a representative office in Singapore to promote investment, trade
and tourism. Others will want to follow suit to maintain their relative profile. However, it is simply not
feasible for all 64 provinces to have representative offices abroad. It would be too expensive from a
national standpoint. Second, more specific investor targeting is likely to emerge as provinces seek to
upgrade into more technology intensive manufacturing and services. Both developments will increase the
risks of duplication and of individual provinces disparaging their provincial competitors.

The Government has taken two important steps that could mitigate these risks. It has announced that
the national Government will set up representative offices for investment promotion in nine countries. It
is also encouraging three groups of provinces to cluster as unified investment promotion themes.

The establishment of overseas representative offices was announced in 2007. To be most effective they
should develop a clear understanding with provinces as to how they will collaborate in lead generation so
that Viet Nam as a country gets on short lists. Equally, they must be able to demonstrate to all provinces
in their work methods that they will fairly represent their interests, especially when recommending to
prospective investors in which provinces to undertake site visits.

The second initiative is the designation in 2004 of key economic zones or regions. These are three
clusters of neighbouring provinces in which a major city is the economic driver. The Northern key
economic region comprises eight provinces led by Hanoi with a theme of upgrading agriculture and
industry and developing a comprehensive services base. It includes infrastructure investment focused on improving infrastructure in and connected to Hanoi. Investment promotion is organized along industrial corridors, which specialize in particular industries.

The Central key economic region comprises six provinces, including Da Nang city as the driving force. Investment promotion emphasizes heavy industry such as petrochemicals and steel. It is planned to emphasize this region’s role as a hub for the Mekong Region since it is on the East–West corridor of the Greater Mekong subregion transport programme and there will be complementary port improvements. The Southern key economic region involves Ho Chi Minh City and six neighbouring provinces. The themes of investment promotion is the attraction of export IT hardware and software investors, the building of key infrastructure which includes developing seaports and connecting infrastructure to benefit all provinces in the region (the present Ho Chi Minh City port facilities are crowded river port facilities). A new airport and training and research facilities will be built outside Ho Chi Minh City.

The economic region concepts are still in their early stages, but they should be helpful in incorporating neighbouring provinces in a coordinated rather than conflicting investment promotion campaign. Economic regions are also starting to differentiate the investment offer of various areas of Viet Nam. They offer the prospect of combining the best of Viet Nam’s public investment planning capabilities with more targeted forms of investment promotion. So far, the principal investment promotion activities appear to have been in-country exhibitions in the form of investment marts.

The economic regions concept is also a useful way of systematically helping investment promotion by the disadvantaged provinces and areas within the regions. However, so far only one of the poorest 10 provinces is included in any of the three special economic regions (and only 2 of the 20 poorest provinces). All 10 of the richest provinces participate in one or other of the regions.

A.I.4.3. Investment facilitation

All the relevant laws and regulations are set at the national level and are uniform throughout the country. However, given the rapid changes taking place in business regulations, there is the risk that legal interpretations and treatment of investors could vary considerably across provinces. UNCTAD’s interviews with the private sector suggest that provincial level civil servants, especially in the less advantaged provinces, may not fully understand what is required.

There is no systematic investor facilitation provided by DPIs except where land clearance is needed (a provincial function). There may be ad hoc assistance on request. Some of the zones are more active in providing facilitation assistance although the only on-site body is customs.

As noted in Chapter II, the 2005 Investment Law has decentralized the authority to issue investment certificates to the provincial level. Investment certificates are issued either by the People’s Committee or by the Management Committee of a zone, if the investment is located in a zone. Most projects involving foreign investors will require an evaluation process. This process requires that all affected line ministries approve the project. It involves steps that a foreign investor would not normally encounter in other countries. In particular, projects will normally require assessment as to whether they are in conformity with applicable master plans. (box II.1, chapter II).

The approval process is coordinated by the People’s Committee or the zone Management Committee. Investment certification or regulation does not mean that all regulatory permits have been obtained. (For
example, even if the provincial environmental agency approves the project, an environmental permit will still need to be obtained as a subsequent step.) But the coordination role of the People’s Committee has the merit of giving the investor comfort that many key government agencies have been consulted and have no objections to the investment. This should reduce the risk of surprises when operating permits are applied for.

Nevertheless, the pre-establishment process is complex and could easily lead to lengthy delays in investment approvals and to non-transparent decision-making. On the whole, these problems are not on a scale that deters investors. Provinces that are keen to attract investment will try to make the system work. In this respect, the national Government has urged the provincial authorities to set up “one-stop shops” to facilitate investor permitting. These one-stop shops are not, however, the same mechanism that is used in many other developing countries.

A one-stop shop is typically managed by the investment promotion agency. It provides office space within its premises for representatives of the government agencies that investors must deal with. This enables investors to have face-to-face contact with these representatives in a single place in a welcoming and helpful environment. Investors do not have to visit many individual agencies, at least for their initial enquiries. Viet Nam’s concept of a one-stop shop does not seem to be a centralized system but the provision of a single point of contact within each individual ministry and agency. This is an approach of “many shops” rather than a true one-stop shop.

Provinces that are keen to facilitate investment could consider setting up a one-stop shop managed by the Department of Planning and Investment or, where it exists, the specialized investment promotion agency of the Peoples Committee. Such a facility could service all prospective investors in the province, both inside and outside zones.

A one-stop shop would have the following features:

- A centralized facility should be established in the offices of the investment promotion agency with representatives from key ministries and agencies that deal with investors;
- The facility should be comfortable and welcoming. It should not represent the regulatory face of the DPI but the facilitation face;
- On-site representatives should have customer service training and appropriate language skills as well as in-depth knowledge of the regulatory requirements on their parent agencies. Customer service standards should be agreed with each agency and monitored by the management of the one-stop shop;
- Telephone and on-line enquiries should be enabled as well as personal visits. Customers should be supported to make on-line information searches of regulations. There should be links to the one-stop shop established on the investment websites of the DPI, the chambers of commerce and the websites of other government ministries and agencies that have regulatory oversight of business.

99 For example, the one-stop shop operated by Egypt’s investment promotion agency has on-site representatives of 52 government ministries and agencies.
100 Where possible these representatives may also have the authority to issue permits on site. For example, in Egypt’s one-stop shop the representatives of 16 agencies have been authorized to issue permits. Representatives of the remaining agencies act as liaison officers with their headquarters.
101 Such as the Investment and Trade Promotion Centre in Ho Chi Minh City.
102 Under the current Investment Law, Viet Nam’s DPIs have a prominent regulatory function. They differ from the investment promotion agencies of most countries, which have principally promotion and facilitation functions. Viet Nam’s DPIs have the awkward task of handling both regulatory and facilitation roles side by side. Chapter II suggests that in time the DPIs should have a less prominent regulatory role.
An important aspect of one-stop shops is customer service training of representative and capacity building in the DPI to manage the one-stop shops. The regional centres of the Foreign Investment Agency would be good candidates to provide this kind of training. The priority in assisting provinces to establish true one-stop shops could be given to the 20 poorest provinces and especially those that rank low on the Provincial Competitiveness Index (box A.I.2).

**Box A.I.2. The Provincial Competitiveness Index**

Viet Nam published a Provincial Competitiveness Index (PCI) in 2005 and 2006, which ranks provinces in terms of treatment of and support to investors. It aims to help the provincial authorities to understand the problems confronting the private sector and improve their administrative processes in dealing with investors. The PCI is an initiative of the Viet Nam Chamber of Commerce and Industry (VCCI) and the United States Agency for International Development (USAID)-funded Viet Nam Competitiveness Initiative (VNCI).

The PCI uses a combination of survey data from businesses describing their perceptions of the local business environment and data from official sources regarding local conditions. Provinces are rated on 10 indicators as follows:

- Entry costs;
- Land access and security of tenure;
- Time costs of regulatory compliance;
- Informal charges;
- SOE bias (competition environment);
- Pro-activity of provincial leadership;
- Private sector development services;
- Labour training;
- Legal institutions.

Provinces are rated against each other on each component of the indicators rather than on international comparators. Best practice is thus determined by local peers rather than on the basis of potentially unattainable international standards.

The sponsors of the index report that some provincial governments have been quick to respond to the PCI rankings, most commonly by requesting a customized diagnostic analysis of their province’s performance. Many provinces have since implemented new measures to promote business participation in the policy and planning process, to streamline licensing and to improve information for investors.

Source: The Viet Nam Provincial Competitiveness Index 2006, Measuring Economic Governance for Private Sector Development, Summary Report. Viet Nam Chamber of Commerce and USAID.

Table A.I.3 shows the performance of the poorest provinces in their rankings on the PCI, which is the best available indicator of administrative performance at provincial level. As may be expected, the poorest provinces tend to be among the least effective administrators of investment regulations and services. Yet the results also demonstrate what poor provinces can achieve. The fact that the 4 of the 10 poorest provinces rank among the 20 most effective administrators is encouraging and indeed one of these, Lao Cai, is ranked 6th compared with Ho Chi Minh City (7th) and Hanoi (40th). The regional
units of FIA should have programmes to assist willing provinces to improve their performances. Priority could be given to assisting the poorer and more remote provinces.

**Table A.I.3. Ranking in Provincial Competitiveness Index, 2006**

(Number of provinces per category)

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Top 10</th>
<th>Top 20</th>
<th>Bottom 20</th>
<th>Bottom 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 poorest</td>
<td>1</td>
<td>4</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>10 poorest</td>
<td>1</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Viet Nam Provincial Competitiveness Index 2006.

**A.I.4.4. Investor after-care**

After-care means the range of services offered by investment agencies to investors to support the retention and expansion of their investment and build linkages between local suppliers and foreign affiliates. This function is becoming a key deliverable of investment promotion agencies. There appear to be no well-developed after-care programmes among Viet Nam’s investment agencies. In relation to investment expansion, the government approach is regulatory rather than supportive since investment expansions require a new round of registration or certification.

In relation to linkages, international research on best practices suggests that active government support is vital in areas of policy, training and SME development. In Viet Nam, linkage programmes have relatively little government support (in contrast, for example, to Malaysia’s Penang programme). Unilever Viet Nam’s successful linkages programme has been a company initiative rather than a joint initiative.

Most aspects of after-care are well-suited to decentralized systems of investment promotion. They involve working closely with the day-to-day operations of foreign affiliates once they have established in the province. There is less scope (compared for example with lead generation) for duplication or conflict with efforts at national level or by other provinces.

**A.I.5. Summary**

Investment promotion as discussed in this annex includes the range of activities from image building, investor targeting, facilitation and after-care. Viet Nam’s highly decentralized administrative system presents challenges for effective investment promotion. These are to ensure a coherent and cost-effective promotion effort from a national standpoint and to ensure that the poorer provinces are not left behind.

In some important respects Viet Nam’s approach meets these challenges. The uniform national policy on taxation sharply reduces the scope for provinces to bid too aggressively against each other and provide incentives that may be greater than is required to attract an investment to Viet Nam. Under the leadership of People’s Committees, the provinces nevertheless have strong authority to promote inward investment and the opportunity to offer excellent facilitation of businesses in the establishment and post-establishment phases. This sets the stage for beneficial competition amongst the provinces. The recent creation of the Provincial Competitiveness Index (PCI) is an excellent initiative. It enables provinces to benchmark and improve their administrative processes and related facilitation and after-care services. Few other developing countries have such a sophisticated system.

Some current and emerging challenges need consideration.

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103 UNCTAD (2007a).
A.I.5.1. Achieving coherent, cost effective foreign investment marketing

Viet Nam currently attracts large FDI inflows without the need for aggressive promotion, including specific investor targeting. Provinces have been able to market themselves individually without colliding. This could change as provinces upgrade their efforts. They may target specific industries and possibly the same investors. More may open their own representative offices in target countries. It will not be sensible for all 64 provinces to open overseas promotion offices, and a degree of national coordination is needed.

The Government has taken two steps in this regard:

- National investment promotion offices will be opened in nine key target countries. This is an essential step towards better organized promotion of Viet Nam as a whole. To succeed, the overseas offices need to: (a) develop clear understandings with provinces as to their respective roles and modalities; and (b) be able to demonstrate to all provinces that their interests are being appropriately reflected in promotional activities and in guiding prospective investors as to where to undertake site visits.
- Special economic regions have been designated in the North, Centre and South and there is now an attempt to differentiate the investment offer of each region. The regional concepts are at an early stage but they should be helpful in coordinating and harmonizing the marketing effort for groups of provinces.

A.I.5.2. Offering better investment facilitation and after-care

The FDI entry and establishment process is complex and is undergoing rapid change. This increases the possibility of slow or inconsistent treatment of investors. The after-care process to encourage expansion and better integration with local partners and suppliers is not developed at national or provincial level. Steps to consider for each People's Committee are to:

- Set up within the DPI true “one-stop shops” which contain representatives of all the principal administrative agencies to give information, guidance and support to investors in the permitting process.
- Begin after-care programmes as an integral part of the work of the DPI to support (not interfere with) the initiatives of foreign affiliates.

A.I.5.3. Helping the poorer provinces

Inevitably, some provinces are better endowed and better located than others and they attract more FDI. But on the whole, FDI does not exacerbate existing provincial inequalities, unlike in other countries. However, the very poorest provinces lag in FDI attraction. The Government could consider using systems already in place to aid the poorest provinces:

- Directly assist and subsidize the poorer provinces to establish zones with first class infrastructure. Zones have been a key instrument in Viet Nam’s success but almost a half of the provinces, and most of the poorest ones, do not have one. Consider special facilities to improve their attractiveness such as the provision of low-cost housing and training grants for employees.
- Establish a special unit within FIA to assist the poorest provinces to develop more specific, better researched and more targeted investment propositions than the current “projects calling for
investment” offer. The propositions so developed should link directly into the work programmes of the proposed national investment promotion offices to be set up overseas.

- Give priority, through the regional offices of FIA, to the poorest provinces in setting up true one-stop shops for investor facilitation.
- Consider piloting further liberalization measures in the poorest provinces – including streamlining certification and registration procedures for new projects and expansions, and accelerating equitization.
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