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Foreword

This second *OECD Investment Policy Review of Viet Nam* uses the updated OECD *Policy Framework for Investment* to present an assessment of the investment climate in Viet Nam and to discuss the challenges and opportunities faced by the Government of Viet Nam in its reform efforts. It includes chapters on foreign investment trends and performance, the entry and operations of foreign investors, the legal framework for investment, corporate governance and competition policy, tax reforms, investment promotion and facilitation, infrastructure connectivity, investment policy framework for green growth, and policies to promote and enable responsible business conduct.

The *Review* was prepared in partnership with the ASEAN Secretariat and in close collaboration with an inter-ministerial taskforce established and chaired by the Ministry of Planning and Investment. A draft version of the *Review* was discussed at a workshop with ministries and government agencies organised by the Government of Viet Nam and at a workshop with embassies and business representatives from OECD countries in Hanoi in April 2016. The draft *Review* was also presented and discussed in the OECD Advisory Group on Investment and Development in Paris in October 2016.

The *Review* has been prepared by a team comprising Stephen Thomsen, Alexandre de Crombrugghe, Fernando Mistura, Hélène François, John Hauert, Tihana Bule, Naeeda Crishna Morgado, Nariné Nersesyan, Austin Tyler and Ruben Maximiano from the Investment, Corporate Affairs and Competition Divisions of the OECD Directorate for Financial and Enterprise Affairs, the OECD Development Co-operation Directorate and the OECD Centre for Tax Policy and Administration. Secretariat inputs were received from Maria Borga, Emilie Kothe, Chung-a Park, Dirk Röttgers, Monika Sztajerowska, Leona Verdadero and Martin Wermelinger. The *Review* was supported by the ASEAN-Australia-New Zealand Free Trade Agreement Economic Cooperation Support Programme.

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Acronyms and abbreviations

AANZFTA	ASEAN Australia New Zealand Free Trade Agreement
ACIA	ASEAN Comprehensive Investment Agreement
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AETR	Average Effective Tax Rate
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral Investment Treaty
BOP	Balance of Payments
BOT	Build Operate Transfer
CDIS	Coordinated Direct Investment Survey
CDM	Clean Development Mechanism
CETA	Comprehensive Economic and Trade Agreement
CIT	Corporate Income Tax
CLMV	Cambodia Lao PDR Myanmar Viet Nam
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee
DPI	Department of Planning and Investment
EIA	Environmental Impact Assessment
EIU	Economist Intelligence Unit
ERC	Enterprise Registration Certificate
ESG	Environmental Social and Governance
EU	European Union
EVN	Electricity of Vietnam
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment

FIA	Foreign Investment Agency
FiT	Feed-in-tariff
FPS	Full Protection and Security
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GIZ	Gesellschaft für Internationale Zusammenarbeit
GMS	Greater Mekong Subregion
GSO	General Statistics Office
GVC	Global Value Chain
HCMC	Ho Chi Minh City
ICSID	International Centre for Settlement of Investment Disputes
ICT	Information and Communication Technology
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IIA	International Investment Agreement
ILO	International Labour Organization
IMF	International Monetary Fund
INDC	Intended National Determined Contribution
IP	Intellectual Property
IPA	Investment Promotion Agency
IPP	Independent Power Producer
IRC	Investment Registration Certificate
ISDS	Investor-State Dispute Settlement
ISIC	International Standard Industrial Classification
JETRO	Japanese External Trade Organisation
JICA	Japan International Co-operation Agency
KOTRA	Korean Trade and Investment Promotion Agency
kWh	Kilowatt Hour
LEP	Laws on Environment Protection
LPI	Logistics Performance Index
LUR	Land Use Right

M&As	Mergers and Acquisitions
METR	Marginal Effective Tax Rate
MFN	Most Favoured Nation
MNE	Multinational Enterprise
MoF	Ministry of Finance
MOIT	Ministry of Industry and Trade
MONRE	Ministry of Natural Resources and Environment
MPI	Ministry of Planning and Investment
MW	Megawatt
NAFTA	North American Free Trade Agreement
NAP	National Action Plan
NGO	Non-governmental organisation
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
PDP	Power Development Masterplan
PFI	Policy Framework for Investment
PPA	Power Purchase Agreement
PPP	Public-Private Partnership
RCEP	Regional Comprehensive Economic Partnership
RBC	Responsible Business Conduct
SBV	State Bank of Viet Nam
SCIC	State Capital Investment Corporation
SDG	Sustainable Development Goal
SEA	Strategic Environmental Assessment
SEDP	Socio-Economic Development Plan
SEDS	Socio-Economic Development Strategy
SEZ	Special Economic Zones
SHTP	Saigon Hi-Tech Park
SME	Small and Medium-sized Enterprise
SOE	State-Owned Enterprise
SSC	State Securities Commission
TFP	Total Factor Productivity

TPP	Trans-Pacific Partnership
TRIPS	Trade-Related aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
TVET	Technical Vocational Education and Training
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Change
UNIDO	United Nations Industrial Development Organization
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollars
VAS	Vietnamese Accounting Standards
VAT	Value Added Tax
VBF	Vietnam Business Forum
VCA	Vietnam Competition Authority
VCCA	Vietnam Competition and Consumer Authority
VCC	Vietnam Competition Council
VCCI	Vietnam Chamber of Commerce and Industry
VCL	Vietnam Competition Law
VNEEP	Viet Nam Energy Efficiency Programme
VGGAP	Vietnam Green Growth Action Plan
VGGS	Vietnam Green Growth Strategy
VND	Vietnamese Dong
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Preface

by

Angel Gurría, Secretary-General, OECD

The Government of Viet Nam has achieved tremendous progress since the launch of the Renovation Policy, or *Doi Moi*, just over three decades ago. Market-oriented structural reforms have allowed it to become one of the world's fastest growing economies, dramatically reducing poverty and delivering socio-economic progress. It has increasingly integrated into the world economy by attracting growing amounts of foreign direct investment which have fuelled sustained export growth. Although Viet Nam stands out from other emerging economies, notably for its social inclusiveness, some investment climate challenges still need to be addressed. These include boosting slowing productivity growth, helping public institutions cope with the rapid pace of legislative activity and ensuring economic growth is inclusive, balanced and sustainable.

Drawing on OECD's *Policy Framework for Investment* (PFI), this second OECD *Investment Policy Review* of Viet Nam illustrates the government's commitment to reform and align with international best practices. A first review was conducted in 2007-08, together with the Ministry of Planning and Investment, one of the first reviews to use the newly developed PFI. Since then, the OECD has been working with Viet Nam on several fronts, including administrative simplification, social cohesion, science, technology and innovation, and agricultural policies.

This second *Review* builds on our past joint work and is the result of an ever closer co-operation between the Government of Viet Nam and the OECD. It also builds on the OECD's investment work with the Association of Southeast Asian Nations (ASEAN) at a time of strengthening collaboration between the OECD and the ASEAN. This partnership supports the open and fruitful exchange of information and practices with regional peers.

The *Review* recognises Viet Nam's impressive achievements but also provides an independent view of what could be improved. It focuses on how to strengthen policies and institutions to make Viet Nam an even more attractive investment destination. Further possible reforms are suggested to help ensure that rapid growth continues and that it is both environmentally sustainable and socially inclusive.

We would like to express our gratitude to the Economic Co-operation Support Programme of the ASEAN-Australia-New Zealand Free Trade Area for supporting the *Review*, which is both a product of the deepening collaboration between the OECD and Viet Nam as well as a comprehensive tool to foster Viet Nam's further modernisation and development.

Angel Gurría

Secretary-General, OECD

Executive summary

The economic transformation of Viet Nam over the past three decades has been almost unparalleled. Since the launch of *Doi Moi* (or "Renovation") policy in 1986, market-oriented structural reforms have paid off handsomely. Once one of the poorest countries in the world, Viet Nam is now a lower middle-income market economy. Tremendous socio-economic progress has been achieved, poverty has been substantially reduced and a middle class is rapidly emerging. The pace of economic growth has been impressive, with a remarkable capacity of the Vietnamese economy to weather global storms. Viet Nam has been one of the fastest growing economies in the world, boasting an average growth of almost 7% over the past two decades. In many ways, Viet Nam is the envy of its neighbours, not only its growth performance, but also its ability to attract growing amounts of foreign direct investment and to sustain export growth in difficult times.

This performance is the result of continuous reforms since the advent of *Doi Moi*. In terms of investment policy alone, the *Investment Law* has been amended multiple times, first to unify the treatment of foreign and domestic investors and then to improve the registration process. The *Enterprise Law* was also recently revised. This responsiveness to changing conditions is one of the reasons for the sustained economic performance of Viet Nam, but the pace of legislative activity has also imposed a cost on government administration. Implementing regulations have often been delayed, and issues of consistency arise across the various legislative reforms, creating uncertainty for existing and potential investors.

The domestic legislative agenda has been matched and reinforced by the active engagement of Viet Nam in international agreements. On top of dozens of bilateral investment treaties, Viet Nam has signed free trade agreements (FTAs) with many developed economies, including most recently the European Union-Viet Nam FTA. It also participated in the negotiations for the Trans-Pacific Partnership – the only economy at its level of development to do so. As part of the Association of Southeast Asian Nations (ASEAN), Viet Nam has also committed itself to the ASEAN Economic Community and to numerous FTAs negotiated by ASEAN as a group. Viet Nam also made substantial commitments as part of its accession to the World Trade Organization in 2007. These agreements will not only sustain and anchor the reforms that have already been undertaken but will also entail further reforms in the years to come.

In spite of these substantial achievements and the continuing reform agenda, Viet Nam still faces many challenges on its path to sustainable development and in further modernising its economy. Productivity growth has slowed precipitously, as factor accumulation has not given way to growing technological sophistication and improved efficiency as engines of future productivity growth. Poor resource allocation, across sectors and between firms within sectors – particularly between private and state-owned enterprises – helps partly to explain this decline. State-owned enterprises still account for one third of gross domestic product and receive preferential treatment, including favourable access to credit and land. They dominate many of the sectors such as mining, public utilities, construction and finance where labour productivity has declined. Other factors include poorly co-ordinated capital spending across provinces, resulting often in redundant infrastructure. Viet Nam also faces an aging population. Some foreign investors also complain about corruption and weak enforcement of foreign arbitral awards.

Viet Nam has generally performed well in terms of social development given its income level, but it will need to ensure that development remains sustainable and inclusive. Not only is it highly vulnerable to climate change, but its rapid economic growth has relied on natural resources, and environmental degradation and pollution are now threatening future growth. The national energy mix is increasingly focused on fossil fuels. While the government has made great strides in implementing a policy framework for green growth, it is still a work in progress, with often overlapping and inconsistent targets and a lack of institutional and enforcement capacity.

The legal framework that protects the public interest and underpins responsible business conduct (RBC) has been partially established, although more efforts are needed to ensure implementation and enforcement of relevant laws. Awareness of international RBC principles and standards is not yet widespread, but the economic and social reforms currently being implemented as a result of Viet Nam's international commitments, particularly in areas related to labour relations and human rights, represent a positive step in strengthening the overall policy framework that enables RBC. This is an important signal for investors, as certain RBC-related risks in Viet Nam are perceived to be high.

The government has demonstrated a consistent ability to address development challenges in the past. Its willingness to submit its policy framework to external scrutiny through this review testifies to a strong desire to absorb outside experience in order to improve the climate for investment and to learn from successes – and failures – elsewhere. A first OECD *Investment Policy Review* of Viet Nam was conducted together with the Ministry of Planning and Investment in 2007-08 and was one of the first Reviews to use the newly developed *Policy Framework for Investment* or PFI. This second review builds on the earlier one and uses the recently updated PFI to assess a broader range of policy areas and in more depth than was covered in the first review.

Assessment and recommendations for Viet Nam

The economic transformation of Viet Nam over the past three decades has been almost unparalleled. Since the launch of *Doi Moi* (or "Renovation") policy in 1986, market-oriented structural reforms have paid off handsomely. Viet Nam was once one of the poorest countries in the world but is now a lower middle-income market economy. Tremendous socio-economic progress has been achieved, poverty has been substantially reduced and a middle class is rapidly emerging. The pace of economic growth has been impressive, with a remarkable capacity of the Vietnamese economy to weather global storms. Viet Nam has been one of the fastest growing economies in the world, boasting an average growth of almost 7% over the past two decades. In many ways, Viet Nam is the envy of its neighbours, not only its growth performance, but also its ability to attract growing amounts of foreign direct investment and to sustain export growth in difficult times.

This performance is the result of continuous reforms since the advent of *Doi Moi*. In terms of investment policy alone, the *Investment Law* has been amended multiple times, first to unify the treatment of foreign and domestic investors and then to improve the registration process. The *Enterprise Law* was also recently revised. This responsiveness to changing conditions is one of the reasons for the sustained economic performance of Viet Nam, but the pace of legislative activity has also imposed a cost on government administration. Implementing regulations have often been delayed, and issues of consistency arise across the various legislative reforms, creating uncertainty for existing and potential investors.

The domestic legislative agenda has been matched and reinforced by the active engagement of Viet Nam in international agreements. On top of dozens of bilateral investment treaties, Viet Nam has signed free trade agreements (FTAs) with many developed economies, including most recently the EU-Viet Nam FTA. It also participated in the negotiations for the Trans-Pacific Partnership which was unprecedented for a country at its level of development. As part of the Association of Southeast Asian Nations (ASEAN), Viet Nam has also committed itself to the ASEAN Economic

Community and to numerous FTAs negotiated by ASEAN as a group. Viet Nam also made substantial commitments as part of its accession to the World Trade Organization (WTO) in 2007. These agreements will not only sustain and anchor the reforms that have already been undertaken but will also entail further reforms in the years to come.

In spite of these substantial achievements and the continuing reform agenda, Viet Nam still faces many challenges on its path to sustainable development and in further modernising its economy. Productivity growth has slowed precipitously, as factor accumulation has not given way to growing technological sophistication and improved efficiency as engines of future productivity growth. Poor resource allocation, across sectors and between firms within sectors – particularly between private and state-owned enterprises (SOEs) – helps partly to explain this decline. SOEs still account for over one quarter of GDP and receive preferential treatment, including favourable access to credit and land. They dominate many of the sectors such as mining, public utilities, construction and finance where labour productivity has declined.[1] Other factors include poorly co-ordinated capital spending across provinces, resulting often in redundant infrastructure. Viet Nam also faces an aging population. Some foreign investors also complain about corruption and weak enforcement of foreign arbitral awards.

Viet Nam will also need to ensure that development is sustainable and inclusive. Not only is it highly vulnerable to climate change, but its rapid economic growth has relied on natural resources, and environmental degradation and pollution are now threatening future growth. The national energy mix is increasingly focused on fossil fuels. While the government has made great strides in implementing a policy framework for green growth, it is still a work in progress, with often overlapping and inconsistent targets and a lack of institutional and enforcement capacity.

In terms of inclusiveness and social development, Viet Nam has generally performed well in the *Human Development Index* for a country at its level of development. The legal framework that protects the public interest and underpins responsible business conduct (RBC) has been partially established in Viet Nam, although more efforts are needed to ensure implementation and enforcement of relevant laws. Awareness of international RBC principles and standards is not yet widespread, but the economic and social reforms currently being implemented as a result of Viet Nam's international commitments (particularly in areas related to labour relations and human rights), represent a positive step in strengthening Viet Nam's overall policy framework that enables RBC. This is an important signal for investors, as certain RBC-related risks in Viet Nam are perceived to be high.

Box 1. **Viet Nam: Facts and figures**

Population: 92.7 million; 54 ethnic groups

Geography: 331 000 sq km, 63 provinces

Coastline: 3 260 km

International borders: 4 550 km (Cambodia, Lao PDR, China)

Economy (2015): GDP: USD 193 600 million; GDP per capita: (current) USD 2 111; (PPP) USD 6 023

Viet Nam still faces many challenges, but the government has demonstrated a consistent ability to rise to the occasion in the past. Its willingness to submit its policy framework to external scrutiny through this review demonstrates a strong desire to absorb outside experience in order to improve the climate for investment and to learn from successes – and failures – elsewhere. This is the second such OECD *Investment Policy Review* of Viet Nam. A first one was conducted together with the Ministry of Planning and Investment in 2007-08 and was one of the first reviews to use the newly developed *Policy Framework for Investment* or PFI (Box 2). This second review builds on the earlier one and uses the recently updated PFI to assess a broader range of policy areas and in more depth than was covered in the first review.

The historical context

An economic crisis catalysed reform

After reunification in 1976, the government established a centrally planned economy, nationalising private enterprises, collectivising agriculture and developing heavy industries (Thoburn, 2009). Economic performance was poor and, despite price controls, inflation reached almost 500% by 1986 as government deficits were financed by printing money (World Bank, 2004). The economy also faced trade and fiscal deficits, as well as widespread shortages of food and other staple goods. Industrial development was limited, infrastructure was inadequate and poverty was both pervasive and persistent. Viet Nam was also isolated from the global economy and its trade relations were limited to countries from the former Communist bloc countries which, by the late 1980s, were engaged in their own political and economic reforms.

Box 2. **The Policy Framework for Investment**

The *Policy Framework for Investment* (PFI) helps governments to mobilise private investment in support of sustainable development, thus contributing to the prosperity of countries and their citizens and to the fight against poverty. It offers a list of key questions to be examined by any government seeking to create a favourable investment climate. The PFI was first developed in 2006 by representatives of 60 OECD and non-OECD governments in association with business, labour, civil society and other international organisations and endorsed by OECD ministers. Designed by governments to support international investment policy dialogue, co-operation, and reform, it has been extensively used by over 25 countries as well as regional bodies to assess and reform the investment climate. The PFI was updated in 2015 to take this experience and changes in the global economic landscape into account.

The PFI is a flexible instrument that allows countries to evaluate their progress and to identify priorities for action in 12 policy areas: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; promoting responsible business conduct; human resource development; infrastructure; financing investment; public governance; and investment in support of green growth. Three principles apply throughout the PFI: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

The value added of the PFI is in bringing together the different policy strands and stressing the overarching issue of governance. The aim is not to break new ground in individual policy areas but to tie them together to ensure policy coherence. It does not provide ready-made reform agendas but rather helps to improve the effectiveness of any reforms that are ultimately undertaken. By encouraging a structured process for formulating and implementing policies at all levels of government, the PFI can be used in various ways and for various purposes by different constituencies, including for self-evaluation and reform design by governments and for peer reviews in regional or multilateral discussions.

The PFI looks at the investment climate from a broad perspective. It is not just about increasing investment but about maximising the economic and social returns. Quality matters as much as the quantity as far as investment in concerned. It also recognises that a good investment climate should be good for all firms – foreign and domestic, large and small. The objective of a good investment climate is also to improve the flexibility of the economy to respond to new opportunities as they arise – allowing productive firms to expand and uncompetitive ones (including state-owned enterprises) to close. The government needs to be nimble: responsive to the needs of firms and other stakeholders through systematic public consultation and able to change course quickly when a given policy fails to meet its objectives. It should also create a champion for reform within the government itself. Most importantly, it needs to ensure that the investment climate supports sustainable and inclusive development.

The PFI was created in response to this complexity, fostering a flexible, whole-of-government approach which recognises that investment climate improvements require not just policy reform but also changes in the way governments go about their business.

For more information on the Policy Framework for Investment, see: www.oecd.org/investment/pfi.htm.

It was under these conditions that the *Doi Moi* policy reform was officially adopted in December 1986 to encourage economic growth and development by launching a gradual transition from central planning to a market-based economy and progressively integrating into the global economy. Reforms sought gradually to reduce the dominance of the public sector in the economy and allow for private investment. Agricultural land was transferred from large state-owned farms to household farms, prices were liberalised and private ownership in industry and commerce was permitted. Reform of SOEs also began, and the economy gradually opened to foreign investment. Between 1989 and 1992, the number of government-owned corporations was halved to 6 000 and approximately 800 000 employees were let go (World Bank, 2004).

The strong commitment to *Doi Moi* was further solidified and reaffirmed in a new constitution adopted in April 1992 which specified issues concerning a market economy, proprietary rights and private enterprises, long-term land-use rights, joint enterprises with foreign investors, and protection against nationalisation (Tsuboi, 2007). It specifically encouraged foreigners to invest capital and technology in Viet Nam and in return “guarantee[d] the right of ownership of the legitimate capital, property and other interests of foreign organisations and individuals” and further stipulated that "business enterprises with foreign invested capital shall not be subject to nationalisation” (Article 25).

A more liberal *Law on Foreign Investment* was enacted in 1987 permitting foreign businesses and investors to operate in Viet Nam via joint state-private ventures or wholly foreign-owned corporations. Foreign investors were in principle allowed to invest in any sector, subject to a long list of exceptions.[2] In 1990, the *Law on Private Enterprises* was enacted to serve as a legal basis for establishing sole proprietorships, while the *Law on Companies* allowed for limited liability and joint-stock companies.

In foreign trade, the government created an open door policy that focused on export development, opening up the country to inputs from world markets, encouraging local enterprises to take advantage of export opportunities and exposing the economy to foreign competition (Van Arkadie and Mallon, 2003). By 2003, import quotas existed only for sugar and petroleum products, and quantitative restrictions on exports applied to only a few items. The average tariff on imports fell from 12.7% in 1996 to 9.3% in 2003 (WTO, 2013). A summary of the first 15 years of *Doi Moi* reforms is presented in Table 1.

Table 1. **The first 15 years of *Doi Moi* reforms**

Year	Reform Measure
1987	– Law on Foreign Investment in Viet Nam: permitted foreign businesses and investors to operate in Viet Nam via joint state-private ventures and via wholly foreign-owned corporations
1988	– Law on Land: Establishes the private use of allocated land in agriculture – Industry policy introduced encouraging private investment in industrial development.
1990	– Law on Private Enterprises established legal basis for establishment of sole proprietorships. – Law on Companies established basis for limited liability
1991	– Private companies allowed to engage directly in international trade.
1992	– New constitution reaffirms leading role of the Communist Party, but also recognises private property rights in a state-managed, market-oriented, multi-sector economy with socialist orientations. – Law on Foreign Investment in Viet Nam amended to reduce bias against 100% foreign owned enterprises and to introduce build-operate-transfer (BOT) options.
1993	– Amended Land Law makes agricultural land-use rights transferable and useable as collateral.
1994	– Law on Promotion of Domestic Investment specifies incentives for domestic investors.
1995	– Law on State-owned Enterprises consolidates previous legislative initiatives on state enterprises. – Civil Code enacted deepening foundation for market economy, including some legal protection for industrial property rights.
1997	– Approval of certain foreign investment projects decentralised to selected='selected='selected'' provincial people's committees and industrial zones.
1996	– New Law on Foreign Investment in Viet Nam which reduces import duty exemptions for FDI projects.
1998	– Legislation amended to improve incentives and simplify access for domestic investors. – Foreign invested enterprises permitted to export goods not specified in investment licences.
2000	– Enactment of the Enterprise Law. – FDI law amended to streamline procedures, clarify land-use right provisions, provide greater flexibility in corporate structure, and liberalise foreign exchange controls. – 10th Party Plenum states that there is "no other choice but to continue with regional & global integration".
2001	– Ninth Party Congress concludes with resolution confirming a leading role for the state but also recognising a long-term role for private domestic and foreign investors in economic development. A new Socio-Economic Development Strategy for 2001-10 and 5 Year Plan to 2005 are endorsed. – Amendments to Land Law clarify stipulations on land prices and land-use planning, authorised levels on land allocation, compensation for land clearance and transferring land-use rights. – Enterprises, individuals, cooperatives and foreign investors are allowed to export and import all permissible goods. – Domestic investment legislation amended to improve incentives – Foreign invested enterprises permitted to export goods not specified in investment licences. – National Assembly amends constitution to recognise role of private sector and to better protect private property rights.
2002	– Labour Code amended in April 2002 to allow foreign investors to recruit staff directly.

Source: Van Arkadie and Mallon (2004).

International economic integration has proceeded rapidly

Domestic reforms have taken place in a context of Viet Nam's active participation in international agreements, whether bilateral, plurilateral or as part of ASEAN. Key milestones are shown in Table 2. This assertive international stance culminated in accession to the WTO in 2007 and its most recent participation in the negotiations for the Trans-Pacific Partnership agreement and in the Free Trade Agreement with the European Union. As a result, Viet Nam has dramatically increased its integration into the global trade and investment system. This can be seen readily in Figure 1 which shows the growth of exports of goods and services as a share of GDP for the largest ASEAN economies. Exports of goods and services from Viet Nam continue to grow at a time when the export performance of most ASEAN members has stagnated or even deteriorated.

Table 2. **Milestones in internationalisation in Viet Nam**

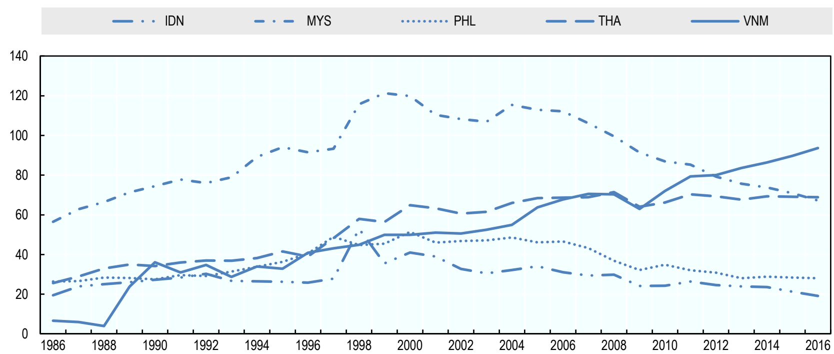
1976		Reunification (2 July)
1986	–	Doi Moi (December)
1992	–	Textile and garment trade agreement with European Community
	–	New Constitution (April)
1995	–	ASEAN membership
	–	Application for WTO membership
	–	Normalisation of political relations with US
1998	–	APEC membership
2001	–	US-Viet Nam Bilateral Trade Agreement (signed in July 2000, in force in December 2001)
2006	–	Permanent Normal Trade Relations with US (December)
2007	–	WTO membership (January)
2007	–	US-Viet Nam Trade and Investment Framework Agreement (June)
2015	–	Trans-Pacific Partnership negotiations concluded (October)
2016	–	EU-Viet Nam FTA signed (December)

Accession to the WTO resulted in important changes in Viet Nam's legal framework. It is estimated that for Viet Nam to meet the requirements of joining the WTO, around 500 laws and regulations had to be either created or modified. For example, to adhere to the principle of national treatment, the *State Enterprise Law* was abolished and replaced by the *Unified Enterprise Law* (2005), which applied to all enterprises regardless of ownership. Similarly, the *Law on Foreign Investment* and the *Law on Domestic Investment Promotion* were merged into the *Common Investment*

Law (2005). Viet Nam also promulgated the *Competition Law* (2005), with provisions explicitly prohibiting unfair practices by the government (Anh, 2014).

Figure 1. **Exports of goods and services for ASEAN member states**

(share of GDP)



Source: World Bank: World Development Indicators

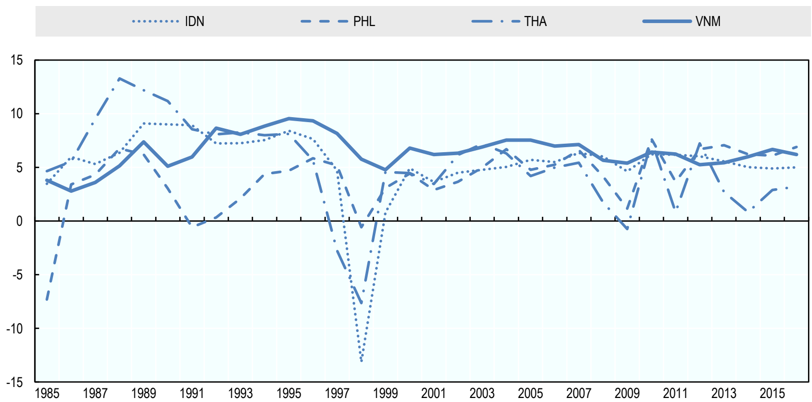
Doi Moi policy reforms demonstrated a pragmatic flexibility that highlights the government's willingness to experiment with changes when the system was not working (*i.e.* post-reunification economic crisis) (Van Arkadie and Mallon, 2003). Such flexibility and pragmatism, combined with the commitment to reform, is seen in the policy options the government has pursued over the past three decades in building a modern Viet Nam.

Viet Nam's growth performance over 30 years is among the world's highest

Since the beginning of *Doi Moi*, Viet Nam has enjoyed rapid and uninterrupted growth. Figure 2 compares Viet Nam's GDP growth performance with that of other large ASEAN economies. Viet Nam is the only large economy within ASEAN not to suffer an economic contraction since the mid-1980s, in spite of the crises which ravaged many other countries in the region and the rising share of exports in total GDP which increased the vulnerability to external shocks. GDP growth in Indonesia, the Philippines and Thailand may have exceeded that in Viet Nam in some recent years, but none has matched the stability of the Vietnamese economy. Neither the Asian financial crisis, nor the global one a decade later, could significantly dent this performance – although growth has been slightly slower since 2007. Income per capita grew from USD 240 in 1986 to over

USD 2 100 by 2015, and poverty levels have been reduced, with the share of the population living in extreme poverty falling from over 50% in the early 1990s to 3% by 2015.

Figure 2. **Real GDP growth rates in ASEAN 4**



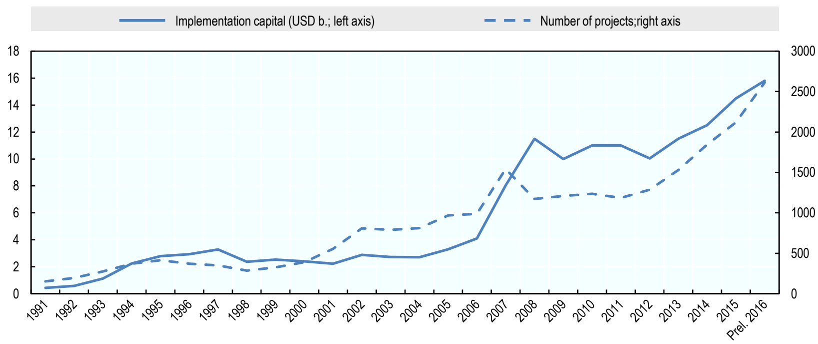
Source: World Bank: World Development Indicators

Foreign investment in Viet Nam is at record levels and growing…

At a time when global flows of foreign direct investment are still below their peak in 2007, FDI inflows in Viet Nam are at record levels and growing (Figure 3). To the extent that registered capital is actually implemented, there is ample scope for further FDI in Viet Nam. Much of this FDI has come from Asia, suggesting that investors from Europe and North America have substantial scope to expand their presence in Viet Nam, adding further to FDI inflows. Much of the investment has been in the manufacturing sector, with investors exporting a large share of their output. The recent conclusion of negotiations on the EU-Viet Nam FTA is likely to provide even more scope for export-oriented investments. Owing to the importance of manufacturing for export, the share of greenfield investments in total FDI is high, above 90% according to the authorities. In mature markets, mergers and acquisitions (M&As) are the preferred entry mode for foreign investors.

By sector, most M&As involving foreign investors have been in finance and insurance, oil and gas, metals and steel, and food and beverages. Even within these sectors, however, the share of foreign-owned firms in total assets remains small. Furthermore, equitisation has provided relatively few opportunities for foreign investors. These M&As can be an important vehicle for raising total factor productivity in acquired firms and in restructuring and consolidating whole sectors of the economy, such as in banking. It remains to be seen how the recent removal of the 49% foreign equity limit will affect trends in M&A activities.

Figure 3. **Realised FDI projects, 1991-2015**



Source: General Statistics Office of Viet Nam

Cross-border M&As have been less prevalent in Viet Nam for several possible reasons: the absence of targets owing to the prominence of state-owned enterprises; the existence until recently of an overall 49% cap on foreign equity ownership in publicly listed companies[3]; the uncertainty surrounding which activities performed by the target firm would face equity restrictions; weak corporate governance standards; and complex administrative procedures. Several recent policy developments are likely to provide more fertile ground for takeovers of Vietnamese companies in the future. These include improved corporate governance standards, the removal of restrictions on majority foreign ownership of public companies, a 2014 decree which strengthens the *Competition Law* by including new provisions on determining fines for violations, and the inclusion of an SOE dimension in recent agreements to which Viet Nam is a party, as was the case in the Trans-Pacific Partnership Agreement.

…but more could be done to maximise the development impact of FDI

Foreign-owned enterprises as of 2014 represented only 6.4% of employment and 16% of GDP, while contributing 38% to economic growth. Studies have found a consistent impact of FDI in Viet Nam on growth, largely through the capital infusion it provides. Foreign investors contributed 68% of exports in 2015, although because of a high import propensity (with only 27% of purchases made locally) their contribution to net exports has not been high. Their contribution to fiscal revenue, at 14%, is less than that to GDP as a whole, reflecting in part the generous tax incentives they sometimes receive (GSO, 2016).

While the strong positive contribution of foreign investors to economic performance is widely accepted, a recent government report nevertheless pointed to some areas where their performance has been disappointing (GSO, 2016). It found that FDI in Viet Nam has not created a basis for accelerated growth, efficiency gains or sustainability. The average capital size of foreign projects is relatively small at USD 8 million and only 8% of projects use the most sophisticated technologies. They have transferred relatively little technology and have created few linkages with local firms that would allow them to participate in global value chains.

This mixed performance is symptomatic of the policy environment in which all firms, including foreign ones, operate. A good investment climate should not favour foreign investors over domestic ones, but host governments need to be cognizant of the policy framework which can enhance the contribution of foreign firms to sustainable development. The potential benefits from foreign investment include not only the capital they bring but also their technologies, corporate governance and management practices and access to global markets, including for local firms that supply the foreign affiliate. Foreign investors also tend to raise the productivity of local firms, through vertical and horizontal spillovers or when they directly acquire a local firm.

These benefits do not all flow automatically through FDI; they depend very much on the overall policy framework for investment in place. The Vietnamese government has been very successful at attracting foreign investment, much to the envy of some of its peers, but it will have to do more – as part of more general reforms – to ensure that this investment contributes fully to inclusive and sustainable development. The various ways to achieve this are discussed in detail below and in the technical chapters. Investment climate improvements require a whole-of-government approach to reform. It is not simply a question of removing red tape but rather of thinking strategically about the role of investment in fostering development and of designing policies across a broad spectrum of policy areas to address challenges.

Viet Nam is facing a new set of challenges as it develops

Viet Nam has successfully navigated the transition from agricultural subsistence to export-led manufacturing. Growth has been both strong and relatively stable, poverty has been reduced dramatically and Viet Nam has one of the fastest growing middle classes. Its legislative framework has developed rapidly and it has used international agreements both to lock-in reforms and to enhance market access abroad. By almost any metric, it is a development success story, but past success is not a guarantee of future progress. Mobilising resources for development and the structural transformation away from agriculture needs to be accompanied by greater attention to the allocation of resources within the economy and to the efficiency with which factors of production are utilised. Rapid growth can also lead to social and environmental strains which need to be addressed. New challenges also appear as rising incomes lead to lower fertility rates and ultimately an aging population.

The *Policy Framework for Investment* which underpins this review is designed to address these broader questions. It looks not only at the policy framework necessary to stimulate both domestic and foreign investment but also at broader efficiency considerations and at the impact of investment on sustainability and inclusiveness. Although there is scope to raise investment levels by both foreign and domestic firms, the greater challenge is to improve the allocation of capital within the economy: to ensure that the most productive firms are allowed to expand at the expense of the least productive and to raise the overall productivity of all firms that remain; and to channel that investment into activities which contribute most to sustainable and broad-based development.

Productivity growth has slowed but has started to pick up recently

Since the 2000s, labour productivity in Viet Nam has improved by approximately 4% annually, slightly below the rate of per capita income growth at around 5%. However, aggregate labour productivity growth slowed in the 2000s compared to before the Asian financial crisis, when labour productivity improved at approximately 6% annually (The Conference Board, 2017). The picture looks more challenging, when looking at total factor productivity (TFP) growth; corresponding to the residual of GDP growth that cannot be explained by pure production factor accumulation (labour and capital) and can thus be interpreted as firms' improvement in how these factors are combined to produce output. TFP growth was negative throughout the period 1990-2010 in Viet Nam (Figure 4). While productivity slowed, output growth has been sustained by the demographic dividend which has brought new workers into the workforce each year, by the shift in employment from agriculture to industry as well as by continued capital deepening (Figure 4, see bars for 'Labour quantity' and 'Capital').

Figure 4. **GDP growth decomposition**

Notes: For methodological details, see: https://www.conference-board.org/data/economydatabase/.

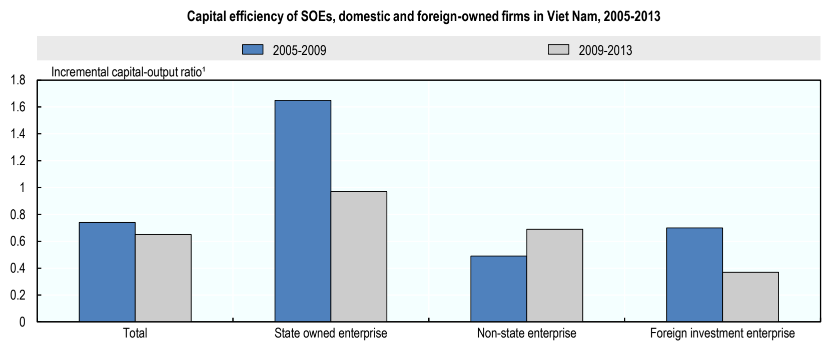
Source: Authors' calculations based on data from The Conference Board Total Economy database.

Understanding the causes of the productivity slowdown is difficult, but some elements can be ascertained. The first is the relatively weaker productivity of SOEs which tend to be prevalent in those sectors with the weakest productivity growth (such as mining, public utilities, construction and finance) (World Bank/MPI, 2016). But while some of this poor productivity performance can be attributed to SOEs, it has also afflicted the domestic private sector. In fact, the efficiency of capital investment to increase output in the SOE sector has improved recently; while it has been decreasing in the domestic private sector (Figure 5).

Labour and capital accumulation-driven growth is slowing as the country develops; and thus growth increasingly needs to be boosted by productivity. A new productivity growth span is becoming evident since 2010: TFP growth has been positive and contributed on average more than one fifth to GDP growth each year. Bolstering productivity growth in Viet Nam sustainably will however require a greater effort to address the misallocation of resources within the economy, no longer between low and higher productivity activities but increasingly between firms in the same sector. The government will also need to address more fundamental policy and institutional constraints to create a more competitive environment.

Beyond entry and exit barriers, the government will still need to improve the functioning of factor markets. Capital, labour and other factors of production should be freed from low-productivity activities and under-performing firms, mostly SOEs. Productivity growth has also been affected by the fact that infrastructure development in Viet Nam has been sub-optimal, with duplicative facilities across the provinces. The growing demand for infrastructure will also require not just a suitable framework for public-private partnerships but also improved resource mobilisation on the part of the government. This in turn will require an assessment of whether the forgone revenue from tax incentives for investors would not be better spent on infrastructure and skills development, both of which will contribute to productivity growth.

Figure 5. **Incremental capital-output ratio**



Notes: ([1]) ICOR refers to the amount of investment needed to generate one additional unit of revenue. It is measured as the net increase in fixed-asset and long-term investment over net turnover increase. The higher the ratio, the lower the efficiency of capital invested.

Source: Statistical Yearbook of Viet Nam, 2011; and Statistical Handbook of Viet Nam, 2014.

Public governance is still weak, owing partly to the pace of legislative activity

Viet Nam is unusual for the pace of its legislative activity and stands out from many of its peers in Southeast Asia in this regard. Table 3 shows the reforms since *Doi Moi* of three key pieces of legislation: the laws on investment and enterprises and the law on laws. Over time, there has been a clear tendency not only to refine and modernise existing laws but also to harmonise them. The laws on foreign and domestic investment were merged to become the *Law on Investment*; those covering SOEs and private enterprises became the *Law on Enterprises*; and the laws on laws covering central and provincial levels were merged.

Table 3. **Legislative reforms in Viet Nam**

Investment	Adopted	Amended
Law on Foreign Investment	1987	1990, 1992
Law on Promotion of Domestic Investment	1994	1998
Law on Foreign Investment	1996	2000
Law on Investment	2005	
Law on Investment	2014	
Enterprises		
Law on State-Owned Enterprises	1995	
Law on State-Owned Enterprises	2003	
Law on Companies Law on Private Enterprises	1990	1994
Law on Enterprises	2005	2013
Law on Enterprises	2014	
Law on Laws		
Law on the Promulgation of Legal Normative Documents	1996	2002
Law on the Promulgation of Legal Normative Documents of People's Councils and People's Committees	2004	
Law on the Promulgation of Legal Normative Documents	2008	
Law on the Promulgation of Legal Documents	2015	

Each new version of legislation is generally considered to be an improvement over earlier versions and has provided greater legal coherence, but the cumulative effect of these laudable efforts may have imposed a burden on public administration and confusion for investors. The OECD *Policy Framework for Investment* recognises that predictability is a key concern for investors. Regulatory change imposes costs and frequent changes can cause uncertainties and compliance costs. Regulatory stability has value in itself and should be included in the cost/benefit analysis for new regulation. An OECD report on *Administrative Simplification in Viet Nam* (OECD, 2011) raised concerns about legislative complexity at the time: "Foreign investors in particular complain that they face a regulatory maze where they cannot identify differences between legal normative documents" and that "Laws and other legal normative documents are revised rapidly, with little clarity about which requirements are invalidated by later revisions" (OECD, 2011).

Uncertainty is increased when implementing regulations are delayed. A theme which recurs throughout the various policy chapters of this Review is the gap between the often high quality of national legislation and the efficiency of implementation. While this dichotomy exists in many if not most countries, it may be particularly relevant in Viet Nam where investors complain about complexity and inconsistencies in implementation, as implementing regulations have sometimes come only after a long lag (Phillips Fox, 2006; Freshfields Bruckhaus Deringer, 2008).

An example of this gap between rules and implementation performance arises in corporate governance. While Viet Nam has taken important strides in recent years in the area of corporate governance, the overall legal and regulatory corporate governance framework remains complex, with scattered inconsistencies and at times limited awareness by market participants. In tax policy, the complex system of tax incentives has added to investor uncertainty and transaction costs. This problem is compounded by discretionary decision-making which increases investor uncertainty about how the tax system will treat them in comparison with competitors and may inadvertently discourage, rather than encourage, investment spending.

Administrative discretion in the hands of government officials can add to project risks and costs and increase the possibility of corruption, undermining good governance objectives fundamental to securing an attractive investment environment. A lack of transparency in the governance of SOEs also provides fertile ground for corruption and a number of high-profile cases have become public. By its nature, corruption is difficult to measure, but the annual *Corruption Perceptions Index* of Transparency International puts Viet Nam in 113th place out of 176 countries in 2016, ahead of other CLMV countries but behind the other large economies in the region. Corruption can act as a strong deterrent for potential investors, not only because of the risk of contravening Vietnamese laws against bribery but also because of potential criminal liability in their home country.

Public administration is also sometimes affected by a lack of institutional co-ordination both horizontally (across ministries) and vertically (between the central and provincial administrations). Many of the policy areas discussed in this review raise the issue of a lack of consistency and coherence in policies, whether the potential for overlap in investment promotion between MPI and the Ministry of Industry and Trade, the multiplicity of tax incentives offered, the incoherence among green growth targets in different strategic documents, or the overlapping powers and mandates among the various agencies enforcing intellectual property rights.

Viet Nam's current development path is not environmentally sustainable

Rapid economic growth has been supported by Viet Nam's natural resource base, but this growth has to some extent come at the expense of the environment. The quality of forest resources has declined significantly since the 1950s, with the loss of mangrove forests estimated to result in losses of USD 34 million a year (World Bank & MPI, 2016). Rapid urbanisation has been accompanied by increasing air pollution and water quality issues. These issues are further exacerbated by the increasing effects of climate change.

The discussion of green growth in this review is analogous in many ways to the earlier one on productivity. How can the government channel investment to greener activities and improve energy and resource efficiency of existing firms in all activities? With ever increasing pressures on natural resources, the need to improve and optimise the way resources are used is critical. Rapidly increasing demand for energy and other natural resources, supported by an increasingly carbon-intensive energy supply, is a challenge to achieving energy security and green growth. Demand for energy in Viet Nam is expected to continue to rise at a rapid pace. With a growing population and rapid urbanisation expected over the next two decades, pressures on natural resources and costs of environmental degradation will only increase. Viet Nam will need to better manage its natural resources and reverse negative trends in environmental quality in order to support future growth and development.

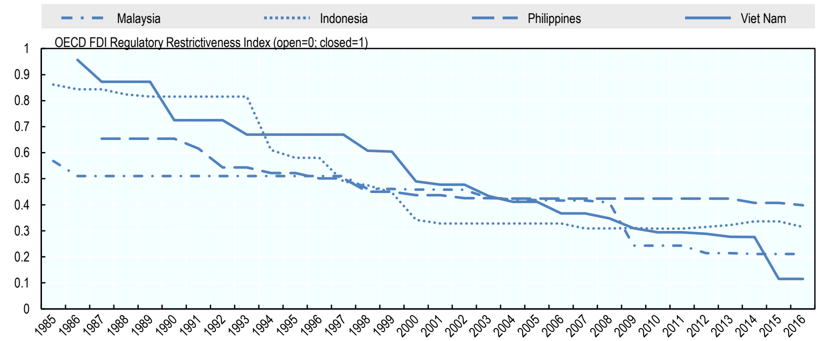
Further measures to improve the investment climate in Viet Nam

Reforms since the mid-1980s have paid handsome dividends in terms of growth, poverty reduction and integration into the global economy. An active legislative agenda at home, coupled with an assertive international treaty-making strategy, make Viet Nam stand out from many other emerging economies at the same level of development. At the same time, the challenges mentioned above will need to be addressed to ensure that rapid growth continues and that it is both environmentally sustainable and socially inclusive. This review outlines possible reforms in many policy areas having an impact on the investment climate.

Viet Nam has gradually liberalised and now has fewer FDI restrictions than many of its peers

Deep reforms over three decades have transformed Viet Nam from virtually a closed economy prior to *Doi Moi* to become one of the most open to investment in Southeast Asia in terms of statutory restrictions and a leading destination for foreign direct investment. Foreign investment, mostly in the form of greenfield investment, has taken off as a result. Figure 6 shows the liberalisation of FDI restrictions over time according to the OECD *FDI Regulatory Restrictiveness Index* (described in Box 2.1) compared to selected large ASEAN economies.

Figure 6. **Viet Nam's FDI liberalisation compared to regional peers**



Source: OECD FDI Regulatory Restrictiveness Index.

As shown in Figure 6, the extent of discrimination against foreign investors has been reduced over time. The revised *Law on Investment* further narrows the list of business sectors subject to investment conditions and adopts a negative list approach for the first time. It also restricts the ability of ministries, the People's Council and People's Committees to issue regulations on investment, thereby removing a degree of uncertainty from overlapping and sometime contradictory legislation. At the same time, some key services networks are still partly off limits to foreign investors, holding back potential economy-wide productivity gains. Access to world class services inputs is crucial for moving up the value chain as well as for boosting growth and jobs in the services sector. Further liberalisation would also help to raise efficiency in SOE-dominated sectors, which has sometimes acted as a drag on economic growth.

The major domestic players have traditionally been SOEs. Early investors eager to tap into the domestic market had often chosen to form joint ventures with SOEs in order to navigate the complex and discriminatory regulatory framework and to benefit from incentives only available to joint ventures. Over time, the preference has shifted towards majority-ownership, as is common in other countries. Further restructuring of the economy, however, has been partly impeded by the earlier prohibition of foreign majority-ownership acquisitions in public companies, removed in 2015, and by the restrictions on foreign participation in the equitisation process. This helps to explain the low level of cross-border mergers and acquisitions seen in Chapter 1.

Policy recommendations

- Consider further services sector liberalisation. Some key services sectors, such as transport, communications and banking, are still partly off limits to foreign investors, holding back potential economy-wide productivity gains.

- Allow for greater private and foreign participation in SOEs being equitised. Revising foreign equity limitations could provide further impetus for the equitisation programme and help to enhance the productivity of SOE-dominated sectors. Foreign investors' interest in buying up stakes in SOEs is vastly reduced if they are offered only minority stakes, which impedes the necessary restructuring of the acquired assets.

In spite of progress, the administrative burden on investors could be further reduced

The procedures for establishing a business in Viet Nam are still complex. Over time, it has been a common intention among all Viet Nam's investment and enterprise law reform efforts to further streamline and narrow the scope of investment entry procedures. The new *Investment* and *Enterprise Laws* are no exception and provide for a much improved environment in this respect. In the past, Viet Nam has been among the worst performers in the World Bank rankings for starting a foreign business under *Investing across Borders*.

Policy recommendations

- Continue to eliminate or further narrow the scope of investment registration requirements where possible, and make the public policy objectives of requiring investment certificates clearer. Entry regulations raise the cost of business and may be inefficient in achieving public policy objectives. Countries have most often opted for requiring only the registration of an enterprise, and have addressed other concerns through post-entry regulation.

- Make sure the content of the National Foreign Investment Web Portal is up to date and available in English in order to ensure transparency, clarity and predictability for investors. As of June 2017, the negative list of entry and operational conditions applying exclusively to foreign investors remained available in Vietnamese only.

The legal framework for investment regulation and protection has improved substantially

The unprecedented economic reform efforts undertaken by Viet Nam over the past three decades have been coupled with numerous, successive regulatory reforms, from the 1987 *Law on Foreign Investment in Viet Nam* to the recently enacted *Law on Enterprises* and *Law on Investment*. These gradual improvements have brought Viet Nam's legal investment framework closer to the level of the most advanced ones across the ASEAN region. As a result, the investment framework has gradually improved: registration procedures, tax policies, rights to transfer capital and foreign exchange abroad and access to land have been progressively relaxed, while the investment environment has gradually been brought closer to Viet Nam's international commitments (ASEAN in 1995, and WTO in 2007).

In 2005, a significant milestone was achieved with the introduction of the unified law on investment. The *Investment Law* came into force together with a new *Enterprise Law* and an *Intellectual Property Rights Act*. In 2013-15, the government revised various laws fundamental to the investment climate, such as the *Enterprise Law*, the *Investment Law*, the *Housing Law*, the *Real Estate Business Law* and the *Land Law*. The new *Investment Law* moves further away from the previous "positive list" approach to a "negative list". These various amendments have played a significant role in Viet Nam's efforts to fully integrate the ASEAN Economic Community (AEC).

Yet, while the wave of reforms of the economic legislation is a very positive step towards the integration of Viet Nam in the global market and, as such, has been widely praised by the business community, further efforts are needed to create the conditions to be a top investment destination. Substantial challenges persist and there is still some way to go to fully achieve an enabling legal infrastructure for investment. Despite well-drafted laws, the legal environment still suffers from loopholes that might impede its predictability. The implementation of the newly enacted laws has been challenged by delays in adopting the implementing decrees, which has caused confusion for the business community, with deleterious – although perhaps only temporary – effects on the investment climate. The application of regulations is also sometimes hampered by inconsistent administrative practices, notably at provincial levels. Likewise, a more even and harmonised implementation of these regulations across the country would greatly enhance the enabling environment for investment.

International investors in Viet Nam tend to favour alternative dispute resolution means over domestic courts to settle their business disputes. Commercial arbitration has thus become the most common way of seeking business dispute resolution before private arbitration centres such as the Viet Nam International Arbitration Centre. There seems to be a widely shared perception among the business community that the difficulty, too often encountered, of getting foreign arbitral awards recognised and enforced by domestic courts, is one of the most stringent impediments to an enabling investment climate in Viet Nam.

While private ownership of land is still not permitted in Viet Nam, restrictions on access to land have been progressively relaxed. The new *Land Law*, enacted in 2013 and in force since 2014, has brought a significant milestone towards further opening access to land to foreign investors. As for the protection of intellectual property (IP) rights, there is a strong awareness, at the highest level of government, of the immediate stakes of having a robust IP policy. Substantial improvements to better protect IP have been made over the past two decades at policy and legislative levels. Yet, despite this successful reform process and concrete improvements, enforcement of IP regulations still needs to be strengthened.

Viet Nam is a contracting party to 66 bilateral investment treaties and an increasing number of multilateral trade and investment agreements. With the completed Viet Nam-EU FTA, the country has recently participated in a major and high-profile treaty, placing it at the centre of international investment policy making. Viet Nam's investment treaties typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to investor-state dispute settlement mechanisms (ISDS) to enforce those provisions. Increasingly, the treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment.

The review of the substantive provisions in Vietnamese investment treaties shows that the language of key treaty provisions has evolved, particularly since the advent of the new regional ASEAN treaty policy in 2009. In recent treaties, Viet Nam has specified the meaning of key treaty provisions, such as on indirection expropriation and fair and equitable treatment, to clarify government intent, which can be an important tool in the quest for balance between investor protection and governments' right to regulate.

In the field of ISDS, the conclusion of the FTA with the EU makes Viet Nam the first country to agree to the Investment Court System, proposed by the European Union. The proposed system constitutes an important departure from other ISDS mechanisms found in Viet Nam's treaties, which are largely inspired by commercial arbitration.

Overall, investment treaties appear to be an important element in Viet Nam's efforts to create an attractive investment climate. Recently concluded treaties suggest that Viet Nam is actively managing its treaty policy, which will help the country to integrate its treaties into its broader economic development objectives.

Policy recommendations

- While Viet Nam often has well-drafted laws, the implementation of legislation can be difficult. For legal security purposes, the authorities would need to ensure that the enactment of new laws is promptly followed by the adoption of implementing regulations. Likewise, the application of laws and regulations should be harmonised, so as to ensure consistency of rules and administrative practices from one province to another.
- The enforcement, by domestic courts, of foreign arbitral awards should be made easier, in accordance with the provisions of the New York Convention to which Viet Nam is a party. Giving access to dispute resolution mechanisms, including arbitration, with the guarantees that awards will easily be enforced is key to creating a strong and enabling business climate.
- Viet Nam's legal instruments – its laws, but also its investment treaties – provide different levels of protection to specific groups of investors: while domestic and foreign investors receive different levels of protection, there are also different levels of protection among foreign investors because of differences in the treaty provisions under which they are covered. Viet Nam might wish to ensure that offering varying levels of protection to specific investors is justified by a need to provide extra incentives for their investment.
- Many Vietnamese investment treaties only protect investors once they have invested, *i.e*. post-establishment. Viet Nam could consider strengthening the use of investment treaties to facilitate the making of new investments by extending the coverage of certain clauses to the pre-establishment phase.

Improve corporate governance, including in SOEs, to help in industrial restructuring

Corporate governance concerns the structures framing the relationships among a company's executive management, board of directors, shareholders and stakeholders. From the perspective of modernising legal and regulatory frameworks for investment, effective corporate governance affects not only individual firm behaviour but also broader macroeconomic activity. For emerging market economies, improving corporate governance can serve several purposes, including reinforcing property rights, reducing transaction costs, and lowering the cost of capital, which together can improve investor confidence. The Asian financial crisis that began in 1997 acted as a significant catalyst for improving corporate governance frameworks in Asia with the aim of building well-functioning and stable financial markets.

Regulatory reforms in the past few years have reconfigured Viet Nam's corporate governance framework to encompass all firms, public and private, listed and non-listed, thereby marking a significant change in the investment landscape. Viet Nam's entry into the WTO in 2007 was preceded by an important restructuring that involved the passing of the *Law on Enterprises* and the *Law on Investment* in 2005 and the *Law on Securities* in 2006. This was followed by the issuance of a number of decrees, circulars and decisions to ensure implementation of the new framework.[4] The EU-Viet Nam Free Trade Agreement will encourage further reforms of corporate governance, particularly of SOEs, as would the provisions in the Trans-Pacific Partnership (TPP) Agreement.

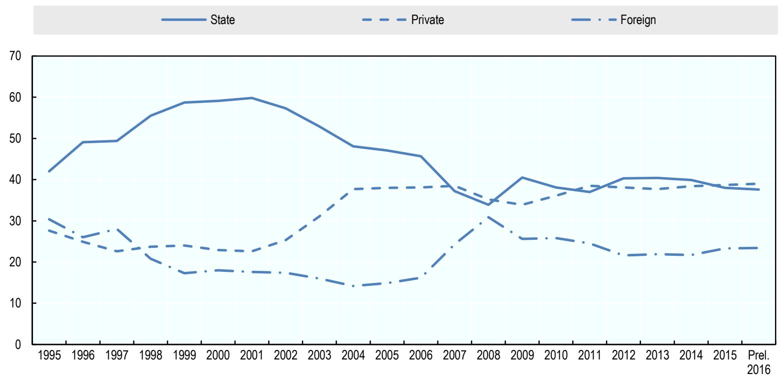
In late 2014, the National Assembly approved a number of new and amended laws, including the *Law on Enterprises* which has established a comprehensive and ambitious framework governing firms. The Law clarifies provisions regarding independent board directors, raises the number of days for which shareholders must receive notice for annual general meetings and introduces e-voting. The perception is that the new regulation has helped to set the bar high for Vietnamese companies and to improve Viet Nam's ranking on a number of corporate governance assessments. Ensuring full compliance by individual firms will be the greatest challenge.

In spite of these improvements, the overall legal and regulatory corporate governance framework remains complex, with scattered inconsistencies and at times limited awareness by market participants. The equitisation of SOEs proceeded rapidly in the 1990s and early 2000s but has slowed down over the past decade, although more recent efforts by the government have to be acknowledged. Many equitised SOEs have retained significant state ownership and have not attracted foreign investors. Total assets of fully state-owned enterprises correspond to 80% of GDP. While listed SOEs have performed best among all SOEs, they appear to be more distressed than private listed companies.

Figure 7 shows the share of total investment contributed by SOEs, private local companies and foreign investors over time. The SOE share dropped rapidly in the early years of *Doi Moi* until 1992 but rose again in the subsequent decade. It has stabilised over the past few years at about the same level of investment as local private firms and roughly twice the share of foreign investors.

Figure 7. **Investment by type of ownership**

(share of total investment)



Source: GSO

Equitisation has had less impact than might have been expected on the shares in Figure 7. This relates partly to restrictions as part of individual equitisations, but also to the prohibition in the past on majority foreign ownership of public companies, together with weak corporate governance of SOEs. Restrictions on foreign participation in the SOE equitisation programme have been an important explanation for the lack of a broader investor base. Foreign investors' interest in buying stakes in SOEs has been vastly reduced in most cases because they are offered only minority stakes, which would prevent them from pushing for broader governance reforms. Revising foreign equity limitations could provide further impetus for the equitisation programme and support enhancing the productivity of Viet Nam's economy.

The continued prominence of SOEs and the preferential treatment they receive in terms of access to finance calls into question the extent to which a level playing field, or "competitive neutrality" has been achieved. The quality of the ownership and governance of SOEs is of particular interest to foreign investors because it determines the attractiveness of these SOEs as either targets of direct investment or as partners in business transactions and joint ventures or strategic partnerships. Some SOEs have managed to successfully attract foreign investors by making a convincing push towards alignment with internationally-recognised standards of corporate governance.

The corporate governance framework in Viet Nam remains a work in progress, but the regulatory steps taken in the last few years to address (*i*) the organisation of the state ownership function of SOEs, (*ii*) the rights and equitable treatment of shareholders, (*iii*) the requirements for disclosure and transparency, and (*iv*) the functioning of boards of listed companies offer promise to domestic and foreign investors.[5] The reform of the corporate governance framework is ongoing and new regulations are expected to come into force soon. The *G20/OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* are useful benchmarks for Vietnamese policymakers as they continue to develop and measure progress in developing their corporate governance frameworks.

Policy recommendations:

- *Clarify and ensure effective separation between the state ownership function and regulation.* A clear separation is a fundamental prerequisite for ensuring a level-playing field with the private sector and for avoiding competitive distortions. Clear laws and regulations should be developed to protect the independence of regulators, especially vis-à-vis line ministers. Nominal independence is not enough. Operational independence might be jeopardised by a narrowly based fee structure, for example, or by a lack of budget autonomy. Appropriate financial and human resources should be provided to allow regulators to function adequately with the right level of operational independence.

- *Develop and disclose a state ownership policy.* The ownership policy should define clearly the overall rationale for state ownership and should be made public, clarifying the main objectives to which this rationale gives rise. Most importantly, the ownership policy should define how the state should behave as an owner. Clear and published ownership policies provide a framework for prioritising SOE objectives and are instrumental in limiting the dual pitfalls of passive ownership or excessive intervention in SOE management.

- *Reinforce provisions protecting the rights of minority shareholders.* The protection of minority interests is a cornerstone to develop the capital market. An effective system is needed to protect against abuses by majority shareholders, such as related-party transactions. This is crucial for Viet Nam to be credible in ensuring an equitable treatment of all shareholders and, to the greatest extent possible, equal access to corporate information.

- *Reinforce minority shareholders' capacity to obtain effective redress for the violation of their rights.* Even if an appropriate legal and regulatory framework is in place with regards to the protection of minority shareholders, effective and timely enforcement is often lacking in Viet Nam. To improve implementation and enforcement of minority shareholders rights, a priority should be to further reinforce the capacity of relevant regulators such as the State Securities Commission.

- *Enhance the quality of disclosure and ensure that it is made in a timely manner.* The authorities should promote the adoption of emerging good practices for non-financial disclosure, in both Vietnamese and English. Full convergence with international standards and practices for accounting and audit should be sought. The implementation and monitoring of audit and accounting standards should be overseen by bodies independent of the profession. Managers, board members, and controlling shareholders should disclose structures that give insiders control disproportionate to their equity ownership.

- *Increase the independence of boards and improve the transparency of the nomination process*. One of the most effective tools to protect minority shareholders is the election of independent directors. The public perception in Viet Nam is sometimes that independent directors are not independent-minded and that there is political interference in the nomination process. Minority shareholders should be able to exert influence on their election through the possibility of nominating candidates through e-voting. The board nomination process should include full disclosure about prospective board members, including their qualifications, with emphasis on the selection of qualified candidates.

Competition policy

A competitive environment is essential for a dynamic business climate in which firms invest. Creating and maintaining this requires a sound and well-structured competition law, as well as competition authorities that are adequately equipped with suitable, skilled resources, free from political interference and that enforce the law. A sound competition regime requires that firms know the rules of the game and respect them and that those rules are applied equally to all firms – private, state-owned, foreign or domestic. By the Viet Nam Competition Authority's own admission, all or at least some of these requirements are not present as it suffers from "limited resources and unsound regulations"[6].

Viet Nam should consider amendments to bring key provisions of the draft law in line with international best practice. The law contains a number of provisions that are not commonly found in the laws or enforcement practices of other jurisdictions. In the interest of adopting a legal framework that can be readily implemented and that avoids politicising the enforcement of law, the following rules and principles should be amended or adopted:

Policy recommendations:

- General recommendations
  - Market shares should be used only as a first screen for the Vietnamese authorities to determine which cases to investigate further but not to determine the outcome of those investigations and ultimately prohibitions of anti-competitive agreements, abuse of dominance and mergers.
  - Laws and regulations should be changed to allow economic analysis and realities to be more integrated into the analysis by making market definition more flexible and less proscriptive and permitting the use of economic tools.
  - Market power should be measured not only via market shares but by considering a number of other factors such as barriers to entry, countervailing buyer power.
- Instrument specific recommendations
  - Hard-core cartels should be made illegal per se and not benefit from exemptions.
  - A leniency system should be introduced into the *Law on Competition*, accompanied by increased enforcement and application of significant sanctions.
  - The *Law on Competition* should be changed to reflect the 2005 OECD Recommendation of clear, objective and quantifiable merger notification thresholds.

Tax policies in Viet Nam

Viet Nam's tax regime is one of the key policy instruments that can either encourage or discourage investment. Tax-related issues are found in the tax legislation, as well as in the *Law on Investment*, and multiple regulations related to economic zones. An important transparency-enhancing tax reform in Viet Nam would be to consolidate all tax-related legislative provisions into a single *Tax Code* and under the authority of a single government body. With such a variety of tax regimes, it is important for Viet Nam to assess thoroughly the effective tax rates applicable to various business segments. The tax burden on profits varies considerably across business segments which can lead to aggressive tax planning strategies by investors, including transfer mispricing.

At the same time, Viet Nam faces a widening budget deficit and a deteriorating fiscal position, with a 20% decline in government receipts between 2010 and 2014 as a proportion of GDP, although this trend began to reverse itself in 2015.[7] Fiscal pressures are nevertheless likely to grow as an ageing population puts strain on pension and health systems. The demographic dividend which ensured an ever-expanding workforce is disappearing, as the share of the population under 14 has been declining for five decades and is now at its lowest level. Viet Nam is one of the most rapidly ageing countries in the world (World Bank, 2016). Fiscal pressures will also arise from trade liberalisation as a result of FTA negotiations, since tariff receipts contributed 7.8% of total fiscal revenue in 2014.[8] Further and deeper equitisation in the future will also have implications for government revenue. SOEs still provide one third of domestic non-oil budget revenue. This will have to be offset in part by rising corporate tax revenues from the entry of more productive firms.

Like many countries in Southeast Asia and elsewhere, Viet Nam offers tax incentives to attract investment and to achieve important socio-economic goals such as promoting development in more peripheral regions. Viet Nam also offers a low corporate tax rate which will be one of the lowest in the region by 2016. Despite the growing recognition by the authorities of the challenges associated with tax incentives, there is inadequate analysis of their costs and benefits in a national context to support government decision making. Limited data are collected either on the direct and indirect benefits to the economy, or on the cost of these tax incentives, including forgone revenue so as to assess whether non-uniform treatment of investors and targeted tax relief can be properly justified. Businesses complain about costly compliance, inconsistent application of rulings in practice, the lack of predictability, and excessive discretion in tax-related decision-making.

Indirect costs include the variability across sectors, complexity and lack of transparency, all of which help to explain the poor performance of Viet Nam in the *Doing Business*: Paying Taxes indicator, albeit with substantial improvements in recent years. Administrative discretion can add to project risks and costs, and increase the possibility of corruption, undermining good governance objectives fundamental to securing an attractive investment environment.

Viet Nam should adopt a whole-of-government approach that ensures consistency between its tax policy, broader national and sub-national development objectives, and its overall investment attraction strategy. The long-term consequences of a tax base narrowed by tax incentives translate into mounting fiscal pressures which weaken macro-economic fundamentals. These rising macro-economic challenges could ultimately start corroding the country's investment attractiveness.

Policy recommendations:

- *Adopt a whole-of-government approach to tax incentives.* The Ministry of Planning and Investment (MPI) and the Ministry of Finance (MoF) have shared responsibilities, but are working towards different objectives. The MPI offers tax incentives on the assumption that it will help to attract investors, while MoF argues that revenues need to be raised to provide public goods, including the key pillars of a business-enabling environment, such as infrastructure. Effective co-ordination of various Vietnamese authorities mandated to promote investment with tax policymakers is a daunting but critically important task.

- *Simplify the tax system and broaden the tax base.* More revenues need to be generated for development needs. This can be achieved by streamlining the tax system and eliminating wasteful tax incentives identified through a credible cost-benefit analysis. Simplifying the tax system, including through eliminating (or, at the least, limiting) tax holidays, and reducing the number of preferential tax rates, will not only increase tax revenue but also reduce administrative costs of servicing the tax system.

- *Conduct tax expenditure analysis and reporting.* Regular and consistent tax expenditure analysis is an essential element of good governance. The revenue forgone through tax incentives should be reported regularly, ideally as part of an annual tax expenditure report covering all main tax incentives. This exercise should be used to focus policymakers' attention on the fact that tax expenditures are quite similar to direct spending programmes and have to compete with other government spending priorities when the government makes its budget decisions.

- *Systematise data collection.* The analysis of tax incentives required for public statements, budgeting, periodic reviews and tracking of behavioural responses by business is data intensive. Revenue authorities need periodically to collect and analyse taxpayer data which may require introducing institutional mechanisms to do so.

- *Strengthen capacity for policy analysis.* To support coherent and comprehensive government decision-making, the MoF needs the capacity to analyse and explain the impact of tax reforms to decision makers and the public. Both human and institutional capacity need to be strengthened. Staff need to be trained in modern fiscal analysis techniques and equipped with the necessary tools for putting those techniques to practical use in order to improve delivery of economic research and analysis for key policy decisions.

- *Limit non-uniform treatment of investors.* Viet Nam imposes a non-uniform effective tax rate on different businesses, depending on their business activity, location, or size. Certain firms are specifically targeted to receive preferential tax treatment. Policy makers should examine and weigh arguments in favour of and against such targeted tax relief; a tax burden that varies considerably from one investment type to another must have a clear rational.

- *Improve transparency and strengthen governance.* In creating an investment-promoting business environment, transparency and clarity in providing tax incentives are important. Discretionary decision-making on tax incentives, ambiguous legal drafting, inconsistent application of rulings in practice and the lack of predictability, a proliferation of rulings, an uncertain environment, frequent legislative changes, and above all, costly compliance due to excessive complexity of the tax system are all factors that deter investment. Improving clarity, transparency and good governance of the tax framework, will improve the business environment and stimulate investment.

Investment promotion and facilitation

Investment promotion and facilitation measures can be powerful means to attract FDI by marketing a country as an investment destination and making it easier for investors to establish or expand their existing investments. Such activities can also raise the contribution of FDI to development. They can support the creation of a favourable environment for all firms and help ensure that foreign investments create linkages with domestic companies and contribute to skills transfer.

In Viet Nam, investment promotion and facilitation activities occur both central and provincial levels since the decentralisation of certain investment-related government functions was launched in 2005. Over the past decade, while the central government has made considerable efforts to improve the business environment through administrative simplifications and regulatory reforms, provinces have taken a leading role in both promoting inward investment and facilitating business establishment. Industrial parks and other types of special economic zones (SEZs) have been increasingly developed to attract foreign investors in almost all provinces. As a result, Viet Nam has attracted significant amounts of FDI, although inflows have levelled off since 2010, as a result of increasing competition from a number of countries in the region.[9]

Decentralisation of investment promotion and facilitation came with both advantages and disadvantages. On the one hand, competition between provinces encouraged them to become more efficient in attracting FDI and in improving the local investment climate. On the other hand, roles and responsibilities between the different levels of government have been unclear, and excessive competition among provinces has, in some cases, led to duplication of efforts, misuse of resources and inconsistent application of policies – often leaving the poorer provinces behind. The MPI and its implementing agencies, such as the Foreign Investment Agency, are in charge of national policy design and overall investment promotion and facilitation – including outward FDI promotion. They implement an ongoing and constructive dialogue with the private sector, including through the Viet Nam Business Forum, and are increasingly taking a co-ordinating role in terms of providing overall guidance to provinces and monitoring implementation. Overall, central and provincial institutions are not yet sufficiently well-equipped to properly implement policy reforms.

Small and medium-sized enterprises have blossomed since *Doi Moi* reforms but their overall level of competitiveness remains low. Few business linkages between multinational enterprises (MNEs) and domestic companies have occurred until now, notably due to productivity and quality gaps. Although SEZs have proliferated across the country, they tend to generate few spillovers to the domestic economy. As a result, the government is increasingly putting the development of supporting industries at the centre of its small and medium-sized enterprise (SME) strategy so as to enhance the benefits of FDI through business linkages and further integrate global value chains. Higher education and vocational training have a solid track record in producing basic skills but face challenges in generating more advanced skills that are increasingly in demand on the labour market. In order to avoid a skills mismatch, the government has put the development of human resources and skills for modern industry and innovation at the heart of its ten-year national strategy plan (2011-2020 Socio-Economic Development Strategy).

Policy recommendations:

- Viet Nam should translate its investment promotion vision into a concrete and precise countrywide action plan. For this purpose, the MPI should put more efforts into the co-ordination of FDI attraction initiatives emerging from provinces and from industrial parks and economic zones. A well-delineated division of labour with efficient co-ordination mechanisms amongst different levels of government will be essential to avoid unhealthy competition between provinces and ensure that all activities are in the interest of the nation as a whole. Beyond co-ordination, the MPI's Foreign Investment Agency could focus its activities, on the one hand, on targeting FDI in high-value added and knowledge-intensive activities and, on the other hand, on providing increased support to poorer provinces in their investment promotion efforts.
- After notable measures taken by the central government and some provinces on administrative and regulatory improvements in the business environment, priority should now be given to ensuring effective and consistent implementation of policies. In order to sustain the results of policy reforms, human capacities need to be reinforced and resources better used to build modern institutions at both central and provincial level. Central government agencies need to support provincial authorities and provide them with the tools to apply new regulations and facilitate the establishment of new investors, while carefully monitoring progress. While the monitoring aspect needs to be undertaken countrywide, capacity building activities should principally target provinces with least resources.
- Measures to encourage business linkages should primarily focus on strengthening SME performance and competitiveness. They should combine a stronger, whole-of-government approach to SME development with industry-specific measures to build supporting industries' absorptive capacities. FDI attraction efforts could focus prominently on MNEs that are inclined to source locally and SEZ promotion should be given a stronger cluster focus articulated around SME development and integration into global value chains. Central and provincial investment promotion authorities can also facilitate the information exchange between foreign and domestic firms through suppliers' databases and matchmaking events. In order to progressively reduce productivity gaps between MNEs and SMEs, the authorities should also make educational and training programmes more market driven by increasingly involving the private sector in human resource development policies and encourage internal and external training by employers.

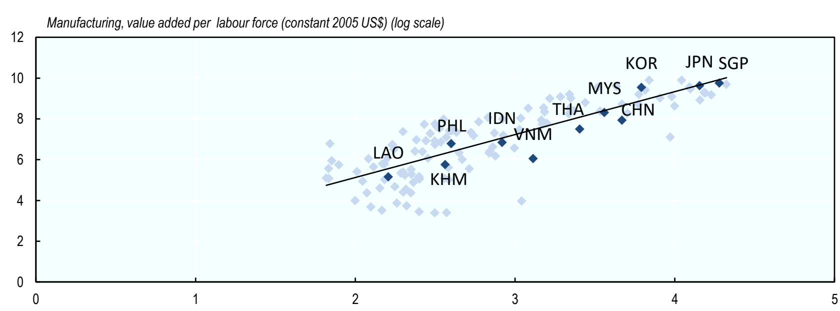
Infrastructure connectivity in Viet Nam

Viet Nam has grown rapidly over the past decades, achieving significant economic and social transformations. Greater integration into the world economy and the expansion of regional production networks in the region and in Viet Nam have played an important role in this process. But the rapidly growing industrialisation and urbanisation are putting increasing strains on Viet Nam's infrastructure. Investment in infrastructure has so far been mostly oriented towards expanding existing networks, but quality has not kept pace with demand. Current infrastructure shortcomings in main economic corridors constitute an important barrier for linking with higher value added GVCs, which require faster and more reliable logistics environments.

Better logistics systems would help Viet Nam to continue moving into higher-value added industries and can have important long-term effects in terms of access to technology and know-how associated with these flows (Figure 8). Recent OECD research shows that global value chains are much more sensitive to behind the border infrastructure than overall trade. Poor infrastructure systems are often a major determinant of overall logistics costs, which in turn are among the primary causes of trade costs. In Viet Nam, Portugal-Perez and Wilson (2010) estimate that improving physical infrastructure to the level of Malaysia could boost exports by almost 30%, which would be equivalent to 20% reduction in the value of tariffs on goods. Improved regional road connectivity and trade facilitation, for instance, could boost Viet Nam's GDP by 3.6%, mostly due to improvements in its links with China (Stone *et al.*, 2012).

Figure 8. **Manufacturing value added per worker**

(constant 2005 USD, log scale)



Source: World Bank Development Indicators.

The government recognises the importance of infrastructure for raising both industrial productivity and rural populations' access to social and economic opportunities. The ten-year Socio-Economic Development Strategy 2011-2020 places infrastructure development as one of the three priority areas to achieve development objectives. But estimated infrastructure investment needs are large. The MPI officially estimates that USD 170 billion will be needed for developing essential infrastructure in Viet Nam over 2011-20, about half of which will have to come from the private sector. As part of the strategy to modernise Viet Nam's infrastructure, the government wants to improve the conditions for private sector participation. In the past, despite the many attempts to boost private participation, relatively little private investment has gone into infrastructure.

The new *Decree on Public-Private Partnership* reflects this renewed attempt to modernise the regulatory framework for private participation in infrastructure. Together with the 2014 *Law on Public Investment,* it brings some important regulatory and institutional mechanisms to improve infrastructure delivery capacity (*e.g.* the project development facility and the possibility for availability-based projects). Its effectiveness will depend greatly on appropriate implementation. The quality of upcoming rules and guidelines will be crucial for the success of the programme. These need to clarify specific issues of concern for investors and help the government prepare and implement such projects efficiently.

The planning and assessment of infrastructure projects also need to be improved so as to secure value for money in infrastructure delivery. In the past, the lack of integrated multi-modal infrastructure planning and a robust value-for-money assessment process led to poor project prioritisation and the implementation of infrastructure projects in a un-co-ordinated fashion across government agencies and levels of government, and with limited societal benefits. Private investment will not solve any funding issue impeding further investments in infrastructure. Therefore, the selection of infrastructure projects and the choice of delivery mode need to be grounded on a robust value for money analysis not biased by fiscal motivations.

The government also needs to continue its reform efforts to bring prices to cost-reflective levels in infrastructure markets and to move forward with the SOE reform programme to ensure a level playing field for investors in infrastructure sectors. The number of SOEs in infrastructure sectors remains high, and their relatively weak corporate governance practices are likely to constitute a further barrier for private investments in infrastructure.

Policy recommendations

- Implement integrated multi-modal infrastructure planning to stimulate complementarities and facilitate a more coherent and welfare-enhancing infrastructure development programme. Strengthen efforts to build capacity in designing a clear and coherent strategic vision for infrastructure.

- Continue to improve the assessment and prioritisation of infrastructure projects so as to secure value for money in infrastructure delivery, including to better balance the need of expanding infrastructure networks and maintaining the quality of existing assets. In the past, some infrastructure projects have been implemented in a un-co-ordinated fashion and with limited benefits to society. The new *Law on Public Investment* and the new framework for PPPs should help address such shortcomings by establishing a more robust value-for-money assessment process and allowing for the government to draw on the recently created project development facility to structure project proposals.

- Ensure that the choice of delivery mode be grounded on a robust value-for-money analysis not biased by fiscal motivations. Under adequate competition and an appropriate regulatory environment, private investment can help to enhance the efficiency of infrastructure, but it should not be used to escape budgetary discipline, notably when the government still bears significant risks and faces potentially large fiscal costs.

- Make sure that upcoming regulations and guiding documents address specific concerns of investors in the new regulatory framework, such as the scope and conditions of government guarantees, rules for project termination and standard guidance for risk allocation.

- Continue the reform efforts to bring prices to cost-reflective levels in infrastructure markets and to move forward with the SOE reform programme to ensure a level playing field for investors in infrastructure sectors. Removing Viet Nam Electricity’s (EVN) cross-ownership of the single buyer and power generation companies, for instance, should facilitate the establishment of a competitive wholesale power market under the 7th Power Development Master Plan and help to secure investments into power generation in the longer run.

Investment policy framework for promoting green growth

Viet Nam is facing several key challenges in its efforts to promote green growth and investment. The country's rapid economic growth has relied on natural resources, and environmental degradation and pollution is now threatening future growth. The national energy mix is increasingly focused on fossil fuels, which exposes Viet Nam to fluctuations in global oil prices, and comes with high environmental costs. The looming threat of climate change is exacerbating existing issues – Viet Nam is particularly vulnerable to climate change, with its long coast line, a population that is heavily dependent on agriculture, forestry and fishing for its livelihoods, and infrastructure that is exposed to climate change-induced events, such as floods and storms.

Addressing these challenges provides opportunities for Viet Nam to mobilise green investment. The need for clean infrastructure, particularly solar and wind energy, the potential for energy efficiency and technological innovation, and increasing opportunities to provide environmental services, such as waste and water management, all create opportunities for private investment, both foreign and domestic. In this regard, a balanced policy framework that promotes investment in green sectors and facilitates the greening of investment overall is crucial to Viet Nam’s efforts to promote green growth and investment.

Viet Nam has made great strides in instituting a policy framework in this area. A vision for low carbon and climate resilient growth has been established, a framework for environmental protection has been put in place, targeted incentives and efforts to promote energy efficiency and renewable energy have been introduced, and the government has begun addressing fossil fuel subsidies. Viet Nam’s Green Growth Strategy (VGGS), the National Climate Change Strategy and the more recent Intended Nationally Determined Contribution, submitted to the United Nations Framework Convention on Climate Change (UNFCCC) in 2015, collectively signal the intention of the government to pursue low carbon and climate resilient growth. In the energy sector, the country’s revised Power Development Plan VII and new renewable energy strategy describe ambitious goals for renewable energy and energy efficiency.

Despite this, implementation of the policy framework is still a work in progress. Policies on green growth and climate change have overlapping, inconsistent targets which suggests a lack of co-ordination and coherence in decision making among the main ministries. While green growth is reflected in policy documents, the level of ambition to take action on climate change and green investment varies. Institutional capacity and human resources are lacking in key policy and decision making units, and enforcement capacity needs to be strengthened so that regulations are complied with.

In addition, several constraints still hamper both foreign and domestic investors who are investing in renewable energy and energy efficiency. Electricity tariffs are regulated and capped, which lowers the returns on investment for renewable energy and acts as a barrier to energy efficiency investment. The feed-in-tariff for wind is too low to spur significant investment and a new proposed feed-in-tariff for solar is also expected to be quite modest. Indirect fossil fuel subsidies support and incentivise SOEs in the energy sector which are investing in fossil fuels. The government has initiated plans to remove all fossil fuel subsidies by 2020 and reform the tariff regime, but the process has been challenging and slow, with several setbacks.

Policy recommendations for mobilising green investment in Viet Nam

- *Improve clarity and consistency of long-term goals on green growth and climate change*. To create predictability and long-term visibility for investors interested in green growth opportunities, Viet Nam needs to align and clearly communicate its long-term greenhouse gas emission reduction targets. National targets should be aligned with international commitments and embedded into the main frameworks for planning and investment in the country, *i.e*. the Socio-Economic Development Plan (SEDP) and policies on investment. National targets should be translated into sector level targets which are, in turn, embedded in sector master plans. Clear, consistent and ambitious national and sector level targets could be a powerful complement to investment incentives in renewable energy and energy efficiency and create demand for green technology development.

- *Invest in building the institutional and technical capacity of key government institutions, at national and subnational levels.* The government's political commitment to green growth needs to be translated into state budget spending on green growth, accompanied by efforts to build the human resources required to co-ordinate, implement and monitor policies. Departments and units in charge of green growth policies at national and sector levels lack the human resources and capacity required to mainstream and implement climate initiatives, which in turn effects co-ordination between ministries. Adequate capacity at the provincial level is also needed to ensure compliance with environmental protection legislation.

- Carefully consider increases in coal-fired power, and ensure effective policies and measures for renewable energy and energy efficiency. The newly adjusted Power Development Plan VII increases targets for renewable energy for the next 15 years but also affirms that coal power will continue to increase, despite the need for coal imports, and will make up over half the country's electricity supply in 2030. It is important that Viet Nam evaluate and clearly identify the range of costs associated with coal-based energy, including the impact climate change and air pollution is having on its development trajectory. A clear, credible and long-term price on carbon emissions across the economy, through market-based instruments such as emission trading schemes or carbon taxes, could help ensure that the full range of impacts from fossil fuel based power are accounted for. Viet Nam should also strive to meet its targets on renewable energy and energy efficiency. Policies and incentives on renewable energy need to be refined in order to spur investment, and financing needs to be made available to demonstrate and pilot the feasibility of new technologies.

- *Phase out fossil fuel subsidies by reforming electricity pricing and improving competition in the energy sector*. Measures to reduce fossil fuel subsidies should be continued and scaled up in order to spur private investment in renewable energy and energy efficiency. The government's efforts to liberalise the energy production and distribution market under the *Law on Electricity* 2004, and increase private investment in the energy sector will go some way in reducing indirect fossil fuel subsidies. Despite social and political pressure, the government should abide by its plan to phase out all fossil fuel subsidies by 2020 in order to make green investment attractive. The government could also consider introducing carbon pricing in order to catalyse investment in energy efficiency and renewable energy.

- Establish programmes to mobilise international support for green growth, and clearly establish roles of different ministries. Focused government programmes emerging from the SEDP, i.e. national target programmes that are prioritised for support from the state budget, can be a useful way of mobilising international support for green growth and investment. Clearer mandates and responsibilities among government ministries will help avoid overlaps and duplication in the implementation of donor financing. As many bilateral donors are transitioning their support away from more concessional support taking into account Viet Nam's income status, it is especially important that donor support should be programmed and deployed effectively in order to have a lasting impact.

- *Diversify financing sources for climate change and actively engage the private sector*. While new multilateral sources of climate finance, such as the Green Climate Fund, offer more opportunities to support Viet Nam's green growth objectives, this finance will not be enough to meet the investment gap required to transition to a low carbon and climate resilient economy. Considering the potential to engage the private sector in, for example, renewable energy, energy efficiency and waste management, it is important to use concessional climate finance to actively promote responsible private sector participation in key sectors. Efforts to promote green finance through the banking sector should also be scaled up.

- *Consider adhering to the OECD Green Growth Declaration*, as 42 OECD and non-OECD countries have done so far. The *Declaration* highlights that growth and sustainable management of natural resources are complementary and points out key policy approaches that can support a green growth agenda. These include supporting market-based instruments and policies to change behaviour and expanding incentives for green investment in areas such as low-carbon infrastructure. Adhering to the *Green Growth Declaration* not only signals Viet Nam's support for green growth but could also pave the way for additional co-operation with the OECD on the issue. Viet Nam could thereby benefit from an understanding of how other countries, with similar developmental challenges, have been able to green their economies and societies.

Promoting responsible business conduct

Responsible business conduct (RBC) principles and standards set out an expectation that all businesses avoid and address negative impacts of their operations, while contributing to sustainable development of the countries in which they operate. Promoting and enabling RBC is of central interest to policymakers that wish to attract quality investment and ensure that business activity in their countries contributes to broader value creation and sustainable development.

In principle, the legal framework that protects the public interest and underpins RBC has been partially established in Viet Nam, although more efforts are needed to ensure implementation and enforcement of relevant laws. Awareness of international RBC principles and standards is not yet widespread, but the economic and social reforms currently being implemented as a result of Viet Nam's international commitments (particularly in areas related to labour relations and human rights), represent a positive step in strengthening Viet Nam's overall policy framework that enables RBC. It is an important signal for investors, as certain RBC-related risks in Viet Nam are perceived to be high.

Much of the FDI in Viet Nam so far has come from Asia, suggesting that investors from Europe and North America have substantial scope to expand their presence. Mainstreaming RBC at a government level and clearly communicating RBC priorities and expectations would help to overcome country risk perceptions, maximise the development impact of FDI, attract quality investment and promote linkages with MNEs, and create a level-playing for business (particularly important in light of increasing RBC expectations in the supply chains, which can include legal obligations for some investors).

Policy recommendations:

- Implement the reforms in the areas of labour relations, transparency, corporate governance, human rights, and environment that have been agreed to in recent international agreements.
- Develop a *National Action Plan on Responsible Business Conduct*, in collaboration with stakeholders and in line with international good practices. Clearly communicate expectations on RBC, provide guidance on accepted practices, and promote policy coherence and alignment on RBC. Support awareness-raising events. Consider establishing a focal point on RBC in the government.
- Actively promote RBC among Vietnamese businesses. Encourage the establishment of firm-level grievance mechanisms as a complement to government complaints mechanism in order to strengthen the capacity of workers to voice concerns. Encourage cross-sectoral learning for addressing RBC risks.
- Include RBC in the efforts to promote linkages between MNEs and domestic industries, in line with recommendations from Chapter 6. Include RBC principles and standards in the design of the systematic and well-institutionalised industry-specific training programmes for supporting industries, in collaboration with the business community and educational institutions. Consider how social enterprises can be promoted through these programmes.
- Include RBC expectations in FDI attraction efforts and as one element in efforts by central and provincial investment promotion authorities to facilitate information exchange between foreign and

domestic firms. Include RBC criteria in supplier databases and matchmaking events.

- Involve the private sector in human resource development policies and encourage internal and external training by employers. Communicate to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC – and recognise those that do it.
- Communicate the extent of business responsibilities for protecting the environment in strategic documents on the environment at both national and provincial levels.
- Improve the implementation of the regulations on environmental impact assessments by clarifying exact mandates and direct responsibilities for follow up and monitoring activities of national and provincial authorities. Improve technical capacities of responsible authorities, particularly for industries new to Viet Nam.
- Establish expectations on RBC for SOEs and publicly disclose them.
- Consider strengthening disclosure requirements for non-financial information in line with international best practice.
- Implement broader reforms that support entrepreneurship, such as developing an entrepreneurship promotion policy. Promote social entrepreneurship as one component of promoting responsible business practices across the entire economy.

Notes

1. World Bank and Ministry of Planning and Investment (2016), p. 19.
2. The law specifically encouraged foreign investment in five areas: (*i*) implementation of major economic programmes, export-oriented production and import substitution; (*ii*) the use of high technology or skilled labour, and investment in natural resources and in increasing the production capacity of existing factories; (*iii*) labour-intensive production which uses existing materials and natural resources available in Viet Nam; (*iv*) infrastructure projects, and (*v*) foreign currency earning services such as tourism, ship repairing, airports, and sea ports and other services (Le, 1995).

3. This was partly removed with reforms introduced in 2015. Thenafter, as per Decree No. 60/2015/NDD-CP of 26 June 2015, foreign investment in public listed companies remains restricted as per restrictions provided under international treaties to which Viet Nam is a party or under Vietnamese law, as well as in cases where the company operates in business lines and industries with conditions applicable to foreign investors, but where no foreign ownership ratio is specified in the legislation. In this case, the 49% cap on foreign ownership continues to apply.

4. Decision No. 12/2007/QD-BTC on Corporate Governance Regulations of 2007 and the Circular No. 121/2012/TT-BTC Amendments of 2012

5. The base of institutional investors in Viet Nam remains small. Some of the largest domestic institutional investors include Mekong Capital, Dragon Capital, Viet Nam Holding Limited, VinaCapital, and PXP Asset Management.

6. Page 54 of the 2014 Annual Report; page 50 of the 2013 Annual Report.

7. Total government revenues increased by 50% from 2010 to 2014.

8. Tariff revenue is only part of the revenue from foreign trade which includes: import and export duties, value added and excise taxes on imported goods (for certain categories of goods subject to excise tax, such as gasoline, automobiles, cigarettes, alcohol products or beers…) and environmental protection taxes on imported goods, such as on gasoline. Export duties are also imposed on number products, such as crude oil, coals or other minerals.

9. According to data collected from an enterprise survey, about half of the foreign investors currently in Viet Nam considered other countries before investing in Viet Nam – most commonly China, Thailand, Cambodia, Indonesia and Malaysia (Malesky, 2015). Each of these shares has increased since 2013, while the Philippines and Lao PDR have been identified as emerging regional competitors for FDI.

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Chapter 1

Foreign investment trends and performance

This chapter reviews trends in foreign direct investment in Viet Nam using various national and international data sources. It looks at the performance of foreign investment relative to neighbouring and regional economies and its impact on the local economy. It also includes a specific section on trends in mergers and acquisitions and one assessing how foreign direct investment statistics are compiled in Viet Nam.

By all accounts, foreign direct investment (FDI) in Viet Nam is booming. Global flows are still below their 2007 peak, while FDI inflows in Viet Nam are at record levels and growing. This trend shows no signs of abating, on the back of further reforms and given the high and sustained volumes of registered foreign capital in projects a share of which will eventually be implemented. Much of this investment has come from Asia, suggesting that investors from Europe and North America have substantial scope to expand their presence in Viet Nam, which will add further to the growth. Manufacturing is the most important sector for FDI, as investors benefit from market access in third markets. The recent conclusion of negotiations on the EU-Viet Nam FTA is likely to provide further scope for export-oriented investments.

Owing to the importance of manufacturing for export, the share of greenfield investments in total FDI is high. In mature markets, mergers and acquisitions (M&As) are the preferred entry mode for foreign investors. Cross-border M&As have been less prevalent in Viet Nam for several possible reasons: the absence of targets owing to the prominence of state-owned enterprises and the slow progress in equitisation; the previous existence of an overall 49% cap on foreign ownership in publicly listed companies, which has been partly removed by Decree No. 60/2015/NDD-CP of 26 June 2015[1]; the uncertainty surrounding which activities performed by the target firm would face equity restrictions; and complex administrative procedures. It remains to be seen how the recent removal of the 49% foreign equity limit will affect trends in M&A activities.

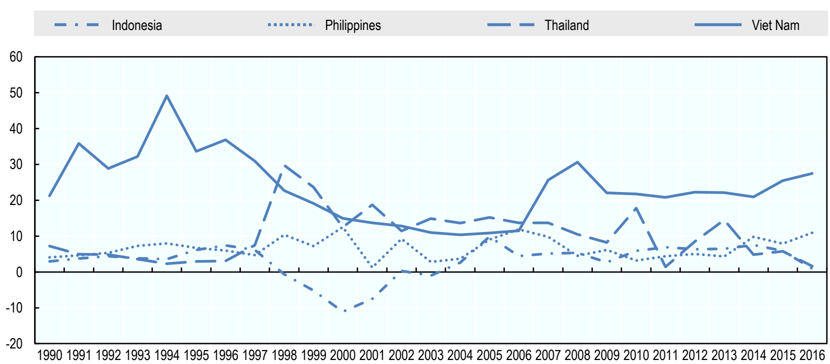
By sector, most M&As involving foreign investors have been in the finance and insurance, oil and gas, metals and steel, and food and beverage sectors. Even within these sectors, however, the share of foreign-owned firms in total assets remains small. These M&As can be an important vehicle for raising total factor productivity in acquired firms and in restructuring and consolidating whole sectors of the economy, such as the banking sector.

Long-term trends in FDI in Viet Nam

Foreign investment and export-led growth have been central to Viet Nam's development strategy over three decades. The exact nature of reforms affecting FDI will be discussed in the next chapter, but the importance of reforms and of ever-increasing international commitments can easily be seen in Viet Nam’s performance over time in attracting FDI. Within roughly five years of the initial reforms covering FDI, FDI as a share of gross fixed capital formation in Viet Nam had surged from 0.5% to almost 50% (Figure 1.1). This pace could not be sustained, but even at its trough in the early 2000s, Viet Nam's performance exceeded that of both Indonesia and the Philippines. Indeed, except for the decade after the Asian financial crisis when Thailand attracted considerable FDI inflows relative to domestic investment, FDI inflows into Viet Nam have represented a far higher share of gross fixed capital formation than in the other populous ASEAN members (Indonesia, Philippines and Thailand).

Another way of looking at Viet Nam's relative FDI performance within ASEAN is to consider its share of the total stock among the same four ASEAN members. Viet Nam's share grew from almost nothing in 1990 to almost 25% just over a decade later as a result of *Doi Moi* reforms. This rising share was further sustained by the Asian financial crisis which affected other ASEAN members, particularly Indonesia. Viet Nam's share has now stabilised at 15%, given the strength of recent inflows into both Indonesia and the Philippines but is still above its share of ASEAN4 GDP (11%).

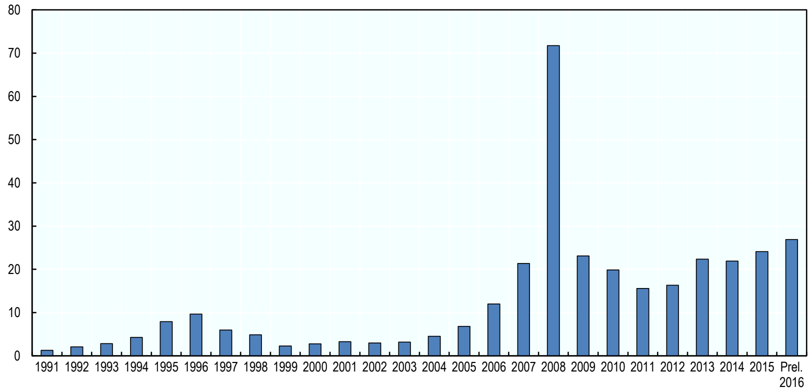
Figure 1.1. **ASEAN4 FDI inflows as a share of gross fixed capital formation**



Source: UNCTAD

The sharp rise in FDI relative to domestic investment in the 1990s seen in Figure 1.1 is partly the result of the relatively small size of the Vietnamese economy at the time. While the number of FDI projects has been growing fairly steadily, if sporadically, since the early 1990s, much of the growth in the value of registered capital in FDI projects occurred around the time of Viet Nam's accession to the WTO in 2007 (Figure 1.2). Registered capital represents the planned investment in a project over time and is more a measure of investor sentiment than of actual investment. Investors sometimes have an incentive to inflate the total amount so that they will not have to reapply in the future, and some projects never go ahead. Nevertheless, the sharp increase in registered capital in 2007 (exceeding total registered capital over the previous decade) demonstrates the importance of WTO membership, not only for the liberalisation which it caused but also as a signal of an improved investment climate.

Figure 1.2. **Total registered foreign capital in Viet Nam**
(USD million)



Source: GSO

The trend in implemented capital tells much the same story (Figure 1.3) in terms of a sharp increase in foreign investment around the time of WTO accession which was sustained in subsequent years, as part of the USD 70 billion of registered capital in 2007 was eventually invested. There nevertheless remains a wide discrepancy between the capital registered in FDI projects and the amount actually implemented. In total, only 44% of total registered capital has actually been realised as investment, representing on average just over one half of total registered capital in any given year. The ratio of realised to registered capital can vary for many reasons – it is common for investors to commit less capital than initially registered with the authorities – but it does suggest that Viet Nam could do even better in attracting FDI if it could pursue policies which facilitate investment. For example, Tran (2009) attributes the large and increasing gap between registered and realised capital prior to 2008 to the deep decentralisation at the time. This implementation gap and the likely causes will be considered in more detail in subsequent chapters.

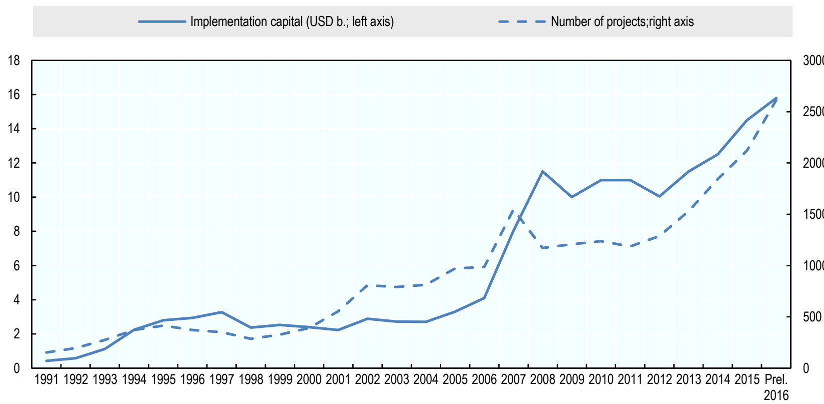
Table 1.1. **FDI in Viet Nam by source country, end 2015**

	Number of projects	Total registered capital (USD m.)*	
TOTAL	20 069	281 883	
Korea	4 970	45 191	16.0%
Japan	2 914	38 974	13.8%
Singapore	1 544	35 149	12.5%
Chinese Taipei	2 478	30 997	11.0%
British Virgin Islands	623	19 275	6.8%
Hong Kong, China	975	15 547	5.5%
Malaysia	523	13 420	4.8%
US	781	11 302	4.0%
China	1 296	10 174	3.6%
Netherlands	255	8 265	2.9%
Thailand	419	7 728	2.7%
Cayman Islands	67	6 392	2.3%
Samoa	150	5 772	2.0%
Canada	147	5 253	1.9%
UK	241	4 739	1.7%
France	448	3 423	1.2%
Russian Federation	113	2 080	0.7%
Switzerland	111	2 045	0.7%
Brunei	187	1 905	0.7%
Luxembourg	40	1 857	0.7%
Australia	357	1 653	0.6%
Germany	260	1 394	0.5%
British West Indies	11	1 148	0.4%
Turkey	13	729	0.3%
Denmark	118	682	0.2%
Belgium	63	552	0.2%
India	118	440	0.2%
Seychelles	41	418	0.1%
Indonesia	46	397	0.1%
Italy	69	357	0.1%
Mauritius	43	325	0.1%
Philippines	72	324	0.1%
Finland	14	321	0.1%
Other	549	2 689	1.0%

* Including supplementary capital to licensed projects in previous years.

Source: GSO

Figure 1.3. **Realised FDI projects, 1991-2016**



Source: GSO

Most foreign investment comes from Asia…

The four largest investors in terms of registered capital are all from East Asia (Table 1.1), with ASEAN representing 21% of the total and the rest of Asia 50%. Investment from Europe and North America represents only 15% of the total, barely more than that attributed to offshore centres – although some European and American investment might come through these centres or through Singapore and hence might be underestimated in the bilateral figures.

…and involves manufacturing and real estate

Over one half of the cumulative stock of registered capital is in the manufacturing sector, followed by real estate (Table 1.2) with the share of manufacturing even higher in recent annual inflows. This finding is very different from that provided by statistics on cross-border M&As, as will be shown later. To the extent that M&As do not go through the same channel as registered capital, it suggests that much of the market-seeking investment in services involves acquisitions of local companies. Registered capital is more likely to reflect greenfield investment, as foreign multinational enterprises establish affiliates in Viet Nam to supply global value chains.

Table 1.2. **Total FDI by sector, end 2015**

	Number of projects	Total registered capital (USD m.) *	Share (%)
Total	20 069	281 883	
Agriculture, forestry and fishing	521	3 655	1.3%
Mining and quarrying	97	4 448	1.6%
Manufacturing	10 764	162 773	57.7%
Electricity, gas, stream & air conditioning supply	109	12 568	4.5%
Water supply, sewerage, waste management	43	1 353	0.5%
Construction	1 264	10 894	3.9%
Wholesale and retail trade; vehicle repair	1 735	4 602	1.6%
Transport and storage	505	3 829	1.4%
Accommodation and food service activities	445	11 950	4.2%
Information and communication	1 263	4 224	1.5%
Financial, banking and insurance activities	82	1 334	0.5%
Real estate activities	500	50 896	18.1%
Professional, scientific and technical activities	1 926	2 103	0.7%
Administrative and support service activities	170	413	0.1%
Education and training	240	710	0.3%
Human health and social work activities	111	1 767	0.6%
Arts, entertainment and recreation	143	3 622	1.3%
Other service activities	151	742	0.3%

(*) Including supplementary capital to licensed projects in previous years.

Source: GSO

Trends in FDI in Viet Nam from a home country perspective

Another way of assessing trends in FDI in Viet Nam is to look at what major home countries report investing. Understanding patterns of international direct investment is becoming increasingly difficult owing to the rise of special purpose entities and pass-through investments in third countries for fiscal reasons, to benefit from the protection of an existing treaty or simply because a large MNE will have regional headquarters which might undertake the investment on behalf of the global MNE. US investors in many ASEAN countries, for example, may invest through their affiliates in Singapore.[2]

Investors based in OECD countries account for 44% of total registered capital in Table 1.1. Table 1.3 shows the stock of FDI from OECD countries based on home country reporting. Companies from OECD countries had invested a total of USD 36 billion as of the end of 2015. This amount is equivalent to 29% of the total registered capital attributed to OECD investors in the Vietnamese statistics. As with the GSO figures, investors from Japan and Korea are the most active, representing two thirds of the total stock of FDI from OECD countries.

Table 1.3. **FDI position of OECD member countries in Viet Nam**

(2015 or nearest year; USD m.)

OECD total	35 755
Australia	996
France	592
Germany (2014)	574
Italy	451
Japan	13 072
Korea	12 547
Netherlands	3 816
Switzerland	605
United Kingdom (2012)	1 674
United States	1 285
Other OECD	151

Source: OECD FDI database

Tables 1.4 and 1.5 provide more information for individual home countries, Japan and the United States. While the manufacturing sector represents almost two thirds of the total stock of Japanese FDI in Viet Nam, particularly transport equipment, electric machinery and metals, the most important sector overall is finance and insurance. The importance of this sector does not come out in the FDI data provided by Viet Nam, probably because investors enter through acquisitions of shares in existing companies and therefore do not register their capital through the same channel. The importance of finance and insurance will come out more clearly later in the data on mergers and acquisitions. Table 1.4 also provides an estimate of the rate of return on Japanese investment in Viet Nam by sector (defined as the ratio of total income receivables over total outward FDI positions). The highest returns by a wide margin are in transport equipment, construction and in the precision machinery and food industries.

Table 1.4. **Stock and rate of return of Japanese FDI in Viet Nam by industry**

	Outward FDI position, end 2014(USD m.)	Income receivables over outward FDI position*
Total	**13 703**	**6%**
Manufacturing	8 710	7%
Food	419	12%
Textile	82	3%
Lumber and pulp	274	2%
Chemicals, pharmaceuticals	652	2%
Petroleum	549	-
Rubber and leather	575	-
Glass and ceramics	558	4%
Iron, non-ferrous, and metals	1 068	2%
General machinery	911	4%
Electric machinery	1 132	6%
Transport equipment	1 576	19%
Precision machinery	511	12%
Non-manufacturing	4 993	4%
Farming and forestry	5	0%
Fishery and marine products	0	
Mining	0	
Construction	28	17%
Transport	61	5%
Communications	32	0%
Wholesale and retail	303	1%
Finance and insurance	3 779	5%
Real estate	545	1%
Services	125	3%

Source: OECD calculations based on Bank of Japan

Table 1.5 provides activities data on US MNE affiliates in Viet Nam which can yield further insights into the nature of their investment. By any measure, the presence of US MNEs in Viet Nam lags behind that in other large ASEAN member states. Value added (gross product) is still low, as are exports to the United States, employment and affiliate sales. Only 61 US-owned affiliates in Viet Nam have assets, sales or net income above USD 25 million.

Table 1.5. **Activities of US MNEs in selected ASEAN countries**

(2014; USD m. except employment)

	Affiliates #	FDI stock (2015)	Assets	Sales	Emp.
Indonesia	187	13 546	78 548	33 761	135 900
Malaysia	277	13 959	73 326	52 942	179 600
Philippines	175	4 724	39 262	24 918	326 800
Thailand	254	11 295	65 027	69 944	187 900
Viet Nam	61	1 285	11 525	5 810	53 700

only those affiliates with assets, sales or net income > USD 25 million

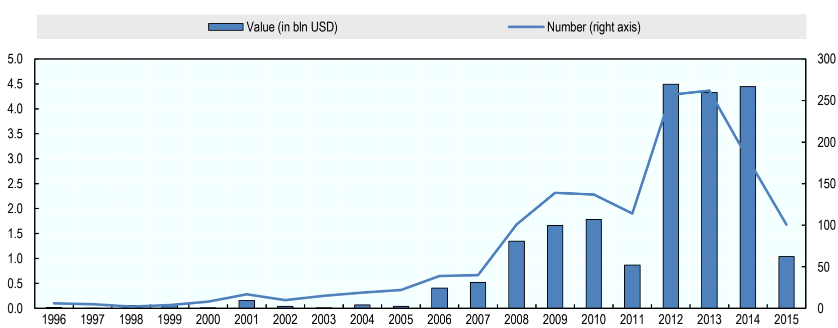
Source: Bureau of Economic Analysis, US Department of Commerce.

Mergers and acquisitions

M&A markets have grown dynamically in Viet Nam over the past ten years...

The overall activity in M&As has increased dynamically in Viet Nam since 2005, with almost no activity prior to that date (Figure 1.4). While there were on average 14 M&A deals annually between 1996 and 2005 with a total value of USD 90 million, the number increased to 143 M&A deals a year between 2006 and 2015 and a total value of USD 2.3 billion each year. The annual growth in the total value of completed M&A transactions has been faster in Viet Nam than in comparable ASEAN economies, reflecting both rapid increases and the small size of the Vietnamese M&A market.

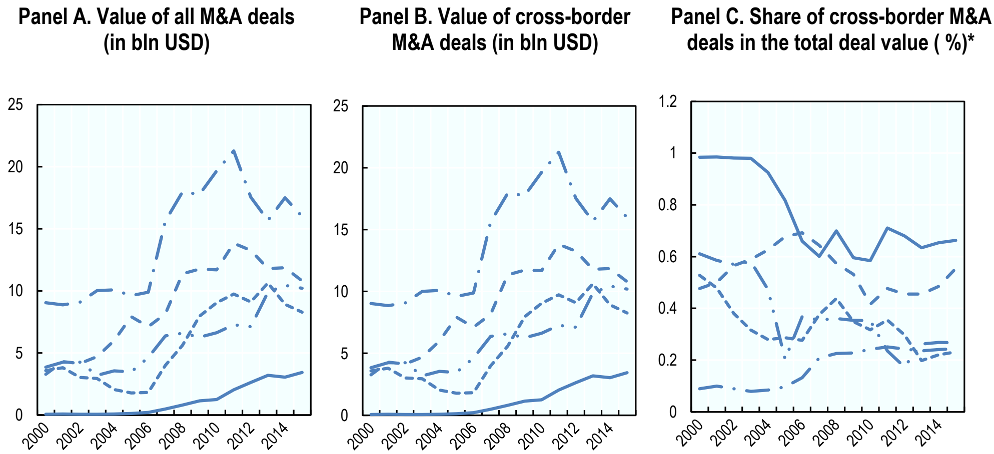
Figure 1.4. **M&A deals involving a Vietnamese target firm, 1995-2015**



Note: Deals are identified as cross-border when the target and the acquirer are of different nationality.

Source: OECD calculations using Dealogic M&A data.

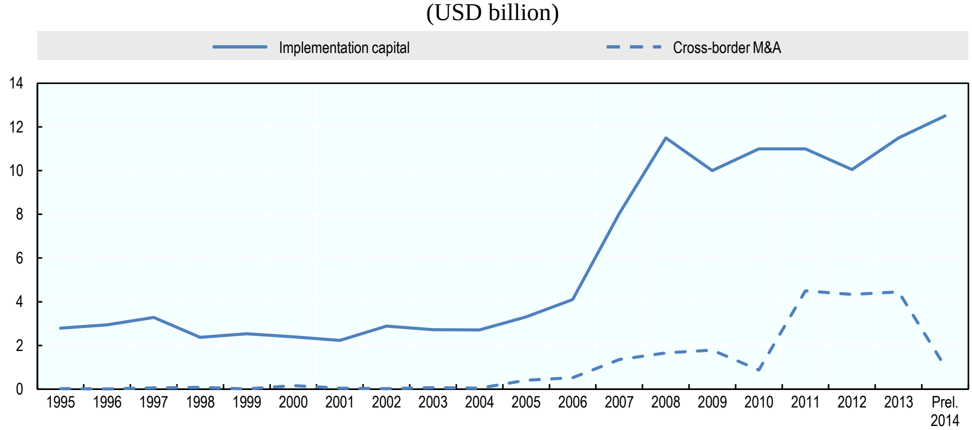
Figure 1.5. **M&As in the ASEAN 5***



*ASEAN 5: Indonesia, Malaysia, Philippines, Thailand and Viet Nam

Source: OECD calculations based on Dealogic database.

Figure 1.6. **Realised FDI projects and cross-border M&A in Viet Nam, 1995-2014**
(USD billion)



Source: Dealogic M&A database and GSO.

About 60% of the M&A deals concluded between 2006 and 2015 were cross-border in nature, and the average share of cross-border M&A deals has decreased both in terms of the total number of deals and the total deal value over time. Despite the decline, Viet Nam still registers a higher share of cross-border M&A in total M&A than comparable ASEAN economies (ASEAN 5) and has followed the trend experienced by other economies with a similar market size (Figure 1.6). Among the reasons for a relative decline in foreign participation in the M&A market in Viet Nam may be the process of maturing of domestic firms that increasingly engage in M&A deals to increase their scale and competitiveness, a decline in privatisations over time and a relatively slow process of equitising state-owned enterprises (SOEs) in recent years, a lack of suitable targets for corporate control in sectors of interest to international investors (including due to a large SOE presence) as well as the existence of persisting barriers to cross-border M&A activity in Viet Nam, discussed later.

A higher share of total M&A in Viet Nam involves foreign acquirers than in other ASEAN5 countries while total M&A activity in Viet Nam is much less than in its four peers (Figure 1.5). This performance is in stark contrast to Viet Nam's strong record in attracting FDI. The low level of M&As is likely to reflect in part a relatively under-developed capital market, but may also be a legacy of earlier restrictions on foreign equity shares in Vietnamese listed companies which were lifted only in 2015, as well as other regulatory barriers. To the extent that cross-border M&A transactions can facilitate corporate restructuring and productivity growth, Viet Nam may consider whether some of its existing policies are not unduly impeding M&A activity. Box 1.1 considers the question of whether M&As contribute to higher firm performance in the host economy, while Box 1.2 looks specifically at studies attempting to measure the impact of FDI on Viet Nam's economic performance.

Comparing cross-border M&A values with implemented capital in greenfield or expansion projects involving foreign investors reveals that very little of the entry of foreign investors in Viet Nam to date has been through the acquisition of a share in a local company (Figure 1.6).

Box 1.1. **Do mergers and acquisitions contribute to higher firm performance**

As with greenfield FDI, cross-border mergers and acquisitions (M&A) can be an important source of capital and act as a catalyst of structural change in the economy. This can take place through the market entry effect, *i.e*. the entry of new foreign market participants and provision of goods and services that were previously unavailable, and the associated increased competitive pressures on local firms, or an improved access of the acquired firms to the MNE supplier and client networks, technologies as well as superior management and corporate governance practices (so-called technology and know-how transfer). The entry of foreign firms, which the theoretical literature expects to be on average more productive than domestic firms (*e.g*. Melitz, 2003, Helpman *et al*., 2004), can hence generate productivity increases in particular firms, market niches or sectors. There may also be an improvement in the level of management or corporate governance practices as a result of the entry of global firms that are subject to global standards.

Box 1.1. **Do mergers and acquisitions contribute to higher firm performance** (cont.)

Given these theoretical assertions as well as a preoccupation of the general public with the differential impact of M&A and greenfield FDI on host economies, a rich empirical literature on the subject has emerged. Generally, studies find a positive impact of cross-border M&A on the total factor productivity of the acquired firm, while in some countries or sectors insignificant results are found.[1] More generally, results tend to vary depending on the sector in which the M&A takes place (*e.g*. Girma and Görg, 2002), investor characteristics (*e.g*. Benfratello and Sembenelli, 2002; Chen, 2008), the absorptive capacity of domestic firms (Girma, 2005; Girma *et al*, 2007) as well as the policy environment in the home and host economies (Wang and Wong, 2009; Albuquerque *et al*., 2014).

Evidence also suggests that cross-border M&A can be a powerful tool for facilitating corporate restructuring and improving managerial and corporate governance practices in developed and developing countries, including in Viet Nam. For example, Rossi and Volpin (2003), using data from 49 countries between 1992 and 2002, including Viet Nam, find that cross-border take-overs facilitate convergence in corporate governance regimes across countries and facilitate corporate restructuring. Albuquerque *et al*. (2014) using firm-level data on cross-border M&A and corporate governance in 22 developed countries also find that cross-border M&As are associated with subsequent improvements in the governance, valuation, and productivity of the target firms' local rivals. The positive spillover effect is stronger when the acquirer is from a country with stronger shareholder protection. A relatively recent survey of firms involved in FDI projects in Viet Nam also confirms that the access to managerial capabilities gained through cross-border acquisitions is considered an important source of the surveyed firms' competitiveness (Nguyen *et al*. 2004).

Lastly, being an additional source of capital and facilitating market consolidation, cross-border M&A can also help alleviate financing constraints of the acquired firms and facilitate domestic investment and greenfield FDI in the future. Indeed, empirical results confirm this prediction. For example, Calderón *et al*. (2004), using annual M&A and greenfield FDI data for the period 1987-2001 and a large sample of industrial and developing countries find that higher M&A is typically followed by higher greenfield FDI and domestic investment. Greenfield FDI is also found to be followed by increased cross-border M&A in developing countries. This finding highlights the interdependence in different modes of market entry by foreign firms and policies that facilitate different forms of investment.

Hence, cross-border M&A can play a positive role in facilitating restructuring of domestic firms and industries. These effects are nevertheless far from automatic and require the right regulatory environment. Cautionary tales, including those found in Asian economies, show that the reduction of barriers to cross-border M&A needs to be accompanied with improvements in the domestic regulatory framework, in particular in relation to competition and corporate governance, to achieve desired effects (Mody and Negishi, 2000). Governments, hence, have an important role to play in both facilitating and setting the right regulatory framework for all firms, both domestic and foreign, to participate in the domestic market for corporate control.

1. For example, Lichtenberg and Siegel (1987) find positive effects on the acquired firm's productivity in the US; Conyon et al, 2002 in the UK; Arnold and Javorcik, 2005, in Indonesia; Bertrand and Zitouna, 2008, in France. Meanwhile, Harris and Robinson (2003) find no significant impact in the UK and Girma and Gorg (2002) and Schiffbauer (2009) find positive results in selected industries only.

Recent regulatory changes may facilitate a pick-up in cross-border M&A activity in Viet Nam…

Some evidence suggests that the regulatory environment and administrative procedures in Viet Nam may have been one of the factors impeding cross-border M&A activity. For example, as outlined in Chapter 2, the horizontal statutory restriction limited the purchases of shares in local targets by foreign investors to minority stakes only until the reforms associated when WTO membership came into effect (2005-09).[3] Only in 2005, did the *Law on Investment* and the *Law on Enterprises* allow foreign investors to purchase stakes in Vietnamese targets without any limitations, provided that they were not subject to the list of conditional sectors[4] and were not public companies.[5] In the case of public enterprises, the maximum equity limit was raised to 49% in 2007 (from 30%), but remained capped at 49% until 2015.[6] In addition, the list of conditional sectors has been relatively large and the lack of legal clarity has made it difficult for investors to ascertain the extent of conditions that applied (see Chapter 2), further limiting the opportunities for cross-border M&A transactions in some sectors.

Box 1.2. **The economic impact of FDI in Viet Nam**

Econometric studies, often involving many countries, have a mixed record in linking FDI inflows to economic growth. This has not been the case in Viet Nam. Given that rapid and sustained economic growth in Viet Nam coincided with a dramatic expansion of FDI in the economy, it is perhaps not surprising that many studies have found a link between the two. Hoang *et al*. (2009) find a strong impact of FDI on economic growth, even if it does crowd out domestic investment to some extent. Foreign direct investment can exert a positive influence on growth through many channels: X-efficiency, technology transfer, human capital development, exports and capital accumulation. The authors find that the additional capital brought in through FDI is the only one that explains the improved growth performance. Other studies using different methodologies and at different points in time find a similar positive effect. These include Nguyen and Hemmer (2002) and Tran Tong Hung (2005). Hoa (2004) and Nguyen (2006) both find a positive impact of FDI at the provincial level. Doan Nguyen Phuc (2003) looks at the period 1988-2003 and finds that economic growth largely depends on the FDI sector.

Hoi and Pomfret (2010) estimate the impact of FDI on wages paid by domestic private firms in Viet Nam and find strong evidence of horizontal wage spillovers from foreign to domestic private firms, despite different labour market conditions and firm characteristics. They find that "wage levels in domestic private firms are higher in sectors where there is a higher presence of foreign firms (horizontal wage spillovers), and domestic private firms with backward linkages to foreign firms can gain productivity spillovers and pay higher wages (vertical spillovers)" (Hoi and Pomfret, 2010). Nguyen *et al*. (2006) find that FDI not only increases the capital stock but also improves investment efficiency throughout the economy. FDI is found to increase the overall labour productivity of Vietnamese firms but not for SOEs.

Even with progressive liberalisation and reduction of outright restrictions on foreign participation over the past ten years, significant legal uncertainty around cross-border M&A transactions in Viet Nam persisted in the past. For example, when a foreign investor acquired a share in a local company, it was difficult to predict which business lines of the acquired company would be allowed to be maintained, and which would have to be shed due to the restrictions on foreign ownership (US State Department, 2015: 5). Lastly, the administrative procedures for obtaining approval for undertaking cross-border M&A deals have been lengthy and burdensome, further adding to the transaction costs faced by foreign investors interested in M&A in Viet Nam (see Chapter 2).

The recent reforms to the *Investment Law* and *Enterprise Law*[7] and related regulations may facilitate cross-border M&A activity in Viet Nam in the future. The lifting of the maximum equity limits for foreign acquisitions of public companies in Viet Nam, except for conditional business lines[8], is seen as an important landmark and is likely to boost the number of acquisitions involving Vietnamese targets in coming years. The new *Investment Law* and the implementing legislation[9] which reduces the number of conditional sectors and clarifies the extent of sectors in which foreign investments are subject to special conditions, may help improve investment opportunities for some M&A investors and reduce the legal uncertainty surrounding cross-border transactions. The improved definition of foreign investor embedded in the new *Investment Law* can have a similar effect. Lastly, the removal of the obligation for foreign-owned M&A investors seeking to buy minority shares in non-conditional sectors to undergo a lengthy and complex registration procedure[10] can also ease the administrative burden on foreign-owned M&A investors. While the true test will come once all the implementing regulations are available and the new rules start to be applied by the Vietnamese authorities to particular transactions, the direction of the recent regulatory changes is likely to facilitate cross-border M&A activity in Viet Nam and has already provoked a perceptible amount of enthusiasm among investors.

…with a likely strong demand for cross-border acquisitions in financial and other services

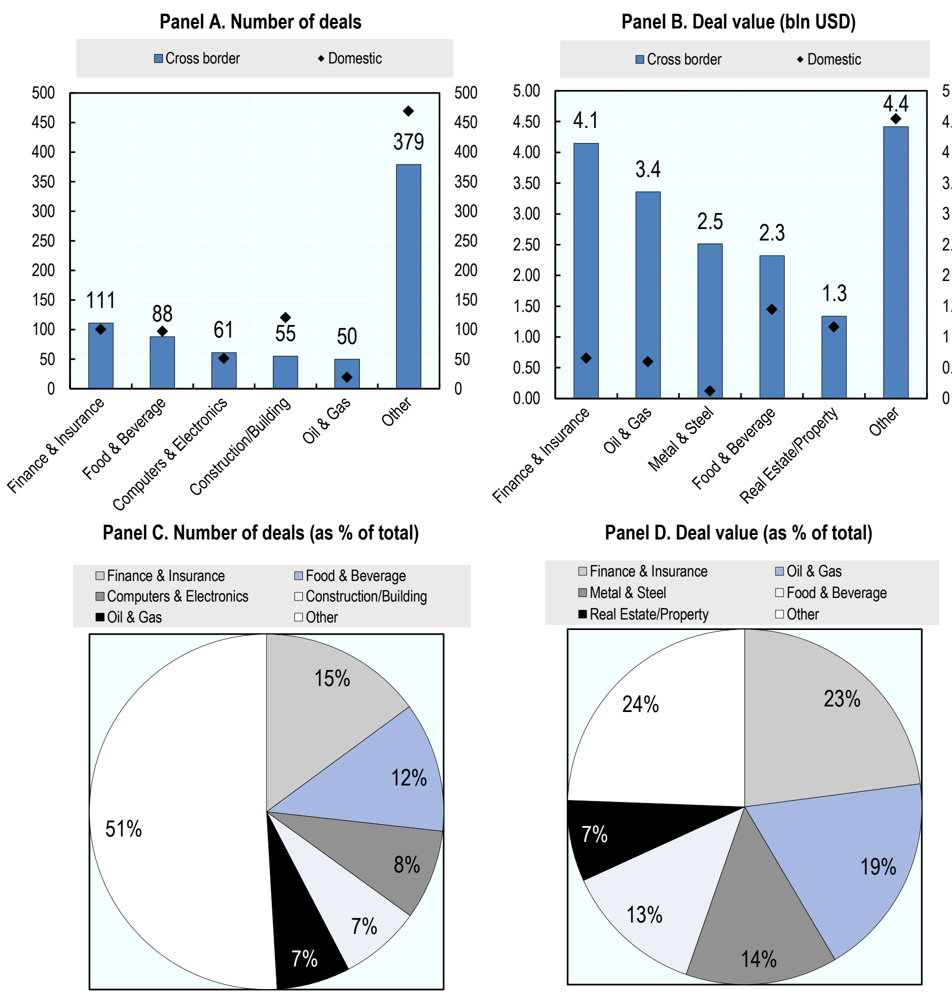
The effect of recent reforms may be particularly prominent in some sectors, in which investment opportunities have been limited to date. Thus far, finance and insurance sector, oil and gas, and metal and steel have been the most important sectors in terms of total value of M&A deal value registered between 1995 and 2015 (Figure 1.7), accounting jointly for over 50% of the total cross-border activity, followed by the food and beverage, computers and electronics, and real estate sectors. Acquisitions in all the services sectors mentioned above were largely limited to minority stakes due to the existing restrictions on foreign equity mentioned above and in Chapter 2.

With the recent changes in maximum foreign equity limits in public companies and other reforms, such as the planned and on-going equitisation process of a number of SOEs and the intensified reform in the financial sector, the financial sector could experience more M&A activity in the coming years. Several large state-owned banks in Viet Nam (*e.g.* Vietcombank and Military Bank) have announced their willingness to enter a partnership with a strategic foreign partner. Foreign banks also have an appetite to enter the Vietnamese market to service foreign-owned investors in other sectors. With some of the implementing regulations still pending, it remains to be seen if the sector-specific limitations on foreign ownership in the sector will be removed.[11]

Beyond the formal rules covering foreign firms in the sector, the speed of progress in SOE equitisation and broader financial sector reform will also influence the degree to which investment opportunities become available to foreign firms. Most recently, progress in selling off state-owned assets has been slow – only about a fifth of SOEs planned for equitisation in 2015 were sold off (see Chapter 4). In addition, domestic SOEs have also acquired targets in the financial sector in Viet Nam, in some cases tightening rather than relaxing government control. For example, according to data published by the National Assembly[12], 47 of the most powerful state-owned conglomerates and large corporations raced in 2006-08 to invest in the financial sector.[13] The limited number of initial public offerings and the heavy SOE presence in some sectors may have also obstructed the emergence of new investment opportunities for M&A activity in the sector by foreign firms. As a result, despite the on-going reforms in the financial sector in Viet Nam, the share of foreign banks in total commercial banking assets has remained small, at 10% in 2015 and has remained stable over the past decade.[14]

Greater foreign participation in the country's financial sector may allow for the development of more sophisticated or more competitive financial products and assist in the process of financial deepening (Box 1.3), thereby facilitating the process of restructuring of the sector. The shortage of capital for private-sector firms in Viet Nam has been well documented[15] and is reflected in the available rankings and firm surveys. While several global market players have been able to enter the Vietnamese market, such as Morgan Stanley, HSBC, Standard Chartered, Deutsche Bank, BNP Paribas, Société Générale, the fact that they were allowed only minority equity stakes has reduced the opportunities for meaningful changes to internal management and corporate governance systems in the acquired firms.

Figure 1.7. **Cross-border M&As involving a target firm in Viet Nam, 1995-2016**



Source: OECD calculations using Dealogic M&A data

Box 1.3. **Potential role of foreign banks in the development of local financial markets**

The opening of the financial sector to foreign participation is often accompanied by concerns from national authorities and local players. The typical fear is that foreign-owned banks will not serve SMEs and rural clients, and that their likely superior performance will allow them to cherry-pick clients, weakening local banks. While it is true that often the client profile of foreign-owned banks differs considerably from that of local banks (especially when foreign-owned banks face regulatory restrictions limiting their retail presence or their business strategy), it is often the case that a higher penetration of foreign-owned banks in the market is associated with greater access to finance by SMEs from local banks. When facing higher competition by foreign banks in the upper segments of the market, often local banks tend to increase their emphasis on the SME sector.

In general, foreign banks have positive effects on competition, stability and financial development in host countries. The positive effects of foreign banks are associated with lower costs of financial intermediation, as well as lower rents; increased access to financial services, even for SMEs as explained above; enhanced economic and financial performance of borrowers as a result of the introduction of new and more diverse products and services, as well as up-to-date technologies, improved marketing skills and corporate governance, and know-how spillovers; accelerated domestic reform as a consequence of pressures on governments to increase transparency, and improve regulation and supervision to international best practice levels; and greater financial stability as foreign banks are generally more capable of absorbing shocks occurring in the host market, and hence providing a more stable source of capital, particularly in the case of greenfield subsidiaries. Foreign banks also contribute to reduce connected lending as these banks are usually not as politically-connected as local banks.

Foreign bank presence may also sometimes have a potentially disruptive effect, however, depending on their funding strategy. Evidence suggests that allowing foreign-owned banks to access local deposit markets to fund host country operations is more likely to be beneficial for financial development and stability in times of crisis. Foreign-owned banks relying more heavily on international funds tend to reduce lending more sharply than locally-funded banks in the case of shocks to the parent bank, such as in times of global or home country crisis. However, in some cases, foreign banks can also contribute to minimise financial stress in times of host country crisis through their internal capital market.

The magnitude of the effects of foreign bank entry on development and efficiency in the financial sector also depends on some conditions. Limited general development and entry barriers can hinder the effectiveness of foreign banks in facilitating the expansion of financial services. Limited participation of foreign banks, relative to total banking system, also seems to produce fewer spillovers, suggesting a possible threshold effect. For instance, in relation to risk management practices, foreign banks are likely to enjoy superior risk management capacity, which the local supervisor can draw on to accelerate technology transfer to the local market. Also when a larger number of foreign banks relative to domestic ones exist, foreign banks seem to play a more …/

Box 1.3. **Potential role of foreign banks in the development of local financial markets** (cont.)

important role in financial intermediation. In contrast, they tend to be niche players when less important in number. The size of institutions also matters. Larger foreign banks are associated with greater effects on access to finance by SMEs, as well as healthier parent banks are associated with higher credit growth. In certain cases, cherry-picking by foreign-owned banks can also undermine overall access to financial services, particularly in low-income countries where relationship lending is important, by worsening the remaining credit pool left to domestic banks, which can hurt their profitability and willingness to lend. These are only a few characteristics of foreign bank entry implications for financial sector development. Other home and host country characteristics, as well individual bank characteristics, play a role in the impact of foreign bank entry on host country financial development and should be carefully taken into consideration by regulators.

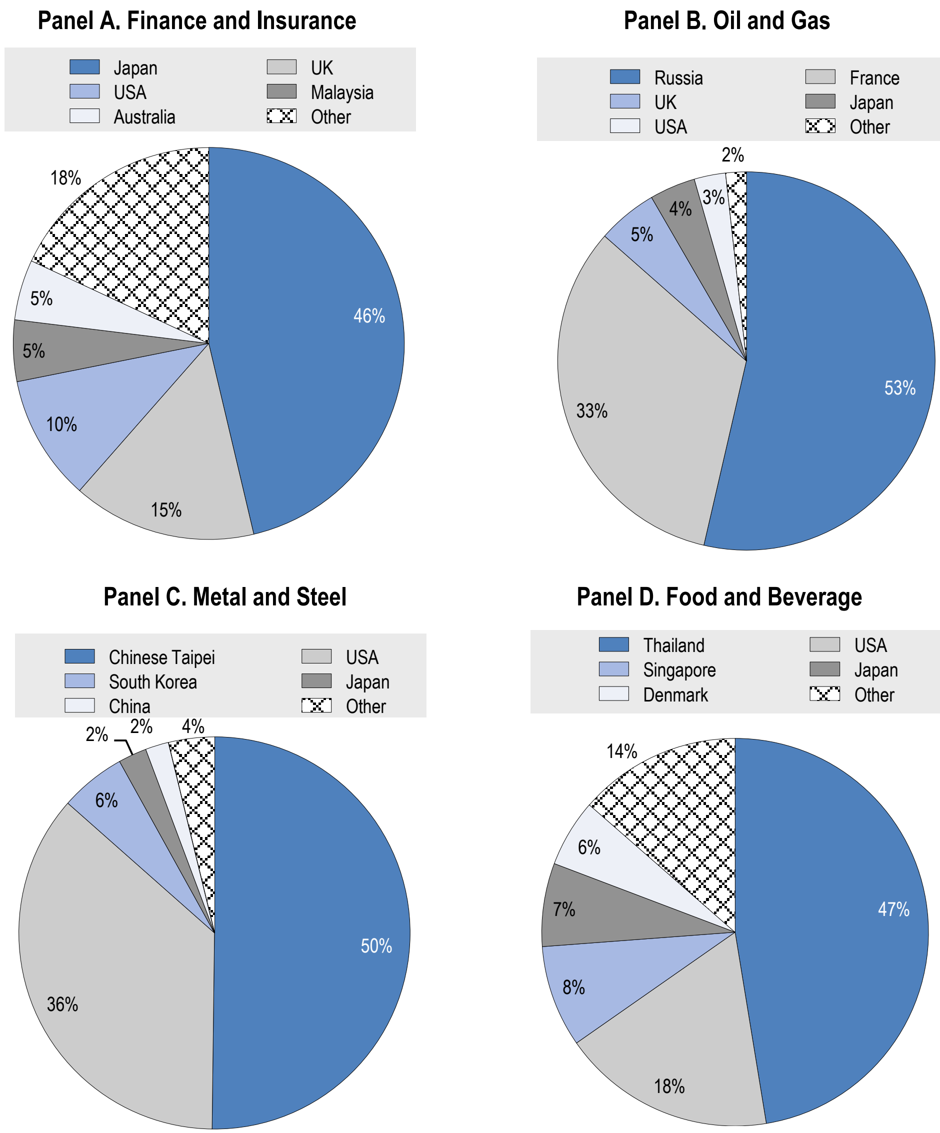
Source: Based on the literature review in Claessens and van Horen (2012), as well as on the World Bank and IMF (2005) and presentations by Stijn Claessens, Ralph De Haas and Maria Soledad Martinez Peria during the OECD Experts Meeting on Financial Services held at the OECD on 30 November 2012.

…in which OECD investors are likely to play a prominent role and can facilitate restructuring.

Within the financial sector and other key sectors for cross-border M&A activity in Viet Nam, such as oil and gas and metal and steel, investors based in OECD countries play a prominent role (Figure 1.8). For example, acquirers from Japan accounted for nearly half of all acquisitions between 1996 and 2016 in the finance and insurance sector, followed by the United Kingdom (15%) and the United States (11%). In oil and gas, investors from France (*i.e.* Technip SA and Perenco SA) have been the second largest source of investment, after the firms from the Russian Federation (*i.e.* LUKoil OAO and Rosneftegaz OAO). In steel and metal sectors, Chinese firms dominate (*e.g.* China Steel Corp and Mayer Steel Pipe Corp), but investors from the United States have also been prominent, accounting for 36% of the total deal value in the sector. Lastly, in the food and beverage sector in Viet Nam, investors from Denmark (*e.g.* Carlsberg) have been the second largest source of foreign investment through M&A in the sector after Thailand. Therefore, while investors from the region remain important in the cross-border M&A market in Viet Nam, OECD investors have also been prominent, particularly in value terms (Figure 1.9). To the extent that recent reforms and the expected increased cross-border M&A activity offer new investment opportunities, investors based in OECD countries may further rise in prominence.

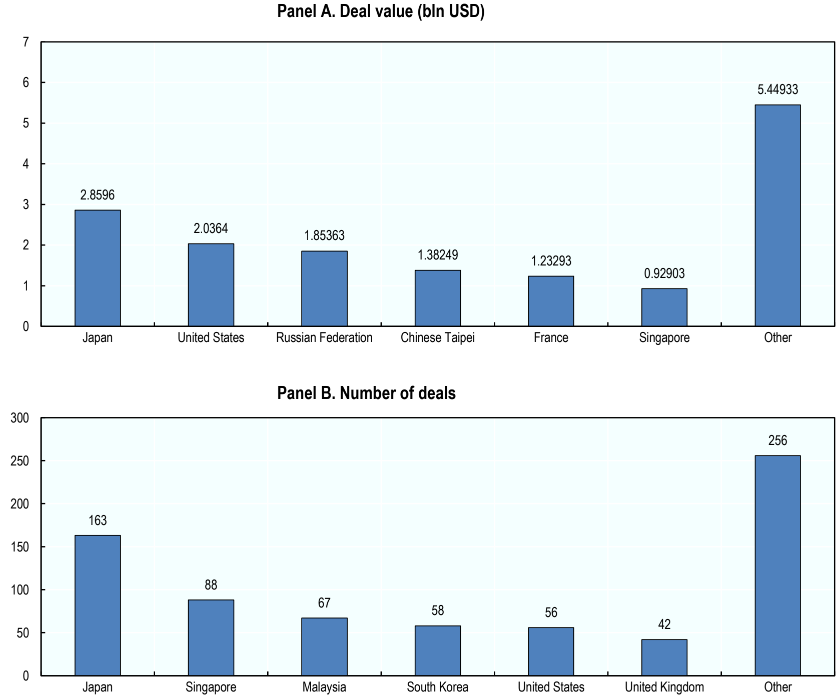
Figure 1.8. **Value of M&A deals in Viet Nam by acquirer's nationality, 1995-2015**

(% of total cross-border M&A in each sector)



Source: OECD calculations using Dealogic M&A database.

Figure 1.9. **Dominant acquirers in Viet Nam by nationality, 1995-2015**



Source: OECD calculations using Dealogic M&A database.

Notes

1. For more information, see endnote No. 3 of the Assessment and Recommendations.
2. Tran (2005) cites an MPI study from 2005 revealing that 50-81% of US FDI came through subsidiaries in Singapore, Mauritius, Bermuda, the Netherlands and Hong Kong, China (amounting to over USD 800 m. of capital).
3. Law No. 59-2005-QH11 on Investment, dated 29 November 2005; Law No. 60-2005-QH11 on Enterprises, dated 29 November 2005; Decision No. 238-2005-QD-TTg of the Prime Minister, dated 29 September 2005; Decree No. 139/2007/ND-CP (Decree 139) on the 2005 Enterprise Law and 2005 Investment Law.

4. The list of conditional sectors (*i.e.* sectors in which investments were subject to additional conditions) was fixed at the time by Decree 108/2006.

5. Public companies in Viet Nam refer to companies that (i) have carried out a public offering, or (ii) have no less than 100 shareholders and VND 10 billion of contributed charter capital or (iii) are listed in the stock market. The maximum foreign equity limit in public companies was raised from 30% to 49% in 2007 and remained capped at 49% until the most recent reform in 2015 (Decree No. 60/2015/ND-CP)

6. Decree No. 60/2015/ND-CP issue by the Government on June 26, 2015 removed the maximum foreign equity cap and allowed foreign investors to acquire majority stakes in public companies in Viet Nam.

7. The new Law on Investment No. 67/2014/QH13 and the new Law on Enterprises No. 68/2014/QH13, took effect on 1 July 2015, replacing the 2005 Law on Investment and the 2005 Law on Enterprises.

8. Decree No. 60/2015/ND-CP dated June 26, 2015.

9. In the new Investment Law of 2015, the Government has specified a list of sectors where investment (both domestic and foreign) is banned and where investments are subject to conditions (which are to be specific in the implementing regulation). The number of so-called conditional sectors has also been reduced, from 386 to 267. A decree, recently published, also includes a list of sectors where foreign investment specifically is subject to conditions.

10. Due to the reform, an "investment registration certificate" (IRC) is no longer required for an M&A transaction by foreign investors when the target does not operate in a conditional sector for FDI (*i.e.* sectors listed in the Law that require a prior approval based on specific conditions to be settled by regulations) or when the acquisition does not result in the investor holding a stake of 51% or more in the target company.

11. The supporting regulation to the new Investment Law and Decree No. 60/2015/ND-CP will decide what conditions will apply to sectors subject to conditions, and what the degree of conditions will be.

12. Hong Anh "National Assembly discusses P&L story of state-owned conglomerates," VNExpress Online, November 9, 2009 as cited in Vuong et al. (2009: 28)

13. This included, among others, which included transactions undertaken by Vietnam Post and Telecommunications Corporation, Vietcombank, and Petrovietnam.

14. IMF (2014), ADB (2014), Vietnam Banking Industry (2015).

15. See, for example, Vuong, 1997(a) and 1997(b), Vuong and Nguyen (2000), and Pham and Vuong; (2009).

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Annex 1.1

Compiling FDI statistics in Viet Nam

Foreign direct investment is one of the principal ways that economies integrate into the global economy. It is not only an important channel for exchanging capital across countries, but also for exchanging goods, services, and knowledge and serves to link and organise production across countries. FDI provides a means to create stable and long-lasting relationships between economies, and it can be an important vehicle for local enterprise development. FDI has grown rapidly in recent decades and both the destinations and sources of FDI have expanded with globalisation. Internationally harmonised, timely, and reliable FDI statistics are essential to assess the trends and developments in FDI activity globally, regionally, and at the country level. The usefulness of FDI statistics depends on several dimensions of quality: *i*) alignment with international standards; *ii*) accuracy and credibility; *iii*) timeliness; and *iv*) accessibility.

FDI is one of the major types of investment included in the balance of payments (BOP) and international investment position statistics. The International Monetary Fund (IMF), in its *Balance of Payments and International Investment Position Manual, 6th edition* (BPM6), and the OECD, in its *Benchmark Definition of FDI, 4th edition* (BMD4), present recommendations for compiling FDI statistics. The recommendations of the two agencies are aligned, but the OECD offers supplemental series that are particularly useful in analysing globalisation. The recommended measures of FDI statistics in these guidelines produce meaningful FDI statistics that are part of the larger System of National Accounts and, so, ensure that FDI statistics are compatible with other important economic statistics. Following the recommendations in the international guidelines is critical to producing relevant and coherent FDI statistics.

This section describes the current system for compiling FDI statistics in Viet Nam, including a discussion of recent and planned improvements in these statistics. It concludes with an assessment of the FDI statistics of Viet Nam along the quality dimensions discussed above and makes recommendations for further enhancing the quality of these statistics.

Current system for compilation of FDI statistics in Viet Nam

Viet Nam compiles two sets of FDI statistics. The first set of statistics is compiled by the Foreign Investment Agency (FIA), which is part of the Ministry of Planning and Investment (MPI), and covers licensed FDI projects. These project-based statistics cover the number of projects licensed, the total registered capital, and the total implemented capital and are presented at the aggregate level as well as by main industry sector according to International Standard Industrial Classification (ISIC) Rev. 3 and by main counterpart economy. These data also cover overseas projects by Vietnamese companies. The second set of FDI statistics is compiled and disseminated by the State Bank of Viet Nam (SBV) as part of the Balance of Payments statistics. The project-based FDI statistics of the MPI differ from the BOP FDI statistics of the SBV in terms of coverage, definitions, classifications and concepts but are an important data source for the SBV.

Overall, Vietnamese FDI statistics are based on sound data sources, are timely, and are easily accessible on several different website and databases, but they are not completely in line with international standards. Some important gaps in coverage could be closed by developing a dedicated FDI survey. Building on the existing cooperation between different agencies in Viet Nam would further enhance FDI statistics and lead to the development of additional statistics that would help to understand the role that FDI plays in the globalisation of the Vietnamese economy. Recommendations for improvement are included at the end of this section.

FDI statistics by the MPI

The MPI has the authority to collect data through surveys from all registered enterprises with foreign capital. The provincial authorities are also authorised to manage, license, and collect the FDI data of companies with foreign capital. The MPI collects the information gathered from its surveys and from the provincial authorities along with information from investment approval authorities and uses it to produce a monthly report on foreign investment. MPI also uses information from other ministries, including the Ministry of Industry and Trade and the Ministry of Justice, and banking authorities in compiling its data. The monthly report is available 10 days after the end of the reference month. The data are so timely because foreign investors must register on-line so the data are continuously updated. These project-based FDI statistics are publicly disseminated through the General Statistics Office (GSO) website; they are also reported to the ASEAN Secretariat. MPI also produces quarterly and annual reports and revises the data as more up-to-date information is obtained.

These statistics present both registered and implemented capital, which cover both equity and debt investments. Data on registered capital by partner economy are available, but not data on implemented capital by partner economy at this time. The registered capital by partner economy statistics are by the country of the immediate investor, but information on the country of the ultimate investor is also collected. While these data are not publicly available, they can be provided for internal use upon request. The data on registered capital are also available by economic activity based on ISIC Rev. 3.

Lastly, in addition to the data on registered and implemented capital, MPI produces data on the contributions of foreign-owned firms to trade and employment, based on the surveys conducted, and provides data on the total exports and imports of foreign-owned firms and the total employment of foreign-owned firms. Such statistics are very useful for understanding the role that foreign-owned firms are playing in the economy.

FDI Statistics by SBV

The project-based statistics discussed above are an important data source for the SBV in compiling its FDI statistics. The MPI gives data on the foreign capital contribution to registered foreign enterprises to the SBV on a quarterly basis. The SBV adjusts these data to match the BOP concepts. For example, the MPI data distinguish between foreign and domestic capital but do not distinguish foreign capital between capital from the foreign parent companies and capital from unaffiliated foreigners. FDI only covers foreign capital from foreign parent companies; any foreign capital raised from unaffiliated parties is classified elsewhere in the BOP accounts. In addition to the MPI, the other main data sources for the SBV include the banking system and the tax authorities. The SBV gathers information on dividends paid by foreign-owned enterprises from the tax authorities, but these data exclude companies that are tax-exempt. As a result, these data are not complete enough to produce reliable estimates of total income and dividends, leading to gaps in series.

Since 2005, the SBV has published data on outward FDI of Vietnamese companies based on the data provided by the MPI. The SBV publishes its statistics on its website and submits the data to the IMF. The SBV also makes adjustments to the registered capital data by country it receives from MPI so that they can provide data on FDI by partner country to the ASEAN Secretariat.

Recent and planned improvements

Recent amendments to Viet Nam's investment laws had direct effects on the data collected by MPI. For example, prior to the recent amendments, the MPI was limited in its ability to collect data on M&As to those where the foreign investor acquired more than 50% of the domestic company, but it now has the authority to collect data on those M&As that involve ownership of less than 50% and is developing a mechanism to collect this information. This is an important improvement because the 10% ownership criteria to distinguish direct investment from other forms of investment is a crucial feature of the international guidelines for FDI statistics. Lastly, the MPI began an electronic data collection vehicle in 2016 but needs to improve the uptake by respondents.

Currently, the MPI only publishes data for registered capital by partner country, but there can be substantial differences between the amounts of implemented and registered capital. MPI has begun to collect data so that implemented capital by country can be presented. Once the quality and completeness of the data reporting have been determined to be sufficient, they will begin to publish these statistics. It would also be good to start publishing the statistics on implemented capital by economic activity as well as the only statistics currently published by economic activity are registered capital.

The SBV is working with the IMF to develop a survey that can be used to collect data to close some of the important gaps in coverage in their FDI statistics. This survey would provide the data needed for Viet Nam to participate in the Coordinated Direct Investment Survey.

Assessment of the compilation of FDI statistics in Viet Nam

There are several very positive aspects to the system for compilation of FDI statistics in Viet Nam that provide a strong foundation for the production of high-quality FDI statistics. These include:

- A legal framework authorising the collection of data from foreign-owned firms as well as overseas Vietnamese investors. These surveys are mandatory, which is critical to ensuring that the coverage and response rates are sufficient to ensure the quality of the statistics. The agencies collecting the data are also required to ensure the confidentiality of the information, which can help to boost response rates.
- Some of the key data sources are very timely, including the permits that are registered in an on-line system enabling continuous updating. Introducing further electronic data collection vehicles will help to enhance the timeliness of the data. The SBV compiles BOP

statistics on a quarterly and annual basis and publishes the statistics within three months of the end of the reference period. This meets the requirements of the IMF's Enhanced General Data Dissemination System.

- Strong data sharing and working arrangements between different agencies. Due to the multi-faceted nature of FDI, it is often important for different government agencies to work together to provide the data needed to compile the statistics. There is already a good working relationship for the collection and sharing of FDI-related data between different agencies in Viet Nam as shown by the collaboration between the MPI and the SBV, but also as evidenced by the cooperation between the GSO, MPI, the Ministry of Trade and Industry, and other ministries. This builds a strong foundation for the compilation of FDI statistics.

- The SBV is working with the IMF to improve the data sources and compilation methods for their FDI statistics. This could lead to the development of a survey of FDI that the SBV could use to close gaps in coverage and introduce further enhancements in their FDI statistics.

- The collection of data on the employment and trade of foreign-owned firms is very useful and can play an important part in understanding the role that foreign investment is playing in the domestic economy.

- The statistics are readily available on both the SBV and GSO websites. The SBV submits the data to the IMF, and both the SBV and MPI submit data to the ASEAN FDI database.

- Both the MPI and SBV participate in activities related to FDI statistics as part of ASEAN. The ASEAN Secretariat FDI statistics group is an important vehicle for improving FDI statistics in the ASEAN region by, for example, enabling the sharing of best practices between compilers in different countries. It also affords countries an opportunity to compare bilateral statistics which is a useful way to detect potential issues with the statistics.

As a result, the FDI statistics of Viet Nam are timely and accessible. The statistics that are published are based on sound data sources, but, despite these strong foundations, there are still improvements that could be made. A closer alignment with international standards, would enhance the comparability of the FDI statistics with other domestic statistics as well as with the FDI statistics of other countries. The latter suggestions for improvement would produce additional FDI statistics that would provide additional information on the role of FDI in the global integration of the economy.

- *Close the gaps in coverage by including reinvested earnings*. The SBV does not include reinvested earnings in its FDI financial flow statistics which can be an important source of financing for foreign-owned firms, especially as those investments mature. Given the size and maturing of foreign investment in Viet Nam, it is likely that reinvested earnings are a substantial portion of the recorded equity capital and debt flows. For example, a pilot study of 300 companies conducted by the SBV with the IMF found that reinvested earnings accounted for up to 40% of implemented capital in 2015. As a result, there could be a considerable understatement of the amount of FDI in Viet Nam in the official statistics.

- *Include data on FDI income flows*. Currently, Viet Nam does not disseminate income flows as part of its FDI statistics. The information on income flows is important to assess the profitability of FDI in Viet Nam and in assessing the impact of FDI on the current account.

- *Develop FDI position statistics for Viet Nam*. International Investment Position statistics are becoming increasingly important in assessing the vulnerabilities of economies to financial crises and other shocks. While FDI financial flow statistics are important for assessing the new international investment links being created, it is the FDI position statistics that shed light on the role that the cumulative foreign investments over time are playing in the economy. Lastly, FDI positions can be useful in analysing such things as the profitability and rate of return on FDI in the host economy.

- Currently, the SBV only compiles statistics according to the asset/liability presentation but should *consider also presenting statistics according to the directional principle*. While the asset/liability presentation is in line with the recommendations in BPM6 for aggregate FDI statistics, the directional presentation is still useful because it shows both the direction and degree of influence of foreign investors in the economy. This could be done by collecting information on reverse investment—that is, investment from foreign-owned firms in their parents.

- Viet Nam should continue to work with the IMF to improve its data collection and compilation system for FDI statistics to close these gaps and to eventually participate in the Coordinated Direct Investment Survey (CDIS) which is an important tool for comparing

FDI position statistics for a large number of countries. It requires that the FDI positions by partner country be presented on a directional basis to enable cross-country comparisons.

- The international guidelines call for presenting all FDI statistics—financial and income flows and positions—by detailed partner country and by industry according to the directional principle. The directional principle is considered to be the most meaningful basis for analysis since it shows the direction of influence—inward or outward investment—as well as the degree of influence. The SBV should also develop FDI flow statistics by partner country. Not only would these statistics be more comparable to those of other countries, but they would provide information on the origin of direct investors in the Vietnamese economy.

- Collecting information on the ultimate owner by the MPI could be very useful for the SBV to incorporate into their FDI statistics. The presentation by ultimate owner provides information on the country of the investor who ultimately controls the investment, which is an important piece of information for policymakers. Because a data source already exists for this information, it could be relatively easy to implement for Viet Nam.

- FDI statistics by economic activity—both FDI flows and positions—are also important to understand the sectors of the economy that foreign investors are attracted to. For example, FDI position statistics by economic activity can identify those sectors of the economy where foreign investors play the largest role. Such statistics could be developed from a dedicated FDI survey and from information on implemented capital by economic activity if the MPI were to make such data available.

- The need to link what were previously considered separate data sets, such as trade data, FDI data, and other business statistics has become more apparent. Such linked datasets enable a better analysis and understanding of the interconnections between economies and the role that FDI plays. Many advanced countries struggle to create these linked datasets because of laws and regulations that limit the sharing of data between agencies. Viet Nam has an advantage in that many of the agencies responsible for these different data sets are already cooperating. Indeed, Viet Nam already publishes information on the employment and trade of foreign-owned firms. These working arrangements should be formalised in law or official agreements, such as a memorandum of understanding, between the different agencies involved if they have not already done so.

Chapter 2

Foreign investor entry and operations in Viet Nam *

This chapter provides an overview of the framework for the entry and regulation of investment in Viet Nam and reviews existing regulatory restrictions to foreign direct investment. It looks at the current regime for investment licensing and regulation, reviews key policy reforms covering foreign investment liberalisation and benchmarks the remaining restrictions against those in other countries.

* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

In Viet Nam, domestic and foreign investors in conditional sectors, as well as foreign-invested enterprises with majority foreign ownership, are required to register for both an investment registration certificate and an enterprises registration certificate. In the past, these procedures were particularly lengthy and complex for foreign investors (Figure 2.1), generating uncertainty for potential investors. Over time, it has been a common intention among all Viet Nam's investment and enterprise law reform efforts to further streamline investment entry procedures. The new *Law on Investment* and *Law on Enterprise* issued in 2014 provide a renewed interest to improve the efficiency and reduce the costs for investors of such procedures.

In spite of improvements over time, Viet Nam is still in the bottom half of the World Bank's *Doing Business* indicators for starting a business (discussed in Chapter 6 on investment promotion and facilitation). It also ranked 81st out of a sample of 87 countries in terms of the time it took for a foreign investor to start a business in 2012 (based on the 2005 procedures), according to the World Bank's *Investing across Borders*. *Ex ante* regulation of business activities through registration procedures is common worldwide, but practices vary widely. Viet Nam will need to continue to review both the nature of registration requirements as well as the rationale to ensure that they are both effective and well-tailored to what they are intended to achieve. Although there is no unequivocal link between *Doing Business* rankings and investment trends, business regulations have been found in some studies to have a dissuasive effect on foreign investment by raising the administrative costs and uncertainty involved in investing.

A second layer of regulations covering foreign investors concerns the list of conditional sectors where FDI is either restricted or prohibited. As with business registration, Viet Nam has made significant progress over time in liberalising its regime covering FDI and is now one of the most open economies to foreign investment in Southeast Asia in terms of statutory restrictions. Deep reforms over three decades have transformed Viet Nam from a virtually closed economy prior to *Doi Moi* to become a leading destination for foreign direct investment. More than many other countries in the region, Viet Nam has been one of the most active in revising its laws to keep pace with developments in the economy and to react to trends in FDI inflows. The *Foreign Investment Law*, for example, was first enacted in 1987, with a new version in 1996, a unified *Investment Law* in 2005 and the latest in 2014, with frequent amendments in between these different iterations of the law. Many of these changes have reflected good practice, such as the unification of foreign and domestic laws in 2005, but implementing regulations have sometimes materialised only slowly, adding uncertainty for potential and existing investors.

Over time, the extent of discrimination against foreign investors has been reduced. The new *Law on Investment* further narrows the list of business sectors subject to investment conditions and adopts a negative list approach for the first time. It also restricts the ability of ministries, the People's Council and People's Committees to issue regulations on investment, thereby removing a degree of uncertainty from overlapping and sometime contradictory laws. At the same time, some key services networks are still partly off limits to foreign investors, holding back potential economy-wide productivity gains. Access to world class services inputs are crucial for moving up the value chain as well as for boosting growth and jobs in the services sector. Further service sector liberalisation should also help to raise efficiency in sectors dominated by state-owned enterprises (SOEs), which in some cases has acted as a drag on economic growth.

The major domestic players have traditionally been SOEs. Early investors eager to tap into the domestic market had often chosen to form joint ventures with SOEs in order to navigate the complex and discriminatory regulatory framework and to benefit from incentives only available to joint ventures. Over time, the preference has shifted towards majority-ownership, as is common for investment in other countries. Further restructuring of the economy, however, has been partly impeded by the prohibition of foreign majority-ownership acquisitions in public companies, removed in 2015, and by the restrictions on foreign participation in the equitisation process. This helps to explain the low level of cross-border mergers and acquisitions seen in Chapter 1.

Policy recommendations

- Continue to eliminate or further narrow the scope of investment registration requirements and make the public policy objectives of requiring investment certificates clearer when appropriate. Entry regulations raise the cost of business and may be inefficient in achieving public policy objectives. Countries have commonly opted for having only an enterprise registration and addressing other concerns through appropriate regulation.

- Make sure the content of the National Foreign Investment Web Portal is up to date and available in English in order to ensure transparency, clarity and predictability for investors. As of June 2017, the negative list of entry and operational conditions applying exclusively to foreign investors remained available in Vietnamese only.

- Consider further service sector liberalisation. Some key services, such as transport, communications and banking, are still partly off limits to foreign investors, holding back potential economy-wide productivity gains.

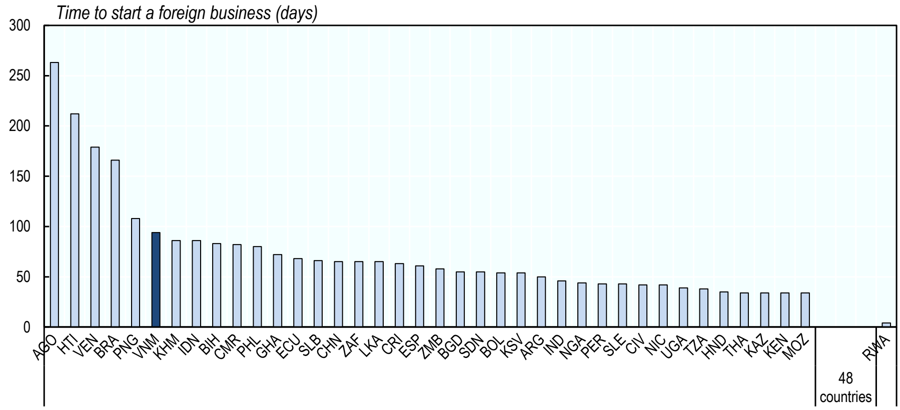
- Allow for greater private and foreign participation in equitised SOEs. Revising foreign equity limitations could provide further impetus for the equitisation programme and help to enhance the productivity of SOE-dominated sectors. Foreign investors' interest in buying up stakes in SOEs is vastly reduced if they are offered only minority stakes, which prevent them from undertaking broader governance and strategic reforms.

The current regime for investment licensing and registration

Investment in Viet Nam is governed by two new laws: the *Law on Investment* and the *Law on Enterprises*. They were both enacted in November 2014 and became effective in July 2015, replacing earlier laws from 2005.[1] As in the previous reforms, the aim was to enhance the transparency of the investment regime and streamline the procedures for investment registration and approval, and improve corporate governance rules for private and state-owned enterprises. After almost a decade since the 2005 reform, the pressure had mounted for a more transparent, simple and comprehensive investment regime. In spite of improvements over earlier versions, the 2005 *Law on Investment* had continued to generate a considerable amount of uncertainty and inconsistency, even with regards to basic investment law provisions, such as the definition of foreign investor.[2] It also maintained in place a relatively burdensome registration procedure and imposed conditions on investments in a large number of sectors.

Foreign investors had complained of the complexity and length of the previous enterprise registration and investment approval procedures. Viet Nam ranked 81st out of a sample of 87 countries in terms of the time it took for a foreign investor to start a business, according to the World Bank *Investing across Borders*, despite a high but relatively common number of required procedures (Figure 2.1). According to legal practitioners in Viet Nam, the authorities would also often require additional detail and justification, and request multiple meetings with the investors to revise their investment application dossier. The statutory delays for registration and approval procedures were rarely met (Tilleke and Gibbins, 2015), although authorities noted that this was mostly related to the investment approval process.

Figure 2.1. **Time to start a foreign business (days) under the 2005 Investment and Enterprise Law**



Notes: Information was collected in 2012 through a survey of more than 2900 lawyers, accountants, academics, business advisers and public officials in over 100 surveyed economies.

Source: World Bank Investing Across Borders.

The new 2014 *Law on Investment* addresses many of these previous challenges, providing, for instance, a new and clearer definition of a foreign investor which should help to improve transparency and predictability (Table 2.1). A foreign investor is now defined as any organisation established in accordance with foreign laws and conducting business investment activities in Viet Nam. The law also clarifies that, for the purposes of investment licensing, any organisation established in Viet Nam with majority foreign-owned capital (51% or more of charter capital) will also face the same investment conditions and procedures as those applicable to foreign investors (Frasers Law Company, 2015). Therefore, foreign companies or Vietnamese companies with 51% or more foreign ownership are now subject to the same registration conditions under the law.

Despite maintaining a two-tier registration system – requiring foreign investors and foreign majority-owned ones to apply for both an Investment Registration Certificate (IRC) and an Enterprise Registration Certificate (ERC) – the new registration procedure brings some important improvements over the 2005 *Law on Investment*. The new procedure allows fully domestically-owned investors or investors with minority foreign ownership to apply for only the ERC but not an IRC. For foreign investors and majority-owned foreign investors, the new procedure keeps the enterprise registration process separate from the investment registration process, but these investors can apply concomitantly for both certificates with the competent investment registration authority, which shall co-operate with the enterprise registration authority.

Table 2.1 **Investment registration and approval under the 2014 Investment and Enterprise Laws**

	Who is entitled?	What investment process applies?	What investment document is issued?
Enterprise registration (only)(3 working days)	Any investor who would like to set up a enterprise in Vietnam is required to process an enterprise registration procedure. In the case of Investment projects by fully domestically-owned investors or investors with minority foreign ownership (less than 51% of charter capital), this is the only registration required. They are dispensed from the investment registration.	None. Also, investors wishing to obtain investment incentives are no longer required to apply for an IRC as previously. If the conditions for investment incentives are satisfied, they shall follow the procedures for investment incentives at the tax authority, finance authority, or customs authority	None, only the enterprise registration certificate (ERC) is issued as per the new Law on Enterprises
Investment registration (15 working days) **+** **Enterprise registration** (3 working days)	Greenfield investment projects by foreign investors or Vietnam-established investors with majority foreign ownership (51% of charter capital or more) Only a notification required: in the case of mergers and acquisitions by foreign investors whereby the target is not in a conditional sector for FDI or the acquisition does not result in the foreign investor holding a stake of 51% or more of the target company capital, investors are only required to follow the procedures for change of a shareholder or member in accordance with the law	Registration of investment with the provincial DPI, where the headquarters of the business is situated, and accompanied by prescribed documentation (more onerous for foreign projects) for projects located outside the special-purpose zones; otherwise, registration should be made with the management board of the special-purpose zones. For foreign investors applying equally for an ERC, the investment registration authority shall co-operate with the enterprise registration authority for delivery of both certificates	An investment registration certificate (IRC) is issued For foreign investors establishing an enterprise, the application for the ERC can be made at the same time as for the IRC with the competent investment registration authority

	Who is entitled?	What investment process applies?	What investment document is issued?
In-principal approval (35 days) + **Investment registration** (5 working days after approval) + **Enterprise registration** (3 working days)	In-principal approval is required, regardless of their capital structure, from: The National Assembly for projects: with a significant environmental impact, including nuclear power plants; using forest land; using land meant for rice cultivation over 500 hectares; relocating over 20 000 people in mountainous areas or over 50 000 in other areas; or requiring special policies decided by the National Assembly The Prime Minister for projects: which relocate over 10 000 people in mountainous areas or over 20 000 in other areas; in the following sectors: airports, seaports, petroleum, casinos, cigarettes, industrial parks and economic zones, golf courses; in which investment is over VND 5 billion; foreign investment in sea transport, telecommunications services with network infrastructure, afforestation, publishing, journalism, wholly foreign-invested science and technology organisations or companies The People's Committee for projects: involving land allocated or leased out by the state without auction, tender or transfer; involving conversion of land-use purposes (unless located in special-purpose zones); or using technology listed on the technology transfer restricted list	Approval-in-principle must be obtained from the relevant authorities prior to submitting an application for issuance of an IRC and ERC to the local registry office of the provincial People's Committee The application for an IRC after obtaining the approval-in-principle from the relevant authority is optional for projects by domestic or foreign minority-owned projects, unless in business lines subject to conditions to foreign investors The law provides guidance on the criteria for approval by the National Assembly, which includes necessity of the project; conformity with socio-economic plans; objectives, scale, time, location, land use and environmental protection issues; capital investment; and socio-economic effects; and special policies, investment incentives, support, and conditions (if any)	For projects subject to approval-in-principle and requiring an IRC, the local Department of Planning and Investment shall issue the IRC within 5 working days from the receipt of the decision For projects subject to approval-in-principle, but not requiring an IRC, investors may register for the issuance of the ERC as per the new Law on Enterprises even prior to obtaining the approval by the relevant authority

Source: OECD elaboration based on Viet Nam's 2014 *Law on Investment*.

The new process also eases the registration procedure for investments through merger and acquisitions by foreign-owned enterprises, which was one of the main constraints under the previous framework. An IRC is no longer required for an M&A transaction by foreign investors where the target does not operate in a conditional sector for FDI or the acquisition does not result in the investor holding a stake of 51% or more in the target company. Otherwise, as in the case of greenfield investments by foreign or majority-owned foreign investors, and unless the investment lies in a sector requiring approval, a notification to the local Department of Planning and Investment (DPI) under the provincial-level People's Committee is required, and the authority has 15 days to verify the company meets all the requirements in the law and issue the IRC. Previously, all foreign investors had to go through a complicated, expensive and long (45 days) investment registration process.

For greenfield projects too, the two-tier registration process may not necessarily lead to a more complex and time-consuming process, since the statutory time frame for the authorities to issue the IRC and ERC are approximately the same as the time frame allotted to issue the earlier single investment certificate (which concurrently served as an ERC). Under the previous framework, the legally prescribed time limits were rarely respected according to legal practitioners, with the issuance of IRCs taking two to six months from the date of filing (Tilleke and Gibbins, 2015).

The new implementing regulation[3] helps to address this issue by establishing that if an agency does not make any comments on the investment project by the deadline specified in the 2014 *Law on Investment* and its implementing decree, it is considered that it concurs with the content of the investment project under its management. The new separate procedure also facilitates making any necessary amendment relating to ERC or IRC, which was a long and complex process under the previous framework.[4]

The new law also narrowed the scope of activities subject to the "investment in-principle approval" mechanism. Besides a range of projects where both foreign and domestic investment projects are subject to screening by the People's Committees, foreign investors (regardless of foreign ownership levels) are now subject to the Prime Minister's approval in the following sectors: maritime transport; telecommunications services with network infrastructure; afforestation; publishing and press; and establishment of scientific and technological organisation or enterprise with 100% foreign owned capital. The approval should be given within 35 days and the IRC issued within 5 working days once approval is granted. The new law abolished the previous approval requirement for investment in conditional sectors, which consisted of a longer list in the case of foreign investors. Henceforth, foreign investors in such sectors, except those projects where the law explicitly requires an "in-principle approval", are only required to obtain an IRC with the local DPI.

Is the rationale for the specific regulations on foreign entry still valid?

Empirical evidence suggests that the administrative costs of entry regulations raise the entry barriers for investors and can effectively influence the resulting productivity benefits. In a globally competitive environment, economies tend to receive larger inflows of FDI where there is a relatively larger reduction in the length of investment procedures, which contributes to greater welfare gains through greater market competition and higher nominal wages. In contrast, welfare gains are lower for those economies lagging behind as other economies become relatively more attractive locations for foreign investors (Arita and Tanaka, 2013). Contrary to expectations, stricter regulation of entry is not found to be associated with higher quality products, less pollution, improved health outcomes, or keener competition but rather with sharply higher levels of corruption and a larger share of the informal economy (Djankov *et al*., 2002). Regulations need to be effective and well-tailored to what they are trying to achieve (Box 2.1).

To what extent are the investment and enterprise registration procedures in Viet Nam actually necessary and proportional to their specific objectives? Business registration is a common requirement worldwide. It allows authorities to collect basic information about enterprises wishing to invest and engage in business transactions with the general public and other enterprises and serves to recognise the enterprise as a legitimate business under the country's law so that it can benefit from, and be legally responsible for, its acts under the legal regime. In Viet Nam, all investors are required to register their enterprises with the relevant authority, but what is the additional need for separately registering every investment project by an enterprise, especially when the procedure does not constitute an approval mechanism as seems to be the case, with the exception of investment projects subject to the in-principle approval requirements provided for in the law?

The rationale for requiring an investment registration certificate is not clearly stated in the law, nor are the objectives for applying an investment screening and approval mechanism, although for the latter some of the provisions in the law provide some elements behind the assessment: the project's alignment with socio-economic development and industrial plans; its socio-economic effects; and the fulfilment of investment, technology, incentives and land use conditions. These objectives could all ostensibly be achieved through the appropriate implementation of specific labour and environmental laws, health and safety regulations and so on. For discriminatory screening and approval of foreign investments, its efficacy is likely to be impeded by the fact that civil servants often do not have the relevant expertise or training to effectively assess the merits of a project.

Box 2.1. **Ensuring that existing regulations achieve their intended objectives**

Public interest theory holds that any regulation should serve the greater interest of society as a whole (Pigou, 1938). Unregulated markets can generate market failures, ranging from monopoly power to negative externalities, which require some sort of regulation to correct the inefficient or inequitable market practices and protect social efficiency. Regulating investment entry (of both foreign and domestic investors) is therefore justified if it ensures that the ultimate public interest objective is met. Do market failures exist that can be corrected by the regulation of investment entry, and are implemented regulations proportional to these failures so as to avoid generating any other larger distortion to social efficiency? Historically, countries that have opted for the regulation of investment entry justify it by the need to make sure consumers are protected from low quality products from "undesirable" sellers (Djankov *et al*., 2002).

Many countries impose discriminatory regulations on the entry of foreign investors, although this approach has vastly diminished over time across countries. Currently, discriminatory restrictions on foreign investment are most often motivated by concerns over the loss of national sovereignty to "protect essential security interests" and to maintain "public order or the protection of public health, morals and safety". While national security is a legitimate concern, it should not be used as a cover for protectionist and discriminatory policies (OECD, 2008). Several of these concerns are not directly related to the ownership of the investment and could be addressed through other non-discriminating regulatory practices. Domestic investors too can act against the public interest with regards to environmental and labour policies, for instance, or with regards to security issues. The ex-ante regulation of investment entry can be an inefficient way to address public policy objectives which can be addressed by specific regulations, such as on environmental protection, health and safety, or other measures preventing fraudulent practices by investors.

Countries also pursue other broad economic objectives through investment restrictions and entry regulation, such as the protection of infant industries, employment or technology transfer. The right of governments to favour some investors over others in order to achieve social, economic or environmental goals is widely accepted, but discriminatory measures only serve the broader public interest to the extent that their potential costs in terms of forgone investment and efficiency gains are compensated by broader economic and social benefits. For this reason, exceptions to non-discrimination need to be evaluated with a view to determining whether the original motivation behind an exception remains valid, supported by an evaluation of the costs and benefits, including an assessment of the proportionality of the measure to ensure they are not greater than needed to address specific concerns (OECD, 2015a).

Administrative entry procedures may sometimes be necessary to carry out legitimate and clearly delineated public policy objectives but these objectives need to be weighed against the cost of these procedures (*e.g.*, increased cost of entry, reduced competition, increased corruption). They also impose a burden on public administration which diverts resources from other activities. Governments should be clear about the market failures the regulations and administrative procedures are addressing and constantly assess to what extent these objectives are being achieved in the most efficient way. Reforming administrative procedures is not an easy task, however, as governments face resistance to reform because of administrative opposition, cultures of intervention, and relationships with private interest groups (Jacobs and Coolidge, 2013).

Restrictions on foreign direct investment in Viet Nam

As with the simplification of business registration over time, the government has progressively reduced its restrictions on foreign direct investment and is now one of the most open economies in the region in terms of statutory restrictions. The 2014 *Investment Law* explicitly adopts a "negative list" approach for the first time by allowing investment to take place in industries and activities not prohibited by law. The law specifies the list of sectors where investment (both domestic and foreign) is banned and those where investments are subject to conditions. The implementing regulation[5] issued in December 2015 brought further clarity on what conditions apply and provides for all conditions on investment to be publicised in the National Enterprise Registration Portal and the National Foreign Investment Web Portal (for conditions specific to foreign investment). Where investment conditions are changed, they shall be updated to the respective portals within eight working days. As of March 2017, the aggregate list of sectors and conditions specific to foreign investment was still not available in English.

The 2014 *Law on Investment* also limits the regulation of investment conditions to the Laws, Ordinances, Decrees, and the international agreements to which Viet Nam is a signatory. In practice, this restrains the government's ability to regulate by means other than decrees. Ministries, ministerial agencies, the People's Council, People's Committees, and other entities can no longer issue regulations on conditions for making business investments. In the past, the parallel existence of a government decree and a ministerial circular for the same area of law had sometimes led to inconsistencies and ambiguity, undermining the transparency of Viet Nam's framework (Rödl & Partners, 2015). This is a welcome step towards ensuring a predictable business environment.

The government has also demonstrated its commitment to continue liberalising restrictions on foreign investment. In 2015, following the 2014 reforms, a new regulation (Decree 60) eased the remaining restriction on foreign acquisition of public companies.[6] The new decree paves the way for foreign investors to acquire majority stakes in public Vietnamese companies. Until recently, foreign ownership in these companies was capped at 49%. The decree now permits foreign investors to hold up to 100% of a public company in Viet Nam, which comprises, in addition to publicly listed companies, those with more than 100 shareholders and with charter capital of VND 10 billion or more (approximately USD 460 000), although subject to the conditions mentioned above.

FDI restrictions in Viet Nam in an international context

An investment climate cannot be captured in a single indicator, whether on the costs of doing business or a measure of statutory restrictions on FDI. Many different policies and practices impinge on investment decisions, and the way – and whether – policies are implemented is arguably as important as the policies themselves. Quantitative indicators have nevertheless proven highly effective in drawing attention to the burdens of business regulation, identifying priorities for reform and communicating success and progress.

The OECD *FDI Regulatory Restrictiveness Index* (*FDI Index*) seeks to gauge the restrictiveness of a country's FDI rules (Box 2.2). The *FDI Index* is currently available for almost 60 countries. It does not provide a full measure of the investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the *FDI Index*, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' FDI policies and to explaining in part the performance of countries in attracting FDI.

Viet Nam has gradually liberalised its FDI regime, and in 2015 further liberalising reforms entered in force, but remaining restrictions still constitute an important barrier to FDI according to the OECD *FDI Regulatory Restrictiveness Index* (Figure 2.2). Since the entry into force in 2015 of Decree 60/2015/ND-CP and the 2014 *Law on Real Estate*, which, respectively, lifted the previous 49% foreign shareholding limit in Vietnamese public companies and the horizontal restriction on land use rights for foreign-owned companies, the main restrictions in place are the sector-specific foreign equity restrictions established in Viet Nam's WTO Schedule of Commitments and other international investment agreements

(Table 2.2). Reflecting market access commitments under international agreements as foreign investment conditions in domestic legislation, as is the case with Viet Nam's *Law on Investment*, is a rather unusual practice. Commitments normally refer to the minimum standard a country commits to provide in terms of liberalisation, and not the ceiling beyond which foreign investment is not allowed. But it may provide investors with some legal assurance and predictability that the list of conditional sectors will not be modified to their disadvantage.

Box 2.2. **Calculating the OECD FDI Regulatory Restrictiveness Index**

The OECD *FDI Regulatory Restrictiveness Index* covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

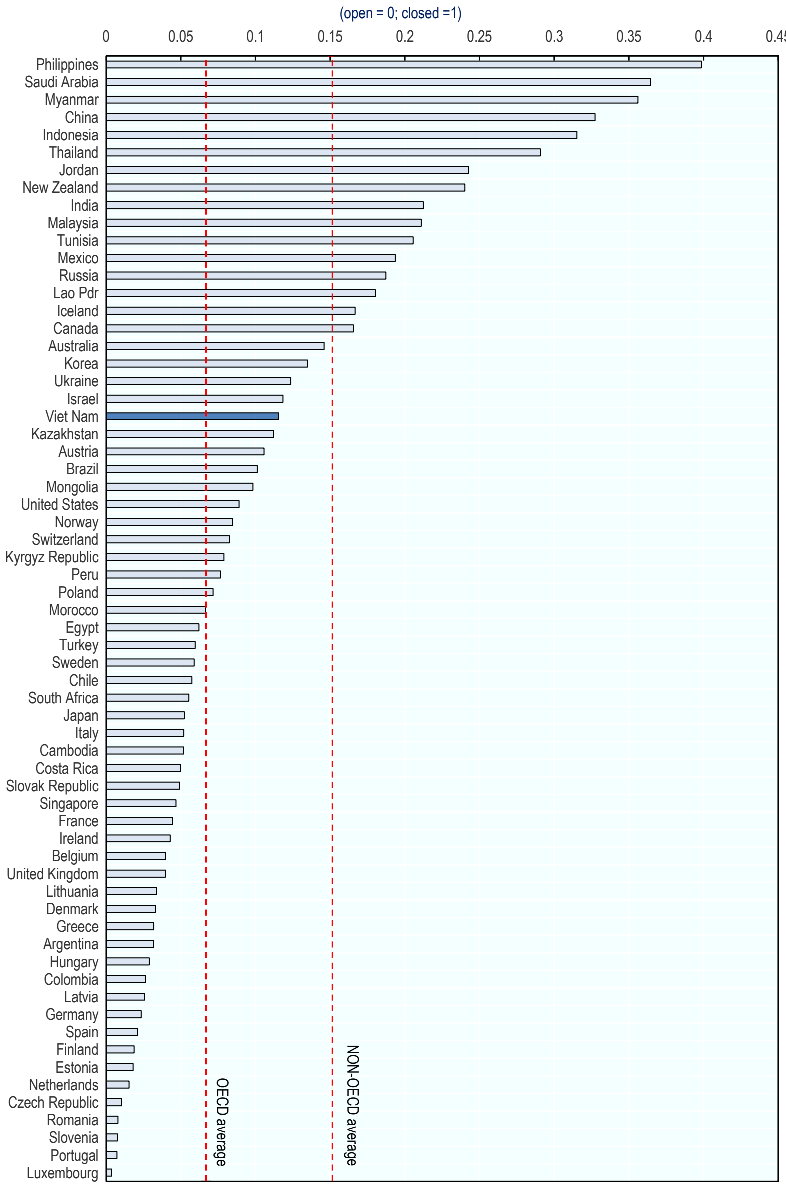
1. the level of foreign equity ownership permitted,
2. the screening and approval procedures applied to inward foreign direct investment;
3. restrictions on key foreign personnel; and
4. other restrictions such as on land ownership, corporate organisation (*e.g*. branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI, typically listed in countries' lists of reservations under FTAs or, for OECD countries, under the list of exceptions to national treatment. The *FDI Index* does not assess actual enforcement and implementation procedures. The discriminatory nature of measures, *i.e*. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. Preferential treatment for special-economic zones and export-oriented investors is also not factored into the *FDI Index* score.

For the latest scores, see www.oecd.org/investment/index.

Figure 2.2. **OECD FDI Regulatory Restrictiveness Index, 2016**[1]

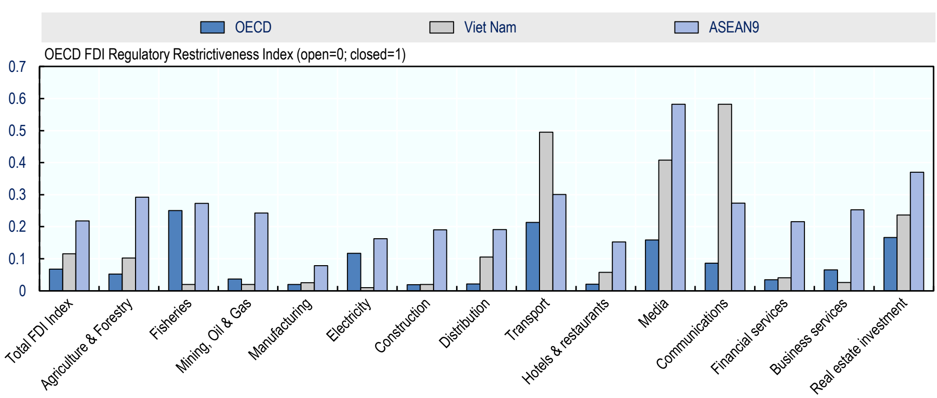


Source: OECD FDI Regulatory Restrictiveness Index, www.oecd.org/investment/fdiindex.htm.

1. Scores reflect regulatory restrictions as of end-2016. Data for Cambodia, Lao PDR, Singapore and Thailand are preliminary and reflect regulatory conditions as of end-2014. The Index covers only statutory measures discriminating against foreign investors (*e.g.* foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment climate such as the implementation of regulations and state monopolies are not considered.

On a sectoral level, Viet Nam could focus on enhancing liberalisation efforts of certain key network services, such as transport and telecommunications, which remain partly off limits to foreign investors, holding back potential economy-wide productivity gains. Figure 2.3 illustrates the level of restrictions by sector for Viet Nam compared to ASEAN9 and OECD countries. Viet Nam maintains above average restrictions in these sectors, which are likely to hamper the competitiveness of local firms. OECD analysis shows that access to world class services inputs is crucial for moving manufacturing up the value chain as well as for boosting growth and jobs in the services sector (OECD, 2015b). FDI restrictions and stringent product market regulations constraining competition and contestability in service sectors raise service input costs, including notably for logistics and financial services, for other economic sectors and affect their ability to compete on a global scale,[7] as well as limiting potential access to new technologies and evolving production techniques. Greater liberalisation of services and investment, therefore, would support efforts to strengthen Viet Nam's level of integration within ASEAN and could help strengthen its participation in global value chains (OECD, 2015b).

Figure 2.3. **OECD FDI Regulatory Restrictiveness Index, by sector, 2016**



Source: OECD FDI Regulatory Restrictiveness Index, www.oecd.org/investment/fdiindex.htm.

Notes: ASEAN9 refers to the average scores of the nine ASEAN member states covered. Only Brunei Darussalam is not covered. Data for Lao PDR, Viet Nam, Cambodia, Singapore and Thailand are preliminary. See also previous Figure note.

Box 2.3. **Viet Nam's recent liberalisation efforts should support productivity growth**

Viet Nam’s efforts to enhance foreign participation in the economy, by allowing foreign investors to acquire majority control of public companies, are likely to support greater productivity levels. Evidence suggests, that in catching-up countries, lower productivity firms could achieve large productivity gains if they could benefit from the expertise of foreign owners, if regulations do not impede the necessary restructuring (Kalemli-Ozcan *et al*., 2014).

Besides capital, foreign direct investment is associated with the flow of technology, management and organisational skills that can help firms to move towards their frontier capacities. Multinational enterprises will rather deploy their best productivity-enhancing technology and practices under the right enabling environment, including, *inter alia*, strong intellectual property rights, efficient contract enforcement mechanisms and appropriate corporate organisation regulations. In this context, with few exceptions, multinational enterprises (MNEs) have a strong preference for majority ownership. Fully 94% of the foreign affiliates of US MNEs worldwide and 95% of affiliates in Southeast Asia, for example, are majority-owned (OECD, 2014). Having full control over affiliates allows MNEs to protect their intangible assets and proprietary technology, better control any reputational risks concerning labour practices and the environment, and minimise legal liabilities based on home country laws in the case of corruption. Beyond these considerations, having full control may be preferable simply because it allows the MNE parent to avoid conflicts when its strategy for the affiliate diverges from that of the domestic partner (OECD, 2014). Kokko *et al*. (2003) find that joint ventures between foreign investors and Vietnamese firms (mostly SOEs), tend to have higher failure rates than fully foreign-owned ventures.

Evidence from Viet Nam also highlights the importance of foreign-invested enterprises in raising productivity levels. Newman *et al.* (2009) show that FDI in Viet Nam has been associated with higher levels of productivity, driven almost entirely by higher levels of investment and technology usage. Their findings also suggest that state-owned enterprises are less productive than domestic private enterprises, controlling for their higher levels of investment and technology usage. Accordingly, the observed relatively higher productivity levels of SOEs can be attributed to their relatively higher levels of investment and technology usage, which have relied heavily on government support in the past. SOEs tend not only to be larger than their domestic counterparts, which allows them to absorb greater levels of investment, but they have also often benefited from relatively more favourable opportunities for obtaining government incentives for both investment and technology development.

Allowing for foreign acquisition of Vietnamese banks above the current 30% threshold and beyond specific cases where Prime Minister’s authorisation can be granted (*e.g.* restructuring weak credit institutions facing difficulties or ensuring the stability of the credit institutions system) could also potentially contribute to enhancing banking sector efficiency. Foreign banks may be more likely to enter the market, and participate in the restructuring of weaker banks, if they can have access to higher quality assets as well.

Services sector liberalisation should also help to bring more efficiency to SOE-dominated sectors, which have been seen, in some cases, as a drag on Viet Nam's economic growth (see the discussion in Chapter 4 on corporate governance). The lack of an investor base, together with some inefficiencies of government agencies, partly explain the pace of privatisation falling behind schedule (Viet Nam, 2015, Ministry of Finance). The remaining restrictions on foreign ownership participation in the SOE equitisation programme are an important explanation for the lack of a broader foreign investor base. Foreign investors' interest in buying up stakes in SOEs is reduced where they are offered only minority stakes, which may prevent them from pushing for broader governance reforms. Revising foreign equity limitations could provide further impetus for the equitisation programme and enhance the productivity of Viet Nam's economy (Box 2.3).

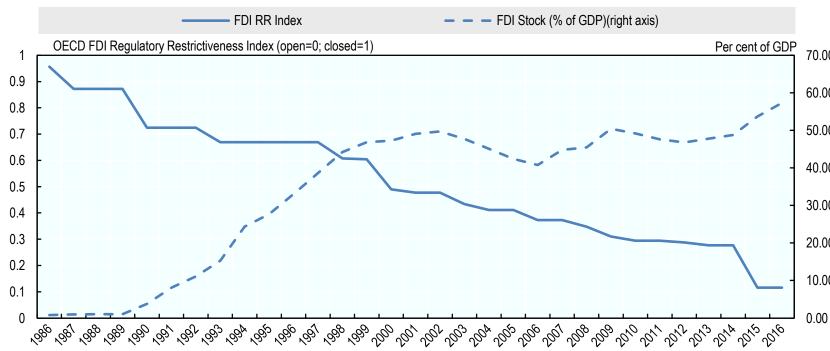
Trends in investment policy reform in Viet Nam since 1986

As seen in the frequent amendments to the laws covering investment and enterprises, Viet Nam has been one of the most active and persistent reformers of its foreign investment regime in the region. The impact on FDI inflows is easily ascertained, although the exact timing of the investor response sometimes depended on the necessary implementing regulations (as discussed above) or flanking reforms in other policy areas. The following section describes major reform episodes and benchmarks this reform trajectory against FDI inflows and against other economies in the region using historical estimates of the *FDI Index*.

Reforms of FDI policies in Viet Nam have sometimes slowed but never abated

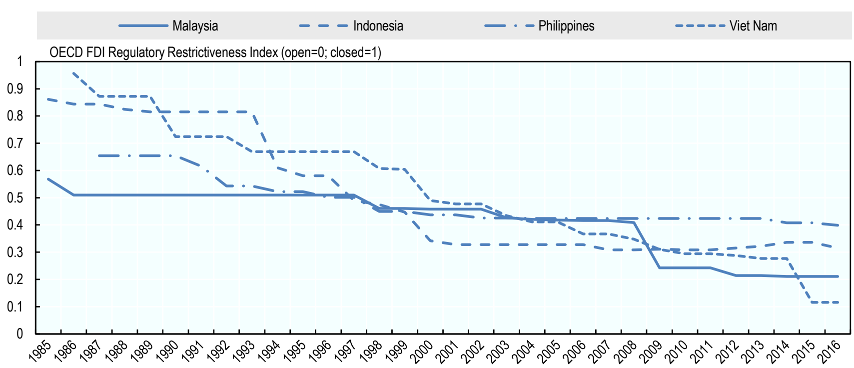
Since the start of *Doi Moi* in 1986, Viet Nam has steadily worked to improve the regulatory environment for foreign investors, including by gradually removing specific FDI restrictions. Based on an estimate of the OECD *FDI Regulatory Restrictiveness Index* since 1985 (Figure 2.4 and 2.5), many of these improvements have helped Viet Nam to attract increasing amounts of FDI. The major reforms liberalising FDI were concentrated in three periods: the initial opening period in the late 1980s; the reforms following the Asian financial crisis; and those implemented in preparation for Viet Nam's accession to the WTO in 2007 (see Annex Table A2.1). They are described in more detail below.

Figure 2.4. **Viet Nam: Historical FDI Liberalisation**



Source: OECD FDI Regulatory Restrictiveness Index and UNCTAD FDI statistics.

Figure 2.5. **Viet Nam's FDI liberalisation compared to regional peers**



Source: OECD *FDI Regulatory Restrictiveness Index*. See Annex 2.1 for information on reforms and Box 2.2 for the methodology.

The early days of the opening up to foreign investment

As part of the liberalisation of its economy, Viet Nam passed the *Law on Foreign Investment* in 1987, allowing foreign investors to enter through fully-owned subsidiaries for the first time, although subject to several conditions. Together with the development of several export-processing zones in the early 1990s, the law was the first step towards an open economy for foreign investment (Vo and Nguyen, 2012). It not only allowed foreign investors to establish fully-owned subsidiaries but also explicitly ruled out nationalisation (Trai Le, 1995). The 1992 Constitution further reassured investors by explicitly encouraging "foreign organisations and individuals to invest capital and technology in Viet Nam", and by providing for state guarantee of the right of "ownership of legitimate capital, property, and other interests of foreign organisations and individuals" (Article 25 of the Constitution).

In spite of these first steps, legal uncertainties and restrictions remained in place, including the absence of a regulatory framework allowing private domestic enterprises. This came only in 1990 with the promulgation of the *Law on Private Enterprises* and the *Law on Companies,* which recognised for the first time the right of citizens and entities to establish businesses. Until then, private-owned enterprises were not legally permitted in Viet Nam. Foreign investors complained at the time that the 1987 *Foreign Investment Law* meant little in the absence of a broader legal framework guaranteeing their rights (Trai Le, 1995). It also maintained vague conditions on the application of key investor rights and investment incentives,[8] taxed income remittances and imposed a discriminatory and burdensome FDI licence requirement for foreign wholly-owned businesses and joint ventures with domestic investors.[(9)(10)] Foreign acquisitions of domestic enterprises were forbidden and a minimum capital requirement of 30% of registered capital applied. Foreign-invested enterprises were also required to go through burdensome procedures to obtain export licences to undertake export activities on their own, which in practice required them to go through Vietnamese foreign trade companies.[11]

Thus, not surprisingly, although approved FDI increased rather rapidly in the years following the promulgation of the *Foreign Investment Law*, as foreign investors held great expectations for a newly-opened economy with a potentially large consumer market and the presence of import controls, it soon started to account for decreasing shares of registered capital (Vo and Nguyen, 2012). In the early period, following the opening of the economy in 1987, most of the investment went to oil and gas, hotels and construction, mostly through joint ventures with state-owned enterprises, with only a few manufacturing projects (van Thuyet, 1995).

The government subsequently made several revisions to the investment regime in order to make it more attractive to foreign investment, including to strengthen the rights of investors, sharpen the applicable investment incentives regime and expand the possible modes of entry, as well as to narrow the policy gap with domestic investors.[12] The *Foreign Investment Law* was revised in 1990 and 1992, and then replaced by a new *Foreign Investment Law* in 1996, amended once again in 2000. During this period, the government took a few important liberalisation measures. In 1993, the implementing regulations were issued to allow foreign investment in the recently created export processing zones and in build-operate-transfer contracts. The profit remittances tax was also reduced and wholly-owned foreign investors were allowed to obtain land use rights, which until then was only possible for joint ventures. The implementing regulations also further clarified that private enterprises established in accordance with Viet Nam's legislation could partner with foreign investors in every sector of the national economy, with the exception of those in which investment was prohibited by laws and regulations of Viet Nam. The 1996 *Foreign Investment Law* sought to further facilitate the entry of foreign investors by decentralising the approval for specific projects to the Provincial Committees.[13]

The reform momentum in the early 1990s in Viet Nam and the regional dynamism at the time paved the way for the rapid increase in FDI in the 1990s up to the Asian financial crisis. Foreign investors began to play an important role in Viet Nam's industrialisation and economic diversification, as manufacturing, notably in the textile and garment industry and in the assembly of electronics and home appliances, became a major driver of FDI. By the late 1990s, the manufacturing sector accounted for almost half of registered FDI. Most of the investments were export-oriented and located in export processing zones, partly to benefit from better infrastructure in and around the zones, the clearer land registration systems and the easier licensing procedures. Despite the Asian financial crisis, the real industrial output growth of foreign-invested enterprises in Viet Nam increased from about 15% in 1996 to almost 35% in 1999, while that of domestic enterprises declined considerably during the period (UNCTAD, 2009).

The adjustments following the Asian financial crisis

While foreign investment registrations started to decline before the Asian financial crisis in July 1997[14], the crisis was a major watershed for FDI in the region and in Viet Nam. A large share of foreign investments flowing into Viet Nam was from countries affected by the crisis (*e.g.* Korea, Singapore, Thailand and Hong Kong, China), which retrenched considerably their investments abroad during the period. Despite the decline in FDI, Viet Nam was relatively less exposed to short-term capital flows than some of its neighbours, which allowed it to withstand relatively better the crisis than other affected economies in the region (UNCTAD, 2009). Yet, under the stricter economic conditions in the region and despite high expectations and interest in Viet Nam, foreign investors became more sensitive to the difficulties encountered in doing business in the country. The ban on foreign acquisitions of domestic enterprises at the time also precluded foreign investors from participating in the restructuring of businesses in Viet Nam and slowed down the recovery in FDI as compared to other countries in the region (ADB, 2004).

The crisis increased the pressure for reforms to improve the investment climate, so that Viet Nam could continue to compete as a leading production location for multinational firms. The government then sought to accelerate structural reforms and improve the investment framework. The 1998 *Foreign Investment Law* sought to increase the transparency of the foreign investment regime and issued the first list of closed sectors and those where investment was conditional.[15] The *Law on the Promotion of Domestic Investment* from 1994 was also amended to allow foreign investors to purchase up to 30% of certain types of Vietnamese enterprises, including state-owned enterprises which had been equitised, albeit subject to Prime Ministerial approval on a case-by-case basis. In 2000, the *Foreign Investment Law* was amended to enhance the licensing regime for foreign investors by further streamlining and narrowing down the scope of investment projects subject to approval by the authorities.[(16)(17)] In the same year, foreign acquisitions of public companies up to 20% were also permitted.[18] This was further raised to 30% in 2003 to align with the limits applied to unlisted companies (the limit was later raised in 2005 to 49%).[19] In 2002, the government further simplified the procedures for acquiring domestic enterprises, replacing the previous Prime Ministerial approval with a local registration procedure. It also increased the number of industries in which foreign acquisition of unlisted Vietnamese enterprises was permitted.[20]

FDI inflows started to recover in 2003 (see Chapter 1). This was relatively later than other countries in the region, as the regulatory environment in place remained restrictive to FDI in the form of M&A (limited to 30% within specific business sectors), which played an important role during the post-crisis period in the corporate and bank restructuring process in affected countries, such as Thailand and Korea. But the recovery in 2003 also partly reflected the improved investment framework and reforms undertaken in the early 2000s and the economic recovery in the region. The reform momentum was further consolidated with the ratification of the bilateral trade agreement with the United States in 2001, which opened up large export opportunities for Vietnamese enterprises, notably in the textile and garment industry benefitting from export quotas under the agreement.

Viet Nam's increased competitiveness for key manufacturing sectors also allowed FDI to play an increasing role in the economic transformation and diversification following the crisis. FDI intensified in industries beyond footwear and textiles and garments, such as electronics and electrical equipment. By 2002, foreign-invested enterprises were responsible for 82% of the exports of electronics and electrical equipment, compared to 42% of footwear and 25% of garments and textiles (ADB, 2004).

The reform momentum in the run up to WTO accession

The run up to WTO accession on November 2006 (effective January 2007) after 11 years of negotiations provided further important reform momentum for Viet Nam, notably the adoption of a new *Law on Investment* and a new *Law on Enterprises* in 2005, which entered into force in July 2006. Both laws aimed, *inter alia*, to modernise and simplify the establishment procedures for investment and to provide for a common legal regime for both foreign and domestic investors. They also provided for greater market access to foreign investors. The unification of the regimes was an attempt to diminish the disparities and uncertainties generated by the previous dual-regime and to send a strong message to domestic and foreign investors of the government's commitment to improving the investment climate. The reality proved less positive, however. Legal practitioners claimed that both laws lacked clarity and transparency in a number of areas, and the long delay to issue implementing regulations only aggravated the situation by generating considerable policy uncertainty and implementation inconsistencies (Phillips Fox, 2006; Freshfields Bruckhaus Deringer, 2008).

Despite some areas for improvement, the reforms achieved some important landmarks. For instance, following internationally recognised best practice, the *Law on Investment* stated clearly, for the first time, the principle of non-discrimination, although different rules were still applicable, notably with regards to registration procedures and mostly to the detriment of "small" domestic investors. While domestic investment projects with invested capital below VND15 billion (just under USD 1 million as of December 2005), excluding project in conditional sectors, were required to apply for an "enterprise registration certificate" only, they were required to additionally (separately) apply for an "investment certificate" if they wished to obtain investment incentives as per the new law. Foreign investors, on the other hand, regardless of the projects' amount of capital invested and unless in conditional sectors, were required to apply only for an investment certificate, which also served as an ERC for the first investment project. Investments by a registered company (foreign or domestic) in a different business line from the one specified in its investment certificate also required a new investment certificate subject to the conditions mentioned above.

Despite this fairly complicated registration procedure (for both domestic and foreign investors), the law narrowed the scope of investment projects subject to investment evaluation (approval requirement). Only investment projects with capital invested of VND 300 billion or more or in conditional sectors, regardless of the amount, were required to obtain approval of the relevant authority before registration. But the list of conditional sectors was longer for foreign investment. Depending on the project characteristics, the approval was required either from the Prime Minister or the provincial/municipal People's Committee or, in case of projects in zones, the provincial/municipal Zone Management Committee.[21]

The 2005 *Law on Investment* and its implementing regulations also provided greater market access to foreign investors.[22] While the list of conditional sectors specific to foreign investment (provided for in the implementing Decree 108/2006) was relatively longer and broader than the previous existing list (established in Decree 27/2003),[23] it no longer explicitly required foreign investors to form a joint venture or business co-operation contract with a Vietnamese party to undertake business in those sectors. Nonetheless, several uncertainties surrounding the implementation of the law remained.

For instance, the new list of conditional sectors to foreign investors included any sector which was subject to conditions on market access under an international treaty, of which Viet Nam was a member – a clear reference to Viet Nam's WTO commitments. But this raised considerable uncertainty for foreign investors, as it meant that every investor would have to undertake an assessment of Viet Nam commitments under international treaties to know with some level of certainty if they applied to their case. In some sectors, this meant that the applicable regime became stricter as the equity limits committed by Viet Nam under the WTO accession were lower than previously allowed. The decree also failed to specify the nature and extent of conditions that applied under each sector. Hence, for investors it was difficult to ascertain whether the investment project was in a conditional sector and thus subject to specific approval procedures and to understand which conditions applied. In the previous Decree, the list of conditional investment stipulated at least in which sectors foreign investment was permitted only through business co-operation contracts or joint ventures with domestic investors.[24]

The 2005 *Law on Enterprises* unified the previous fragmented regime governing enterprises (the 1999 *Law on Enterprises*, the 2003 *Law on State-Owned Enterprises* and the 1996 *Law on Foreign Investment*, as amended in 2000) and provided further impetus for foreign investors by raising the cap on foreign ownership of domestic enterprises. Foreign investors were finally allowed to purchase shares without restriction up to 100% in Vietnamese companies operating in all industries and sectors, although subject to the conditions under the list of conditional sectors and other restrictions stipulated by law (*e.g*, foreign ownership of public companies was kept limited to 49%). This interpretation was not without uncertainty as neither the *Law on Investment* nor the *Law on Enterprises* and their respective implementation decrees specifically repealed Decree No 36 of 2003 regulating capital contributions and purchases of shares by foreign investors in Vietnamese enterprises. The needed clarification came only with Decree 139 of 2007,[25] which finally lifted the 30% cap on foreign ownership of domestic enterprises (Allens Arthur Robinson, 2009).[26]

As seen in Chapter 1, in the years following accession to the WTO, FDI inflows into Viet Nam boomed despite the global financial crisis. The positive expectations associated with the increased market opportunities provided by accession to the WTO, as well as the growth prospects and the increased confidence in Viet Nam's willingness to improve its investment climate resulting from the reforms, provided a fertile environment for foreign investment. FDI inflows continued to grow, particularly in manufacturing industries, driven by Viet Nam's young, relatively cheap and more technologically qualified labour force. Building also on its relative political and economic stability, Viet Nam offered an alternative and competitive location for firms wishing to diversify their manufacturing base away from China, notably for Japanese and Korean firms. The impact of growing FDI inflows has been considerable. By 2015, foreign invested enterprises were responsible for 68% of Viet Nam's exports, compared to 47% in 2000, and their share of GDP was 16% in 2014.

Notes

1. *Law on Investment* No. 67/2014/QH13 as amended by Law No. 03/2016/QH14 and the *Law on Enterprises* No. 68/2014/QH13.
2. In some cases, for instance, provincial authorities deemed a foreign invested enterprise (as per the previous regime) to be an enterprise with majority foreign ownership, while others, more typically, found even a 1% foreign ownership to be sufficient. The different applications of the law had significant implications for foreign investors' capability to invest or expand in some sectors and to which registration procedure to follow (Allen & Overy, 2014).
3. Decree No. 118/2015/ND-CP of November 12, 2015.
4. Currently, an ERC amendment requires only a simple 3 working days process in comparison to at least 15 days process under the previous framework. There has also been a great effort to simplify procedures for amendments of both IRC and ERC.
5. Decree No 118/2015/ND-CP.
6. In Viet Nam, a public company refers to companies which (i) have carried out a public offering, or (ii) have no less than 100 shareholders

and VND 10 billion of contributed charter capital or (iii) are listed in the stock market.

7. Nordås and Kim (2013); Arnold, Javorcik and Mattoo (2011); Arnold *et al*. (2012); Fernandes and Paunov (2012); Duggan, Rahardja and Varela (2013).

8. For instance, tax incentives provided in the law were restricted to only joint-ventures; wholly-owned foreign invested companies and business co-operation contracts were not entitled to incentives (van Thuyet, 1995).

9. Foreign investors in joint ventures were required to contribute at least 30% of the prescribed capital, but there was no upper limit (Art. 8, 1987 *Law on Foreign Investment*). Joint ventures, particularly with SOEs, were the preferred mode of entry both due to the incentives benefit (see previous note) and also due to the lack of clear laws and regulations on land use rights for private business. This further induced foreign investors to partner with SOEs for which land use rights were well documented, on top of the political clout of SOEs (van Thuyet, 1995). The burdensome and discretionary FDI approval procedure also induced foreign investors to partner more with SOEs, as they feared that joint ventures with domestic private investors would not be able to get all the required approvals, since these companies would be in competition with the SOEs (World Bank, 1992).

10. The approval procedure required foreign investors to provide studies of economic and technical feasibility of the project/venture, besides the charter of incorporation and other possible documents that could be required by the State Committee for Co-operation and Investment – the state body in charge of foreign investment in Viet Nam (Art. 37 of the Law No. 4-HDNN8 of December 29, 1987 – on foreign investment in Viet Nam). For the most important projects ("Group A" and "Group B"), approval was required from the Council of Ministers in addition to a review by the National Council for Project Evaluation and by the SCCI. For the less important projects ("Group C"), only the approval by the SCCI was required. But the SCCI maintained a large amount of discretion and did not provide investors with any right of appeal (World Bank, 1997). The World Bank (1997) reports that the investment approval requirement allowed the government to pursue an unstated policy, which was to steer foreign investment into joint-ventures, notably with SOEs, and to fight for greater participation of domestic parties through inflated value for land use rights. Indeed, according to reported data from the Ministry of Planning and Investment, land use rights accounted for 90% of domestic investors' capital contribution in 1995, followed by 8% in the form of building and equipment, and 2% in cash or other liquidities. Under the *Regulations on evaluation of projects with foreign owned*

capital(issued with Decision No. 366-HDBT of the Council of Ministers dated 7 November 1991) “Group A projects included: projects over USD 20 million in 'exploitation or processing of precious or rare mineral resources; telecommunications, broadcasting, television, and publishing; marine, aviation, and railway transport and, construction of sea ports, airports, railways, and national highways; production of pharmaceutical products, poisons, and explosives; real estate business, finance, and banking; projects related to defence and security; and export and import business and international tourism'; projects over USD 40 million in 'heavy industry'; projects over USD 30 million in other areas; and projects 'which require a large area of land and will significantly affect environment. […] Group B projects included: those in the specified industries of any value, those over USD 30 million in heavy industry, and others over USD 20 million” (Trai Le, 1995).

11. The export licence requirement was abolished in 1999. Since then foreign-owned firms no longer need to submit their export plans and wait for approval (Decree no. 191/CP dated 28 December 1994, the Instruction no. 11/1998/CT-TTG dated 16 March 1998).

12. The 1987 *Foreign Investment Law* introduced a regime that was relatively more favourable for foreign investors. Domestic investors were not given incentives comparable to those offered to foreign investors, and the process of investment approval for domestic investors as defined under the 1990 *Law on Private Enterprises* and *Law on Companies* was not as clearly defined as for FDI (van Thuyet, 1995). Additionally, these laws specifically determined sectors where domestic private investment was forbidden or restricted. Foreign investments, on other hand, were not explicitly subject to sector-specific equity restrictions and conditions in the foreign investment law or implementing regulations (the first list of conditioned sectors to foreign investors was issued only in 1998 despite references to it since the 1987 *Law on Foreign Investment* was issued), although restrictions were applied through the discretionary approval procedure in place. But since the law on foreign investment contained no sector-specific restrictions to foreign investment, the question was to what extent the authorisation for foreign investors would take precedence over the restrictions on domestic enterprises, or vice versa (Trai Le, 1995).

13. The 1996 Law further introduced other forms of foreign investment, notably through Build-Transfer contracts, and extended the duration period of a joint-venture or wholly-owned foreign enterprise to 50 years, extendable to 70 years, up from 20 years set previously. The 1996 Law and subsequent implementing regulations also reduced the applicable profit tax rates, besides implementing a number of other key provisions (e.g. guaranteeing the convertibility of the Vietnamese Dong and

clarifying the conditions for profit tax exemption on reinvested earnings)(World Bank, 1997).

14. The decline of FDI in Viet Nam before the Asian financial crisis is mostly due to the drop in foreign investment in the real estate sector. FDI in manufacturing only slowed down after the crisis. But one element that characterised the pre-crisis period in Viet Nam is that it attracted higher FDI than some larger Asian economies, which may suggest the presence of over-investments or catch-up investments in the years before the crisis. This may partly explain the adjustment observed before the crisis in the level of FDI and also the sharp decline and relatively slower recovery after the crisis (ADB, 2004).

15. The list was issued in 1998 within the Decree No. 10/1998/ND-CP of January 23, 1998 on a number of measures to encourage and guarantee FDI in Viet Nam. Decision 229/1998/QD-BKH further required foreign investment projects in 24 industrial products to meet a minimum export requirement of at least 80%. The list included relevant products, such as motorcycles, low and medium tension electric cables, river boats, motor boats, barges (applicable to 100% foreign-owned projects), ceramic tiles, audio and video products, NPK fertiliser, footwear, and household plastics (Phillips Fox, 1998).

16. Decree 24-2000-ND-CP dated 31 July 2000, effective as of 1 August 2000, provided for the implementation of the 2000 amendments to the Law on Foreign Investment. Among other things, it clarified the conditions for projects to be registered (instead of evaluated) for issuance of an investment licence as per the amended Foreign Investment Law. The following projects were subject to investment registration only without approval: projects that were not in Group A projects (see supra note 10); conformed with approved plan; and were not projects for which environmental impact reports were required were subject only to investment registration without approval. In addition, one of the following conditions should be satisfied (as previously required by Decree 10 and implementing legislation): projects must export all of their products; or be an investment in an industrial zone ("IZ") and satisfy the export ratio requirements stipulated by MPI from time to time; or be in the manufacturing sector with an investment capital of up to USD 5 million and with 80% or more export products. The New Regulations clarified that, where projects satisfied the conditions for registration, licensing bodies had no discretionary decision-making authority and should automatically issue investment licences to qualifying projects (Phillips Fox, 2000).

17. The amendments to the *Foreign Investment Law* introduced in 2000 also allowed foreign investment to take place through the merger or

acquisition of joint-ventures or wholly-owned foreign enterprises, and granted foreign enterprises the right to mortgage their land use rights and use them as collateral for borrowing with foreign banks. Until then, only Vietnamese banks had the statutory authority to foreclose on land and property (Brown, 2002). Foreign-invested enterprises were also allowed to purchase foreign currency from commercial banks to meet the demand of their current transactions without the requirement of a special permit from the State Bank of Vietnam. Until then, a special permit was required in the case of projects not listed as import substitute manufacturers, infrastructure projects or especially important projects (Phillips Fox, 2002b). Additionally, the amendment provided for joint venture and business co-operation contract parties to assign themselves their capital contributions without previous requirement for the approval of the relevant licensing body and also further reduced remittance taxes. Only in 2003, with the enactment of the 2003 Law on Corporate Income Tax, effective 1 January 2004, Viet Nam unified the tax regime for domestic and foreign companies. It repealed the previous tax on profits remitted overseas which were subject to a 3 to 7% tax. Moreover, it imposed a single corporate income tax rate of 28% for all business establishments, regardless of structure and ownership. Before, domestic investors were taxed at 32% under the 1997 Law on Corporate Income Tax, and foreign investors were taxed at 25% subject to the 1999 Law on Foreign Investment (UNCTAD, 2009). Following the abolishment of foreign trade licences in 1998 and the permission to domestic enterprises to trade freely commodities and other items, except those prohibited or under specialised management, foreign-invested enterprises and joint ventures were also granted in 2001 the right to export goods other than those they produced (Vo Tri, 2005; Decision No 46/2001/QD-TTg dated 4 April 2001 on controlling export and import in the 2001-2005 period).

18. Decision No. 139/1999/QD-TTg dated 10 June 1999 of the Prime Minister on Foreign Parties' Participation Rates in Viet Nam's Securities Market.

19. Decision No. 146/2003/QD-TTg dated 17 July 2003 of the Prime Minister on Foreign Parties' Participation Rates in Viet Nam's Securities Market.

20. The Prime Ministerial Decision No. 238-2005-QD-TTg dated 29 September 2005 provided for the percentage of participation of foreign parties in all listed securities in Viet Nam, replacing the previous Decision No. 146/2003/QD-TTg dated 17 July 2003 of the Prime Minister which limited foreign ownership of listed Vietnamese companies to up 30% (raised from the previous limit of 20% that applied since 2000); and the Decision 145-1999-QD-TTg dated 28 June 1999 allowed the acquisition of up to 30% of the charter capital of unlisted non-State owned enterprises

by foreign investors in a few specific sectors. List of sectors: textiles and garments; footwear manufacture; leather processing; manufacture and processing of agricultural, forestry and aquatic products; manufacture of other consumer goods; manufacture of building materials; domestic road and water transport; cargo transport by container; manufacture of study aids; manufacture of children's toys; commercial services and hotels; mechanical manufacture; manufacture of exports in above fields. In 2002, the Decision No. 260 further simplified the procedures for acquisition of domestic enterprises by replacing the previous Prime Ministerial approval requirement with a local registration procedure. It also increased the number of business lines where foreign acquisitions were permitted to 35 activities (Decision No 260/2002/QD-BKH date 10 May 2002) (Phillips Fox, 2002a).

21. Prime Ministerial approval was required for (i) all projects regardless of capital source or amount within certain specified sectors (airports and air transportation; seaports; mining and quarrying; oil exploration, production and processing; radio and TV broadcasting; casinos; cigarette manufacturing; universities; and establishment of industrial zones, export processing zones, high-tech zones and economic zones); (ii) projects regardless of capital source over VND1 500 billion in specific sectors (electricity; mineral processing; metallurgy; construction of railways, roads and internal waterways infrastructure; alcohol production and trading); and (iii) projects with foreign invested capital regardless of the amount in certain sectors (maritime transport; post, delivery, telecommunications and internet networks; printing and distribution of newspapers and other printed media; publishing; and independent scientific research establishment). All other projects required either the approval from the provincial/municipal People's Committee or, in case of projects in zones, the provincial/municipal Zone Management Committee. The new law, however, failed to provide investors with clarity over the approval procedures since the criteria for approval was only stated in general. Further clarifications in this regard came only with the related implementing regulations.

22. The 2005 *Law on Investment* also provided for the list of sectors where investment (both domestic and foreign) was conditional. Previously, such list was set by government decrees, which made any amendment easier. With the passing of the law, further amendments to list were subject to approval by the National Assembly. Besides, the lack of precise definitions remained a concern. The stipulated sectors were: (a) Sectors impacting on national defence and security, social order and safety; (b) Banking and finance sector; (c) Sectors impacting on public health; (d) Culture, information, the press and publishing; (e) Entertainment services; (f) Real estate business; (g) Survey, prospecting, exploration and mining

of natural resources; the ecological environment; (h) Development of education and training; (i) A number of other sectors in accordance with law. For foreign investors, the list of sectors was extended to include any sector which is subject to conditions on market access under an international treaty of which Viet Nam is a member.

23. The failure to specify in the new law all the sectors in which investment was conditional was an issue of concern for investors (Phillips Fox, 2006). Some clarity came only with the implementing Decree 108-2006-ND-CP of the Government (22/09/2006), which provided for the sectors in which foreign investment was conditional. These included: radio and TV broadcasting; production, publishing and distribution of cultural products; exploration and exploitation of minerals; establishment of infrastructure for telecommunications networks; transmission and provision of internet and telecommunication services; public postal networks and provision of postal and express delivery services; constructions and operation of river ports, seaports, terminals and airports; transport of goods and passengers by railway, air, road, sea and inland waterways; aquaculture and tobacco production; real estate business; import, export and distribution business; education and training; hospital and clinics; and other investment sectors for which Viet Nam has committed to market-opening conditions under international treaties.

24. Decree 27/2003/ND-CP of March 19, 2003 amending and supplementing a number of articles of the government's Decree 24/2000/ND-CP of 31 July 2000 detailing the Implementation of the Law on Foreign Investment in Viet Nam.

25. Decree No. 139/2007/ND-CP (Decree 139) on the 2005 Enterprise Law and 2005 Investment Law.

26. Until the 2005 *Foreign Investment Law* and 2005 *Enterprise Law*, foreign ownership in listed companies was restricted to 30% of the charter capital and foreign ownership of unlisted companies operating in 35 specific business sectors was also restricted to 30% by both Decision No. 146/2003/QD-TTg of 17 July 2003 of the Prime Minister and Decision 260 of the Ministry of Planning and Investment of 10 May 2003, respectively. The new laws replaced these but without any implementation guidance.

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Annex 2.1

Main legislation covering foreign investment in Viet Nam

Table A2.1 **Main FDI restrictions under the WTO Accession Agreement and the 2014 Law on Investment**

(as of June 2016)

Restricted sectors	Foreign ownership restriction	Screening and approval	Restriction on key foreign personnel	Other operational restrictions
Horizontal restrictions	The restriction on foreign acquisition of public companies in Viet Nam, which was capped at 49%, was lifted in 2015. Foreign investors are now allowed to acquire 100% shareholding of Vietnamese public companies, although still subject to certain conditions in some cases.	Foreign investors (regardless of foreign ownership levels) are subject to a discriminatory "in-Principal Approval" by the Prime Minister in the following sectors: maritime transport; telecommunications services with network infrastructure; afforestation; publication and press; and establishment of scientific and technological organisation or enterprise with 100% foreign-owned capital.	At least 20% of the total number of managers, executives and specialists shall be Vietnamese nationals. However, a minimum of 3 non-Vietnamese managers, executives and specialists shall be permitted per enterprise.	According to the Constitution, all land is owned by the people and administered by the state on their behalf. There is no private ownership of land. Until July 2014, only Vietnamese individuals or companies could be granted a land use right (LUR) in the form of allocated land (freehold right). Foreign-invested enterprise could only obtain a freehold right if in association (joint venture) with a local partner. Otherwise, a FIE was only allowed to obtain a leasehold right for the duration of the investment project, with rent paid on a lump-sum payment or an annual rent. Since July 2014, the aforementioned discriminatory treatment was removed. Henceforth, both FIEs and domestic investors are allowed to obtain freehold rights for residential land, and leasehold rights for commercial and residential land for lease (not for sale). Since 2015, a FIE is also allowed to purchase constructed real estate for business purposes on a freehold basis

Sector-specific restriction	Foreign ownership restriction	Other operational restrictions
Agriculture & Forestry	Services incidental to agriculture, hunting and forestry: Only in the form of joint-venture or business co-operation contract. Foreign capital contribution may not exceed 51% of the legal capital of the joint venture.	
Distribution (wholesale and retail)	A joint venture with a local partner(s) is required, and foreign capital contribution shall not exceed 49%. As of 1 January 2008, the 49% capital limitation shall be abolished. As of 1 January 2009, wholly-owned FIEs are allowed. FIEs remain prohibited from obtaining distribution rights in certain products for which Viet Nam made no commitment upon accession.[1]	The establishment of retail outlets (beyond the first one) is allowed on the basis of an economic needs test.
Transport (maritime)	Passenger and freight transport, excluding cabotage: (a) Establishment of registered companies for the purpose of operating a fleet under the national flag of Viet Nam: After 2 years from the date of accession, foreign service suppliers are permitted to establish joint ventures with foreign capital contribution not exceeding 49% of total legal capital. (b) Internal Waterways Transport, Passenger and freight transport: Upon accession, foreign service suppliers are permitted to provide services only through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeding 49% of total legal capital. (c) Maritime Auxiliary Services: (i) Container handling services: upon accession joint ventures with foreign capital contribution not exceeding 50% can be established; (ii) Customs Clearance and Container Station and Depot services: upon accession joint ventures with foreign capital contribution not exceeding 51% can be established. After 5 years, joint ventures can be established with no foreign ownership limitation. Decree No 140/2007/ND-CP of September 5, 2007, also provides for conditions on foreign participation in maritime and internal waterways transport services, and related auxiliary services.	
Transport (surface)	(a) Rail Transport Services, passenger and freight: Foreign suppliers are permitted to provide freight transport services through the establishment of joint ventures with Vietnamese partners in which the capital contribution of foreign side not exceeds 49% of the total legal capital. (b) Road Transport Services, passenger and freight: Upon accession, foreign service suppliers are permitted to provide passenger and freight transport services through business cooperation contracts or joint ventures with the capital contribution of foreign side not exceeding 49%. After 3 years from the date of accession, subject to the needs of the market, joint-ventures with foreign capital contribution not exceeding 51% may be established to provide freight transport services. Decree No 140/2007/ND-CP of September 5, 2007, also provides for conditions on foreign participation in road and rail transport services, and related services.	
Transport (air)	Viet Nam made no opening commitments in air transport services upon accession to the WTO. Restrictions apply according to the domestic legislation. Decree of the Government No. 76/2007/ND-CP of May 9, 2007, on air transport business and general aviation establishes that the foreign party in foreign-invested enterprises conducting air transportation and general aviation business shall not own more than 49% of the charter capital, or one individual or legal	

	entity shall not own more than 30% of the charter capital, and not more than 1/3 of the members of the executive apparatus (e.g. director and deputy directors, chief accountant and other members of the executive directorate) shall be foreigners. WTO commitments were made only with regards to: Maintenance and repair of aircraft Upon accession, joint-ventures are permitted with the capital contribution of foreign side not exceeding 51%. After 5 years from the date of accession, 100% foreign invested enterprises shall be allowed.
Banking	As per Decree No 01/2014/ND-CP, the acquisition of Vietnamese Banks remains limited to a 30% total foreign ownership cap. But, subject to approval by the Prime Minister, this limit can be lifted for the purposes of restructuring weak credit institutions and ensuring the stability of the credit institutions system.
Travel agencies & tour operators	Foreign service suppliers are permitted to provide services in the form of joint ventures with Vietnamese partners with no limitation on foreign capital contribution.
Telecommunication	(a) Non facilities-based services: Upon accession joint ventures with telecommunications service suppliers duly licensed in Viet Nam will be allowed. Foreign capital contribution shall not exceed 51% of legal capital of the joint ventures. Three years after accession: joint venture will be allowed without limitation on choice of partner. Foreign capital contribution shall not exceed 65% of legal capital of the joint ventures. (b) Facilities-based services: Upon accession, joint venture with telecommunications service suppliers duly licensed in Viet Nam will be allowed. Foreign capital contribution shall not exceed 49% of legal capital of the joint ventures.
Media (radio & TV broadcasting, and other media)	(a) Audiovisual Services, Motion picture production, distribution and project services: Only in the forms of business cooperation contracts or joint ventures with Vietnamese partners who are authorized to provide these services in Viet Nam. Foreign capital contribution may not exceed 51% of the legal capital of the joint venture. Viet Nam made no opening commitments on radio and television broadcasting upon accession to the WTO. According to the authorities, no specific investment condition is applicable to foreign investors.
Real estate Investment	Since July 2014, FIEs and domestic investors are treated equally with regard to land access: they are allowed to obtain freehold rights for residential land for construction purposes (for both lease and sale of residential units), and leasehold rights for construction on commercial land and residential land (only for leasing residential units in this case; not for their sale). Since 2015 FIEs are allowed to acquire (on a freehold basis) built residential property for own use or investment purposes, subject to not owning more than 30% of units in a condominium or 250 separate units in in an area whose population is equivalent to a ward-administrative division. FIEs are also allowed to acquire built real estate for business purposes (e.g. offices, factories). The acquisition (on a freehold basis) of built real estate other than residential units as an investment activity for lease or sale is not allowed, but renting them for sublease or constructing commercial and residential property for lease or sale are possible.

Source: WTO Schedule of Commitments on Services and 2014 Law on Investment.

Table A2.2. **Main FDI liberalisation measures, 1987-2014**

Date	Legal authority	Main liberalisation measures
1987	Law 04-HDNN of 29 December 1987, on Foreign Investment in Viet Nam	Fully foreign-owned subsidiaries allowed, but several sectors still subject to conditions, notably joint-venture requirements with foreign minority ownership. Foreign investment projects were subject to an approval procedure
1990	Law on Amendment and Addition of a Number of Articles of the Law on Foreign Investment, 30 June 1990 Decree 28-HDBT of the Council of Ministers, dated 6 February 1991 Law on Private Enterprises and Law on Companies, 21 October 1990	Clarified the conditions for operation and management of joint-ventures between foreign and domestic investors Established the legal framework for the establishment of the private sector. Recognised the right of citizens and entities to establish private enterprises and provided for the establishment of limited liability companies and joint stock companies
1992	Constitution of the Socialist Republic of Vietnam	Foreign investors right to ownership of capital, property, and other interests, were enshrined in the Constitution
1993	Law on Amendment And Addition of a Number of Articles of the Law on Foreign Investment 23 Dec. 1992 Decree No. 18-CP of the Government, dated 16 April 1993, providing regulations on Foreign Investment in Viet Nam	Further clarified that Vietnamese private parties from any economic sector were allowed to enter into joint-ventures and business co-operation contracts with foreign investors; allowed foreign investment to take place through build-operate-transfer arrangements and also provided for investments in export processing zones; lowered the tax on repatriation of profits; allowed wholly-owned foreign investors to obtain land use rights (until then only joint-ventures)
1993	Law on Land, dated 14 July 1993	Land transfer restrictions were lifted to allow other market entry forms (including wholly-owned foreign investment) to acquire land use rights
1996-1997	Law on Foreign Investment Decree No 12-CP of the Government, dated February 18, 1997, stipulating in detail the implementation of the Law on Foreign Investment in Viet Nam	Streamlined and decentralised the FDI approval procedure for specific projects to Provincial Committees; introduced other forms of foreign investment, notably through Build-Transfer and Build-Transfer-Operate contracts; extended the lifetime of a joint-venture or wholly-owned foreign enterprise to 50 years, extendable to 70 years, up from 20 years set previously; and reduced the applicable profit tax rates and guaranteed the convertibility of the Vietnamese Dong
1998	Decree No. 10/1998/ND-CP of 28/01/1998 on a number of measures to encourage and guarantee FDI activities. Law No. 03/1998/QH10 of May 20, 1998, on	In 1998, the first list of sectors closed to foreign investment and those where investment was conditional (mostly subject to joint-venture requirements and export requirements) was issued

	domestic investment promotion (amended)	The amended Law on the Promotion of Domestic Investment allowed foreign investors to purchase up to a 30% stake in certain types of Vietnamese enterprises, albeit subject to Prime Ministerial approval on a case-by-case basis
1999	Decision No. 145-1999-QD-TTg of the Prime Minister, dated 28 June 1999 Decision No. 59-1999-QD-BTC of the Ministry of Finance, dated 26 May 1999	Allowed the acquisition of up to 30% of the charter capital of unlisted non-state owned enterprises by foreign investors in a few specific sectors; abolished the fee for consideration of an investment application by foreign investors (in place since 1989); and removed the requirement for approval of export plans of foreign invested enterprises
2000	Law No. 18-2000-QH10, dated 9 June 2000, on Amendments of Additions to a Number of Articles of the Law on Foreign Investment in Viet Nam Decree No. 24/2000/ND-CP of the Government, dated 31 July 2000	Allowed foreign investment to take place through the merger or acquisition of joint-ventures or wholly-owned foreign enterprises; granted foreign enterprises the right to mortgage their land use rights and use them as collateral for borrowing with foreign banks; reduced remittance taxes further; allowed joint venture and business co-operation contract parties to assign themselves their capital contributions without approval by the licensing body; narrowed the scope of application of investment approval procedures. Subject to certain conditions, foreign investment projects were exempted from the approval requirement in place for obtaining an investment license. Foreign invested enterprises were allowed to purchase foreign currency for their current transactions without a special SBV permit
2002	Decision No 260/2002/QD-BKH date 10 May 2002	Simplified the procedures for acquisition of domestic enterprises by replacing the previous Prime Ministerial approval requirement by a local registration procedure; increased number of business lines where foreign acquisitions were permitted to 35 activities
2003	Decision No. 146-2003-QD-TTg of the Prime Minister, 17 July 2003 Decision No. 36-2003-QD-TTg of the Prime Minister, 11 March 2003 Law on Corporate Income tax, dated 17 June 2003 Decree no. 27-2003-ND-CP of the Government, 13 March 2003	Raised foreign ownership limits of listed companies in Viet Nam to 30% (up from 20% applied since 2000); unified the tax regime for domestic and foreign companies, and eliminated the previous profit remittance tax; streamlined registration for investment licensing, and clarified that, where a project satisfies the conditions for registration, the investment licensing body must issue the license without obtaining recommendations from any other body. A new list of conditional sectors to foreign investors was extended to include also press, radio and television sectors

2005	Law No. 59-2005-QH11 on Investment, 29 November 2005 Law No. 60-2005-QH11 on Enterprises, 29 November 2005 Decision No. 238-2005-QD-TTg of the Prime Minister, 29/09/2005	Unified the regime for domestic and foreign investors; revised the approval requirement for foreign investments, further narrowing its scope; allowed foreign investors to purchase shares without restrictions in unlisted Vietnamese companies operating in all industries and sectors, although subject to certain conditions; raised the limit for foreign ownership of listed companies to 49%
2009	Decision No. 88-2009-QD-TTg of the Prime Minister, dated 18 June 2009	Clarified foreign investors' right to contribute capital or purchase shares of a Vietnamese company at unrestricted levels, in accordance with the 2005 Law on Investment and 2005 Law on Enterprise, except in the acquisition of Vietnamese listed companies (limited to 49%) and when otherwise specified in international treaties and sector-specific laws
2014	Law No. 67/2014/QH13 on Investment of the National Assembly, 26/11/ 2014 Law No. 68/2014/QH13 on Enterprises of the National Assembly, 26/11/ 2014 Law No. 66/2014/QH13 on Real Estate Business of the National Assembly, dated 25 November 2014 Law No. 65/2014/QH13 on Housing of the National Assembly, dated	Clarified the definition of foreign investor Narrowed the scope of application of investment registration and approval procedures Narrowed the number of prohibited sectors and the number of business sectors subject to investment conditions Allowed foreign invested enterprises to own land use rights. Previously they could only lease land use rights for up to 50 years (70 years under specific circumstances). As such, they can acquire real estate for business purposes. Foreign real estate investors/developers can build residential and commercial real estate for selling in addition to leasing as per previous legislation. The acquisition of real estate other than houses for lease or selling is not allowed, but renting building for sublease is possible Allowed foreign invested enterprises (and individuals permitted to enter Viet Nam) to own houses for a period equal to their investment registration certificate term. Previously only a limited category of foreign entities and individuals could be owners of a house. They are allowed to own not more than 30% of units in a condominium or 250 separate units in in an area whose population is equivalent to a ward-administrative division.
2015	Decree No. 60/2015/ND-CP of the Government, dated 26 June 2015	Lifted the 49% foreign shareholding limit in Vietnamese public companies

Chapter 3

The legal framework for investment in Viet Nam

This chapter provides an overview of Viet Nam's legal framework for investment. It examines the quality of the country's investment policies and the level of legal protection granted to both domestic and international investors. Particular attention is given to the new Investment Law enacted in 2015. The chapter looks into the rules for expropriation, contract enforcement and dispute settlement as well as the regimes for intellectual property rights and for access to land. It also reviews Viet Nam's international investment treaty practice, including its relation with ASEAN practice and its legal framework for investor-state dispute settlement.

The significant economic reforms undertaken by Viet Nam over the past three decades have been coupled with numerous, successive regulatory reforms, from the 1987 *Law on Foreign Investment* to the recently enacted laws on enterprises and investment. These gradual improvements have brought Viet Nam's legal investment framework closer to the level of the most advanced economies across Southeast Asia. As a result, the investment framework has gradually improved over time: registration procedures, tax policies, rights to transfer capital and foreign exchange abroad and access to land have been progressively relaxed, while the investment environment has gradually been brought more in line with Viet Nam's international commitments (ASEAN in 1995, and WTO in 2007).

In 2005, a significant milestone was achieved with the introduction of the unified law on investment. The *Investment Law* came into force together with a new *Enterprise Law* and an *Intellectual Property Rights Act*. In 2013-15, the government revised various laws fundamental to the investment climate, such as the *Enterprise Law*, the *Investment Law,* the *Housing Law*, the *Real Estate Business Law* and the *Land Law*. The new *Investment Law* draws on the reform initiated in the 2001 *Enterprise Law* and moves further away from the previous "positive list" approach to a "negative list". It also abrogates the evaluation procedure and provides for a single registration process. These various amendments have played a significant role in Viet Nam's efforts to fully integrate the ASEAN Economic Community (AEC).

The wave of legislative reforms has been a very positive step – widely praised by the business community – but further efforts could help Viet Nam to become a top investment destination. Despite well-drafted laws, the legal environment still suffers from a lack of predictability, as delays in adopting implementing decrees has caused confusion among the business community and hence has had a deleterious – although perhaps only temporary – effect on the investment climate. The application of regulations is also sometimes hampered by inconsistent administrative practices, notably at provincial level. Likewise, a more uniform and harmonised implementation of these regulations across the country would greatly enhance the enabling environment for investment.

International investors in Viet Nam tend to favour alternative dispute resolution means over domestic courts to settle their business disputes. Commercial arbitration has thus become the most common way of settling business disputes, such as the Viet Nam International Arbitration Centre. There seems to be a widely shared perception within the business community that the difficulty – too often encountered – of having foreign arbitral awards recognised and enforced by domestic courts, is one of the most stringent impediments to an enabling investment climate in Viet Nam.

While private ownership of land is still not permitted in Viet Nam, restrictions on access to land have been progressively relaxed. The new *Land Law*, , enacted in 2013 and in force since 2014, was a significant milestone towards further opening access to land for foreign investors. As for the protection of intellectual property (IP) rights, there is a strong awareness, at the highest level of government, of the immediate stakes of having a robust IP policy. Substantial improvements to better protect IP have been made over the past two decades at policy and legislative levels, but enforcement of IP regulations still needs to be further strengthened.

Viet Nam is a contracting party to 66 bilateral investment treaties and an increasing number of multilateral trade and investment agreements. With TPP and the Viet Nam-EU FTA, the country has recently concluded two major and high-profile treaties, placing it at the centre of international investment policy making. Viet Nam's investment treaties typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to investor-state dispute settlement (ISDS) mechanisms to enforce those provisions. Increasingly, the treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment. The conclusion of the FTA with the EU makes Viet Nam the first country to agree to the Investment Court System proposed by the European Union which constitutes an important departure from other ISDS mechanisms found in Viet Nam's treaties, all largely inspired by commercial arbitration.

The review of the substantive provisions in Vietnamese investment treaties shows that the language of key treaty provisions has evolved, particularly since the advent of the new regional ASEAN treaty policy in 2009. In recent treaties, Viet Nam has specified the meaning of key treaty provisions, such as on indirection expropriation and fair and equitable treatment, to clarify government intent. These clarifications can be an important tool in the quest for balance between investor protection and governments' right to regulate. Overall, investment treaties appear to be an important element in Viet Nam's efforts to create an attractive investment climate. Recently concluded treaties suggest that Viet Nam is actively managing its treaty policy, which will help the country to integrate its treaties into its broader economic development objectives.

Policy recommendations

- While Vietnamese laws are often well-drafted, the implementation of legislation sometimes proves to be difficult. For legal security purposes, the authorities would need to ensure that the enactment of new laws is promptly followed by implementing regulations. Likewise, the application of laws and regulations should be harmonised, so as to ensure consistency of rules and administrative practices from a province to another.

- The enforcement of foreign arbitral awards by domestic courts should be made easier, in accordance to the provisions of the New York Convention to which Viet Nam is a party. Giving access to dispute resolution mechanisms, including arbitration, with the guarantees that awards will easily be enforced is key to creating a strong and enabling business climate.

- Viet Nam's legal instruments – its laws, but also its investment treaties – provide different levels of protection to specific groups of investors, not only between domestic and foreign investors but also among different groups of foreign investors because of differences in the treaty provisions under which they are covered. Viet Nam might wish to ensure that offering different levels of protection to specific investors is justified by a need to provide extra incentives for their investment.

- Many Vietnamese investment treaties only protect investors once they have invested, *i.e.* post-establishment. Viet Nam could consider strengthening the use of investment treaties to facilitate new investments by extending the coverage of certain clauses to the pre-establishment phase.

The domestic framework for investment regulation and protection

Major regulatory improvements have been achieved over the past 30 years

Viet Nam has undergone an economic upheaval at an unprecedented pace over the past three decades as part of *Doi Moi*. Economic reform efforts have been coupled with many, successive regulatory reforms, from the 1987 *Law on Foreign Investment* to the recently enacted laws on enterprises and investment. These gradual improvements have brought Viet Nam's legal investment framework closer to the level of the most advanced ones across the ASEAN region, as shown in Table 3.1.

Longstanding and sustained efforts to modernise the legal framework have resulted in a fairly robust *de jure* investment framework, which has reinforced Viet Nam's position as a country that is, by and large, perceived as a safe and attractive investment destination. These progressive improvements, together with reforms to gradually liberalise FDI restrictions, have resulted in a much greater foreign participation in the economy and integration into the global economy, while accession to ASEAN and to the WTO has in turn further accelerated the pace of legislative improvements.

More recently, Viet Nam has continued to take concrete steps to improve its business climate and to attract more FDI. There is a strong political will to further advance in this direction, as shown by the 2015 Prime Minister's resolution to improve the business environment and the competitiveness of Viet Nam and to bring Vietnamese regulation further in line with ASEAN standards. In 2014-15, the government revised various laws fundamental to the investment climate, such as the *Enterprise Law*, the *Investment Law*, the *Housing Law*, the *Real Estate Business Law* and the *Land Law*. These amendments, some of which have undoubtedly contributed to substantially improving the business environment, have also played a significant role in Viet Nam's efforts to fully integrate the AEC.

Yet, substantial challenges persist and there is still some way to go to fully achieve an enabling legal infrastructure for investment. Despite well-drafted laws, the legal environment still lacks predictability. The implementation of the newly enacted laws has been challenged by delays in adopting the implementing decrees, which caused confusion among the business community and had deleterious – although perhaps only temporary – effects on the investment climate. The application of regulations is also hampered by uneven, and sometimes corrupt, administrative practices, notably at provincial levels. While the wave of reforms of economic legislation is a very positive step towards Viet Nam's global integration and, as such, has been widely praised by the business community, further efforts are needed to create the conditions as a top investment destination.

The main liberalisation measures taken over the past 30 years are described in Chapter 2. This chapter will focus on legal guarantees and property rights provided to domestic and foreign investors followed by a review of legal guarantees in international agreements to which Viet Nam is a party. It will seek to identify the main improvements brought about by successive reforms as well as areas where further progress remains to be done.

Successive legal amendments have paved the way for a safe and open legal environment

Successive reforms have allowed the country to evolve away from a centrally planned economy and towards a market-based one, with strong guarantees that investors' rights will be protected. The first major legislative change in this direction was the enactment of the 1987 *Law on Foreign Investment*, which repealed an earlier 1977 version by virtue of which the state formerly had maintained 51% of ownership of all businesses. The new

Law on Foreign Investment was a first milestone in the progressive opening to foreign investment by prohibiting nationalisation, allowing foreign investors to operate via joint ventures and providing for a principle of freedom of investment for foreign investors, albeit limited by an extensive list of restricted sectors. This partial opening was nevertheless circumscribed by a number of conditions not always evenly applied.

The government's strong commitment to *Doi Moi* was further solidified and reaffirmed in a new constitution adopted in April 1992 which officially recognised the role of the private sector. The economic chapter affirmed its willingness to increase the inflow of foreign investment and specifically encouraged foreign organisations and individuals to invest capital and technology in Viet Nam (Article 25). In return, it promised to "guarantee the right of ownership of the legitimate capital, property and other interests of foreign organisations and individuals". It specified issues concerning the introduction of a market economy, proprietary rights and private enterprises, long-term land use rights and joint enterprises with foreign investors. In 1990, the *Law on Private Enterprises* and *Law on Companies* further established a liberal corporate regime.

The investment framework has gradually improved over the years: registration procedures, tax policies, rights to transfer capital and foreign exchange abroad and access to land have been progressively relaxed, while the investment environment has gradually been brought closer to Viet Nam's international commitments (ASEAN in 1995, and WTO in 2007). The authorities have made major adjustments towards further transparency and stronger protection for foreign investors. The 1987 law was amended four times in 15 years, including twice in the first five years. The revisions were intended to progressively strengthen investor rights, create a more investor friendly environment and narrow the policy gap between foreign and domestic investors. These gradual and iterative reforms of the legal framework brought new waves of FDI into the country.

In spite of these impressive reform efforts, the legal modernisation process has not been all smooth sailing, with successive investment laws that have had varying degrees of success in strengthening and modernising the legal framework for investment. Despite widely acknowledged improvements brought about by each new version of the investment law, delays in adopting implementing regulations tend to create some uncertainty, upon which the private sector has often expressed its concerns, notably with regards to the scope of application of restricted sectors.

Viet Nam's legal framework for investment protection in a regional context

Table 3.1 compares Viet Nam with its ASEAN peers in terms of where they stand in introducing what are considered to be the key pillars of a healthy investment regulatory climate. First, it looks at the successive legal amendments undertaken by ASEAN member states and identifies which countries have enacted a single law covering both domestic and foreign investment, which was achieved by Viet Nam in 2005. It also compares the core protection provisions for investors, and looks at whether countries have adopted a positive or a negative list approach to the entry of foreign investment. The table also considers the availability of arbitration, as well as adherence to international investment treaties. It thus helps to pinpoint where Viet Nam positions itself compared to its neighbours, and what are the areas that need to be further improved to bring the country closer to the standards set in ASEAN instruments.

The 2005 Investment Law added significant investor protections

The introduction of the unified law on investment in 2005, which merged the regimes for foreign and domestic investment into one single regulatory framework governing all investment activities, was a significant milestone. The *Investment Law* came into force together with a new *Enterprise Law* which unified the treatment of public and private firms and an *Intellectual Property Rights Act*. The clarity and coherence of the laws, regulations and administrative practices associated with investment were thereby substantially improved. Prior to this reform, investment activities were governed by the *Enterprise Law* (1999), *State-Owned Enterprise Law*, *Law on Domestic Investment Facilitation* and the *Law on Foreign Investment*. Other sector-specific laws also contained provisions for foreign investments, resulting in a scattered and unclear regime for investment, unable to create a common playing-field for all investors.

Investment guarantees were considerably improved with the 2005 *Investment Law* which introduced a legal stabilisation clause to protect investors against adverse effects of regulatory changes, recognised intellectual property rights, and ensured consistent prices, fees and taxes for all investors. This major revamping of the regulatory infrastructure created a more uniform and coherent legal framework and had a positive impact on the amount of registered FDI.

Table 3.1. **Comparison of ASEAN members' investment frameworks**

	BRN	KHM	LAO	IDN	MYS	MMR		PHL	SGP	THA	VNM
Existence of a single investment law covering domestic and foreign investments	No, but 2001 Investment Incentives Law	Yes	Yes	Yes	No	2 separate laws for domestic and foreign investments		2 inv. laws	No	2 inv. laws	Yes
Recent amendments of the Investment legislation		Ongoing	Ongoing	2007		2012, 2013, 2015		1987, 1991		2000	2005 - 14
Provision on distributional effects of investment : environmental impact, sustainable economic development, etc.	No	No	Yes	Yes	No	Yes			No		
Guarantee of non-discrimination at post-establishment stage enshrined in domestic legislation	No	Yes, except for land	Yes	Yes	No	No		Yes	Yes	No	Yes
Negative list approach	/	/	/	Yes	/	Yes, but inadequate		Yes	/	Yes	Yes, but still not clear
Protection against expropriation	Yes, but not specific to investors	Yes, but incomplete	Yes	Yes	Yes	Yes, but incomplete		Yes	Yes	Yes, but incom-plete	Yes
Guarantee of free transfer of funds provided by law	Yes	Yes	Yes	Yes	Yes	Yes		Yes	Yes	Yes	Yes
Possibility to recourse to investment arbitration provided by law	Yes	Yes	No	Yes	Yes	Yes, but unclear		Yes	Yes	Yes	Yes
Adherence to international conventions on arbitration (ICSID Convention, & New York Convention)	Yes	Yes	Not ICSID member	Yes	Yes	Not ICSID member	Adhered to NY Conven-tion in 2013	Yes	Yes	ICSID Conv. signed but not yet ratified	Not an ICSID mem-ber
Adherence to International Investment treaties (incl. BITs, FTAs)	Yes	Yes	Yes	Yes	Yes	Yes		Yes	Yes	Yes	Yes

With this key reform, Viet Nam made a major step towards achieving a progressive harmonisation of the regimes for foreign and domestic investments, as set by the successive ASEAN agreements. This stance laid the foundations for the application of a general principle of non-discrimination, which is one of the pillars of the ASEAN Comprehensive Investment Agreement. Yet, the objective of attaching both domestic and foreign companies into a single system was not fully achieved, as foreign investors faced restrictions in many sectors and still have to go through a two-tier registration system to start new business operations in Viet Nam.

The 2005 law has recently been replaced by a new law on investment, passed by the National Assembly in November 2014 which came into force in 2015, aimed at streamlining the entry and registration of foreign investment. The new law shows the recent renewed political impetus within the Foreign Investment Agency of the Ministry of Planning and Investment and has emerged from a widely consultative process.

The new Investment Law

While the 2005 *Investment Law* represented a major improvement in Viet Nam's legislation for investment, the 2014 *Investment Law* is likely to have a more modest impact with regards to the legal protection of investment. Among the recent legal amendments that have been introduced, the 2013 *Land Law* and the 2014 *Real Estate Law* will possibly bring more significant improvements to the regulatory environment for investment. The *Enterprise Law* significantly simplifies and shortens registration procedures for companies (Chapter 2) and strongly improves the regulatory environment for corporate governance (Chapter 4).

As described earlier, the new *Investment Law* moves away from the previous "positive list" approach to a "negative list". It also abrogates the evaluation procedure and provides for a single registration process. Provided that the remaining loopholes are clarified, it will eventually simplify the procedures for issuing investment certificates. Yet, the new law still leaves some questions unanswered, notably with respect to its implementation. With delays in the adoption of some of the implementing decrees, it is difficult to ensure that the commitment to apply consistently all related laws and regulations (Article 4) will be implemented in practice.

Concerns have been expressed, among members of the legal community consulted by the OECD team, as to the degree of uncertainty surrounding the timeframe for implementing the two laws. Pending the introduction of implementing decrees, some of which, but not all, had been issued in January 2016, there is no clear guidance for the interaction across all laws and regulations that apply to the operations of domestic and foreign investors. The legal loopholes created by delays in adopting the implementing decrees, notably on PPPs and on conditional sectors, and the widely shared perception of a lack of visibility with regards to the upcoming implementing decrees have impeded the potential improvements that could have been brought about with the recent enactment. The conditions applying to the lists of restricted investment are still unclear, which could have a deterrent effect on prospective investors. Clarity and predictability of the regulatory environment are key to attracting investment, and the authorities should give priority to reassuring the business community by having a more predictable and co-ordinated regulatory agenda.

The law-making process is gradually improving

The Department of Legal Affairs of the MPI is the leading authority for designing investment legislation and negotiating treaties. The mandate of MPI also includes bringing together line ministries and other relevant government agencies in order to ensure full involvement of all relevant bodies in the law-making process. Likewise, the Policy Division of FIA is the reference authority for collecting private sector feedback on implementing investment regulations and on ways to improve the business regulatory environment, although it did not appear to be actively involved in drafting the new law. In parallel, the International Law Department of the Ministry of Justice ensures the coherence of draft laws with legislation already in force, as well as of treaties under negotiation.

MPI collected comments on successive drafts of the law, to ensure that views from a wide range of stakeholders, including both civil society and the business community, were fully taken on board. Stakeholders and observers acknowledge MPI’s success in undertaking an inclusive stakeholder consultation, which has played a prominent role in the current impetus for reform. The Viet Nam Business Forum was central in driving this process. It has become, over the past ten years, the most important policy dialogue forum between the public and private sectors where ministries can comment on on-going changes, anticipate regulatory frameworks associated with economic activities and in turn, listen to ideas from representatives of the private sector (See Chapter 6 on Investment Promotion and Facilitation). Such dialogues help ensure transparency of the laws and regulations and avoid overlaps and conflicts in the business legal environment. Greater participation of stakeholders in policy design and implementation has been seen to lead to better targeted and more effective policies. Experience from many countries, and Viet Nam is no exception, shows that soliciting investors views, when revising investment policies, contributes to policy effectiveness.

The Ministry has also been very active in disseminating information about the new law, including 36 capacity-building workshops to raise awareness and ensure consistent interpretation of the new legal provisions at provincial level. But the lack of co-ordination across various departments of the MPI, with other line ministries, and between central and provincial levels has been pointed out by observers as a major impediment to a more open, coherent and inclusive law design process. Inter-governmental co-ordination is a key prerequisite to sound investment policy making. On the admission of the MPI itself, institutional co-ordination in designing the new investment law and its implementing regulations has been insufficient, which may slow the pace of reform and its implementation. Experience from other countries shows that the full engagement of all parties, be they from the government or the private sector, is key to ensuring that policies and laws better match the needs and expectations of citizens and businesses. The new legislation is also more likely to be implemented in a consistent and effective manner if it is formed in a structured and transparent way that gathers inputs from all interested parties.

Implementation is a major obstacle to the legal environment for investment

The lack of clarity as to the scope of application of various regulations pertaining to investment is widely acknowledged, particularly of the decree setting out the list of restricted and closed sectors. This weakness was highlighted in the first OECD *Investment Policy Review of Vietnam*: "A thoroughly unequivocal and effective mechanism is still not in place to ensure the transparency of existing discriminatory restrictions on international investment and to review periodically the cost-effectiveness of such discrimination" (OECD, 2009). An English version of the list of restricted sectors is currently under preparation by MPI.

The legal regime also suffers, at the implementation phase, from overlapping and conflicting views, practices and procedures across levels of government, particularly between national and provincial levels. This creates additional administrative burdens for investors and increases the scope for corruption. There seems to be a widely shared perception, among the business community as well as public servants, of a capacity gap across provincial investment agencies, which not only channels investors to provinces endowed with better-functioning administrations, but might also promote corrupt practices in provinces with less capacity. Due to such challenges, the interpretation and application of investment regulations tend to vary greatly from a provincial authority to another.

More broadly speaking, OECD country experience tends to suggest that some central co-ordination is essential for successful regulatory governance.

While Viet Nam has made great efforts to ensure that the formulation of investment policies and regulations is centralised, a more even and harmonised implementation of these regulations nationwide would greatly enhance the enabling environment for investment.

The enactment of the 2014 *Investment Law* has not been promptly followed by the adoption of the implementing decrees. As a result of the lack of co-ordination described above, delays in passing implementing decrees that complete and substantiate legislative reforms sometimes occur in Viet Nam. This situation reinforces the perceived uncertainty among investors about the enforceability of their legal rights and obligations. The confusion over the scope of application of the negative lists attached to the *Investment Law* (see sections above) could increase the cost of capital, thereby reducing investment in Viet Nam and weakening the competitiveness of already-established firms. An unpredictable legal regime can also foster corruption: investors might be more likely to seek to protect or advance their interests through bribery and government officials might seek undue benefits.

It is widely acknowledged by public officials that there is a need to create a legal environment that is more stable, transparent and also more consistent with the stated policy objectives of the government. The multiplicity of tax incentives and, too often, their *intuitu personae* basis, (see Chapter 5) is another illustration of the lack of a coherent translation into regulatory terms of the political vision for the country's investment policy. Investment incentives should not be used as a substitute for a sound, comprehensive legal regime for investment. Delays in implementing reforms and introducing new regulations create legal loopholes that may also encourage these case-by-case approaches to the entry and treatment of investors.

The transparency of the law-making process and the predictability of the legal infrastructure should henceforth be significantly improved with the recent enactment, in 2015, of the *Law on the Promulgation of Legal Documents*. Also known as the *Law on Laws*, it was first adopted in 1996 and later modified in 2002 and 2008. According to the OECD review of *Administrative Simplification in Viet Nam*, the law is intended to "strengthen the rule of law, enhance the quality of legal normative documents, ensure transparency, efficiency and accountability in the preparation of regulation and improve transparency of policies and regulation" (OECD, 2011).

The most recent version of the law aims to enhance the uniformity, transparency, and implementation of the legal system. It ensures greater public involvement in the drafting of laws by requiring all legal instruments to be published online for public consultations and comments for a period of 60 days prior to its enactment, and the opinions of the Ministry of Finance, the Ministry of Home Affairs, the Ministry of Foreign Affairs and the

Ministry of Justice will automatically be collected. As a response to complaints over delays in issuing implementing regulations, the law requires that future draft implementing regulations be prepared and presented at the same time as the draft law. The Ministry of Justice is the leading authority to supervise the issuance of these regulations.

Core investment protections guarantees under the current regime

With regards to the core protection provisions of the laws, there have been some changes but the new *Investment Law* does not entail any substantial overturning of the *de jure* regime, which had already been substantially improved by the earlier 2005 law. As stated earlier, the adoption of the 2014 *Investment Law* was mainly prompted by the necessity to simplify the registration process and the protection dimension of the law did not appear to be a priority in the amendment process. The focus given on the entry of investment might have led to a watering down of some core investment protection provisions that had previously been gradually improved throughout the successive investment laws. As a result, most of the investment protection provisions have remained unchanged.

Commitment to ensure consistency of laws and regulations

Article 4 of the law ensures consistency across various legal instruments and in interpreting the law. The article has been introduced as a safeguard against inconsistent applications of the law, notably on whether a given sector is deemed to be open or closed to some categories of investors. While it is good practice to include this type of provision, it remains to be seen to what extent this commitment to a consistent application of the legislation can be effectively implemented when implementing decrees are missing.

Guarantee of legal stability

The 2005 *Investment Law* contained a legal stability clause, which granted legal predictability to investors while leaving some leeway for the authorities to introduce new regulations. But the guarantee that, in case of changes of law, compensation should be considered in some necessary circumstances was ambiguous as to the extent of protection granted in that regard. The 2014 amendment has slightly changed this stabilisation clause by limiting the application of the stabilisation clause in the new regulation for "reasons of national defence or security, social order and security, social ethics, public health, or environmental protection". While regulatory predictability is at the core of a healthy investment climate, it is legitimate to limit the scope of clauses that could be interpreted as commitments from the state that the legal framework will remain unchanged and hence undermine the state's capacity to take legitimate public policy measures. In the future, this might prevent interpretations of the clause that a measure that may negatively affect an investment or affect an investor's expectations of profits violates the guarantees provided to investors.

Definitions of covered investment

The definitional section of an investment law is crucial, as it determines the scope of the law, and hence the extent of the obligations, rights and guarantees that are provided in the law. Clearly defining the typology of covered investments is key as it determines the scope of application of the lists of restricted sectors. Rules that apply only to foreign investors, such as profit repatriation, are provided together with provisions applying to domestic investors only, such as those applying in sectors that are not open to foreign investment, and with provisions applying to both foreign and domestic investors. It is therefore crucial to clearly define "foreign" and "domestic" investment within the law, as well as to avoid any ambiguity as to the criteria that must be met to benefit from the provisions of the law. Some national legislation in other countries, for example, clearly excludes portfolio investment, or states that the investment must meet certain conditions of durability, or contribute to national economic development objectives, to fall under the scope of the law.

The definition of covered investment has been refined through the changes to the law. While the former foreign investment law excluded portfolio investment, the domestic investment law had no such requirement as to its material scope. The 1996 *Law on Foreign Investment* removed any ambiguities as it used the term "direct foreign investment" instead of "foreign investment" as used in the previous version of the law. As a result, the protection and incentives provided by the law were not applicable to portfolio investment. Before the merger of the two regimes for domestic and foreign investments, domestic investors had to operate in a rather less clear regulatory environment than foreign ones. In 2005, the unified law defined in detail "direct" and "indirect" investment.[1]

This distinction between indirect and direct investment has not been retained in the 2014 law because, while on paper this distinction was expected to bring further clarity as to the scope of the law, it has proved to be difficult to apply in practice. The authorities have hence decided to adopt a new approach to the definition of covered investment according to which any investment activity is either governed by the Stock Exchanges law or by the investment law, with no distinction between direct and indirect investment. The law still provides for a condition of duration in the definition of "investment projects", which must involve a "midterm or long-term" commitment of capital to be eligible as a covered investment. One of the most significant changes brought about by the new law is the clarification of what defines a foreign investment. While ambiguities persisted under the former regime, the introduction of a clear threshold in the ownership to define the nationality of a company is likely to provide investors with greater legal predictability, stability and transparency.

Gradual introduction of a principle of non-discrimination

The government commits to treat equally investors in all sectors and not to discriminate between domestic and foreign investors. Affirming the non-discrimination principle in a law is a common practice that signals a positive and open investment policy, without prejudice to the possibility for the state to preserve its sovereign right to implement any developmental policies.

This commitment to the non-discrimination principle was introduced with the merger of the two laws regulating domestic and foreign investment separately which was the main innovation brought about by the 2005 law. Prior to enacting a single investment law, the treatment of established domestic and foreign investment did not differ substantially, despite the fact that there were two distinct laws. The 1998 *Law on Domestic Investment* already provided the same level of protection as the one granted to foreign investment in the *Law on Foreign Investment*. The same protection against unlawful expropriation was contained in the law, as well as a general commitment to protect the right of ownership of assets.

Guarantee of equitable treatment of investors

The 2014 *Investment Law* does not contain specific protection provisions such as those found in investment treaties, like the fair and equitable treatment (FET) and full protection and security (FPS) provisions. Instead, Article 5 reaffirms the state's commitment to treat investors equitably. Provided that the authorities strictly abide by this principle, it is good practice to provide only for a general commitment of equitable treatment. As extensively shown in the section on Viet Nam's international investment agreements, provisions such as FET and FPS, when not well drafted, can strongly interfere with the state's ability to introduce public policy measures that have an impact on the operation of investment. It is therefore advisable not to introduce these protection provisions in a domestic law. As in the previous one, the law provides foreign investors with a guarantee of free transfer of funds abroad, with no limitation to this right in case of exceptional circumstances.

Investment dispute settlement provision

The article on the settlement of investment disputes does not apply exclusively to disputes involving state authorities, but also cover those between domestic and foreign investors, which is rather uncommon. It provides that investment disputes must be settled through negotiation and conciliation, yet it does not give any indication of the relevant bodies before which the disputes should be referred to seek amicable settlement. With no precision of a cooling-off period, the article states that if amicable settlement cannot be reached, the dispute can be brought either before domestic courts, domestic arbitration, foreign arbitration, international arbitration or before an *ad hoc* arbitral panel as decided by the parties, depending on whether they are domestic or foreign or if the state is involved in the dispute.

This article raises unanswered questions. While the provision contained in the 2005 law had the merit of being clear and unambiguous, the vagueness of the new drafting creates confusion as to the availability of foreign and international arbitration. The provision would deserve to be further clarified, so as to avoid any difficulties of interpretation. If it is the intention of the authorities not to give a unilateral consent to international arbitration, then it should be clearly stated in the law. It could also be improved by including a "fork in the road" provision stipulating that if the investor chooses to submit a dispute to the courts of the host state or to any other agreed dispute resolution procedure, the investor will lose the right to submit the same claim to international arbitration. The "cooling-off" period within which amicable settlement should be sought also needs to be detailed. Investment legislation in other countries typically specifies that parties to the dispute must try to reach amicable settlement for a period of six months before being allowed to bring the case before a court or an arbitral tribunal.

Investors require an effective and transparent legal system to carry out their contracts and settle disputes pertaining to their investments. As developed below, arbitration plays a primary role as an alternative dispute resolution mechanism to settle disputes between foreign investors and host states. It is therefore key to create the conditions for a clear arbitration regime, not only in the domestic arbitration law, but also through a clear and well-drafted dispute settlement provision in the investment law.

Expropriation regime

Protection against expropriation without fair compensation is one of the most crucial rights of investors and must be granted in the regulatory framework for investment through provisions for transparent and predictable procedures.

The 1992 Constitution stipulates that "business enterprises with foreign invested capital shall not be subject to nationalisation" (Article 25). The 1987 *Law on Foreign Investment Law* explicitly ruled out nationalisation, a position that Vietnamese leaders have consistently emphasised.

Subsequently, the protection against expropriation as stated in the 1996 *Law on Foreign Investment* was detailed and contained guidelines as to the compensation process and methodology. The 2005 *Investment Law* followed along the same lines for protecting against expropriation and the mechanisms for compensation. The expropriation provision in the 2014 law is more succinct which could add further uncertainty as to its scope, with detrimental effects not only on investors' rights, but also on the state's ability to introduce legitimate public policy measures that may be tantamount to an expropriation.

Article 9 grants that "lawful assets of investors shall not be nationalised or confiscated by administrative measures". It also provides for a list of exceptional reasons whereby the state can expropriate an asset for "reasons of national defence and security, national interests, state of emergency, prevention or recovery of natural disaster". In the event of a legal expropriation occurring under these conditions, the investor shall be reimbursed or compensated. While it is good practice to provide for a general principle of prohibition of expropriation, accompanied by a list of exceptions, the current expropriation provision may be difficult to interpret due to its lack of detailed language. It is silent on the calculation of compensation in case of expropriation and does not make any explicit distinction between direct and indirect expropriation, although it is understood that both direct and indirect forms of expropriation are covered under the new regime.

Ideally, a good expropriation regime should distinguish indirect expropriation from lawful regulation in the public interest, the latter being non-compensable, even if it has an economic impact on a particular investment. The distinction between expropriation, be it direct or indirect, and regulatory takings, is crucial as it retains the policy space necessary to implement public policy objectives. Expropriation can take many forms, and this should be reflected in legislation. It includes direct expropriation where the state obtains a formal transfer of title or outright physical seizure and indirect expropriation where a state interferes in the use of a property or in the enjoyment of its benefits even where the property is not seized and the legal title to the property is not affected. Determining whether a regulation may constitute an indirect expropriation for which compensation should be paid is made on a case-by-case basis. It is not enough that a regulation adversely affects profits for it automatically to be regarded as an act of expropriation. For example, some legislation provides that, except in rare circumstances, non-discriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriation.

Despite the lack of detail in the expropriation provision of the law, in practice, expropriations do not appear to be a major issue in Viet Nam, although the 2015 Investment Climate Assessment issued by the US Department of State reports that several foreign investors have expressed concerns over threats by state authorities to revoke their investment licences if additional capital is not raised.

Obligations for investors

The incorporation into domestic legal frameworks of an obligation for investors to preserve the environment and other public policy objectives is increasingly common among ASEAN member states. This practice aims to strike a balance between guarantees offered to investors and obligations that investors must respect in order to be eligible for these guarantees and for incentives. Viet Nam was once a leader in this area and had incorporated, through legal changes mainly introduced in the past decade, a set of general obligations binding upon investors. As of 1987, it provided a set of obligations upon foreign investors, mainly relating to tax and social obligations. It subsequently provided a much wider range of obligations that were binding upon foreign investors, specifically, that foreign investments operate in conformity with labour collective agreements and laws, and "respect the honour, dignity, and traditional customs of each other", and comply with environmental obligations. A few other obligations relating to the corporate governance principles (accounting rules, transparency principles, etc.) were also contained in the law. The article dedicated to investors' obligations in the 2005 *Investment Law* was not retained in the recent law.

Contract enforcement and dispute settlement

The judiciary in Viet Nam is composed of the Supreme People's Court; Provincial People's Courts; and District People's Courts. Meanwhile, the People's Procuracy supervises the judiciary and can appeal any judgment. In parallel to its court system, Viet Nam has developed a legal framework for commercial arbitration. In 2010, the adoption of a *Commercial Arbitration Law* and of the *Law on Administrative Procedures* brought the legal system more in line with international standards. The *Commercial Arbitration Law* covers only domestic arbitration for business disputes, exclusive of those involving a public authority.

When investors perceive a lack of independence and efficiency of the court system, they tend to favour alternative dispute resolution means to settle their business disputes. Commercial arbitration has thus become the most common way of seeking business dispute resolution before private arbitration centres such as the Viet Nam International Arbitration Centre. Foreign companies established in Viet Nam commonly bring dispute cases before the Centre, where awards are more easily enforced than foreign arbitral awards. There seems to be a widely shared perception among the business community that one of the problems with Viet Nam's investment climate is the difficulty, too often encountered, of getting foreign arbitral awards recognised and enforced by domestic courts. Vietnamese courts tend to have an extensive interpretation of the clause by virtue of which if the award to be enforced is found to be in violation of fundamental principles of Viet Nam's legal system, domestic judges can refuse to recognise and enforce it. As a result, and despite Viet Nam's obligations under the New York Convention, it is often difficult to obtain enforcement of an arbitral award obtained in a foreign jurisdiction.

Beyond this difficulty, there seems to be a broader issue of enforcement of arbitral awards, even when they are rendered by local arbitration centres within Viet Nam. During consultations with the private sector, the OECD team came across recurring concerns about the growing tendency of businesses to seek annulment of unfavourable local arbitral awards before domestic courts. Despite these major challenges, the first signs of an evolution towards a more arbitration-friendly judicial system are occurring. In 2014, for the first time in Viet Nam, an arbitral award rendered against an SOE at a local arbitration centre has been recognised and enforced by an Economic Court.

Another positive step was taken with the enactment of a new *Bankruptcy Law* in 2014 which substantially simplified and clarified the bankruptcy procedures for companies. It was prompted by the very low rate of declarations of bankruptcy, and by the high number of companies which ceased their operations instead of seeking recovery. Further reforms are nevertheless necessary in this regard, as the recovery rate remains half as high as in most Asian countries (World Bank, 2015).

Access to investor-state dispute settlement

The Ministry of Justice has been mandated since 2014 to lead the defence of the state in investor-state dispute cases. Other relevant bodies, such as the FIA, are involved in such cases, although not automatically. The MPI takes part in the inter-ministerial taskforce managing investment dispute cases but does not automatically follow ongoing disputes. Line ministries should consider intensifying their dialogue and cooperation to ensure a better management of investment disputes and, to the extent possible, to prevent conflicts from evolving into a formal dispute case. The mandate of the inter-ministerial taskforce includes the responsibility to establish dispute prevention mechanisms and, in practice, MPI and FIA work efficiently to prevent disputes at an early stage and are recognised by the business community for their very active and efficient role in mediating at an early stage emerging disputes.

There is nevertheless no institutionalised mediation mechanism to avoid having claims escalate into international arbitration proceedings. Viet Nam could consider establishing a formal dispute prevention and early alerts mechanism and setting up an Ombudsman inter-ministerial team to forestall potentially very costly international arbitration proceedings that may stem from investor-state disputes. Early alert mechanisms for preventing disputes are increasingly used in many countries, notably in Asia. Under these mechanisms, relevant government bodies would be required to share any information they have on potential emerging investment disputes to a designated co-ordinator within one ministry. This early warning mechanism to central authorities allows for early and co-ordinated action to be taken. Part of the mandate of the appointed team would typically involve centralising information on the legislation, contracts and international investment agreements applicable to the cases. It would also keep track of all commitments made by the state, and provide guidelines for the negotiations of dispute settlement processes. Such initiatives could be envisaged as part of a broader effort to optimise the defence of the state in the event of international investment disputes, which represent a growing challenge for the government of Viet Nam.

Viet Nam is one of the last ASEAN countries, with Myanmar and Lao PDR, not to have adhered to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention). Despite heavy pressure from the international investment community, the government has not expressed any willingness to adhere to ICSID although the MPI is reportedly once again studying the possibility (see Box 3.1 for a discussion of the New York and Washington Conventions). In the absence of the availability of ICSID-based arbitral panels, most investor-state dispute cases involving Viet Nam are brought before *ad hoc* tribunals applying UNCITRAL arbitration rules.

Regardless of any political considerations, becoming a member of the ICSID Convention could enhance Viet Nam’s perception abroad as an investor-friendly country. The ratification of the Convention would allow foreign investors to be able to choose ICSID arbitration, provided that they benefit from an investment treaty containing an ICSID clause. From an investor’s view, the availability of ICSID arbitration could therefore reduce the risk of investing in a given country. Compared to other *ad hoc* arbitration forums, ICSID tribunal awards are not subject to national laws on the recognition of foreign arbitral awards and domestic courts cannot interfere with arbitral proceedings. If envisaged in the future, the adhesion to the ICSID convention should be preceded by an assessment of political and economic costs and benefits.

Box 3.1. **Recognition and enforcement of arbitral awards**

For disputing parties it is important to know that decisions and awards of arbitral tribunals will be enforced. The international community has developed specific institutions and rules to enforce arbitration awards. Viet Nam is a party to the New York Convention and is currently considering adhering to the ICSID Convention. Both agreements increase investor confidence that arbitral awards will be recognised and enforced effectively.

New York Convention

Viet Nam is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also called New York Convention), the leading international treaty applicable to commercial arbitration. The New York Convention addresses the recognition and enforcement of foreign arbitral awards (i.e., those made in a country other than Viet Nam) and for certain awards made in Viet Nam. The national courts of contracting parties to the New York Convention must generally recognise arbitration awards rendered in other contracting parties, subject to narrow exceptions, and enforce the awards in accordance with their rules of procedure. Since Viet Nam is a contracting party to the New York Convention, investors that have prevailed in arbitral proceedings know the conditions under which the awards will be recognised and enforced in Viet Nam. The New York Convention also facilitates the recognition and enforcement of Vietnamese awards in third countries that are party to it.

ICSID Convention

The ICSID Convention addresses both the arbitral proceedings and the enforcement of awards rendered under these proceedings. The recognition and enforcement of ICSID awards is governed by the ICSID Convention itself rather than the New York Convention. The ICSID regime is thus more self-contained in this respect. In particular, ICSID awards cannot be reviewed by national courts of the country in which their enforcement is sought. In contrast, the New York Convention permits national courts to refuse the enforcement of awards for, inter alia, reasons of public policy.

Access to land and protection of investors' land rights

Private ownership of land is not permitted in Viet Nam and the state is the administrator of all land rights. Within this overall framework, restrictions have nevertheless gradually been relaxed. The *Land Law* has been revised many times and, together with the *Real Estate Law* enacted in 2015, the legal framework for land ownership has been characterised by concerted efforts over time which have yielded major improvements in the treatment of investors, particularly foreign ones.

The new *Land Law* is a very significant milestone towards further opening access to land to foreign investors. Prior to this reform, one of the major measures taken under *Doi Moi* was to transfer state-owned agricultural land to household farms. The *Land Law* introduced in 1987 established the private use of allocated agricultural land, albeit with some major limitations to the rights of possession to the land, including the transfer of land parcels through inheritance. Following the 1993 revision of the law, farming households were granted more property rights, including the right to rent out, to use land properties as collateral and to transfer property rights by inheritance.

The regime only allows ownership of "land use rights" (LUR), which can be acquired from the state and are divided in three main categories: allocation, recognition and leasing. No fee is applicable to the recognition of LURs, while the allocation can sometimes be subject to fees. Under the new law, the state can lease LURs to both domestic and foreign companies. LUR leases are concluded on a contractual basis and are subject to a land use rent.

Foreign investors can lease land parcels either directly, once they have established as a foreign company in Viet Nam, or by way of a joint venture with a Vietnamese partner. Prior to the 2013 *Land Law*, foreign investors could only lease land parcels from the government or sublease land from an infrastructure developer. Under the new regime, foreign investors established in Viet Nam can lease land from domestic companies, such as limited liability companies or SOEs, or from existing foreign companies which lease land from the state, and develop an infrastructure project on the land. Except under very specific circumstances set out in the law, only domestic companies or citizens that have obtained a land allocation can subsequently lease land to foreign investors.

The duration of the lease must be aligned to the duration of the approved project, for a maximum period of 50 years or, in special circumstances, 70 years. The lease term can be extended upon approval by the state authority and provided that the use of the land is consistent with the initial land plan. LURs leased by foreign investors are paid either through an annual rent or a one-off rental payment at the date of conclusion of the lease contract. If the lease is paid by an annual rent, foreign investors are not allowed to transfer, sublease or mortgage the LUR, while investors that have paid their lease through the one-off arrangement are allowed to transfer, sublease or mortgage their LURs as well as assets attached to their land.

The new law places local and foreign investors on an equal footing regarding the pricing of land. Land prices are now fixed on a case-by-case basis based on a market price, leading to concerns in some quarters that land pricing will be less predictable with this new system. But despite these important liberalisation efforts, foreign and domestic investors still face some differences in treatment with regards to their access to land.

While Land Use Rights are managed at district level, the land registration system for enteprises is managed at provincial level. The existing registers are often partially outdated and inaccurate. Full computerisation of the land titling and registration system will be needed to efficiently address common problems of fraudulent titling. It has recently started and has already been completed in a minority of districts. These modernisation efforts are essential to enhance firms' ability to take securities on their land properties and thus improve their access to credit, when their LUR allows them to use the land parcel as a mortgage. Reliable land titling and property registrars also help individuals and businesses to seek legal redress in case of violation of property rights.

The revocation of LURs by state authorities has been made more difficult by the more stringent conditions to the expropriation by public authorities in the new land law, which is likely to greatly improve the protection of investors' land rights. The LUR licence can be revoked by MPI if the investment project for the completion of which the land parcel has been granted is not implemented. Investors can challenge such decisions by bringing their land disputes against state authorities before administrative courts. Land disputes occurring between private parties are not arbitrable and must be settled before civil courts.

Protection of intellectual property rights in Viet Nam

The legal regime for the protection of intellectual property (IP) rights comprises several pieces of legislation, including the 2005 *Civil Code*, the *Criminal Code*, the 2005 *Intellectual Property Law* as amended in 2009, and a series of implementing regulations. Viet Nam is party to the main international conventions on IPRs, such as the Berne Convention on Copyright and the Paris Convention on Industrial Property. Since Decree 31 in 1981, through which IP regulations were first introduced in Viet Nam's legal framework, Viet Nam has substantially improved its IP system, especially over the past 15 years. The government started by developing an IP Rights Action Plan to bring its IP system in line with the WTO's Trade-Related aspects of Intellectual Property Rights (TRIPS) commitments There is a strong awareness, at the highest level of the government, of the immediate stakes of having a robust IP policy (Box 3.2).

The introduction of a new dedicated IP Law in 2005 was a milestone in the reform process and fully implemented the country's TRIPS obligations. The three main categories of IP rights – copyrights and related rights, industrial property rights, rights to plant varieties – are all managed under the authority of different ministries: Ministry of Culture, Sports and Tourism, Ministry of Science and Technology, Ministry of Agriculture and Rural

Development. The 2005 IP law was amended in 2009, so as to further bring the legislation in line with the provisions of the TRIPS WTO agreement, thereby considerably reducing the timeframe for trademark applications.

In parallel with legislative reform efforts, the government initiated a "modernisation of industrial property administration project, as well as a number of sensitisation campaigns to raise awareness on the legal and institutional IP protection framework among the business community. Capacity-building programmes were undertaken to train specialised IP officers. Awareness raising programmes are regularly undertaken through mass media and more specifically targeted training courses. These efforts have borne fruit and the number of IP assets, Vietnamese inventions and utility solutions applications in Viet Nam has increased dramatically.

Box 3.2. **The benefits of IP rights in developing countries: The shifting debate**

Traditionally, a limited number of developed countries in which a high proportion of the world's R&D was concentrated were the main "demandeurs" of strong IP rights internationally. Four recent developments are helping to broaden acceptance of the benefits of intellectual property rights.

- More firms in more developing countries are now producing innovative products and thus have a direct stake in the protection of intellectual property rights. In Brazil and the Philippines short-duration patents have helped domestic firms to adapt foreign technology to local conditions, while in Ghana, Kuwait, and Morocco local software firms are expanding into the international market. India's vibrant music and film industry is in part the result of copyright protection, while in Sri Lanka laws protecting designs from pirates has allowed manufacturers of quality ceramics to increase exports.

- A growing number of developing countries are seeking to attract FDI, including in industries where proprietary technologies are important. Foreign firms are reluctant to transfer their most advanced technology, or to invest in production facilities, until they are confident their rights will be protected.

- There is growing recognition that consumers in even the poorest countries can suffer from the sale of counterfeit goods, as examples ranging from falsely branded pesticides in Kenya to the sale of poisoned meat in China attest. Consumers usually suffer the most when laws protecting trademarks and brand names are not vigorously enforced.

- There is a trend toward addressing intellectual property issues one by one, helping to identify areas of agreement and find common ground on points of difference.

Source: OECD, (2015).

Despite this successful reform process and concrete and substantial improvements, there is still room for improvement in the enforcement of IPRs. As of 2015, Viet Nam remained one of the 37 trading partners of the United States included on the Special 301 Watch list issued yearly by the US Trade Representative. Although the authorities have shown a strong political willingness to fight IP rights infringements, violations of IP rights remain very common and implementing agencies are not always fully armed to prevent and prosecute such violations. Problems of trademark counterfeiting and design infringement persist. The implementation of civil, criminal and customs procedures still needs to be further improved. Viet Nam's case illustrates that a successful legal reform process nevertheless requires a strong complementary emphasis on enforcement mechanisms, which is a prerequisite for policies and laws to have a real and positive impact.

Another recognised issue is the overlapping powers and mandates among the various agencies involved in enforcing IP rights. Some implementing decrees have also never been issued, which has compounded the lack of clarity and guidance for implementing agencies. The Ministry of Science and Technology is the governmental body in charge of the execution of intellectual property. In parallel, a wide range of authorities are also involved in executing IP policies, including the Market Management Authority, the Economic Police, Customs authorities, the provincial committees in charge of issuing licences, and the courts of justice dealing with IP cases.

The Ministry of Industry and Trade's market management is also involved in the fight against counterfeit products. Sanctions for IP infringements are of three types: administrative, civil and criminal penalties. There are no specialised IP courts, and IP cases are resolved by administrative or civil courts. IP cases between IP holders and state authorities are brought before administrative courts, before which decisions to refuse a licence can be challenged. Although judges in local courts are often not sufficiently aware of the existing tools and measures to protect IP rights, courts have recently started to tackle IP dispute matters more efficiently, particularly in major urban areas, as well as at higher level courts such as the People's High Court. IP disputes are most often settled by administrative measures; companies also tend not to bring IP cases before civil courts and favour alternative dispute resolution means such as mediation and conciliation.

The government has shown that it is very well aware of the need to uphold its efforts to create a well-functioning infrastructure for protecting intellectual property. A National Steering Committee was created in 2014 to give further impetus to enforcement agencies' fight against IP violations, and new decrees were also recently issued to impose heavier and more dissuasive fines.

Viet Nam's international investment agreements

Viet Nam has a broad network of international investment agreements, both stand-alone treaties and investment chapters in broader free trade agreements. Investment treaties typically protect existing covered investments against expropriation without compensation and against discrimination, and give covered investors access to investor-state dispute settlement mechanisms (ISDS) to enforce those provisions (see Box 3.3 for common features of IIAs). Increasingly, treaties also facilitate the establishment of new investments by extending their application to foreign investors seeking to make an investment. Viet Nam has over 40 bilateral investment treaties in force and is also a party to an increasing number of regional and multilateral trade and investment agreements. Its first bilateral investment treaty – concluded with Italy in 1990 – was signed shortly after the *Doi Moi* reforms began.

Box 3.3. **Common features of international investment agreements**

IIAs, entered into between two or more countries, typically offer covered foreign investors substantive and procedural protection. They provide additional protection to covered foreign investors beyond that provided to all investors and or to foreign investors specifically in national legal frameworks.

Substantive protections generally include protection against expropriation without compensation and against discrimination by, for example, guaranteeing that covered foreign investors will be treated no less favourably than investors from the host state (national treatment, or NT) or third states (most-favoured nation treatment, or MFN). Particularly important for policy considerations are guarantees of fair and equitable (FET) treatment or treatment, which can be equated (or not) with the international minimum standard of treatment of aliens under customary international law. The FET provision has been the one most frequently invoked by foreign investors in recent years. Additional clauses in IIAs can facilitate the transfer of profits, or limit or exclude certain performance requirements, such as local content rules.

IIAs can also foster liberalisation of investment by including commitments to open sectors to more foreign investment (market access) or by giving prospective covered foreign investors certain rights, typically by extending the NT and MFN standards to those seeking to make investments.

IIAs usually provide for procedural venues to enforce the host state's obligations under the substantive standards. Today, most IIAs give investors the right to bring claims themselves against the host state before international arbitration tribunals for an alleged breach of the IIA – the so-called investor-state dispute settlement mechanism (ISDS) (Pohl et al., 2012; Gaukrodger and Gordon, 2012). The number of ISDS claims under IIAs has risen significantly in recent years to over 600 known claims currently (UNCTAD, 2015). Precise numbers of the cases are difficult to establish because of the confidentiality of certain arbitral proceedings.

As an ASEAN member state, Viet Nam's recent investment treaty policy has in many cases been driven by a new regional dynamic: since the conclusion of the intra-ASEAN Comprehensive Investment Agreement (ACIA) in 2009, the group of ASEAN member states has signed agreements with Australia and New Zealand (2009), Korea (2009), China (2009), and India (2014).[2] ASEAN is currently also negotiating the inclusion of an investment chapter for the existing Economic Partnership Agreement with Japan. Viet Nam has recently concluded two major and high-profile treaties, the Trans-Pacific Partnership (TPP) and the EU-Viet Nam FTA, and it is also negotiating the Regional Comprehensive Economic Partnership (RCEP) as part of ASEAN.[3] These treaties and negotiations place Viet Nam at the centre of international investment policy making today.[4]

The review of the substantive and procedural provisions in Vietnamese investment treaties[5] shows that the language of key treaty provisions has evolved, particularly since the advent of the new regional ASEAN treaty policy in 2009. In recent treaties, Viet Nam has specified the meaning of key treaty provisions to clarify government intent. Viet Nam might wish to consider the consistency of its existing treaties with recent approaches. Table 3.2 below gives some useful information on the temporal validity of Viet Nam's investment treaties in this regard. Dates for renewal or termination of treaties could inform Viet Nam's timetable to engage with its existing treaty partners.

Regional and multilateral approaches offer an opportunity to create an integrated investment region in ASEAN and to establish common rules on investment protection and liberalisation. At the same time, additional commitments in agreements covering investment relations already subject to bilateral or other multilateral treaties may jeopardise the consistent implementation of Viet Nam's treaty policy: investors may circumvent new treaty policies by invoking the older investment treaty, which does not yet reflect these new policies. International practice shows that investment protection standards in older IIAs have often been relatively vague. Where they provide for arbitration, this gives investment arbitrators broad discretion to interpret and thereby determine the scope of protection they provide. While Viet Nam's investment treaty practice since 2009 reflects more specific treaty language, its older treaties, which are still in force, often remain vague.

Direct and indirect expropriation

Vietnamese IIAs require host states not to expropriate unless the measures are taken in the public interest, on a non-discriminatory basis and under due process of law, with prompt, adequate and effective compensation.6 The relevant provisions typically address the determination and modalities of payment of compensation as well. Vietnamese treaties distinguish and cover both direct and indirect expropriation.7 Direct expropriation generally refers to an actual taking of legal title to property or a physical seizure of property by a government. As a result, the host state is enriched by, and the investor deprived of, the value of the expropriated property. Indirect expropriation is a more complex and sensitive issue. Regulatory action or other behaviour by a government can sometimes have a dramatic effect on an investment, without involving a formal transfer of title or outright seizure. At the same time, provisions on indirect expropriation can affect the host state's policy space because regulatory action can give rise to claims for compensation. Because most policy issues relating to expropriation arise with regard to indirect expropriation, this section focuses on Viet Nam's policy in that area.

Most Vietnamese IIAs explicitly cover indirect expropriation, but they typically do not clarify the circumstances under which regulatory measures do not amount to expropriation and where therefore no compensation has to be paid. This gives arbitrators discretion to draw the line between indirect expropriations that entitle the covered investor to compensation, and legitimate regulation that has a significant economic impact on the investor without obligating the government to pay compensation. Under treaties that refer only generally to indirect expropriation, ISDS tribunals have used varying approaches to determining whether an indirect expropriation has occurred (UNCTAD, 2012).

Beginning with ACIA in 2009, some treaties with Vietnamese involvement started to include specifications on indirect expropriation, aiming to ensure that non-discriminatory measures, designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an expropriation.[8] Such clarifications are also included in the ASEAN agreement with Australia and New Zealand, and in the agreement signed with India; it is also referred to in the Work Programme for the ASEAN agreement with Korea.[9] In contrast, the investment chapter of the FTA with the Eurasian Economic Union (2015) and the agreements with UAE (2009) and Morocco (2012), none of which is in force yet, do not contain a clarification. While several investment agreements signed since 2009 are not publicly available,[10] it appears that only the ASEAN agreements and the EU-Viet Nam FTA contain a clarification regarding the scope of indirect expropriation.

Fair and equitable treatment and the international minimum standard of treatment of aliens

Fair and equitable treatment (FET) is another standard at the centre of investment treaty claims and treaty policy. Since 1997, investors worldwide have invoked the standard in 341 claims and tribunals have found a breach in 129 of the cases.[11] All Vietnamese IIAs reviewed grant FET to covered investors. These treaties often merely state that foreign investors shall be accorded FET without further specification. Provisions for fair and equitable treatment have been considered or applied by tribunals in a broad range of claims. Some interpretations of FET are widely seen as having a significant impact on the right to regulate.

There is a growing trend to define fair and equitable treatment provisions, both in Viet Nam and internationally, to give more direction to arbitrators by clarifying the original intent of the contracting parties. Two approaches are outlined in Box 3.4 below.

Box 3.4. **Two approaches to specifying and limiting the FET provision**

Two important approaches to further specifying the scope of fair and equitable treatment have emerged:

- **Limitation to the minimum standard of treatment under customary international law:** This approach has been used in a number of major recent treaties in Asia and the Americas. ASEAN-Korea IIA (Art. 5), ASEAN-India IIA (Art. 7) and the ASEAN IIA with Australia and New Zealand (Art. 6) A FET provision limited to Minimum Standard of Treatment has been repeatedly interpreted under the North American Free Trade Agreement (NAFTA). It has been interpreted more narrowly than FET provisions under other treaties and NAFTA governments have had much greater success than other governments in defending FET claims (UNCTAD, 2012: 61). In addition to the limitation to MST, the Trans-Pacific Partnership agreement (TPP), which is a largely built on US practice, specifies that the mere fact that government action is not consistent with an investor's expectation does not constitute a breach of FET (Art. 9.6(4). Art. 9.6(3) and (5)) contain further specifications.
- **Defined lists of elements of FET:** The EU's proposal for the Transatlantic Trade and Investment Partnership (TTIP), which is reflected in the investment chapter of the EU-Viet Nam FTA, contains a defined list of elements of the FET provision. The FET provision lists the elements that can constitute a breach of the standard, namely denial of justice, fundamental breach of due process, targeted discrimination on manifestly wrongful grounds, and abusive treatment of investors. While it is a closed list, this approach is broader than some interpretations of MST. Under this emerging EU policy, the parties may agree to add further elements to the list. The article also provides that the tribunal "may take into account" (or "will take into account", in EU-Viet Nam FTA) specific representations that created legitimate expectations. Other defined list approaches are also used. For example, the ASEAN-China Investment Agreement (2009) limits the application of its FET provision to cases of denial of justice (Art. 7).

Both options are more specific than the broad language of treaties that only refer to "fair and equitable" treatment. This does not mean, however, that issues of interpretation might not arise. The content of the minimum standard of treatment, for example, is subject to important debates as are a number of elements in the defined EU lists.

Given the centrality of FET to many investor claims, clarification of government intent could improve predictability for both governments and investors, and Viet Nam might wish to reflect the more specific language found in recent treaties to its older treaties as well.

Most-favoured nation treatment

Most of the investment treaties entered into by Viet Nam reviewed for this report contain most-favoured nation (MFN) treatment provisions which guarantee that covered investors will be treated no less favourably than those of third states. Similarly to the other investment treaty provisions reviewed above, the Vietnamese international investment agreements (IIAs) typically use general language to accord MFN treatment to foreign investors.

The meaning of general wording in an MFN clause has been subject to doctrinal and arbitral debates. With respect to investment protection granted to nationals of third states in investment treaties, one important element is the question of whether the MFN provision only applies to substantive protection provisions – such as the indirect expropriation or FET provisions discussed above – or also to procedural aspects, and notably the ISDS mechanism (Dolzer and Schreuer, 2012). On this particular question, several Vietnamese agreements provide more specific language, and some specifically provide that the MFN clause does not apply to ISDS available to investors under IIAs.[12] The agreement with the United Arab Emirates specifies that MFN does not apply to “procedural and juridical” matters.[13] The agreement with Japan does not specifically exclude access to ISDS from the scope of MFN, but it provides that MFN applies to access to the courts of justice and administrative tribunals and agencies.

Specifications of treaty language reflect policy choices

More specific language in investment protection provisions would lead to increased predictability and thereby benefit both investors and governments. The specifications also reflect policy choices and, in some cases, may affect the degree of protection for covered foreign investors. Policy-makers need to carefully consider the costs and benefits of these choices, and their potential impact on foreign investors and domestic investors, as well as on the host state’s legitimate regulatory interests and its exposure to investment claims (see Box 3.5 on the increasing public scrutiny of IIAs).

Box 3.5. **Public scrutiny and reform of international investment agreements**

IIAs have come under increasing scrutiny by a variety of stakeholders, including civil society and academia, but also by contracting parties to IIAs themselves. Critics argue that international investment agreements unduly restrict governments' "right to regulate" and that arbitral proceedings are subject to important flaws. In this process, a number of core assumptions have been challenged. Econometric studies, for example, have failed to demonstrate conclusively that IIAs actually lead to increased FDI flows – a policy goal commonly associated with the investment protection regime (Sauvant and Sachs, 2009). Furthermore, while it has been contended that IIAs advance the international rule of law and good governance in host states by providing mechanisms to hold governments accountable, critics argue that opaque legal proceedings and potential conflicts of interest of arbitrators are contrary to rule of law standards (Van Harten, 2008). Moreover, the availability of international investment arbitration to investors has been seen by some as an instrument that could circumvent, and thereby weaken domestic legal and governance institutions instead of strengthening them (Ginsburg, 2005). Many governments are engaged in review of their investment treaty policy and the field has been marked by significant reforms in recent years.

Reconsidering policy rationales for different levels of treatment

Treatment of domestic and foreign investors

In general, Viet Nam should seek to guarantee a sound investment climate for both domestic and foreign investors. Parts of Viet Nam's legal framework applicable to investment protection, such as its 2014 *Investment Law*, apply to both domestic and foreign investors. Viet Nam's legal framework for investment also contains many provisions that exclusively cover only some foreign investors, such as IIAs. Viet Nam should consider whether distortions to efficient investment decisions may occur because of more favourable regulatory conditions for certain investors based on nationality. At the same time, many governments see the value or the need to provide certain extra incentives and guarantees to attract foreign investment in a highly competitive market for that investment. The balance between these interests is a delicate one and may evolve over time. In an apparent response to such considerations, Viet Nam already shifted from a *Law on Foreign Investment* from 1987 covering exclusively foreign investors to an *Investment Law*, applicable to both foreign and domestic investors.

Increasing complexity of investment obligations towards foreign investors

Different levels of investment protection and liberalisation in Viet Nam's various investment treaties also raise policy issues. If and when they enter into force, TPP and the FTA with the EU will cover the investment relations with 39 countries.[14] For many of these countries, Viet Nam already has investment treaties in place. Some investment relations might as a result be covered by more than one treaty. The investment relations between Singapore and Viet Nam provide an example: the bilateral investment treaty between the two countries entered into force in 1992; since 2012, investments between the two countries can also be covered by ACIA; TPP adds another layer of protection, which investors could invoke in their claims against the respective host government. The impact of treaty reforms and policy innovations can be negated because covered investors can circumvent them by choosing to bring a claim based on the bilateral, potentially more favourable, treaty. Multi-layering of investment provisions can be a burden on the effective implementation of new policies.

The EU-Viet Nam FTA addresses this issue by providing for the replacement of existing bilateral treaties with EU member states, with only narrow exceptions.[15] It also clarifies that the "survival clauses", which typically extend certain treaty protections following termination of a treaty for already-made investments, cease to have effect. The FTA norms thus supersede the earlier norms immediately upon the entry in force of the FTA. Multiple layers of investment protection reflecting different treaty policies would also jeopardise the establishment of harmonised investment policy across ASEAN member states, a policy goal set forth in the ACIA.

Investment treaties as a tool to liberalise investment policy

Although econometric studies have not found any unambiguous link between the extent of investor protection and FDI inflows, several studies have found that investment treaties might lead to more FDI flows when they facilitate investment, for example by reducing barriers and restrictions to foreign investments (Berger *et al.*, 2013; Lesher and Miroudot, 2006).

Increasingly, IIAs are being used to liberalise investment policy. These provisions are often referred to as applying to the "pre-establishment" phase of an investment. A key tool to foster liberalisation is to extend the national treatment (NT) and most-favoured nation (MFN) standards to those covered foreign nationals seeking to make investments. The Vietnamese agreement with Japan grants covered investors pre-establishment NT and MFN.[16] The Agreement with the Eurasian Economic Union contains a specific section on pre-establishment providing for MFN and NT, subject to reservations (Box 3.6).[17]

Box 3.6. **Negative and positive list-approaches to NT and MFN exceptions**

When countries grant national and/or most-favoured nation treatment, whether pre- or post-establishment, they typically do so subject to reservations. There are two broadly different approaches.

A negative list-approach typically provides that MFN and NT are generally afforded, except for specific exceptions or provisions ("negative lists") specified in annexes. The Japan-Viet Nam IIA, for example, provides that the governments may adopt and maintain measures not conforming with the MFN and NT provisions in the sectors or with respect to matters specified in Annex I (Art. 5), and maintain non-conforming measures specified in Annex II (Art. 6). The Annexes themselves specify which exceptions apply only to NT, and not to MFN.

A positive-list approach specifies that its liberalisation provisions only apply to specific identified sectors, as with ACIA, for example (those listed in Art. 3(3)). Generally, the negative list-approach is seen as more conducive to investment liberalisation particularly over time with the development of new areas of economic activity that are not covered by negative lists.

Investment liberalisation is a core commitment under ACIA, and it provides for pre-establishment MFN and NT.[18] At the same time, ACIA limits the application of its liberalisation provisions to a defined list of sectors which can be expanded, including manufacturing, agriculture, fishery, forestry, mining and quarrying, and to services incidental to these sectors. The ASEAN Plus agreements also address investment liberalisation, but there are differences with ACIA, notably the exclusion of MFN from the pre-establishment phase in some of them.[19] These differences may be explained by the fact that a country does not necessarily want to grant advantages, which it might have agreed to in exchange for other concessions, to all international partners.

In sum, the liberalisation provisions – in ACIA in particular, targeting only specific sectors – are carefully calibrated and subject to important reservations. Providing explicitly for the possibility to cover additional sectors by the liberalisation provisions and by aiming to reduce the reservations,[20] ACIA provides a framework for further investment liberalisation. If Viet Nam seeks to foster liberalisation, it might wish to consider broadening the pre-establishment application of NT and MFN provisions.

Sustainable development and responsible business conduct considerations

A new emphasis in recent treaty making has been on sustainable development and responsible business conduct considerations. Some of these innovations are also found in Viet Nam's existing investment treaties and they play an even more prominent role in the EU-Viet Nam FTA and TPP texts. While specific investor obligations are so far not encountered in treaty practice, treaties often make investment protection conditional on compliance with host state law. The Vietnamese IIAs use different ways to ensure that only investments that do not violate host state law are covered and protected. These include making legality a condition for application of the treaties or by defining covered investments as those made in accordance with host state law.[21] Such requirements serve as a filter mechanism and can potentially incentivise investors to be more mindful of their obligations under host state law.[22]

To seek to protect certain types of regulation from challenge, several Vietnamese IIAs have used other tools, often apparently inspired from international trade law, such as general exceptions clauses. While individual bilateral treaties include exception clauses,[23] they are more regularly found in the ASEAN agreements since 2009. The rationale for these clauses is to ensure that the host state will not be prevented from implementing measures that pursue specific regulatory goals providing certain requirements are satisfied. Unlike clarifications limited to a particular provision, like for indirect expropriation addressed above, these provisions can apply to protect measures that satisfy their criteria from challenge under most if not all treaty provisions. These general exceptions clauses are in a few cases also complemented by more targeted provisions relating to measures addressing security issues, the stability of the financial system, or efforts to safeguard the balance-of-payments.[24]

The investment chapter of the EU-Viet Nam FTA also includes sustainable development and responsible business conduct considerations. Some provisions seek to influence the actions of governments themselves. In the Japan-Viet Nam IIA, for example, both countries "recognize that it is inappropriate to encourage investment by investors of the other Contracting Party by relaxing environmental measures".[25] In a bilateral side instrument to TPP with the United States, Viet Nam committed to specific reforms in its labour laws.[26] Practice suggests that contracting parties have rarely sought to enforce this type of commitment, which is subject to state-to-state dispute settlement mechanisms.[27] The absence of a venue for other stakeholders to enforce those provisions is seen as a weakness by some civil society organisations.[28]

Viet Nam's legal framework for investor-state dispute settlement

Starting in the 1990s, mechanisms for covered investors to bring claims directly against host governments – ISDS mechanisms – have become a frequent feature of investment treaties. OECD research shows that around 96% of the global IIA stock provides access to ISDS (Pohl *et al.*, 2012). It appears that all of the investment treaties to which Viet Nam is a party – all signed in the 1990s or later – contain ISDS provisions.

Box 3.7. **The EU-Viet Nam FTA and new approaches to investor protection and dispute settlement**

In response to growing criticism of international investment agreements and ISDS in particular, the EU has developed a new approach to investment protection and dispute settlement. The European Commission proposes to set up a permanent court and an appellate tribunal to resolve investor-state disputes (the Investment Court System (ICS)).

A slightly revised version of this approach was agreed upon by Viet Nam and EU in the EU-Viet Nam FTA. As the first concluded treaty to include provisions for a standing investment court and appellate tribunal, this treaty is a major innovation in dispute settlement. Canada has also agreed on a similar standing investment court and appellate tribunal system for dispute settlement in its Comprehensive Economic and Trade Agreement (CETA).

The EU development of the ICS provisions follows the outcome of a 2014–15 EU public consultation and extended public debates about ISDS, as well as input from the European Parliament and national Parliaments in Europe. The European Commission has explained the ICS as a response to "a fundamental and widespread lack of trust by the public in the fairness and impartiality of the old ISDS model" of *ad hoc* investment arbitration and a way to help "enshrine government's right to regulate".[29]

The ICS continues to allow for claims against governments by individual covered foreign investors, but seeks to address legitimacy issues associated with such claims in investment arbitration by "introducing the same elements that lead citizens to trust their domestic courts". These include judges publicly appointed in advance by governments, removal of certain perceived economic incentives and conflicts of interest among adjudicators and appointing authorities, transparency of dispute settlement, and elimination of foreign investor input into the selection of judges in individual cases. The ICS also contains innovative provisions to help investors by accelerating the treatment of claims and facilitating access to dispute settlement for SMEs. Aspects of the system that have attracted interest and commentary include its approach to the enforcement of awards, the selection of judges and appellate members, and the functioning in light of the expected flow of cases.

The EU has proposed negotiations towards a permanent multilateral Investment Court and appellate tribunal. In the EU-Viet Nam FTA and in CETA, the Parties have agreed to work towards this goal. Questions remain about how individual treaty versions of the ICS could evolve into or be superseded by a multilateral ICS that would apply to many treaties.

Until recently, ISDS provisions in investment treaties provided for investor-state arbitration using *ad hoc* arbitration tribunals selected for each case in an approach derived from international commercial arbitration. Proponents of investor-state arbitration contend that it provides a forum to settle disputes that is independent from both the host state and the investor. This view has been increasingly challenged in recent years. Issues raised in the debate include among other things the characteristics of the pool of investment arbitrators, conflicts of interest, and lack of transparency (Gaukrodger and Gordon, 2012).

Some jurisdictions have been actively developing different approaches to dispute settlement. In September 2015, the EU Commission announced a proposal to use a standing court of judges publicly appointed in advance by governments and an appellate tribunal for its on-going and future investment treaty negotiations (Box 3.7). As agreed by the Parties, the EU-Viet Nam FTA was the first treaty to reflect this new approach with minor modifications.

While it is difficult to establish a precise number and status of investment claims due to the confidentiality of certain ISDS proceedings, it appears that there have been few such claims against Viet Nam. It has prevailed in two known cases and settled in another; a fourth claim is pending.[30] There are no known claims by Vietnamese investors against foreign states.

Vietnamese investment agreements still feature a low level of regulation of ISDS

OECD research suggests that ISDS mechanisms in investment treaties are typically subject to only low levels of regulation (Pohl *et al.*, 2012: 39; Gaukrodger and Gordon, 2012). Some issues are addressed by the arbitration rules, but as rules designed for commercial disputes between private parties, they may need adjustment in light of the nature of investment claims. Other issues remain unregulated if the treaties refrain from doing so. The available data suggest that Vietnamese IIAs do not provide a high level of regulation.[31] As part of the government's drive to foster an enabling investment climate, Viet Nam could consider assessing whether this low level of regulation of ISDS proceedings appropriately reflects its treaty policy objectives. For example, few agreements in Viet Nam specify time limits for claims. Recent agreements include time limits often set at three years. The post-2009 ASEAN Plus agreements constitute an exception in this regard by providing that the submission of the investment dispute shall take place within three years of the time at which the investor became aware, or should reasonably have become aware, of a breach of an obligation of the host state under the IIA.[32]

Arbitral proceedings and enforcement of awards

Since investment claims are typically not brought before public courts – such as the proposed EU Investment Court System – but administered by arbitral tribunals, these proceedings need to be regulated and the decisions and awards enforced. Even under the Investment Court System proposal, the enforcement of awards remains an important legal and policy issue. The international community has developed specific institutions and rules to guarantee the effectiveness of arbitral justice. As discussed above, Viet Nam is a contracting party to the New York Convention and is currently considering joining the ICSID Convention (See Box 3.1 above for a more detailed discussion of both conventions).

Decisions about review and possible renegotiation of existing investment treaties should take account of their temporal validity

The analysis of investment treaties suggests that Viet Nam might wish to consider reviewing its existing agreements to ensure that they well-reflect government intent and emerging sound practices in recent treaty policy.

Review and renegotiation of investment treaties takes time. It may be more easily conducted without the time pressure of either an imminent tacit renewal for an extended period or its denunciation with the attendant publicity. Viet Nam should accordingly monitor the temporal validity of its treaties in order to allow it sufficient time to approach treaty partners where appropriate. Viet Nam’s treaties have varying duration and different mechanisms for renewal and termination. Bilateral investment treaties generally contain, in the final provisions, the definition of an initial validity period; at the end of this period, treaties are often extended tacitly either for an indefinite period or for another fixed term. Denunciation is possible at certain points in time, but requires advance notice. Most treaties define an additional period during which the treaty has effect for existing investments following termination (Pohl, 2013).

Table 3.2 shows for each of Viet Nam’s treaties the dates of signature and entry into force and key characteristics of their temporal validity (fixed term validity or open-ended validity; indefinite extension or renewal for fixed terms). Treaties that renew for fixed terms require more monitoring, as they limit the possibilities to update or unilaterally end the agreement. For all treaties, Table 3.2 also shows additional information such as the approximate date when the current period to give notice of denunciation ends (i.e. the last notice date before tacit renewal) and the approximate first date when the treaty could cease to be in force.[33]

The temporal validity of Viet Nam’s treaties can also inform discussions on possible joint interpretations of treaty provisions with treaty partners. Joint interpretations can be issued at any time and can be a simpler and faster device than renegotiation to address some aspects of treaty policy providing that the existing treaty text allows sufficient scope to achieve the jointly-desired interpretation (Gaukrodger, 2016). This may often be the case in older treaties with vague provisions. Discussions and exchanges of views with treaty partners about proposed joint interpretations in advance of treaty renewal dates can also help inform future negotiations and decisions about treaties.

Table 3.2. **Viet Nam's investment treaties and their temporal validity**

Treaty	Date of signature	Date of entry into force	Definition of temporal validity	Last notice date before tacit renewal (approx. date)	Treaty will be in force at least until (approx. date)
Bilateral investment treaties					
Argentina	03-06-1996	01-06-1997	indefinite extension	08-07-2016	09-07-2017
Australia	05-03-1991	11-09-1991	indefinite extension	08-07-2016	09-07-2017
Austria	27-03-1995	01-12-1996	indefinite extension	08-07-2016	09-07-2017
Belgium/ Luxembourg	24-01-1991	11-06-1999	renewal for fixed terms	10-12-2018	11-06-2019
Bulgaria	19-09-1996	15-05-1998	renewal for fixed terms	14-05-2017	15-05-2018
Chile	16-09-1999		indefinite extension	*	*
China	02-12-1992	01-09-1993	indefinite extension	08-07-2016	09-07-2017
Czech Republic	25-11-1997	09-07-1998	indefinite extension	08-07-2016	09-07-2017
Protocol (2008) to Czech Republic-Vietnam BIT (1997)				*	*
Denmark	25-08-1993	07-08-1994	indefinite extension	08-07-2016	09-07-2017
Egypt	06-09-1997	04-03-2002	renewal for fixed terms	03-03-2021	04-03-2022
Finland	13-09-1993	02-05-1996	indefinite extension	no action required	expired or terminated
Finland	21-02-2008	04-06-2009	indefinite	04-06-2029	05-06-2030

Treaty	Date of signature	Date of entry into force	Definition of temporal validity	Last notice date before tacit renewal (approx. date)	Treaty will be in force at least until (approx. date)
			extension		
France	26-05-1992	10-08-1994	indefinite extension	08-07-2016	09-07-2017
Germany	03-04-1993	19-09-1998	indefinite extension	08-07-2016	09-07-2017
Greece	13-10-2008			*	*
Hungary	26-08-1994	16-06-1995	contradictory	*	*
India	08-03-1997	01-12-1999	indefinite extension	08-07-2016	09-07-2017
Indonesia	25-10-1991	03-04-1994	indefinite extension	no action required	expired or terminated
Italy	18-05-1990	06-05-1994	renewal for fixed terms	05-05-2033	06-05-2034
Japan	14-11-2003	19-12-2004	indefinite extension	08-07-2016	09-07-2017
Japan-Vietnam EPA				*	*
Korea	13-05-1993	04-09-1993	contradictory	*	*
Korea	15-09-2003	05-06-2004	indefinite extension		
Lithuania	27-09-1995	24-04-2003	indefinite extension		
Malaysia	21-01-1992	09-10-1992	indefinite extension	08-07-2016	09-07-2017
Netherlands	10-03-1994	01-02-1995	renewal for fixed terms	02-08-2019	01-02-2020
Poland	31-08-1994	24-11-1994	contradictory	*	*
Romania	01-09-1994	16-08-1995	renewal for fixed terms	13-02-2025	15-08-2025
Singapore	29-10-1992	25-12-1992	indefinite extension		
Spain	20-02-2006	29-07-2011	indefinite extension	27-07-2020	28-07-2021
Sweden	08-09-1993	02-08-1994	indefinite extension	08-07-2016	09-07-2017
Switzerland	03-07-1992	03-12-1992	renewal for	03-06-2018	03-12-2018

Treaty	Date of signature	Date of entry into force	Definition of temporal validity	Last notice date before tacit renewal (approx. date)	Treaty will be in force at least until (approx. date)
			fixed terms		
Ukraine	08-06-1994	08-12-1994	indefinite extension	08-07-2016	09-07-2017
United Kingdom	01-08-2002	01-08-2002	indefinite extension	08-07-2016	09-07-2017
Philippines	27-02-1992	29-01-1993	indefinite extension	08-07-2016	09-07-2017
Lao PDR	14-01-1996	22-06-1996	renewal for fixed terms	21-12-2017	22-06-2018
United Arab Emirates				*	*
Other agreements					
ASEAN-China Investment Agreement	15-08-2009				
ASEAN-Korea FTA	02-06-2009				
Agreement on Investment under the ASEAN-India CECA	12-11-2014			*	*
ASEAN-Japan CEPA	14-04-2008				
ACIA	26-02-2009				
AANZFTA	27-02-2009				
EU-Viet Nam FTA					
TPP	04-02-2016				

* uncertain
** date cannot be determined with certainty

Notes

1. "Investment means the use of capital in the form of tangible or intangible assets by investors to create assets for carrying out investment activities […]"; direct investment means a form of investment whereby investors use capital for investment and take part in the management of investment activities"; and "indirect investment means a form of investment through the purchase of shares, certificates, bonds, other valuable papers or a securities investment fund and through other intermediary financial institutions whereby investors do not directly participate in the management of investment activities".

2. The dates noted after the treaties indicate their year of signature.

3. The agreement is negotiated between the ASEAN member states, and the countries of the ASEAN Plus agreements (Australia, China, India, Japan, Korea, and New Zealand).

4. Bloomberg, The Biggest Winner From TPP Trade Deal May Be Vietnam, 8 October 2015, available at: www.bloomberg.com/news/articles/2015-10-08/more-shoes-and-shrimp-less-china-reliance-for-vietnam-in-tpp

5. The review analysed treaties available on different databases (ASEAN Briefing, OECD, UNCTAD).

6. In line with the French model BIT, the French-Viet Nam IIA, Art. 5(2) adds that an expropriation is only lawful if it does not violate a specific commitment of the state ("ni contraires a un engagement particulier").

7. E.g. Austria-Viet Nam IIA, Art. 1(4) includes in the "expropriation" definition, every other measure with similar effect ("jede sonstige Maßnahme mit gleicher Wirkung"); China-Viet Nam IIA, Art. 4(1): "Neither Contracting State shall expropriate, nationalize or take similar measures (hereinafter referred to as "expropriation") against investments […]".

8. See ACIA, Annex 2, para. 4.

9. The Work Programme contains a list of issues that the contracting parties agreed to negotiate upon, including an annex on expropriation, which would typically contain such clarification.

10. The agreements with Slovakia (2009), Kazakhstan (2009), Turkey (2014), Sri Lanka (2009), and Oman (2011) are not publicly available.

11. The numbers are based on the UNCTAD ISDS database (available at: investmentpolicyhub.unctad.org/ISDS/), which refers to 668 cases. Data on alleged breaches is available for 425 of them.

12. E.g. ACIA (2009), Art. 6, fn 4; Eurasian Economic Union-Viet Nam IIA (2015), Art. 8.33(2); ASEAN-China IIA (2009), Art. 5(4).

13. UAE-Viet Nam IIA (2009), Art. 4(2): "The Most Favoured Nation Treatment shall not apply to procedural or juridicial matters."

14. The US government officially withdrew from TPP in January 2017 and the status of the agreement is at this point in time uncertain.

15. EU-Viet Nam FTA, investment chapter, Art. 20.

16. Japan-Viet Nam IIA (2003), Arts. 2(1) and (2).

17. Eurasian-Viet Nam (2015), Section III, Arts. 8.21 and 8.22.

18. ACIA (2009), Arts. 5 and 6; Art. 3(3) for addition of sectors.

19. While the ASEAN-Korea IIA follows the ACIA approach, the relevant provisions are subject to the work programme (Art. 27). The agreement with China provides pre-establishment MFN treatment, but not pre-establishment NT (Art. 4). The agreements with Australia and New Zealand, and with India grant pre-establishment NT, but do not refer to MFN-treatment. (The work programme of AANZFTA provides that the parties shall enter into discussions with a view to agreeing on MFN treatment to the investment chapter (Art. 16(2)(a))).

20. ACIA, Art. 9(4).

21. Chile-Viet Nam IIA, Art. 2; Finland-Viet Nam IIA, Art. 1(1).

22. E.g. Singapore-Viet Nam IIA (1992), Art. 1, defining an investment as "every kind of asset permitted by each Contracting Party in accordance with its laws and regulations…"

23. Japan-Viet Nam IIA (2003), Art. 15.

24. Examples include clauses on security issues (ACIA, Art. 18; ASEAN-India, Art. 22; ASEAN-Korea, Art. 21), the stability of the financial system (e.g. Japan-Viet Nam IIA, Art. 16) and – these provisions are widespread in the ASEAN IIAs – measures to safeguard the balance-of-payments (e.g. ACIA, Art. 16; ASEAN-China, Art. 11; ASEAN-India, Art. 12; ASEAN-Korea, Art. 11; AANZFTA, Chapter 15).

25. Japan-Viet Nam IIA, Art. 21. Similar clauses have emerged more broadly in more recent treaty practice.

26. Draft available at: https://ustr.gov/sites/default/files/TPP-Final-Text-Labour-US-VN-Plan-for-Enhancement-of-Trade-and-Labor-Relations.pdf.

27. United States Government Accountability Office (2009), "Four Free Trade Agreements GAO Have Reviewed Have Resulted in Commercial Benefits,

but Challenges on Labor and Environment Remain", available at: www.gao.gov/assets/300/292204.pdf. In 2014, the US has brought a claim against Guatemala for an alleged breach of obligations regarding labour rights under CAFTA-DR.

28. See Human Rights Watch, Q&A: The Trans-Pacific Partnership, 12 January 2016, available at: https://www.hrw.org/news/2016/01/12/qa-trans-pacific-partnership

29. Malmström, C. (16 September 2015), "Proposing an Investment Court System", https://ec.europa.eu/commission/2014-2019/malmstrom/blog/proposing-investment-court-system_en

30. The numbers are based on the UNCTAD ISDS database.

31. Assessment based on the OECD investment treaty data base and the analysis of publicly available treaties.

32. E.g. ACIA, Art. 34(1)(a).

33. This information is provided as a matter of general analysis and should not be relied on with regard to individual treaties. Recourse should be had to the precise treaty text in each case. The dates do not take into consideration the possibility of an agreement by the treaty partners to amend and/or terminate the treaty. The reference date for the calculation is 8 July 2016. The calculation is also approximate due to the different length of months and years.

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Chapter 4

Corporate governance and competition policy in Viet Nam

This chapter provides an overview of Viet Nam's corporate governance framework and its competition policy. The first section addresses ongoing reforms to the ownership and governance of state-owned enterprises, the rights of shareholders, disclosure and transparency rules, and the independence and effectiveness of boards. The second section reviews the institutional aspects of competition and the substantive provisions of the Competition Law.

Improving corporate governance in Viet Nam

Corporate governance concerns the structures framing the relationships among a company's executive management, board of directors, shareholders and stakeholders. From the perspective of modernising legal and regulatory frameworks for investment, effective corporate governance is important because it affects not only individual firm behaviour but also broader macroeconomic activity. For emerging market economies, improving corporate governance can serve several purposes, including reinforcing property rights, reducing transaction costs, and lowering the cost of capital, which together can improve investor confidence. The Asian financial crisis that began in 1997 acted as a significant catalyst for improving corporate governance frameworks in Asia with the aim of building well-functioning and stable financial markets.

Regulatory reforms over the past decade have reconfigured Viet Nam's corporate governance framework to encompass all firms, public and private, listed and non-listed, thereby marking a significant change in the investment landscape. Viet Nam's entry into the World Trade Organization in 2007 was preceded by an important restructuring that involved the passing of the *Law on Enterprises* and the *Law on Investment* in 2005 and the *Law on Securities* in 2006. This was followed by the issuance of a number of decrees, circulars and decisions to ensure implementation of the new framework, including the Corporate Governance Regulations of 2007 and Amendments of 2012. Several recently signed agreements will encourage further reforms of corporate governance, particularly of state-owned enterprises (SOEs), including the Trans-Pacific Partnership Agreement and the EU-Viet Nam Free Trade Agreement.

In late 2014, the National Assembly approved a number of new and amended laws, including a new *Law on Enterprises* which has established a comprehensive and ambitious framework governing firms. The Law clarifies provisions regarding independent board directors, raises the number of days for which shareholders must receive notice for annual general meetings and introduces e-voting. The perception is that the new regulation has helped to set the bar high for Vietnamese companies and to improve Viet Nam's ranking on a number of corporate governance assessments. Ensuring full compliance by individual firms will be the greatest challenge.

In spite of these improvements, the overall legal and regulatory corporate governance framework remains complex, with scattered inconsistencies and at times limited awareness by market participants. The equitisation of state-owned enterprises proceeded rapidly in the 1990s and early 2000s but has slowed down over the past decade. Many equitised SOEs have retained significant state ownership and have not attracted foreign investors. Total assets of fully state-owned enterprises correspond to 80% of GDP according to the authorities. While listed SOEs have performed best among all SOEs, they appear to be more distressed than private listed companies.

The continued prominence of SOEs and the preferential treatment they receive in terms of access to finance calls into question the extent to which a level playing field, or "competitive neutrality" has been achieved. The quality of the ownership and governance of SOEs is of particular interest to foreign investors because it determines the attractiveness of these SOEs as either targets of direct investment or as partners in business transactions and joint ventures or strategic partnerships. Some SOEs have managed to successfully attract foreign investors by making a convincing push towards alignment with internationally-recognised standards of corporate governance.

The corporate governance framework in Viet Nam remains a work in progress, but the regulatory steps taken in the last few years to address (*i*) the organisation of the state ownership function of SOEs, (*ii*) the rights and equitable treatment of shareholders, (*iii*) the requirements for disclosure and transparency, and (*iv*) the functioning of boards of listed companies offer promise to domestic and foreign investors (Figure 4.4).[1] The reform of the corporate governance framework is ongoing and new regulations are expected to come into force soon. The *G20/OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* are useful benchmarks for Vietnamese policymakers as they continue to develop and measure progress in developing their corporate governance frameworks.

Policy recommendations

- *Clarify and ensure effective separation between the state ownership function and regulation.* A clear separation is a “fundamental prerequisite” for ensuring a level-playing field with the private sector and for avoiding competitive distortions. Clear laws and regulations should be developed to protect the independence of regulators, especially vis-à-vis line ministers. Nominal independence is not enough, as the operational independence might be jeopardised by a narrowly based fee structure, for example, or by a lack of control over one’s budget. Appropriate financial and human resources should be provided to allow regulators to function adequately with the right level of operational independence. The government should move ahead with its decision to create a professional agency to lead the state ownership function with the aim of separating state ownership and regulation. Its legal framework as well as the guidance for its organisation and operation should be released as soon as the agency is established.

- *Develop and disclose a state ownership policy.* The ownership policy should define clearly the overall rationale for state ownership and should be published and made public, clarifying the main objectives to which this rationale gives rise. Most importantly, the ownership policy should define how the state should behave as an owner. Clear and published ownership policies provide a framework for prioritising SOE objectives and are instrumental in limiting the dual pitfalls of passive ownership or excessive intervention in SOE management.

- *Consider means to reinforce the governance of SOEs, including state-owned corporate groups*. The diversification of ownership of wholly-state owned enterprises government can be one means of facilitating the promotion of internationally-recognised governance practices. Specific quantitative targets for state capital divestment should be aligned with the government's state ownership policy.[2] The roles and responsibilities of agencies in setting the equitisation roadmap and policy for state capital divestment should be clarified.

- *Reinforce provisions protecting the rights of minority shareholders.* The protection of minority interests is a cornerstone to develop the capital market. An effective system is needed to protect effectively and conveniently against abuses by majority shareholders, such as related-party transactions. This is crucial for Viet Nam to be credible in ensuring an equitable treatment of all shareholders and, as much as possible, equal access to corporate information.

- *Reinforce minority shareholders' capacity to obtain effective redress for the violation of their rights.* Even if an appropriate legal and regulatory framework is in place with regards to the protection of minority shareholders, effective and timely enforcement is often lagging in Viet Nam. To improve implementation and enforcement of minority shareholders rights, a priority should be to further reinforce the capacity of relevant regulators such as the State Securities Commission (SSC).

- *Enhance the quality of disclosure and ensure that it is made in a timely manner.* The authorities should promote the adoption of emerging good practices for non-financial disclosure, in both Vietnamese and English. Full convergence with international standards and practices for accounting and audit should be sought.

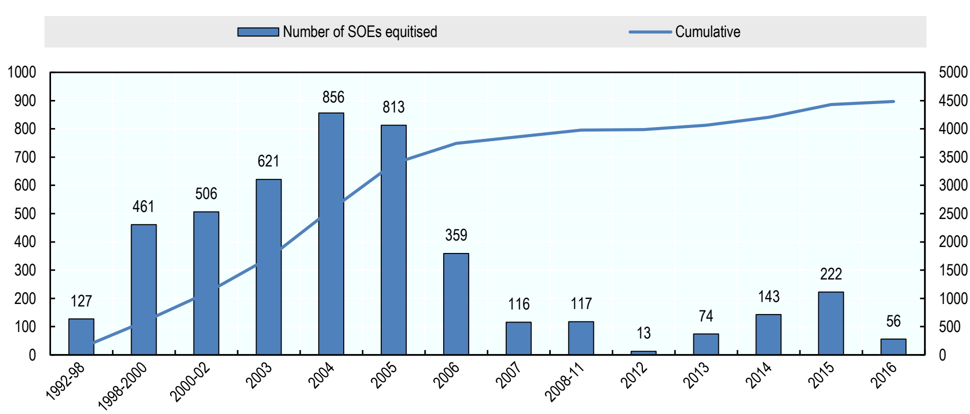
The implementation and monitoring of audit and accounting standards should be overseen by bodies independent of the profession. Managers, board members, and controlling shareholders should disclose structures that give insiders control disproportionate to their equity ownership.

- *Increase the independence of boards and improve the transparency of the nomination process*. One of the most effective tools to protect minority shareholders remains the election of independent directors. In some cases, the public perception in Viet Nam is that independent directors are not independent-minded and that there is political interference in the nomination process. Minority shareholders should be able to exert influence on their election through the possibility of nominating candidates through e-voting. The board nomination process should include full disclosure about prospective board members, including their qualifications, with emphasis on the selection of qualified candidates.

Developing a framework for corporate governance in Viet Nam

Early Vietnamese reforms substantially diminished the economy's primarily state-directed foundation. Between 1991 and 2015, the number of wholly state-owned enterprises was reduced from 12 000 to slightly more than 700, largely through equitisation, mergers, closures and sell-offs.[3] A notable element of the restructuring involved a broadening of ownership through equitisation (*i.e.* the conversion of SOEs into joint stock companies).[4] After significant progress in the late 1990s and early 2000s, the pace of equitisation slowed between 2005 and 2012 (Figure 4.1).

Figure 4.1. **Progress of equitisation, 1992-2016**



Source: MoF, NSCERD and CIEM, 2016

Box 4.1. The G20/OECD Principles of Corporate Governance and OECD Guidelines on Corporate Governance of State-Owned Enterprises

Good corporate governance is not an end in itself. It is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment. Access to equity capital is particularly important for future oriented growth companies and to balance any increase in leveraging. The G20/OECD Principles of Corporate Governance (the *Principles*) therefore support investment as a powerful driver of growth.

The *Principles* were originally developed by the OECD in 1999 and updated in 2004 and 2015. The latest review was carried out under the auspices of the OECD Corporate Governance Committee with all G20 countries invited to participate in the review on an equal footing with the OECD Member countries. The *Principles* provide guidance through recommendations and annotations across six chapters:

- *I) Ensuring the basis for an effective corporate governance framework*
- *II) The rights and equitable treatment of shareholders and key ownership functions*
- *III) Institutional investors, stock markets and other intermediaries*
- *IV) The role of stakeholders in corporate governance*
- *V) Disclosure and transparency*
- *VI) The responsibilities of the board*

Importantly, the *Principles* have a proven record as the international reference point and as an effective tool for implementation. They have been adopted as one of the Financial Stability Board’s (FSB) Key Standards for Sound Financial Systems serving FSB, G20 and OECD members. They have also been used by the World Bank Group in more than 60 country reviews worldwide. They serve as the basis for the Guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision, the OECD Guidelines on Insurer and Pension Fund Governance and as a reference for reform in individual countries.

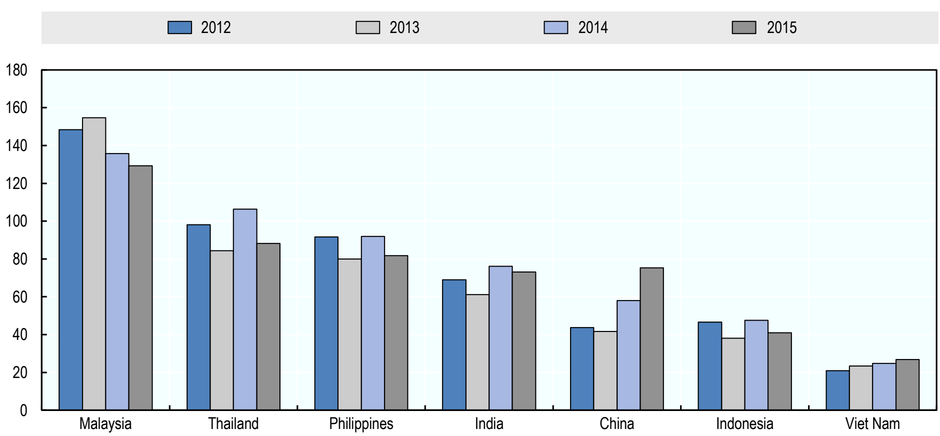
Complementing the *Principles*, the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (the *Guidelines*) are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. The Guidelines were first developed in 2005 and have been updated in 2015 to reflect a decade of experience with their implementation and address new issues that have arisen concerning SOEs in the domestic and international context.

Most equitised SOEs aim to become listed on one of Viet Nam's two stock exchanges, with their shares transferred under the guidance of the State Capital Investment Corporation (SCIC)/Ministry of Finance.[5] As of end-2015, there were nearly 700 companies listed on the Ho Chi Minh Stock Exchange and the Hanoi Stock Exchange, about 450 of which are equitised SOEs.[6] Nevertheless, compared to regional peers, Viet Nam continues to lag in terms of the relative size of the capital market (Figure 4.2).

In some cases, the equitisation and listing of SOEs has faced challenges. Because equitisation and listing are conducted in two separate steps in Viet Nam, a number of SOEs – reluctant to adhere to greater disclosure requirements – have been equitised without listing on a stock exchange. As described further in the next section, it is also important to note that many equitised SOEs have retained significant levels of state ownership.

Figure 4.2. **Market capitalisation of listed domestic companies**

As a percentage of GDP



Source: World Bank, 2016

To improve the governance of both state-owned firms and listed firms, the government has in recent years developed the legal and regulatory framework. Significant elements include the *Law on Enterprises* (first in 1999, then 2005, and most recently in 2014), the *Law on Securities* (first in 2006, and revised in 2010) as well as Decree 81 on SOE information disclosure and Circular 155 on disclosure of information in the securities market (Table 4.1). The *Law on Enterprises*, for example, has established a uniform legal framework, establishing *de jure* equality among enterprises of all economic sectors (OECD, 2016).

Table 4.1. **Main laws and regulations relating to corporate governance in Viet Nam**

Name	Effective	Purpose	Notes
Law on Enterprises of 2014 (No. 68/2014/Qh13)	1 July 2015	Company Law	Replaced Law on Enterprises of 2005
Law on Management and Use of State Capital Invested in Enterprises of 2014	1 July 2015	Organising the management of state capital and investment in SOEs and enterprises with state shares	-
Circular 155/2015/TT-BTC by Ministry of Finance	1 January 2016	Guidance on the disclosure of information on the securities market	Replaced Circular 52/2012/TT-BTC
Decree 116/2015/ND-CP	11 November 2015	Revision of some articles of Decree 59/2011/ND-CP	-
Decree 81/2015/ND-CP	5 November 2015	Information disclosure of state-owned enterprises	-
Decree 87/2015/ND-CP	1 December 2015	Monitoring state capital invested in enterprises; Disclosure of operation performance and financial information of SOEs	Replaced Decree 61/2013/ND-CP
Decree 19/2014/ND-CP	29 April 2014	Issuing the sample charter of one-member limited liability companies owned by the state	-
Decree 189/2013/ND-CP	11 November 2015	Revision of some articles of Decree 59/2011/ND-CP	-
Decree 151/2013/ND-CP	20 December 2013	Functions, tasks and operation mechanisms of the State Capital Investment Corporation	-
Decree 59/2011/ND-CP	5 September 2011	Transformation of wholly state-owned enterprises into joint-stock companies	Replaced Decree 109/2007/ND-CP
Law on Securities of 2010	1 July 2011	Law governing securities offering, listing, transaction, trading, and securities market	Replaced Law on Securities of 2006
Listing rules of the Ho Chi Minh and Hanoi stock exchanges	2000 and 2005	Rules governing the issuance of and trading in equity and debts securities of listed companies	-

Source: OECD research

A significant obstacle remains that, as a result of regular changes in the regulatory landscape, awareness by market participants of the corporate governance framework is sometimes limited. In addition to the various regulations, the State Securities Commission (SSC) and the stock exchanges have collaborated on a number of voluntary initiatives to promote better corporate governance of listed firms, including the Viet Nam Annual Report

Awards, the Viet Nam Corporate Governance Scorecard and the ASEAN Corporate Governance Scorecard.[7]

Though the corporate governance framework has become more comprehensive recently, some important gaps remain. Most importantly, good corporate governance requires not only an adequate legal and regulatory framework, but effective enforcement to ensure that the rules are respected. At the moment, the SSC has a number of enforcement powers over publicly listed companies, including the ability to fine and suspend or remove licences. Yet the SSC is constrained by its inability to initiate civil actions in court or collect damages on behalf of shareholders. Staff resources are another constraint. As of June 2016, the SSC had 399 staff, including 19 in public companies supervision, 31 in inspection and 31 in market surveillance.

Restructuring the ownership and governance of SOEs

An assessment of the investment climate in Viet Nam necessarily includes an evaluation of SOE sector reforms. SOEs in Viet Nam account for about one-third of GDP, and after over 20 years since the equitisation process began, the state retains a majority stake in more than 3 000 SOEs (IBRD/World Bank, 2016). Equitisation and state divestment have been a priority in recent years. Between 2011 and September 2016, 537 SOEs were equitised with a total enterprise value of VND 789.9 trillion (USD 35 billion), of which the real value of state capital was VND 210.7 trillion (USD 9.3 billion). During this same period, state business groups and general corporations divested nearly VND 11.520 trillion (USD 510 million) and the SCIC divested approximately VND 4.3 trillion (USD 190 million). This divestment process has resulted in an increase of the involvement of private investors in equitised enterprises, which has encouraged the application of internationally-recognised corporate governance practices.

However, the continued presence of a large SOE sector is relevant to the investment climate in at least two important respects. First, considering the economic weight of SOEs, it is important to assess whether an economic climate of "competitive neutrality" has been established. This implies a business climate that provides for a level playing field, where no domestic or foreign entity, operating in a mixed market where both state and private actors are present (or could be present), is subject to undue competitive advantages or disadvantages. In the case of an uneven playing field, there is a risk that would-be investors are crowded out by less efficient competitors. Vietnamese SOEs are frequently able to borrow from commercial banks on easy terms and SOEs are among the few firms that are able to borrow from the Viet Nam Development Bank. Moreover, these credits require little or no disclosure by the borrower and are largely unsupervised by the relevant financial sector enforcement agencies (OECD, 2016). As a result, the size of non-performing loans in SOEs is basically unknown. Anecdotal evidence points to a number of cases of poor SOE performance and their potential impact on the Vietnamese economy. In 2010, for example, in a well-known case, the shipbuilder Vinashin defaulted on a foreign loan, triggering a downgrade of Viet Nam's sovereign debt.

Second, the quality of the ownership and governance of SOEs is of interest to foreign investors because it determines their attractiveness as either targets of direct investment or as partners in business transactions and joint ventures or strategic partnerships. Approximately 54% of SOEs in Viet Nam are managed by local governments, 27% by line ministries and 19% by state economic groups. The State Capital and Investment Corporation, meanwhile, has taken stakes in a number of equitised SOEs (Box 4.2). Overall, reform measures to encourage a more transparent and consistently implemented state ownership policy and clarify the role of the state as an owner would be welcome. It would be central in reducing inefficiencies and allowing potential investors to make well-informed decisions.

Box 4.2. **The State Capital Investment Corporation**

The Vietnamese government in 2005 established the State Capital Investment Corporation (SCIC), whose role is to represent the state's shareholdings in the enterprises, in other words, to centralise or integrate the ownership function and clearly separate it from (other) regulatory and policy functions carried out by line ministries. The SCIC commenced it operations on 1 August 2006. It is a special economic organisation of the state whose functions and responsibilities are mandated by law. It is entirely owned by the state and is chaired by the former Chief of Office at the Ministry of Finance. It is organised as a financial holding company. The SCIC receives and represents state equity ownership in enterprises where the state owns shares.

The objectives of the SCIC are to speed up the SOE equitisation and reform process, to split regulatory functions from commercial functions, to enhance effectiveness of the management and investment of state assets and capital, and to promote the introduction of good practices of corporate governance. The SCIC had at one point stakes in about 1 000 companies. The number has been reduced substantially through the implementation of a divestment strategy, and as of end-2016 the SCIC held stakes in about 150 companies.

Among the difficulties that SOEs in Viet Nam face in attracting foreign investment are reputational challenges. Since a number of high-profile corruption cases became public, investors have not been shy to voice their fears of embezzlement or inefficiencies related to corporate graft. In

December 2013, in a highly-publicised case, the former Chairman and Director General of Vietnam National Shipping Lines (Vinalines) were put on trial for allegedly embezzling VND 2 billion. While such cases have weighed on the reputation of the Vietnamese state-owned sector, some SOEs have managed to successfully attract foreign investors by making a convincing push towards alignment with internationally-recognised standards of corporate governance. The dairy producer Vinamilk, for instance, which regularly publishes annual reports and financial information on its website in English and Vietnamese, has attracted a number of foreign strategic and institutional investors.

The recently updated legal framework governing enterprises indicates that Vietnamese policymakers recognise the need to improve the accountability and performance of SOEs. Since 2011, the government has demonstrated its intention of revitalising the restructuring of SOEs in its recently-terminated Socio-Economic Development Plan (SEDP) for 2011-15 as well as in Decision 929/QD-TTg, 17/7/2012 and Decision 707/QDD-TTg, 25/5/2017 that approve the SOE restructuring plan respectively for 2011-15 and 2016-20. Under these plans, the government set a target of equitising 531 SOEs in 2011–15. As of the end of December 2015, 478 out of the targeted SOEs had been equitised (or 93% of the targeted SOEs). Many equitisations, it should be noted, have been slow to involve the sale of large stakes. The equitisation of Vietnam Airlines in November 2014, for example, initially involved offering only a 4.3% stake until an agreement was reached in June 2016 for ANA Holdings, a Japanese firm, to take an 8.8% stake. The slow nature of the equitisation process is acknowledged in the SEDP for 2016-20. Amid slow progress, the government retains its ultimate plan that only enterprises that are considered to be of strategic importance (*e.g.* energy, national security) will retain full state ownership.

During the 12th Party National Congress, the Vietnamese government proposed to establish a professional agency to oversee the management of state invested capital. In June 2017, Resolution No.12-NQ/TW has formalised the establishment of such agency by the end of 2018. The purpose of this agency would be to separate the state ownership function from the state's regulatory role in order to level the playing field between SOEs and private enterprises. This would be in accordance with market principles and international agreements signed by the Vietnamese government. In addition, the regulatory framework governing the financial mechanism of SOEs has been improved with the aim of enhancing the governance of SOEs in accordance with Decree no. 91/2015/ND-CP relating to government capital investment in enterprises as well as Decree no. 87/2015-ND-CP relating to the supervision of government capital, efficiency evaluation and the publication of financial information. In 2016, the Prime Minister also issued Decision

No.58/2016QD-TTg on the criteria for classification of SOEs and proposed the list of SOEs to be rearranged over 2016-20.

Recent international agreements aim to promote further corporate governance reforms

As part of ASEAN, the Vietnamese authorities have agreed to improve corporate governance standards with the aim of facilitating the freer flow of capital. Under the ASEAN Economic Community (AEC) Blueprint, the five core elements to establish a single market and production base include: (i) free flow of goods, (ii) free flow of services, (iii) free flow of investment, (iv) freer flow of capital, and (v) free flow of skilled labour. One of the actions described to facilitate the freer flow of capital is to "achieve greater harmonisation in capital market standards in ASEAN in the areas of offering rules for debt securities, disclosure requirements and distribution rules." With the aim of supporting the implementation of these aims, the ASEAN Capital Market Forum was set up to focus on harmonisation of capital market rules and regulations.

Beyond Southeast Asia, the Vietnamese authorities recently have concluded a notable free trade agreement with the 28 member states of the European Union (concluded on 2 December 2015). The EU-Viet Nam FTA is, according to the European Commission, "the most ambitious and comprehensive FTA that the EU has ever concluded with a developing country." It includes commitments that the signatories will endeavour to ensure that enterprises observe internationally-recognised standards of corporate governance.

Chapter 10 of the EU-Viet Nam FTA on "State-owned Enterprises, Enterprises Granted Special Rights or Privileges and Monopolies" also refers to internationally-recognised corporate governance and competition standards. The signatories commit to ensuring the enforcement of laws and regulations in a consistent and non-discriminatory manner, and to ensuring that SOEs act in accordance with commercial considerations in their purchases or sales of goods or services. Importantly, Article 6 on Transparency includes that a Party which has reasonable reason to believe that its interests are being adversely affected by the commercial activities of an SOE may request in written form that SOE to supply information about its operations related to (a) the ownership and the voting structure of the enterprise, (b) a description of any special shares or special voting, (c) the organisational structure of the enterprise, (d) a description of which government departments or public bodies regulate and/or monitor the enterprise, (e) annual revenue or total assets, and (f) exemptions, non-conforming measures, and immunities.

Regulatory improvements to the rights of shareholders

According to the *G20/OECD Principles of Corporate Governance*, the corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. Shareholders' rights to influence the corporation centre on certain fundamental issues, such as the election of board members, amendments to the company's organic documents, approval of extraordinary transactions, and other basic issues as specified in company law and internal company statutes. Shareholders should have the opportunity to obtain effective redress for violation of their rights.

For Viet Nam, the establishment of a framework for the rights of shareholders benefitted from recent changes with the amendments to the Corporate Governance Regulations (*e.g*. the timely disclosure of documents and materials in English), and the revised *Law on Enterprises* 2014. The new law, meanwhile, introduces e-voting, raises the number of days for which shareholders must receive notice for annual general meetings, and reduces the required quorum for a general shareholder meeting (Table 4.2). These regulations set the bar high for Vietnamese companies, which has helped to improve Viet Nam's ranking on a number of corporate governance assessments. Ensuring compliance by individual firms will be the greatest challenge.

The *ASEAN Corporate Governance Scorecard* takes note of these recent improvements to the corporate governance framework regarding the rights of shareholders. It determines that the Corporate Governance Regulations of 2015 and the *Law on Enterprises* of 2014 have significantly improved the procedures and institutions that allow shareholders to participate in significant decisions of the company at a reasonable cost.

These regulatory changes, which improve access to information and the ability of shareholders to influence company decisions, constitute important developments in strengthening shareholder rights. As a large degree of shareholder rights are exercised through the general shareholders meetings, shareholders need to be assured that they will be properly updated on when the meetings are organised and have access to the relevant material on a timely basis. This revised legal framework puts Viet Nam firmly on par with many jurisdictions. Nevertheless, more time is needed before an assessment of the implementation of these practices at the company level can be made.

Table 4.2. **Recent regulatory changes to the rights of shareholders**

Regulation	Relevant details
Corporate Governance Regulations	Companies should provide timely disclosure of documents and materials in English.
	Companies must disclose voting and voting tabulation procedures before and after a general shareholder meeting.
Law on Enterprises 2014	Shareholders must receive notice for annual general meetings ten days prior to the event, up from seven days in the previous regulation.
	The introduction of e-voting enables absent shareholders to vote for or against resolutions equivalent to shareholders who are present at general shareholder meetings.
	Required quorum for a general shareholder meeting of a joint-stock company for the first and second attempts reduced to 51% and 33%, respectively.

Source: OECD research.

Increasing disclosure and transparency

Directly tied to the rights and equitable treatment of shareholders is the need for high levels of corporate transparency, irrespective of whether the state retains a significant degree of ownership. To accurately evaluate existing and potential risks, investors need access to information detailing corporate decision making processes, monthly or yearly performance statistics, and potential sources of conflicts of interest. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.

The framework of laws, circulars and decrees that together set the standards for public companies to provide for timely, reliable and relevant disclosure in Viet Nam is multi-layered. It is becoming increasingly detailed, but awareness by market players remains low, and some recent regulatory and legislative initiatives may have made this even more challenging. Several standards, from separate laws and regulations appear to overlap with one another. For example, the Department of Accounting and Auditing Policy of the Ministry of Finance has formed standards of accounting and financial/non-financial disclosure through the use of the Vietnamese Accounting Standards Board. The board's authority is supported by the *Accounting Law* of 2003, which established the legal precedent for both public and private sectors. While the board issues the Vietnamese Accounting Standards (VAS), additional mandatory implementation guidance can come in the form of "circulars".

There is also complexity stemming from the fact that under the current structure, some Vietnamese companies prepare financial statements in line with International Financial Reporting Standards (IFRS), in the interest of reporting to foreign investors. In fact, the Ministry of Finance has announced that all listed and public firms will be expected to adopt IFRS by 2020. Those IFRS financial statements are supplementary financial statements published in addition to – not instead of – statements prepared using the national accounting standards, the VAS. In its efforts to enhance comparability and improve transparency, the government has stated that it aims to align its accounting and auditing standards with IFRS. Whether the alignment with IFRS can be fully implemented in the near future remains unclear as its implementation may be hindered by capacity constraints. In a push in this direction, the current system for accounting will soon be overhauled as the Ministry of Finance, on 20 November 2015, issued *Accounting Law* 2015, which will supersede the 2003 version, and will come into effective on 1 January 2017.

Important developments over the last few years – particularly those detailed in the *Law on Enterprises* of 2014, the Corporate Governance Regulations of 2015, Circular 155/2015/TT-BTC and Decree 81/2015/NĐ-CP – have made significant upgrades to the standards for information disclosure.[8] Circular 155/2015/TT-BTC, for example, which regulates the public disclosure of information on the securities market, introduces a rigorous list of 18 disclosure items that a public company must disclose within 24 hours of certain events occurring. A public company must, in one example, not only report any material change adverse to its business but also confirm or deny that that event has had an impact on the price of the securities of the company (Asia Counsel, 2015). While the Corporate Governance Regulations prioritised publications in English to expand access to foreign investors, Circular 155/2015/TT-BTC requires annual and management reports to be in both English and Vietnamese.

From the viewpoint of investors, what remains to be seen is if these different standards will be understood and implemented. The most recently revised standards impose stricter and more thorough requirements for disclosure and transparency, including requirements for financial and operating results, remuneration polices, and related party transactions (Table 4.3).

Table 4.3. **Selected disclosure requirements for Vietnamese companies**

Disclosure requirements	Regulation	Relevant details
Financial and operating results	Circular 155/2015/TT-BTC (effective from January 2016)	"The deadline for disclosure of the annual report is 20 days since publication of the audited annual financial statements but no later than 120 days since the year end date."
-	Decree 81/ 2015/ND-CP (effective from November 2015)	"Governs the contents, orders, procedures, and responsibilities for information disclosure of state-owned enterprises."
Major share ownership and voting rights	Disclosure Rule 2012 (Circular 52), Article 26	"Organizations, individuals or a group of relevant people holding 5% or above of voting stocks of a public company, investors holding 5% or above of fund certificates of a closed public funds or withdrawing from being major shareholders/investors holding 5% or above of fund certificates of a closed public funds must report on ownership to public companies/fund management companies, SCC and SE."
Remuneration polices	Corporate Governance Regulations, Amendment 2012 (Circular 121), Article 16	"The remuneration of the board of management shall be annually approved and announced by the general meeting of shareholders in accordance with regulations."
Related party transactions	Law of Enterprises 2014	The 2014 revision provides that the Chairman, CEO, legal representative, Supervisory Board members and other management personnel must notify the company if he/she owns interest in other companies and if their related persons hold 10% or more in other companies.
Foreseeable risk factors	Circular 155/2015/TT-BTC (effective from 1 January 2016)	Includes a list of 18 disclosure items that a public company must disclose within 24 hours of the event occurring. As an example, a public company must disclose any material adverse change to its business.
Governance structures and policies	Corporate Governance Handbook	In partnership with the State Capital Investment Corporation (SCIC), the Hanoi Stock Exchange developed a Corporate Governance Handbook in September 2014, which is structured around the G20/OECD Principles of Corporate Governance.
Financial and operating results	Circular 155 (effective from January 2015)	"The deadline for disclosure of the annual report is 20 days since publication of the audited annual financial statements but no later than 120 days since the year end date."
-	Decree 81 (effective from November 2015)	"Governs the contents, orders, procedures, and responsibilities for information disclosure of state-owned enterprises."

Source: OECD research.

Bolstering the independence and effectiveness of boards

In the past two decades, as a number of emerging market economies have made progress towards adopting fundamental principles of good corporate governance, ensuring well-functioning and independent boards of directors has been a significant challenge. Legally mandating the introduction of boards is a welcome development but is often inadequate for ensuring their independence and effectiveness. According to the *G20/OECD Principles of Corporate Governance*, key responsibilities of the board include guiding corporate strategy, monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation.

Vietnamese boards – or "boards of management" (Hội đồng quản trị) as they are known – have been tasked with the functions that should nominally give confidence to foreign and domestic investors that the requisite layers of oversight are in place. The *Law on Enterprises* of 2014 has greatly expanded the existing framework related to boards. Some important amendments include the introduction of the concept of independent board directors and the ability for firms to choose between a one-tier and two-tier board system. The 2014 *ASEAN Corporate Governance Scorecard* highlights the positive changes to the mechanisms that are meant to enhance the composition and responsibilities of boards in Viet Nam.

One of the more ambitious changes in the *Law on Enterprises* of 2014 is to allow joint-stock companies to set up an audit committee of the board of directors as an alternative to a supervisory board ("Ban kiem soat"). If this option is adopted, the Law requires joint-stock companies to have at least 20% independent directors.[9] Although the regulations have set high standards for listed companies, the main challenge now is implementation. Vietnamese companies continue to face challenges in finding independent directors with adequate management skills and experience to fulfil these requirements.

It is well known that one of the greatest risks associated with corporate governance, for both publicly and privately held firms, is that boards become "ineffective rubber-stamps", which are then controlled by the management of the company. A common concern to outside observers has been that even though the new legislation is on par with international standards, this legislation may not be enforced adequately. With a regulatory definitions for the term "independence" and ambitious benchmarks for boards in place, the framework regarding boards in Viet Nam has improved significantly. The next step now is to embed these changes in practice at the company level.

Table 4.4. **Assessment of corporate governance in Viet Nam**

Chapters of the OECD Principles of Corporate Governance (now "G20/OECD Principles")	2006	2013	
	Viet Nam	Viet Nam	Selected Asia*
The Corporate Governance Framework	41	60	71
Shareholder Rights and Ownership	53	74	76
Equitable Treatment of Shareholders	35	67	71
Equitable Treatment of Stakeholders	48	55	70
Disclosure and Transparency	48	52	71
Responsibilities of the Board	43	52	69

Note: 95% = fully implemented, 75-95 = broadly implemented, 35-75 = partially implemented, less than 35% = not implemented

*: includes Indonesia, India, Malaysia, Thailand, Philippines and Viet Nam.

Source: Report on the Observance of Standards and Codes (ROSC), World Bank, 2013.

Competition policy

A competitive environment is essential for a dynamic business environment in which firms invest (OECD, 2015). Creating and maintaining this environment requires a sound and well-structured competition law, as well as competition authorities that are adequately equipped with suitable, skilled resources, free from political interference and that enforce the law. A sound competition regime requires that firms know the rules of the game and respect them and that those rules are applied equally to all firms – private, state-owned, foreign or domestic. By the Viet Nam Competition Authority's own admission, all or at least some of these requirements are not present as it suffers from "limited resources and unsound regulations"[10].

Institutional aspects

The main legal instrument to promote competition is the Viet Nam Competition Law (No.27/2004/QH11 or VCL). The VCL was enacted in December 2004 and took effect on 1 July 2005. However, by end of 2016, Viet Nam started revising and amending their Competition Law. As scheduled, the draft of new Competition Law will be submitted to National Assembly for adoption. The VCL stipulates rules governing procedures, and the government also passed a number of guidance decrees to clarify the procedure on complaints, investigations and orders. Competition proceedings are carried out according to the VCL and relevant guidance Decrees. The VCL stipulates that rules governing procedures. For example, Chapter 5 of the Competition Law stipulates that competition cases must be considered and handled through hearings to ensure that parties have the right to be heard and present evidence before imposing any sanctions or remedies. In 2014, the government also issued Decree No. 71/2014/ND-CP which has specific provisions on the imposition of penalties for violations against the Competition Law. It includes new provisions on determination of fines for violations, which is aimed at improving the effectiveness and consistency of competition law enforcement.

Under the competition regime in Viet Nam, there are two competition authorities, which are the Viet Nam Competition and Consumer Authority (the VCCA)[11] and the Viet Nam Competition Council (the VCC). The VCCA is established under the Ministry of Industry and Trade, and its Director-General is appointed by the Prime Minister at the proposal of the Minister of Industry and Trade. The VCC is composed of 11-15 members serving a five-year term who are appointed by the Prime Minister at the proposal of the Minister of Industry and Trade. VCCA investigates competition restriction cases[12] which will be transferred to the VCC for final decision. Regarding unfair competition practices, VCCA investigates, handles and issues final decisions of the cases. VCCA is also responsible for a number of other functions beyond the competition provisions: consumer protection and trade remedies. The VCC has adjudicative powers and is responsible for deciding competition restriction cases and may impose fines and deal with breaches of the law on competition[13].

The VCL is divided into five major substantial arrangements: (*i*) prohibited competition restriction agreements (*ii*) prohibited acts of abusing the dominant/monopoly position on the market (*iii*) economic concentration (*iv*) unfair competition acts (*v*) acts that state management agencies are prohibited from performing.

Institutionally, the VCCA is a Division of the Ministry of Industry and Trade (MOIT) which is responsible for industrial and trade policy in Viet Nam. As mentioned above the head of the VCCA and the members of the VCC are all appointed by the Prime Minister. Therefore, this factor may raise issues of independence from government. Some of the main factors that are generally considered to influence the independence of agencies are factors such as (*i*) who appoints the head of the agency or agencies – whether it be the parliament or the head of government, (*ii*) whether the agencies are integrated into the government structure or are placed outside that structure (e.g., not part of a ministry), (*iii*) budget autonomy.

The degree of independence of competition agencies varies considerably across jurisdictions, but at least some degree of independence is desirable for a sound and effective competition policy regime. The degree of independence of agencies and the advantage of being removed from politics influences legal certainty and consistency of application of rules over time. The fact that the VCCA is integrated into the MOIT means that it depends on the ministry directly for its budget, whilst the appointment of the decision makers of the two agencies (the VCCA and the VCC) by the head of government means that both of these agencies could be more independent than they are currently.

Since the MOIT is a regulatory body, the granting of support to the many industries it governs may impede VCL enforcement in those industries, as this would mean that the same ministry would be delivering what might be seen as contradictory decisions. Furthermore, MOIT’s role in industrial policy and in particular in the support of the development of domestic industries may mean that it is hard to ensure fairness and transparency in enforcing the VCL, in particular against state owned enterprises.[14]

In its Annual Report of 2015, the VCCA pointed to several challenges in its investigations due to some limitations. First is a lack of human resources: the majority of staff is young and does not have enough professional expertise and case handling skills which can be linked to the available budget. There are also many cases where companies refused to cooperate and provide information necessary for handling cases, which may be linked to buy-in by the wider community of the importance of competition policy, or the impression that it is not effective. Lastly, as seen in the tables below, most of the decisions are taken on unfair competition acts. This may be explained on the basis of the priorities that are set for or by the VCCA (which may be linked to its degree of independence)[15], although the higher complexity of competition cases may also play a role. By its own admission, the number of competition cases under investigation by the VCCA is “minimal”.

From 2009 until 2016, the VCCA investigated 172 unfair competition cases, including advertising for unfair competition purpose, sales promotion for unfair competition purposes, discrediting other enterprises, and so on (Table 4.6). 136 cases are related to advertising for unfair competition purposes, followed by illegal multi-level sales. The prioritisation of competition cases should therefore be reinforced. Increasing further the independence of the agencies, in terms of budget and where it sits in the state organigram, may be worthwhile considering in future changes to the VCL.

Table 4.5. **Investigation regarding competition restriction acts**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Initial investigation*	5	3	7	7	10	10	14	12	10	5	78
Official Investigation	0	1	1	1	1	2	1	0	1	0	8
Decision	0	0	0	1	2	0	0	1	1	0	5

* Initial investigation procedure is triggered when the VCCA determines the legal presumption for a case is appropriate, in this stage preliminary evidence is collected to come up with the decision of whether official investigation is justified or not.

Source: VCCA 2015 Annual report

Table 4.6. **Number of unfair competition cases**

Types of unfair competition acts	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Advertising for unfair competition purpose	5	20	33	37	2	6	18	15
Sales promotion for unfair competition purpose	2	2	-	-	-	-	-	-
Discrediting other enterprises	4	1	2	-	-	-	-	-
Misleading indications	-	1	-	-	-	1	1	-
Illegal multi-level sales	3	4	1	3	1	-	4	5
Disturbing business activities of other enterprises	-	-	-	1	-	-	-	-
Total	14	28	36	41	3	7	23	20

Source: VCCA 2016 Annual report

Substantive provisions of the Competition Law

Market shares has an excessive role

The VCL uses market shares extensively when determining the anti-competitive effects of a practice or merger. In particular, a 30% market share is a threshold used throughout the VCL to determine substantial market power and to prohibit certain behaviour. In the case of anti-competitive agreements, even most hard core cartels, they are illegal only if the combined market share is 30% or more, whilst a company is considered dominant should it have 30% or more of the relevant market. In the case of economic concentration, a notification is obligatory once their combined shares reach 30% or more of the market and a merger is prohibited if the combined market share is 50% or more.

There is thus a very strong reliance on the definition of the relevant markets which are needed to determine market shares under the VCL[16]. Market definition is a widely applied analytical framework to examine and evaluate competitive concerns as, if it is done properly, it allows to identify competitive constraints a firm faces, *i.e.* demand and supply side substitution. When a relevant market has been defined, the competitors can be identified and market shares can be assigned to the market participants. Market shares are generally considered to provide an indication of market power[17].

A widely accepted goal of market definition and market shares is therefore to provide a first screen, normally in mergers or abuse of dominance cases, to classify those that give rise to competition concerns and thus warrant closer scrutiny and those that do not. This screening method allows competition authorities to concentrate resources on cases in which it is likely that the merger or practices in question could lead to substantial anticompetitive effects and to eliminate all those cases where the prospect of anticompetitive effects is insignificant. In those cases that merit further competitive analysis, competition authorities normally investigate whether indeed the market power existed in that particular instance by looking at factors such as barriers to entry[18].

This is not the way that market definition and market shares are being used under the VCL, as market shares are more than a first screen as when thresholds are exceeded these determine whether an agreement or commercial practice is considered to be prohibited. This is especially problematic in markets where it is difficult to assess boundaries or where the nature of competition in the market leads to market shares that are only weak indicators of market power, as occurs in a very significant number of markets. Examples may be where products are differentiated[19] or in bidding markets. Indeed market shares are good indicators mostly for homogeneous products.

- Market shares should be used only as a first screen for the Vietnamese authorities to determine which cases to investigate further but not to determine the outcome of those investigations and ultimately prohibitions.

Market definition should allow for more economic analysis

Additionally, the market definition exercise provided for in itself may be rather problematic. As set out in the VCL and Decree No. 116/2005/ND-CP, the "*relevant product market is a market of products or services which are interchangeable in terms of characteristics intended use and price*". All three of these characteristics must be present to determine a relevant market, in a formal check-list approach to market definition. These difficulties are compounded by the fact that the degree of substitutability between products is analysed using a simplified version of the hypothetical monopolist test[20].

The relevant market is usually defined by applying the hypothetical monopolist test, according to which a 'market' comprises all the products and regions for which a hypothetical profit maximising monopolist would impose a small but significant non-transitory increase in price. However, common practice is usually to consider an increase of 5-10% (and not more than 10% as per the Decree) and the price increase is regarded as non-transitory if it lasts for at least one year (as opposed to 6 months under the Decree). Furthermore, the test provided is too proscriptive and leaves no room for the use of economic tools that better reflect the realities of the constraints facing firms when setting prices (in particular the analysis of margins and switching).

- Laws and regulations should allow economic analysis and realities to be more integrated into the analysis by making market definition more flexible and less proscriptive and permitting the use of economic tools.

SMEs are mostly exempt from the prohibitions in the VCL regardless of their market power

The VCL effectively exempts SMEs[21] from most of the competition rules, namely merger control and anti-competitive agreements. The exception seems to be the provisions on abuse of dominance. It should be noted however that size of a firm as measured by the number of employees or capital does not accurately reflect market power on a particular relevant market. In local or regional geographic markets an SME or SMEs may possess market power and distort competition.

In most instances it can be expected that SMEs would not be dominant in a relevant market. There is therefore room for a presumption that an SME does not hold such significant power but this should be rebuttable in case evidence is obtained that determines that the firm does have significant market power. This would maintain legal certainty, reduce the burden of compliance for SMEs, not undermine the objective of increase the competitiveness of SMEs in Viet Nam at the same time as ensuring effectively competitive markets.

Specific anti-trust instruments

Cartels

Hard core cartels are not *per se* illegal

Hard core cartels (when firms agree not to compete with one another) are not considered as *per se* illegal under the VCL. Under Articles 8 and 9 of the Competition Law these types of agreements are illegal should the market shares of the parties to such an arrangement reach 30% or more of the relevant market.[22] Hard core cartels are widely and increasingly considered the most serious violations of competition law. They injure customers by raising prices and restricting supply, thus making goods and services completely unavailable to some purchasers and unnecessarily expensive for others. The categories of conduct most often defined as hard core cartels are: price fixing, output restrictions, market allocation and bid rigging (the submission of collusive tenders). As such, these types of provisions have been consistently subject to increasing sanctions across jurisdictions and are considered a priority area for investigation and prosecution.

- The VCL should be adapted to reflect the significant anti-competitive effects that arise from hard core cartels. This would lower the burden of proof on the competition agencies and raise enforcement of this type of practice.

Export exemption for cartels

Even between companies amounting to more than 30% market share, hard-core type cartels may be exempted from the prohibition should they comply with one of a number of possible conditions, including "*enhancing the competitiveness of Vietnamese enterprises in the international market*"[23] (Article 10.1 of the VCL).

This constitutes a serious risk of violating the competition laws of the importing countries. This is risk is further compounded by the fact that the use of a justification of such an export cartel[24] will require evidence and documentation that such an agreement leads to enhanced competitiveness of Vietnamese enterprises in the international market. This in turn leads to investigations and severe sanctions not only to the companies (and eventually individuals in the case of criminal sanctions) involved in the cartel but also the Vietnamese government's relationships with those importing countries may suffer. In this context it should be noted that Viet Nam has signed FTAs with a number of countries and also multilateral trade agreements with competition provisions, more recently the Trans-Pacific Partnership which may imply that this exemption may not be applied to export cartels to signatories of those agreements.

A further risk is that companies make cartels their normal business practice and thus even if in a particular instance they may ensure that prices do not increase in the domestic market in that particular product this may have spill over effects to other domestic relevant markets.

Time limits for investigations

Another element of cartel enforcement concerns the length of investigations that is legally set by the VCL[25]. Clarity about the length of the enforcement procedures fosters a climate of trust and certainty for firms operating in Viet Nam, but at the same time this raises the issue of whether the resources and investigative powers available for the VCCA to properly investigate cartels allow it to effectively gather the evidence needed within the legal timeframes established. Only a limited number of cartel cases have so far been brought[26] which raises the question of whether these tight investigation deadlines are affecting the enforcement record.

Furthermore, the fact that hard-core cartels (price fixing, market allocation, volume control, bid rigging) are not treated as a *per se* infringement and thus require not only direct evidence of such an arrangement but also additional analysis of relevant markets and market shares, means that additional analysis and investigative efforts are needed. This may further undermine the effectiveness of the cartel enforcement in Viet Nam.

Very few cartel cases

The VCCA has undertaken only four investigations of cartels leading to enforcement decisions since 2004 (2014 Annual Report). None of these cases include bid rigging cases. Competitive markets may also be ensured by fighting cartels in the context of public procurement processes (bid rigging). Not only is it estimated that bid rigging can add an additional 20% or more to procurement prices but procurement that minimises the possibilities of cartels is also a key to keeping markets functioning well and competitive. The few cases and low amount of fines may be due to either short resources or low prioritisation of cartel-type infringements by the VCCA and clearly an area requiring more attention is the fight against bid rigging in public tender procedures.

Leniency

The VCL contains no leniency programme. There is a general consensus that leniency programmes play a crucial role in ensuring effective cartel enforcement by offering lenient treatment to companies or individuals that decide to disclose the existence of a cartel to the authorities and cooperate with the investigation (OECD, 2015). Today a large number of countries have leniency policies in place. Naturally, leniency becomes all the more significant as an effective tool the higher the exposure of the company to liability is, which includes not only the legal sanctions that may apply (e.g., fines or criminal sanctions) but also the higher probability of enforcement of those sanctions by a competition authority. As noted above, the record of enforcement is relatively reduced.

- Leniency should be introduced into the VCL, but this must be accompanied by increased enforcement and application of significant sanctions.

Abuse of dominance

In Viet Nam there are clear thresholds set for dominance and then certain kinds of conduct are prohibited *ex ante*. The thresholds are based on market shares, so that a firm is dominant if it has "*market shares of 30% or more on the relevant market or if it is capable of restricting competition considerably*" (Article.11.1 of the VCL). The VCL therefore sets out a "regulatory" abuse of dominance which does not require evaluation *ex post* to determine anti-competitive effects. Arguably this form-based approach may provide more certainty and is relatively easy to administer, but also may generate results that are inappropriate, given what the actual market effects are (which may even lead to actual efficiencies in some cases). In particular, apart from the issue of using market shares as a bright line test (the limitations are discussed more in detail above) the 30% threshold for single dominance seems rather low and leads to more false positives than would be necessary[27].

Further, the VCL sets out that "groups of enterprises shall be considered to hold the dominant position on the market if they take concerted action to restrict competition" (Article 11.2 of the VCL) and collectively hold combined markets that differ depending on the number of entities[28]. The VCL thus sanctions as a collective abuse of dominant position firms that meet the requirements on the number and market share thresholds. This seems to blur the line unnecessarily between cartels type behaviour and abuse of dominance, which may create additional legal uncertainty. Furthermore, considering that there have only been two cases since 2004, this does not seem to be a priority area for the VCCA and VCC.

Mergers

As under competition restriction practices, the VCL takes a regulatory approach that prohibits mergers that lead to combined market shares greater than 50%, but provides exemptions if one of the parties is at risk of bankruptcy or if the merger promotes exports or contributes to socio-economic development or technological progress (Article 19 of the VCL). This differs from other Southeast Asian jurisdictions with competition law that have adopted a case-by-case assessment of the anti-competitive impact of a merger[29]. The approach is one based exclusively on market shares with no account taken for actual effects that may arise from the merger (including efficiencies). The approach taken should be based on effects of the merger and not just on market definition and market shares be taken in merger control.

In the case of Mergers approved on the basis of the export promotion criteria, this may cause domestic consumers in Viet Nam to pay higher prices. Importing countries may also exercise their merger control rules to intervene in the merger should their substantive rules on merger control meet their legal tests for prohibition.

Notification thresholds

Even the thresholds for notification of a transaction are based on the market shares. This is not in line with the OECD Recommendation[30] nor with the ICN Recommended Practices[31] which in broad terms consider that jurisdictions should base their notification obligations on appropriate local nexus criteria established on objective data such as local turnover or value of assets. Using market shares as notification thresholds imposes serious costs on all transactions, not least legal uncertainty – the parties to any merger would have to calculate their market shares regardless of whether the transaction ultimately needs to be notified, and this when parties are usually not in possession of data on market shares and may lack the ability to properly define markets.

- The government should consider amending the VCL to reflect the 2005 OECD Recommendation of clear, objective and quantifiable merger notification thresholds.

Competition policy commitments in free trade agreements

As regards Viet Nam’s bilateral and multilateral trade agreements, there are currently eight FTAs with individual chapters on competition. Since 2010, a competition policy chapter is included in all FTA negotiations, notably in far-reaching agreements such as the FTA between Viet Nam and the EU, the Trans Pacific Partnership, the Regional Comprehensive Economic

Partnership, where the competition chapter's content has reached deeper and wider commitments. These obligations aim to create and ensure a fair competition framework, prevent and eliminate the anti-competitive behaviour in the market, therefore promoting economic efficiency and welfare of consumers in Viet Nam. As such, the business environment increasingly maintains a level playing field for all types of businesses.

Recommendations concerning competition policy

Viet Nam should consider amendments to bring key provisions of the draft law in line with international best practice. The law contains a number of provisions that are not commonly found in the laws or enforcement practices of other jurisdictions. In the interest of adopting a legal framework that can be readily implemented and that avoids politicising the enforcement of law, the following rules and principles should be amended or adopted:

General recommendations

- Market shares should be used only as a first screen for the Vietnamese authorities to determine which cases to investigate further but not to determine the outcome of those investigations and ultimately prohibitions of anti-competitive agreements, abuse of dominance and mergers.
- Laws and regulations should be changed to allow economic analysis and realities to be more integrated into the analysis by making market definition more flexible and less proscriptive and permitting the use of economic tools.
- Market power should be measured not only via market shares but by considering a number of other factors such as barriers to entry, countervailing buyer power, amongst others.

Instrument specific recommendations

- Hard-core cartels should be made illegal per se and not benefit from exemptions.
- A leniency system should be introduced into the VCL. This should be accompanied with increased enforcement and application of significant sanctions.
- The VCL should be changed to reflect the 2005 OECD Recommendation of clear, objective and quantifiable merger notification thresholds.

Notes

1. The base of institutional investors in Viet Nam remains small. Some of the largest domestic institutional investors include Mekong Capital, Dragon Capital, Viet Nam Holding Limited, VinaCapital and PXP Asset Management.

2. Implementation of SOE restructuring should be done in accordance with SOE criteria issued by Decision No. 58/2016/QD-TTg (28 December 2016) and with the measures in the SOE restructuring project for 2016- 2020.

3. The definition of SOEs having evolved over time, their number across years may have not been calculated exactly on the same basis.

4. Equitisation refers to the transformation of SOEs into joint stock companies, through either the partial or full sale of state capital.

5. As of end-2015, the SCIC held stakes in about 197 companies. Established in 2005 with the aim of improving the efficiency of state capital utilisation, the SCIC had at one point stakes in about 900 companies, though the number has been reduced substantially through a divestment strategy.

6. As of the end of February 2016, Ho Chi Minh Stock Exchange had 311 listed companies with a market capitalisation of USD 50 billion. Hanoi Stock Exchange had 380 listed companies with a market capitalisation of USD 6.7 billion. Ho Chi Minh Stock Exchange and Hanoi Stock Exchange opened for trading in 2000 and 2005, respectively.

7. In 2015, the 8th Vietnam Annual Report Awards honoured the 50 best annual reports from companies, 37 of which are listed on the Ho Chi Minh City Stock Exchange, and 13 on the Hanoi Stock Exchange. The Outstanding Award went to the Ho Chi Minh Securities Corporation. Second and third place were awarded to Bao Viet Holdings and Vinamilk.

8. Circular 155/2015/TT-BTC was issued by the Ministry of Finance on 6 October 2015, and came into effect on 1 January 2016.

9. Article 134 states that for joint-stock companies "at least twenty per cent of the number of members of the Board of Directors must be independent members and there must be an internal auditing committee under the Board of Directors."

10. Page 54 of the 2014 Annual Report; page 50 of the 2013 Annual Report.

11. According to Decree No.98/2017/ND-CP defining the functions, power and organisation structure of the Ministry of Industry and Trade, the Vietnam Competition Authority (VCA) became the Vietnam Competition and Consumer Authority (VCCA) on 18 August 2017.

12. The VCCA have responsibilities such as: a) To accept and conduct investigations of competition cases related to competition restriction practices for the Competition Council to handle in accordance with law; b) To conduct investigations, handle or propose the handling measures with regards to acts in violation of the legislation on competition in accordance with law; c) To evaluate requests for exemption eligibility according to the legislation to submit to the Ministry of Industry and Trade for decision; d) To supervise the process of economic concentration; and e) To build up and manage the information system on dominant and monopoly enterprises in the market, competition principles applied to associations and exemption cases.

13. Other responsibilities include: "*(c) Requiring organizations and individuals involved to supply information and data necessary for the Council to carry out its assigned duties; (d) Resolving complaints in accordance with the law on competition about decisions dealing with a case concerning practices in restraint of competition where such decision was made by the Council dealing with such case; (e) Participating in administrative proceedings in accordance with the law on competition and the law on administrative proceedings.*"

14. This is the case in an economy where the state still holds very important positions in product and service markets. The Viettel-EVN decision by government to exempt this merger from the VCL is a widely recognised example.

15. This view may be supported by the fact that of the eight divisions of the VCCA only three divisions deal with competition related tasks.

16. Since 2015 market definition under VCL has served also for fining purposes, as the fines are linked to the turnover of companies on market.

17. The underlying assumption is that the size of the market share is directly and positively correlated with market power and that the degree of concentration in a market is indicative of competition problems, for example in the form of higher prices than in less concentrated industries.

18. Should the competitive analysis show that there are no substantial entry barriers, even a high market share is no indication of durable market power.

19. Product differentiation usually occurs in two distinct ways: the *attributes* of the product that appeal to differing tastes and preferences of consumers (e.g., design) and the *location* of the product or service.

20. Point c. of Clause 5, Article 4 of Decree No. 116 - : "Goods or services shall be deemed capable of being substituted for each other in terms of price if above fifty percent of a random sample quantity taken from one thousand (1.000) consumers living in the relevant geographical area change to purchase or intend to purchase other goods or services with the same

characteristics and use purpose as the goods they are currently using or intend to use where the price of such goods or services increases by more than ten (10) percent and remains stable for six consecutive months."

21. The definition of SMEs depends on the business area and can include firms up to 300 employees and total capital of USD 5 million.

22. The exception is bid rigging which is considered *per se* illegal.

23. Given that the Law also sets out that such an exemption "must reduce costs to benefit consumers" in the domestic market, this condition seems to be the only one that may actually be used.

24. The OECD defines an export cartel as "an agreement or arrangement between firms to charge a specific export price and/or to divide export markets". The rationale for permitting export cartels is that it may facilitate cooperative penetration of foreign markets, transfer income from foreign consumers to domestic producers and result in a favourable balance of trade. See OECD Glossary of Statistical Terms (http://stats.oecd.org/glossary/detail.asp?ID=3213).

25. 180 days with two possible extensions of 60 days each, totalling 300 days.

26. Cases such as the Insurance cases often cited by the Vietnamese competition agencies in international fora, may be considered as low hanging fruit, in the sense they were all based on publicly available information on the internet. This is certainly explained by the insufficient knowledge companies in Viet Nam have of competition policy, certainly in part also due to the relatively low enforcement record.

27. False positives lead to condemning conduct that is not anti-competitive leading to over deterrence and to the chilling of healthy competitive behaviour as opposed to false negatives and under-deterrence of pricing strategies that unreasonably and unnecessarily exclude rivals.

28. "a/ Two enterprises having total market share of 50% or more on the relevant market; b/ Three enterprises having total market share of 65% or more on the relevant market; c/ Four enterprises having total market share of 75% or more on the relevant market".

29. The exception in the region is Malaysia that has no economy-wide merger control rules.

30. The OECD Council adopted a Recommendation on merger review that aimed to contribute to greater convergence of merger review procedures.

31. 2002 ICN Recommended Practices for Merger Notification and Review Procedures and 2008 ICN Recommended Practices.

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Chapter 5

Tax reforms in Viet Nam

This chapter provides an overview of Viet Nam's tax system, including recent and planned reforms, and an assessment of the country's investment incentives regime. It provides an overview of existing incentives, their implications for the tax administration and proposes options to ensure that tax incentives achieve the government's policy goals in a cost-effective manner. The chapter also looks at tax governance and transparency issues.

Viet Nam's tax regime is one of the main policy instruments that can either encourage or discourage investment. Tax-related issues are found in the tax legislation, as well as in the *Law on Investment*, and multiple regulations related to economic zones. An important transparency-enhancing tax reform in Viet Nam would be to consolidate all tax-related legislative provisions into a single *Tax Code* and under the authority of a single government body. With such a variety of tax regimes, it is important for Viet Nam to assess thoroughly the effective tax rates applicable to various business segments. The tax burden on profits varies considerably across business segments which can lead to aggressive tax planning strategies by investors, including transfer mispricing.

At the same time, Viet Nam faces a widening budget deficit and a deteriorating fiscal position, with a 20% decline in government receipts between 2010 and 2014 as a proportion of GDP, although this trend began to reverse itself in 2015.[1] Fiscal pressures are nevertheless likely to grow as an ageing population puts strain on pension and health systems. The demographic dividend which ensured an ever-expanding workforce is disappearing, as the share of the population under 14 has been declining for five decades and is now at its lowest level. Viet Nam is one of the most rapidly ageing countries in the world (World Bank, 2016). Fiscal pressures will also arise from trade liberalisation as a result of the EU-Viet Nam FTA, since tariff receipts contributed 7.8% of total fiscal revenue in 2014.[2] Further and deeper equitisation in the future will also have implications for government revenue. SOEs still provide one third of domestic non-oil budget revenue. This will have to be offset in part by rising corporate tax revenues from the entry of more productive firms.

Like many countries in Southeast Asia and elsewhere, Viet Nam offers tax incentives to attract investment and to achieve important socio-economic goals such as promoting development in more peripheral regions. Viet Nam also offers a low corporate tax rate which will be one of the lowest in the region by 2016. Despite the growing recognition by the authorities of the challenges associated with tax incentives, there is inadequate analysis of their costs and benefits in a national context to support government decision making. Limited data are collected either on the direct and indirect benefits to the economy, or on the cost of these tax incentives, including forgone revenue so as to assess whether non-uniform treatment of investors and targeted tax relief can be properly justified. Businesses complain about costly compliance, inconsistent application of rulings in practice, the lack of predictability, and excessive discretion in tax-related decision-making.

Indirect costs include the variability across sectors, complexity and lack of transparency, all of which help to explain the poor performance of Viet Nam in the *Doing Business: Paying Taxes* indicator, albeit with substantial improvements in recent years. Administrative discretion can add to project risks and costs, and increase the possibility of corruption, undermining good governance objectives fundamental to securing an attractive investment environment.

Viet Nam should adopt a whole-of-government approach that ensures consistency between the country's tax policy, its broader national and sub-national development objectives, and its overall investment attraction strategy. The long-term consequences of tax base narrowed by tax incentives translate into mounting fiscal pressures, weakening macro-economic fundamentals. These rising macro-economic challenges could ultimately start corroding the country's investment attractiveness.

Policy recommendations:

- *Adopt a whole-of-government approach to tax incentives.* The Ministry of Planning and Investment (MPI) and the Ministry of Finance (MoF) have shared responsibilities, but are working towards different objectives. MPI feels compelled to offer tax incentives in order to attract investors, while MoF argues that revenues need to be raised to provide public goods, including the key pillars of a business-enabling environment, such as infrastructure. Effective co-ordination of various Vietnamese authorities mandated to promote investment with tax policy makers is a daunting but critically important task. Ultimately, strong institutional reforms will be critical to address the fragmented management and the potential for conflicts of interest and rent seeking.

- *Simplify the tax system and broaden the tax base.* More revenues need to be generated for development needs; reversing the recent decline in government receipts is a priority. This can be achieved by streamlining the tax system and eliminating wasteful tax incentives identified through a credible cost-benefit analysis. Simplifying the tax system, including through eliminating (or, at the least, limiting) tax holidays, and reducing the number of preferential tax rates, will not only increase tax revenue but also reduce administrative costs of servicing the tax system.

- *Conduct tax expenditure analysis and reporting.* Regular and consistent tax expenditure analysis is an essential element of good governance. The revenue forgone through tax incentives should be reported regularly, ideally as part of an annual tax expenditure report covering all main tax incentives. This exercise should be used to focus policy makers' attention on the fact that tax expenditures are quite similar to direct spending programmes and have to compete with other government spending priorities when the government makes its budget decisions.

- *Systematise data collection.* The analysis of tax incentives required for public statements, budgeting, periodic reviews, tracking of behavioural responses by business, etc. is data intensive. Revenue authorities need periodically to collect and analyse taxpayer data which may require them to introduce institutional mechanisms to do so. The government has a master plan for e-government with the development and integration of six major database systems, but there has been little progress in implementation. Connectivity and exchange of information across institutions remains a big challenge.

- *Strengthen capacity for policy analysis.* To support coherent and comprehensive government decision-making, the MoF needs the capacity to analyse and explain the impact of tax reforms to decision makers and the public. Both, human and institutional capacity need to be strengthened. Staff needs to be trained in modern fiscal analysis techniques and equipped with the necessary tools for putting those techniques to practical use to improve delivery of economic research and analysis for key policy decisions.

- *Limit non-uniform treatment of investors.* Viet Nam imposes a non-uniform effective tax rate on different businesses, depending on their business activity, location, or size. Certain firms are specifically targeted to receive preferential tax treatment. Policy makers should examine and weigh arguments in favour of and against such targeted tax relief; a tax burden that varies considerably from one investment type to another must have a clear rational.

- *Improve transparency and strengthen governance.* In creating an investment-promoting business environment, transparency and clarity in providing tax incentives are important. Discretionary decision-making on tax incentives, ambiguous legal drafting, inconsistent application of rulings in practice and the lack of predictability, a proliferation of rulings, an uncertain environment, frequent legislative changes, and above all, costly compliance due to excessive complexity of the tax system are all factors that deter investment. Improving clarity, transparency and good governance of the tax framework, will improve the business environment and in stimulate investment.

The tax system in Viet Nam

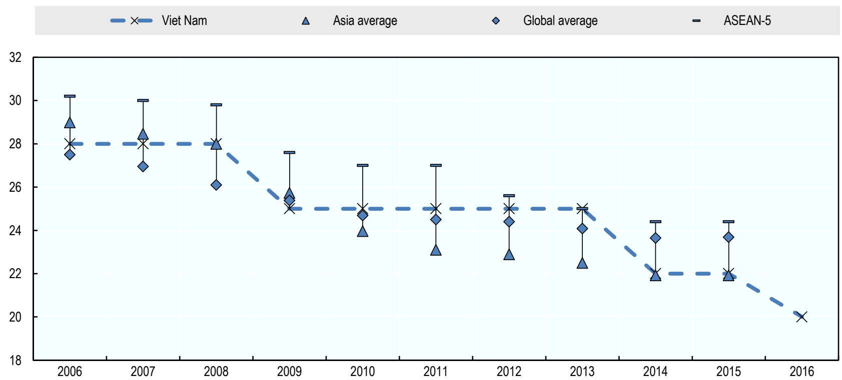
Viet Nam has been implementing a multi-stage tax reform since 1990. During the first stage of tax reforms in the 1990s, several important taxes, including a profit and turnover tax, were introduced. On tax administration, Viet Nam introduced the General Department of Taxation and gradually decentralised tax administration to subnational levels. During the second phase of tax reforms, which took place in the late 1990s and early 2000s, the introduction of a well-functioning value-added tax (VAT) and the enterprise income tax were the key milestones. The 2003 *Enterprise Tax Law* harmonised the taxation of the domestic and foreign investment; effective January 2004, a single income tax rate of 28% was established to eliminate the dichotomy between taxation of domestic companies and foreign investors (at 32% and 25% respectively, before the 2003 law).[3] The third stage of the reforms saw critical amendments to the VAT rates and the list of VAT-exempt goods and services, as well as the introduction of legislative acts and provisions related to natural resource and environmental taxation. Further, significant institutional changes were implemented in the tax administration area, including taxpayer education and taxpayer services programmes.

Most recently, the government has adopted an expansionary tax policy, aimed at stimulating investment in government-prioritised sectors and geographical areas. The adopted tax policy features steadily reduced corporate income tax (CIT) rates and a very generous system of tax incentives. Figure 5.1 shows the evolution of CITs in Viet Nam over the past ten years, compared with global average CIT rates, average CIT rates in Asia, and the average CIT rates of the ASEAN-5 countries[4]. As the Figure demonstrates, Viet Nam's CIT rates have been highly competitive regionally. With a further reduction of the base corporate tax rate to 20% in 2016, Viet Nam can claim one of the lowest corporate tax rates in the region.

Low rates and… narrow base?

A rate-cutting tax reform, akin to the one being implemented in Viet Nam, is expected to be accompanied by significant tax base broadening measures, *i.e.* elimination of tax incentives and exemptions, in order to preserve Viet Nam's fiscal position. That is not the case of Viet Nam. The complex web of tax incentives instituted in the country is not only contrary to the fundamental principle of simplicity of the tax system but, perhaps even more importantly, significantly narrows the country's tax base contributing to a notable loss of tax revenue.

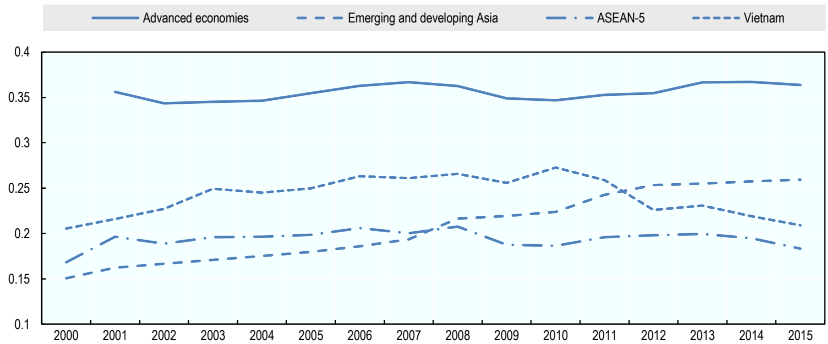
Figure 5.1. **Corporate tax rates: Viet Nam, ASEAN-5, Asia and globally (%)**



Source: KPMG, Corporate tax rates, https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html.

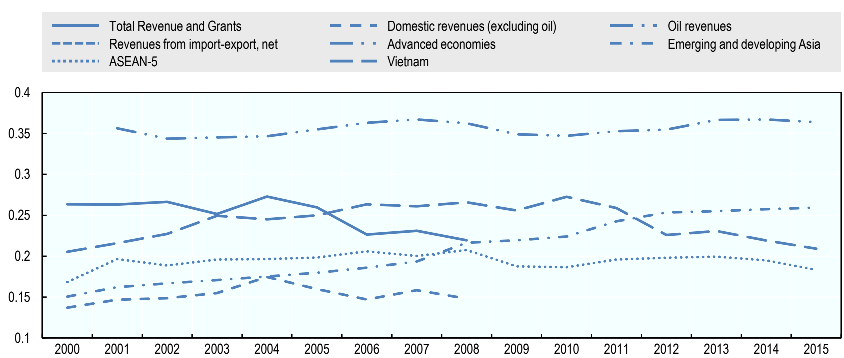
Figures 5.2 and 5.3 show Viet Nam's revenue trends against major country groups and by component and over time. The total revenues of the government went from a high of 27.3% of GDP in 2010 to a low of 21.9% in 2014, due to declining domestic tax revenue as well as shrinking oil receipts (although domestic tax revenue as a percentage of total revenue experienced an upward trend, reflecting stronger reliance on domestic resources).[5] Consequently, and despite government attempts to rein in public expenditures, the fiscal position of the country shows signs of deterioration with a widening budget deficit.[6] The increasing cost of servicing growing public debt[7] adds to fiscal pressures. While Viet Nam remains an attractive investment destination due to low wages, positive demographics, and relative political stability, the rising macro-economic challenges could start corroding the country's investment attractiveness. The questions over costs and risks associated with macroeconomic and business conditions are critically important to potential investors; as such, the mounting fiscal pressures should be eased to ensure stability of the country's macroeconomic fundamentals.

Figure 5.2. **General government revenue, Viet Nam against major country groups (% of GDP)**



Source: IMF (2015), World Economic Outlook Database.

Figure 5.3. **Total government revenue, trend and composition**



Source: Ministry of Finance.

Investment incentives

Despite analysis indicating a limited investment response to a lower tax burden relative to revenue forgone, the government of Viet Nam, as in many other developing countries, has chosen tax incentives as a way to attract investment in general, and foreign direct investment (FDI) in particular. Currently available *tax incentives* include:

- tax holidays
- reduced corporate tax rates

- import duty exemptions on equipment, raw materials, supplies, and semi-finished products
- tax concessions on personal income tax

Various *non-tax incentives* are also offered, including among others:

- exemption from, or reduction of, land use fees
- exemption from, or reduction of, land rental fees
- preferential land lease terms
- exemption from, or reduction of, infrastructure use fees
- assistance with recruitment and training of skilled labour
- assistance with immigration and residence procedures
- reduced regulatory oversight in administrative and customs procedures.

Investment incentives are granted based on:

- the location of the investment, including in difficult or especially difficult social-economic areas and in industrial parks, economic zones, and high-technology parks;
- regulated encouraged sectors, e.g. high-technology and infrastructure;
- size, including small and large investors; or
- employment, such for women or ethnic minorities.

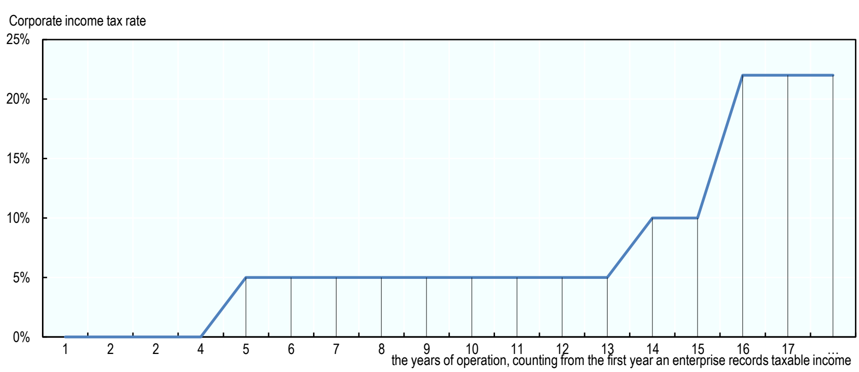
Special economic zones

Viet Nam offers a large number of special economic zones (SEZs) throughout the entire country, with even more planned (Chapter 6 on Investment promotion and facilitation provides additional information on SEZs). Various types of SEZs have been developed, including export-processing zones, industrial parks, economic zones and hi-tech parks. Since the first export-processing zone was built in Ho Chi Minh City in 1991, the number of zones grew exponentially to 61 built or in construction in 2000 and to 324 built or in construction in 2013 (UNIDO, 2015). By the end of 2017, there were 376 functioning zones in Viet Nam, including:

- 326 industrial parks
- 4 export-processing zones
- 43 economic zones (among which 26 border-gate economic zones)
- 3 hi-tech parks.

The corporate income tax incentives offered in zones may differ from one type of zone to another but also amongst industrial parks, as they are based on the socio-economic development of the province where the park is located. For example, in provinces with the lowest socio-economic conditions, they include corporate tax holidays for four years, an application of 50% of the preferential tax rate for nine subsequent years, followed by a preferential rate of 10%, counting from the first year an enterprise has a taxable income. Then, the standard corporate tax rate of 20% applies (Figure 5.4). An extension of the preferential rate of 10% to the full duration of the project can be granted, on a *discretionary basis*, by a decision of the Prime Minister, to investment in high-tech projects and ones with "visible importance."[8]

Figure 5.4. **Progression of an applicable corporate tax rate in a typical economic zone**



Source: Authors' calculations.

The application of other tax and non-tax incentives varies from zone to zone. For example, incentives offered within the Danang Hi-Tech Park include a 50% reduction in personal income tax (as in other zones), exemptions from land rents for 11 years for "special investment" projects and 2-year exemptions from infrastructure use fee for R&D, incubation and training projects.[9] Some zones enjoy special regimes on tariffs, value added tax, as well as special sales tax.

Effective tax rates

With such a variety of tax regimes, it is important that Viet Nam's policymakers thoroughly assess the effective tax rates applicable to various business segments. When considering investment options investors analyse the entire tax landscape. Serving an important signalling function, statutory tax rates are the investors' first point of reference, but effective tax rates that capture specific provisions of the tax legislation, such as tax incentives, are better indicators of the tax system's burden on businesses and the incentives to invest, as they have the ability to reflect the whole tax landscape of the country.

Policy analysts utilise backward-looking and forward-looking effective tax burden measures. Backward-looking average effective tax rates are important measures of the tax burden of the corporate sector, as they reflect actual (not hypothetical) business activities. However, no micro-level firm-specific corporate tax data were made available for analysis.[10] As such, only forward-looking effective tax rate analysis was conducted.

Forward-looking effective tax rate indicators, such as marginal effective tax rates (METR) and average effective tax rates (AETR), capture the net effect of basic statutory tax provisions on a hypothetical investment project. METRs summarise the effect of the legislative tax parameters on an incremental business activity and show how much to invest on the margin given a diminishing expected return on investment. AETRs are a more general tax burden indicator that assesses the impact of taxation on an investor, such as a typical multinational enterprise, when it is weighing up its investment decisions in relation to two or more competing projects.

The advantage of using effective tax rates is that they combine into a single measure the complex tax landscape of Viet Nam, including the statutory tax rate, the years of tax holidays and reduced tax rates, and the level and type of depreciation allowances. This measure expresses the tax liability as a share of the present value of all financial profits expected from an investment. Further, the effective tax rate combines investment-related factors, such as the expected rate of business profitability, or the type of assets invested in.

To show the impact of tax incentives on effective tax rates of various business segments, five representative tax regimes are analysed (based on the 2015 corporate tax rate of 22%), as follows:

- *Regime 1:* A project enjoys a tax holiday for 4 years, 5% corporate tax rate for 9 subsequent years, 10% corporate tax rate for 2 subsequent years; then, 22% for the life of project. This regime applies, for example, to investment in economic zones or technology parks.

- *Regime 2:* A project is granted a tax holiday for 2 years, then a corporate tax rate of 10% is applied for 4 subsequent years, 20% rate is allowed for the next 4 years. Finally, a corporate tax rate of 22% is used for the rest of the project. This regime applies, for example, to investment in geographic areas with socio-economic difficulties.[11]

- *Regime 3:* A corporate tax rate of 10% is used for the life of the project. This regime applies, for example, to investment projects into social housing, as specified in Article 53 of the Housing Law.

- *Regime 4:* A corporate tax rate of 20% is used for the life of the project. This regime applies, for example, to agricultural service cooperatives and people's credit funds.

- *Regime 5:* A standard corporate tax rate of 22% is applied for the life of the project. This regime is relevant to investment projects that don't qualify for any tax incentives.

Table 5.1 shows AETR and METR calculated for investment under each of the five tax regimes discussed above to allow for cross-comparison. Two classes of assets are considered: (1) machinery and equipment or (2) industrial buildings. The assumptions are used uniformly across all scenarios to ensure that the differences in effective tax rates are attributable only to the changes in tax variables. The results are shown in Table 5.1.

Table 5.1. **Effective tax rates on hypothetical capital investment projects (%)**

Corporate income tax regime	Machinery and Equipment		Buildings	
	AETR	METR	AETR	METR
Regime 1	3.7	5.7	5.3	5.3
Regime 2	12.1	16.2	14.1	13.0
Regime 3	9.6	8.7	9.5	8.0
Regime 4	19.3	17.6	18.9	16.3
Regime 5	21.2	19.4	20.8	18.0

Source: OECD calculations.

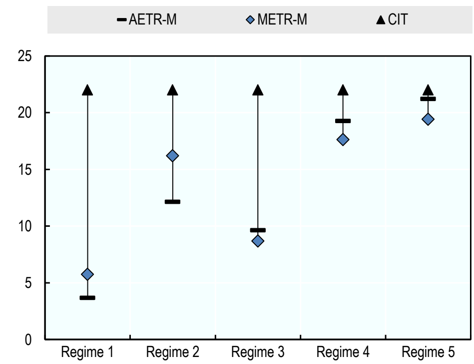
A quick glance at the effective tax rates calculated under various tax scenarios (Table 5.1 above) reveals considerable variation of the tax burden on profits across the segments of business investors in Viet Nam. The results are especially striking when shown against the statutory tax rate, as seen on Figures 5.5 and 5.6, where the size of dotted lines represents the difference between the statutory and effective tax rates for each tax regime under consideration. As observable from the figures, the lowest level of effective tax rates is enjoyed by companies that operate in economic zones or invest in areas with extreme geographic difficulties; these companies enjoy tax holidays followed by considerable reduced corporate tax rates – modelled as Regime 1. The highest level of effective tax rates is applicable to businesses that do not qualify for tax breaks – modelled as Regime 5. The difference between the highest and lowest AETR is as high as 17.5 percentage points for the investment in machinery and equipment, while the same difference in METRs is 13.7 percentage points – a substantial difference.

While the effect of significantly lower effective tax rates on targeted investment in Viet Nam is yet to be analysed, the notable variation in effective tax rates predictably attracts aggressive tax planning strategies, including though transfer mispricing. The differences in effective rates between various tax regimes open up opportunities to shift taxable profits and deductions across entities with different tax treatments either domestically or internationally. This adds further pressure on tax revenues, representing a substantial concern for the Ministry of Finance.

A tax burden on capital investment that varies considerably from one investment type to another should be evaluated. Policy makers need to know whether their targeted investment approach is effective in meeting its intended policy objectives (e.g., encouraging investment in disadvantaged regions). Beyond this, efficient targeting requires accurate estimates of the amount of tax revenue forgone in order to compare the realised benefit against the costs associated with the targeted incentives (see below for further discussion).

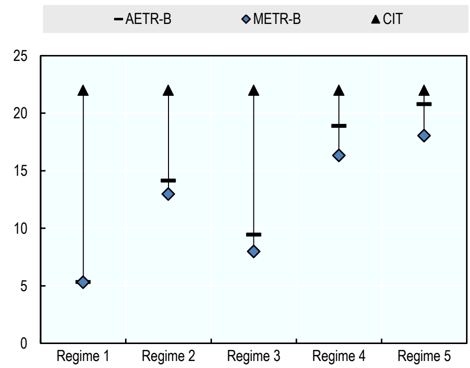
To show the effect of macroeconomic variables on effective tax rates for business investment in capital, historical inflation rates (and real interest rates) have been used in analysing the average effective tax rates that a typical business would have faced in Viet Nam from 2005 to 2015. Figure 5.7 depicts two sets of AETRs; one is modelled under a uniform rate of inflation of 3.5% and the second one is modelled with historical inflation rates. The two AETRs are plotted alongside the historical inflation rate and the statutory corporate income tax rate. The high levels of inflation in 2008 and 2011 suggest a discouraging investment environment; effective tax rates in each of these periods are systematically high. At the same time, the most recent significantly lower inflation levels produce an effect of considerably lower effective tax rates (Figure 5.7), highlighting, once again, the critical importance of macroeconomic fundamentals for attractiveness of the business environment in the country.

Figure 5.5. **Effective tax rates for investment in machinery and equipment, against the statutory corporate tax rate (%)**



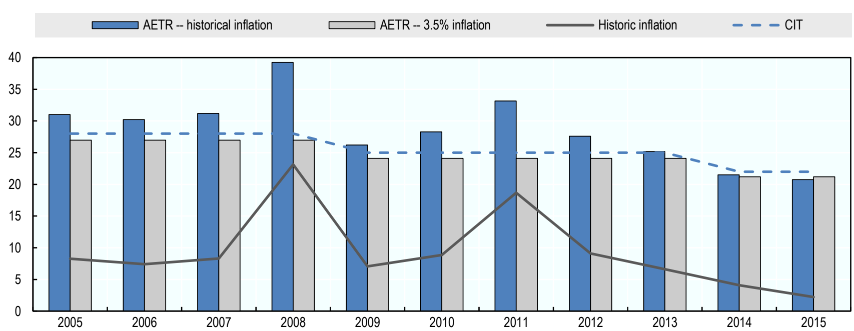
Source: OECD calculations

Figure 5.6. **Effective tax rates for investment in buildings and structures, against the statutory corporate tax rate (%)**



Source: OECD calculations

Figure 5.7. **Effective tax rates under historical and hypothetical/uniform inflation rates (%)**



Source: OECD calculations.

Are tax incentives "working" in Viet Nam? Evaluating costs and benefits of tax incentives

Do the generous tax incentives offered to investors by the government benefit the economy? A tax incentives programme can contribute to a country's economic welfare only when its benefits exceed its costs. As such, Viet Nam's decision-makers should have the capacity to distinguish between beneficial and wasteful tax incentives programmes. Thorough analysis of the effectiveness and cost-efficiency of proposed tax incentives should be conducted both prior to introducing investment-promotion measures as well as systematically *ex post*, to assess the extent to which, and the cost at which, tax incentives meet their intended objectives. Where tax relief is targeted, policy makers should examine and weigh arguments in favour of, and against, such treatment and ensure that the different treatment can be properly justified.

As present, Viet Nam's policy on investment incentives, including tax incentives, is driven mainly by the MPI. As an investment promotion arm of the government, MPI offers tax incentives in order to attract additional investment, which is thought to bring in more jobs, additional profits, and to translate into economic growth. Against this must be weighed the risk that tax incentives significantly erode the tax base and deprive the country of much-needed revenues. The long-term consequences of tax base narrowed by tax incentives translate into mounting fiscal pressures, weakening macro-economic fundamentals.

With the competing arguments *for* and *against* tax incentives, the challenge is to understand if tax incentives can achieve the given policy goals in a cost-effective manner. To this end, a comprehensive and objective assessment of costs and benefits of tax incentive programmes has to be conducted. Box 5.1 presents elements of costs and benefits of tax incentives that should be analysed.

As of December 2015, no cost-benefit analysis of tax incentives had been systematically conducted and hence no proper assessment of either effectiveness or cost-efficiency of tax incentive programmes in meeting their intended objectives – promoting investment in general and driving investment towards priority sectors or regions. Limited data are collected at the moment on the direct and social benefits to the economy generated by incentives-enticed investment; little analysis is conducted to understand the direct and indirect costs associated with the tax incentives.

Analysis of tax expenditures – a key component of the "costs" of tax incentives – has not been possible because of the absence of the required data. The primary purpose of tax expenditures analysis is to identify the revenue losses associated with tax incentives and exemptions and, consequently, focus policy-makers' attention on the fact that tax expenditures are quite similar to other government programmes that spend money directly, all of which reflect the choices that the government makes among competing priorities; it is therefore important to equip policymakers with analysis to support their informed decision-making.

Box 5.1. **Cost-benefit analysis of tax incentives**

When conducting cost-benefit analysis of tax incentives the following components of costs and benefits need to be included in the analysis.

Costs of a tax incentive programme include:

Primary revenue forgone due to tax incentives. The revenue losses associated with the tax incentives could represent a large revenue drain; this foregone revenue needs to be calculated and reported regularly. Estimates of revenues forgone due to tax incentives provide policy makers with the required inputs to inform policy decisions.

Tax planning opportunities. Tax incentives and preferential tax treatments give rise to unintended and unforeseen tax-planning opportunities. The effective tax rate differentials formed by tax incentives open up opportunities to shift taxable profits and deductions across entities with different tax treatments either domestically or internationally, resulting in significant revenue leakages.

Taxpayer compliance costs. Tax incentives impose significant compliance costs on taxpayers in understanding and complying with the tax rules and regulations. Time and money spent by businesses to qualify for and receive tax incentives, as well as to lobby the government for incentives, represent significant indirect costs.

Administrative costs. The indirect costs of tax incentives, including the administrative costs of running them, could be quite substantial; technical personnel need to be hired or (re)trained to ensure compliance with the rules, additional data and information management systems need to be introduced or adjusted. There is also an additional cost of staff and materials required to administer requests for information and auditing of tax accounts to determine if investors are compliant with tax incentives definitions.

Benefits of a tax incentives programme include:

Direct impact and revenue. By reducing the tax burden, tax incentives increase the after-tax return of an investment. That, arguably, encourages additional investment, which translates into more jobs and profits. Greater investment and economic growth results in additional direct tax revenue.

Indirect and induced impact. Through employment and linkages effects, the incentivised investment also generates other income opportunities and corresponding indirect revenue gains. Indirect effects arise from inter-industry transactions, while induced effects are due to changes in income, from spending on local goods and services.

Positive spillover effects, international integration. FDI attracted to the country could generate positive externalities – “spillovers” – for the host economy. Investment can act as a trigger for technology and know-how transfers, but also bring in the “entire package”, i.e. needed management experience, entrepreneurial abilities, marketing and sales experience, which can be transferred to the host country by training programmes and learning-by-doing.

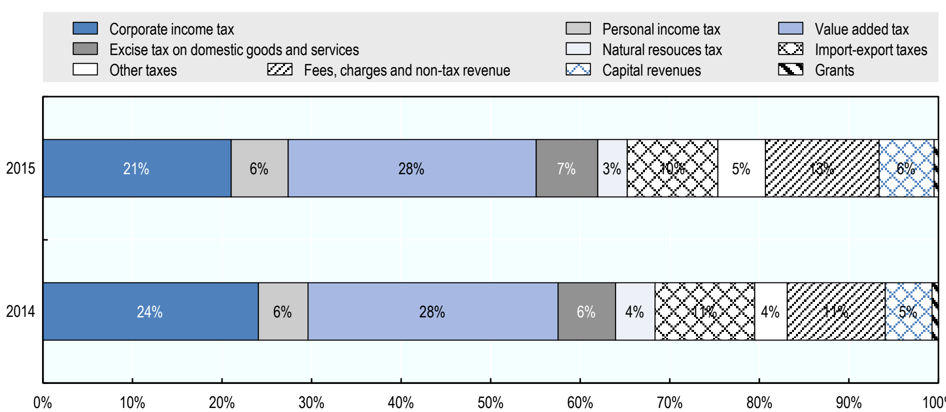
Social/environmental benefits. It is often argued that tax incentives can correct for market imperfections. Where the social rate of return on the investment is higher than the private rate of return (e.g. investments into R&D, green technologies or renewable energy), tax incentives could be justified as an instrument to improve the return on the private investment and correct the instances of market imperfections. The benefits of the incentivised investment to the larger society need to be counted in.

While no data are available for thorough cost-benefit analysis of Viet Nam's tax incentives, the accessible macro-level statistics are of interest. In analysing the impact of the expansionary tax policy adopted by the government to stimulate investment, it is important to place the investment attraction and revenue generation priorities of the government side by side. Indeed, the countries that have been successful in designing tax policy attractive to investment are those that have managed to adopt a whole-of-government approach that ensures consistency between the country's tax policy, its broader national and sub-national development objectives, and its overall investment attraction strategy.

Looking at the change in the composition of the government revenue from 2014 to 2015 (Figure 5.8), the share of corporate tax receipts in total government revenue declined by 3 percentage points, from 24% of total revenues in 2014 to 21% of total revenues in 2015. Some of this can be explained by the decline in oil prices and hence the drop in revenue in that sector.

Figure 5.8. **Share of tax and non-tax revenue sources in the composition of total revenue**

As a percentage of total



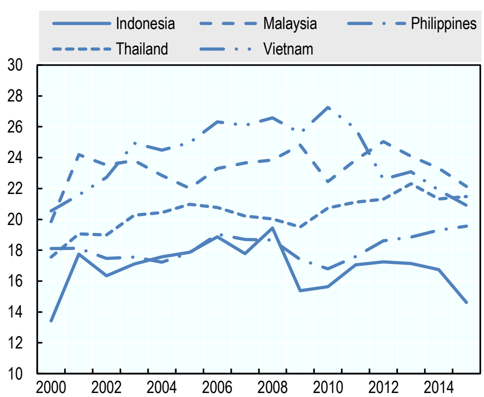
Note: 2014 data are the "second estimate". 2015 data are preliminary for the first nine months of the year.

Source: Ministry of Finance.

While no micro-data are available to understand the exact causes of the downward trend of corporate tax revenue, a general conclusion can be drawn about the impact of both: a narrow corporate tax base (due to generous tax incentives) and gradual cuts in the statutory tax rate.

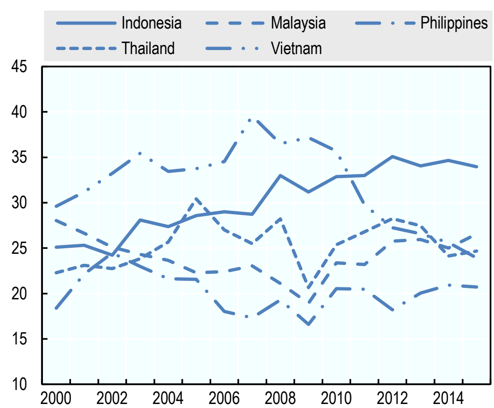
It is informative to contrast Viet Nam's experience against its main regional competitors. Figure 5.9 looks at government revenues as a share of GDP in Viet Nam and the ASEAN-4 countries – Indonesia, Malaysia, Philippines and Thailand. The decline of government receipts in Viet Nam, by 20% between 2010 and 2014 as a percentage of GDP, is not emulated by any of the key regional players. Against this backdrop, the IMF data on investment as percent of GDP[12] shows a similar pattern (Figure 5.10). In contrast to regional experience, Viet Nam's investment as a per cent of GDP declined by 27% between 2010 and 2014 – in the same period where revenue performance also weakened.

Figure 5.9. **General government revenue, Viet Nam and ASEAN-4 (% of GDP)**



Source: IMF (2015), World Economic Outlook

Figure 5.10. **Investment, Viet Nam and ASEAN-4 (% of GDP)**

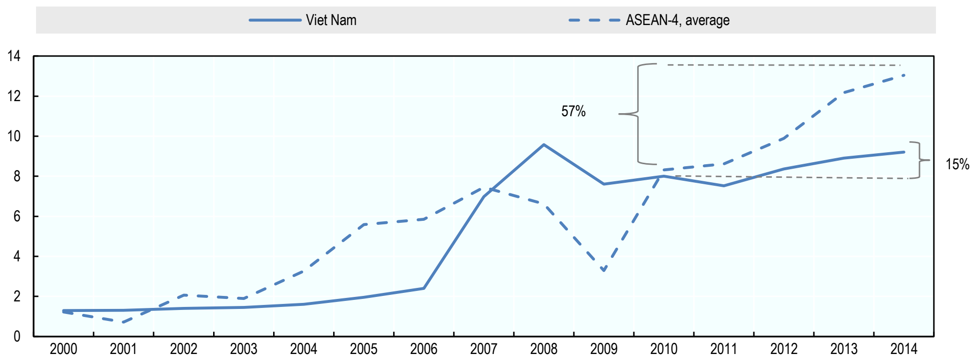


Source: IMF (2015), World Economic Outlook Database

Further, Figure 5.11 shows inward FDI flows to Viet Nam and against ASEAN-4 countries as a group. Based on the UNCTAD data, the FDI inflows to ASEAN-4 countries went up by about 57% from 2010 to 2014, while FDI inflows to Viet Nam grow by 21%. Once again, this is the same period during which government revenue in Viet Nam shrunk by 20%.

Figure 5.11. Inward FDI flows, Viet Nam and ASEAN-4

USD billion



Source: UNCTAD Statistics

While these macro-level statistics are indicative of areas of concern, only a thorough analysis of tax-related policies can reveal the effectiveness of the policy measures that the government is implementing to stimulate investment. As such, it is important to build the human and institutional capacity to conduct performance reviews and policy simulation analysis of tax incentives at the Ministry of Finance. Box 5.2 discusses the purpose of performance reviews.

Box 5.2. **Performance reviews**

The purpose of any performance review is to understand the effectiveness of a given policy measure against its intended policy objective(s). As such, a performance review should ask:

- Does the tax incentive meet its intended goals?
- Could other measures achieve the same goals more cost efficiently?
- What alternative measures could address the country's most pressing priorities and what would their fiscal burden be?

In distinguishing between beneficial and wasteful measures, decision makers should employ the following criteria:

- *Ineffectiveness.* This is the case when the benefits produced by the proposed tax burden-reduction measures fail to exceed the budgetary costs. This situation may also arise where authorities applied faulty cost-benefit analysis (or no cost-benefit analysis at all) to their incentive programmes or where promised benefits do not materialise.

Box 5.2. **Performance reviews** (cont.)

- *Inefficiency.* This is the case where incentives produce benefits that outweigh the costs, but authorities fail to properly maximise the benefits and minimise the costs. In other words, similar results might have been obtained at a lower cost.
- *Opportunity costs.* When the resources available to attract investment are scarce, the issue of alternative use of funds arises. Incentive schemes that are both effective and efficient may nevertheless be wasteful if the funds that are sunk into financing them could have been used more profitably.
- *Poor targeting.* This term refers to a situation when:
  - Investment projects that would have taken place in the absence of incentives are subsidised by a generous incentive scheme.
  - The intended recipients of targeted incentives are not adequately specified, resulting in spillovers to non-target groups.
  - By offering particularly generous incentives to some projects, policy makers effectively "raise the bar", creating a reference point for future investors, who will demand a similar degree of generosity.
- *Triggering competition.* The long-term costs of an incentive scheme include the economic burden that arises if other jurisdictions put in place matching measures. This is of particular concern when new measures are introduced or the existing measures are significantly augmented. Doing so without properly assessing the likely reactions of other jurisdictions can, in many cases, amount to a wasteful practice.

Source: This list of wasteful criteria draws on OECD (2003).

Transparency and governance issues

A country's tax burden is one of many – and not always the most important – factor considered by potential investors when weighing up investment decisions. Critically important to potential investors are questions over costs and risks associated with business conditions, the cost of compliance with laws, regulations and administrative practices. In creating an investment-promoting business environment, the government has to pay particular attention to transparency, simplicity and clarity in the provision of the legal and regulatory framework, including that related to tax incentives for investment.

The following issues are particularly noteworthy:

Legislative provisions. There is no one single consolidated Tax Code in Viet Nam, rendering it difficult for an investor to fully appreciate the prevailing legal framework of taxation without the outside help of a specialised tax expert. The tax system is comprised of multiple pieces of legislation, including a number of laws, and an even greater number of decrees, circulars, and information notes. Tax-related issues are found in the tax legislation, as well as in the Law on Investment, and multiple regulations related to economic zones. An important transparency-enhancing tax reform in Viet Nam would be to consolidate all tax-related legislative provisions into a single Tax Code.[13]

Further, while the legal powers to pass laws are centralised in the National Assembly, implementation is carried out by various authorities through a plethora of legal instruments and guidelines (PWC, 2015). With respect to the legal framework on tax incentives for investment, Viet Nam would be advised to adopt the OECD *Principles to Enhance the Transparency and Governance of Tax Incentives for Investment in Developing Countries* (OECD, 2013). The *Principles* advise developing countries seeking to improve the transparency and governance of their tax incentives to consolidate implementation of all tax incentives for investment under the authority of a single government body.

Granting of tax incentives. Good practice in granting tax incentives is to allow investors to claim tax incentives by meeting the necessary conditions as prescribed, without negotiating with any granting authority. Without such an automatic qualification, there is little defence against rent seeking and special interest pleading that can always make plausible arguments as to why their case, and their tax preference, has merit. Giving tax authorities' discretion over provisions increases the risk of corruption.

Government accountability. It is not uncommon for individual agreements offering special tax breaks to investors to be negotiated behind closed doors in Viet Nam. These agreements are rarely made public. As such, their intended purpose, their costs or their benefits to the country are not known. This opaqueness translates into a lack of government accountability. In the long-run, it can also fuel a "race to the bottom" as it increases the asymmetries in information and reduces the bargaining power of governments in dealing with companies, especially multinational enterprises, pushing for special concessions.

Ambiguity in applying rules. During interviews with the private sector as part of the Review, investors complained primarily about unclear guidance or inconsistent interpretation and application of rules in practice. An extract from an article in the *Viet Nam Investment Review* is indicative of the issue, "…Japanese investors express concerns over the lack of uniform decisions by Vietnamese authorities. The evaluation of the registration of an investment project is often slow, with decisions being made subjectively without sound legal basis" (VIR, 2013)

It is important for tax regulations and guidance to be clearly and objectively defined in order to ease compliance and "to decrease unnecessary debates between taxpayers and tax authorities, resulting in cost saving for both the Vietnamese government and enterprises" (EuroCham, 2015). A transparent, uniform, rule-based system, with a uniform approach and interpretation of tax provisions, allow investors to have a clearer understanding of the tax environment and helps to allay concerns about a potential lack of a level playing field.

Complexity of tax system. According to the World Bank's *Doing Business* survey, Viet Nam ranks 86th out of 190 countries in terms of Paying Taxes indicators which is a substantial improvement over earlier years. Doing Business 2018 lists several reforms in this area which have helped to improve Viet Nam's ranking each year. But in spite of these notable improvements, it still takes 498 hours to comply with taxation in Viet Nam due in part to the complexity of tax rules and the perception of the tax administration as an obstacle to business according to the World Bank Enterprise Survey research (WBG, 2017).

Both the Vietnamese authorities and the public are conscious of the challenge. A recent article in the VietNamNet Bridge[14] states the following: "Experts attributed the enormous time spent on tax procedures in Viet Nam to the long time it takes to complete the paperwork... In addition, information technology infrastructure remains insufficient, which leads to internet congestion, further disturbing taxpayers. Employees in tax departments also create extra difficulties." (VietNamNet Bridge, 2015) To this end, the Deputy Prime Minister Vu Van Ninh, requested that "all tax departments… continue reviewing and minimising paperwork to create favourable conditions for taxpayers". The government is strongly determined to implement online tax declarations; uniform implementation of e-tax services is expected to lead to effective results for both tax administration and taxpayers.

Countering abusive tax planning strategies at home and abroad

Depending on their type and design, tax incentives can give rise to certain unintended and unwelcome results. The presence of tax holidays and several preferential corporate income tax rates encourages individual tax avoidance strategies. As discussed in Annex 4.2, these incentives in Viet Nam are targeted at "new" companies and qualified business extensions. However, to qualify for preferential tax treatment, old firms can reconstitute as "new" ones towards the end of their holiday periods, so that they can continue to be tax-exempt. Further, partial or full profit exemption also opens up transfer pricing opportunities to artificially shift taxable income from non-qualifying business entities to entities that do qualify. Non-qualifying companies can channel asset purchases through qualifying companies. Likewise, qualifying firms in a loss position may attempt to sell their balances of unused business losses and tax credits to profitable firms outside the target tax incentive group so that these firms may reduce their tax liability.

The aggressive tax planning techniques put further downward pressure on already weakened budget revenue collection. To counter that, Viet Nam has sought the OECD's help in improving its capability to deal with transfer pricing and complex audit cases. Since 2013 the OECD has been supporting the Vietnamese tax authorities in instituting effective systems to reduce tax evasion and counter cross-border profit shifting and tax avoidance. This also affects the investment climate by putting in place transparent and predictable approaches to the taxation of multinational enterprises in accordance with internationally recognised standards.

Notes

1. Total government revenues increased by 50% from 2010 to 2014.

2. Tariff revenue is only part of the revenue from foreign trade which includes: import and export duties, value added and excise taxes on imported goods (for certain categories of goods subject to excise tax, such as gasoline, automobiles, cigarettes, alcohol products or beers…) and environmental protection taxes on imported goods, such as on gasoline. Export duties are also imposed on number products, such as crude oil, coals or other minerals.

3. The increase for FIEs was compensated by the removal of the profit remittance tax, which was previously imposed at the rates of 3, 5 and 7%. For domestic enterprises, the standard CIT rate was reduced to 28%. A supplementary CIT on certain domestic enterprises was also abolished. Other changes included the incorporation of capital gains from the transfer of real estate into the tax base of CIT to replace the land use right transfer tax.

4. ASEAN-5 is composed of Indonesia, Malaysia, Philippines, Thailand, and Viet Nam.

5. Other reasons for the decline in government revenue include: (*i*) a decrease in in tax rates to stimulate growth (including the CIT) and the expansion of tax incentives in an effort to increase the attractiveness of the domestic investment environment; (*ii*) lower crude oil prices which cut revenue from crude oil as a percentage of GDP from 4% in 2011 to

1.6% in 2015; *iii*) a decline in import taxes and (*iv*) a reduction in the role of revenue from land, especially from land use rights.

6. The actual level of budget deficit in 2014 for Vietnam was 6.3% of GDP (based on Vietnamese classification) or 4.7% of GDP if calculated based on the classification of IMF (Government Financial Statistics).

7. Public debt is estimated at around 61.2% of GDP in 2015, slightly below government-set legal limit of 65% of GDP. See, IMF, World Economic Outlook Database, accessed October 2015, https://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx.

8. Decree No. 218/2013/ND-CP, which provides details and guidance on the implementation of Law No. 14/2008/QH12 and Law No. 32/2013/QH13 (see Clause 5 of the Article 15)

9. Viet Nam Trade Promotion Agency, *Investment incentives and encouraged investment fields of Dung Quat economic zone*, September 2012, www.vietrade.gov.vn/en/index.php?option=com_content&id=1362:investment-incentives-and-encouraged-investment-fields-of-dung-quat-economic-zone&Itemid=287

10. As indicated by the Ministry of Finance, Viet Nam's tax policy analysts are limited in their ability to access micro-level data necessary for analysis.

11. As defined by the Decree No. 218/2013/ND-CP dated 26 December 2013.

12. Defined as the sum of fixed capital formation and changes in inventories. Further information is available at the IMF *World Economic Outlook Database*, at https://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx

13. Some progress has been made in this regard. In the past, in addition to tax laws, tax incentives were also contained in various non-tax laws, such as the *Law on FDI* (1987) and the *Law on Promotion of Domestic Investment* (1998) and their subsidiary documents. This had created a number of problems, *e.g.* reducing the transparency of the tax incentive regime and creating a burden for implementation. In April 2001 the Prime Minister issued Directive No.07/CT-TTg requesting all line ministries not to include any specific tax incentive provisions when drafting their own legal documents to reduce overlaps in incentives. Currently according to the authorities, most provisions relating to tax incentives are already incorporated into relevant tax laws.

14. http://english.vietnamnet.vn/fms/business/124791/vietnam-strives-for-big-tax-reform.html

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Chapter 6

Investment promotion and facilitation in Viet Nam

This chapter provides an assessment of the investment promotion and facilitation framework in Viet Nam. It examines existing strategies and institutions governing investment promotion and facilitation with a particular focus on the Foreign Investment Agency, Ministry of Planning and Investment, as well as the role of provinces and special economic zones. It highlights key reforms and remaining challenges to improve the business environment and attract higher value-added investments. It looks at existing mechanisms for private sector consultation and also provides recommendations on measures to encourage business linkages with small and medium-sized enterprises and other policies to maximise investment spillovers.

Investment promotion and facilitation measures can be powerful means to attract foreign direct investment (FDI) by marketing a country as an investment destination and making it easier for investors to establish or expand their existing investments. Such activities are also key to maximise the FDI contributions to development. They can support the creation of a favourable environment for all firms and help ensure that foreign investments create linkages with domestic companies and contribute to skills transfer.

In Viet Nam, investment promotion and facilitation activities are run by both central and provincial bodies. Over the past decade, while the central government has made considerable efforts to improve the business environment through administrative simplifications and regulatory reforms, provinces have taken a leading role in both the promotion of inward investment and the facilitation of business establishment. Industrial parks and other types of special economic zones (SEZs)[1] have been increasingly developed to attract foreign investors in almost all provinces. As a result, Viet Nam has attracted significant amounts of FDI, although inflows have levelled off since 2010, as the country faces increasing competition from a number of countries in the region.[2]

Decentralisation of investment promotion and facilitation came with both advantages and disadvantages. On the one hand, competition between provinces encouraged them to become more efficient in attracting FDI and in improving the local investment climate. On the other hand, roles and responsibilities between the different levels of government have been unclear and excessive competition amongst provinces has, in some cases, led to duplication of efforts, misuse of resources and inconsistent application of policies – often leaving the poorer provinces behind. The Ministry of Planning and Investment (MPI) and its implementing agencies, such as the Foreign Investment Agency (FIA), are in charge of national policy design and overall investment promotion and facilitation – including outward FDI promotion. They are major players in the successful implementation of an ongoing and constructive dialogue with the private sector, including through the Vietnam Business Forum, and are increasingly taking a co-ordinating role in terms of providing overall guidance to provinces and monitoring implementation. Overall, central and provincial institutions are not yet sufficiently well-equipped to properly implement policy reforms.

Small and medium-sized enterprises (SMEs) have boomed since *Doi Moi* reforms but their overall level of competitiveness remains low. Few business linkages between multinational enterprises (MNEs) and domestic companies have occurred until now, notably due to productivity and quality gaps. Although SEZs have proliferated across the country, they tend to generate few spillovers to the domestic economy. As a result, the government is increasingly putting the development of supporting industries at the centre of its SME strategy with a view to enhance the benefits of FDI through business linkages and further integrate global value chains (GVCs). Higher education and vocational training have a solid track record in producing basic skills, but face challenges in generating more advanced skills that are increasingly in demand on the labour market. In order to avoid a skill mismatch, the government has put the development of human resources and skills for modern industry and innovation at the heart of its ten-year national strategy plan (2011-2020 Socio-Economic Development Strategy) and as a horizontal theme of its recently launched policy vision *Vietnam 2035: Toward Prosperity, Creativity, Equity, and Democracy*.

Policy recommendations

- Viet Nam should translate its investment promotion vision into a concrete and precise countrywide action plan. For this purpose, the MPI should put more efforts into the co-ordination of FDI attraction initiatives emerging from provinces and from industrial parks and economic zones. A well-delineated division of labour with efficient co-ordination mechanisms amongst different levels of government will be essential to avoid unhealthy competition between provinces and ensure that all activities are in the interest of the nation as a whole. Beyond co-ordination, the FIA could focus its activities, on the one hand, on targeting FDI in high-value added and knowledge-intensive activities and, on the other hand, on providing increased support to poorer provinces in their investment promotion efforts.

- After notable measures taken by the central government and some provinces on administrative and regulatory improvements in the business environment, priority should now be given to ensuring effective and consistent implementation of policies. In order to sustain the results of policy reforms, human capacities need to be reinforced and resources better used to build modern institutions at both central and provincial level. Central government agencies need to support provincial authorities and provide them with the tools to apply new regulations and facilitate the establishment of new investors, while carefully monitoring progress. While the monitoring aspect needs to be undertaken countrywide, capacity building activities should principally target provinces with least resources.

- Measures to encourage business linkages should primarily focus on strengthening SMEs' performance and competitiveness. They should combine a stronger, whole-of-government horizontal approach to SME development with industry-specific measures to build supporting industries' absorptive capacities. FDI attraction efforts could focus prominently on MNEs that are inclined to source locally and SEZ promotion should be given a stronger cluster focus articulated around SME development and GVC integration. Central and provincial investment promotion authorities can also facilitate the information exchange between foreign and domestic firms through suppliers' databases and matchmaking events. In order to progressively reduce productivity gaps between MNEs and SMEs, the authorities should also make educational and training programmes more market driven by increasingly involving the private sector in human resource development policies and encourage internal and external training by employers.

The investment promotion landscape

In Viet Nam, investment promotion and facilitation responsibilities are shared between provinces and the central government. At national level, the MPI is officially competent for all matters that relate to investment and enterprise development. It is composed of 25 departments, many of which deal with investment policy and promotion, including:

- the FIA, which deals specifically with foreign investment; it is in charge of attracting and retaining FDI in Viet Nam, promoting outward investment, and acts as the country's investment promotion agency (IPA);
- the Department of Legislation, responsible for investment law making and the negotiation of international investment agreements;
- the Department for Economic Zones Management, tasked to supervise and guide the development of economic zones from a national perspective;
- the Agency for Business Registration, in charge of driving business registration simplification, monitoring progress and supporting implementing offices;
- the Agency for Enterprise Development, responsible in most part for the development of small and medium-sized enterprises; and
- the Central Institute for Economic Management, which is the MPI's think-tank providing research and advice on economic policies and mechanisms.

Provinces have an important role to play in the investment promotion and facilitation landscape. While the degree of proactive promotion will greatly depend on the provinces' capacities and resources, many of the administrative functions are devolved to them. The MPI sets the legal framework common to all provinces, and aims to monitor their activities. Its intention is to increasingly take a co-ordinating role as well (see below).

Viet Nam's national IPA: the Foreign Investment Agency

The FIA is the dedicated national IPA of Viet Nam. It is officially designated to attract and manage inward FDI in Viet Nam as well as to promote outward investment. IPAs worldwide can be independent, semi-autonomous or part of a ministry. The FIA belongs to the third category and, as a result, is not an autonomous body. It is one of the 25 departments of the MPI and, as such, it is fully government funded. It has little room for manoeuvre in comparison to other IPAs.

Its organisational structure is made of five divisions with the headquarters in Hanoi, three Investment Promotion Centres in the Northern, Middle and Southern regions and 12 investment promotion representatives in nine countries around the world. The FIA's divisions are the following:

1. the Investment Promotion Division, in charge of promoting Viet Nam as an investment destination and attracting FDI in Viet Nam;
2. the Foreign Investment Division, mainly tasked with designing FDI policies (including through consultations with investors) as well as monitoring and inspecting their implementation ;
3. the Outward Investment Division, aiming to prepare policies relating to Vietnamese investments overseas as well as to monitor and support Vietnamese firms abroad;
4. the Statistic and General Information Division, in charge of surveying foreign investors and providing FDI-related statistics; and
5. the Office of the Agency.

The FIA is active in all key functions IPAs usually perform, i.e. *(i) image building*, which consists in fostering the positive image of the host country and branding it as a profitable investment destination; *(ii) investment generation* that deals with direct marketing techniques targeting specific industries, activities, companies and markets, in line with national priorities; *(iii) investor servicing* to provide support to prospective investors in order to facilitate their establishment phase; *(iv) aftercare*, which aims to retain established companies and encourage reinvestments by proactively responding to investors' needs and challenges after their establishment; and *(v) policy advocacy* by identifying bottlenecks in the investment climate and providing recommendations to the government in order to address them.

According to the international business community, the FIA is particularly successful in facilitating dialogue between the public and the private sector and voices the concerns of businesses very successfully to relevant parts of the government. It is the contact point of the Vietnamese government with the private sector for the Vietnam Business Forum (see below) and is recognised by investors as a responsible and responsive agency that effectively takes care of businesses' interests and concerns. In line with Resolution 103/2013/ND-CP on the orientations to improve the efficiency of FDI attraction, the FIA has also recently improved its marketing activities, by focusing its efforts on specific markets and sectors for inward investment promotion. The agency organises events in Viet Nam and overseas, and its investment promotion strategy targets Japan, Korea, Singapore, Chinese Taipei, the United States, Germany, France and Lao PDR, where it has located MPI/FIA representatives.[3] Sector-based promotion is conducted in these eight markets depending on the comparative advantage of the targeted country (e.g. in Japan, the FIA attracts FDI in high-tech agriculture, machinery, electronics, supportive automobile and renewable energy).

Narrowing down the scope of countries and sectors targeted for FDI attraction is a judicious choice for better organised investment promotion. It allows for the best use of resources while serving the country's economic development objectives. Until recently, the bulk of FDI in Viet Nam has been directed to simple and low-value added processes, involving little knowledge-intensive and innovation-based activities (JICA, 2013; OECD/World Bank, 2014). This pattern is slowly changing, however, as illustrated by the investments of world-class electronics companies, such as Samsung, LG Electronics and Intel, in recent years. A more clear-cut targeting strategy will help the FIA attract high-tech investors that can generate higher domestic value and create quality jobs.

Additionally, the FIA could further improve and develop its promotional tasks. As reported by foreign investors, Viet Nam is not sufficiently well branded internationally in view of its investment opportunities and as compared to economies at a similar level of development. The agency does little image building, a function aiming at creating the perception of Viet Nam as an attractive location for international investment. This typically involves developing a country brand; portraying it through information and sales packages, investment plans in sectors or regions, and policies and incentives for investors; as well as creating a good website and other communications materials that showcase this brand and the country's favourable business environment.

The FIA website could clearly present investment opportunities by, for example, providing additional factual and quantitative details on key economic sectors to better allow investors take an informed decision. It could also highlight the reforms taken by the government to improve the investment environment and the country's progress on global rankings. Some IPAs also include success stories and testimonies from existing foreign investors, which is an effective technique to raise the country's profile as an investment location and build investors' confidence. The website should also include a list of all services that the FIA can provide to prospective and existing investors, as well as direct links to provincial investment promotion websites. It would be worth devoting sufficient resources to this important aspect that can contribute putting Viet Nam on the radar screen of potential investors.

Decentralised investment promotion

Each province in Viet Nam has a Department of Planning and Investment (DPI), which is responsible for investment-related activities and reports to the province's People's Committee. While all provinces in Viet Nam constitute the entry point of investors to establish their business and start their investment, their level of activity and efficiency in terms of investment promotion greatly depend on local capacities and resources.

Among countries with decentralised systems of government, different roles are assigned to the different levels of government for the purpose of attracting investment. In those countries that are highly decentralised, such as Brazil and the United States, sub-national IPAs take a leading role in investment promotion while national IPAs have a less proactive role and mainly refer to their sub-national counterparts. In other countries, such as Canada, Germany, Malaysia and the United Kingdom, national IPAs continue playing a key role in investment promotion and have a strategic responsibility for co-ordination across sub-national initiatives. Box 6.1 provides examples of countries that have adopted different approaches to decentralisation and co-ordination of investment promotion.

Box 6.1. **Experience in decentralising investment promotion**

Brazil: decentralised approach

Institutions responsible for FDI promotion in Brazil are APEX (Trade and Investment Promotion Agency), an agency oriented mainly towards exports promotion, RENAI (National Network of Investment Information), which works as an information vehicle about investment opportunities in the country, and SIPRI (Investment and Technology Transfer Promotion System for Companies). The official Brazilian agency to promote investment was created in 2001 as *InvesteBrasil*. It was a public-private agency, owned by the private sector (50%) and the government (50%), but it was closed down in 2004.

Thus, Brazil currently does not have a fully-fledged national IPA that articulates the entire mechanism of attracting investment – although APEX is partly fulfilling this role. Promotional efforts mainly emanate from states. Beside the national level, the network of investment promotion bodies in Brazil includes IPAs originating from state development banks (e.g. *Agência de Fomento de Goiás*; *Agência de Fomento do Rio Grande do Norte*), IPAs composed by government and private organisations (e.g. *Pernambuco Economic Development Agency – AD Diper*; *Minas Gerais Industrial Development Institute*), and private, non-profit organisations (e.g. *Development Agency of Rio Grande do Sul – Pólo-RS*). Some of the latter organisations are development institutions with investment promotion functions.

Malaysia: co-ordinated approach

The Malaysian investment promotion agency (*Malaysian Investment Development Authority* – MIDA) is responsible for the promotion, co-ordination and facilitation of investments in the manufacturing and services sectors (except utilities and finance). It grants all FDI approvals and manufacturing licences. MIDA also leads the co-ordination of activities of sub-national investment promotion agencies. Malaysia's investment promotion framework also encompasses a number of agencies that undertake investment promotion at state-level.

The state of Penang for example has its own IPA, *investPenang*, which spun-off from the Penang Development Corporation's industrial office in 2004 to enhance investment promotion efforts at the state level. Its functions include enhancing Penang's business environment, administrating land for business purposes and supporting companies in their due diligence, as well as promoting SMEs in Penang where the agency promotes business linkages through match-making events and an elaborate database of suppliers for larger companies. The agency co-operates closely with MIDA as the federal IPA, particularly on incentives, which are under MIDA's sole responsibility. Examples of such co-operation include the attraction of big brand name electronics and medical device companies, which were able to benefit from Multimedia Super Corridor status for incentives. Investment promotion also occurs at the city level. Kuala Lumpur has its own IPA, *InvestKL*, mandated by the federal government to attract and service large MNEs in Greater Kuala Lumpur and Klang Valley.

Box 6.1. **Experience in decentralising investment promotion** (cont.)

Indonesia: hybrid approach

Indonesia chose to allocate FDI attraction to the national IPA and domestic investment promotion to sub-national agencies. The division of labour stands as follows:

- The Indonesia Investment Co-ordinating Board – the national IPA – administers all foreign investment projects and those domestic investment projects with scope covering multiple provinces;
- Provincial governments administer domestic investment projects with scope covering multiple districts/cities; and
- District/city governments manage domestic investment projects with scope limited to one district/city.

Source: Giroud A., and Botelho D. (2008), *Policies Promoting MNEs Linkages in Host Economies: A Comparison between Brazil and Malaysia*, Paper presented at the OECD Global Forum on International Investment, Paris; OECD (2013a), OECD Investment Policy Reviews: Malaysia, Paris; and OECD (2010), *OECD Investment Policy Reviews: Indonesia*, Paris.

Investment promotion measures carried out at Provincial level can be effective instruments to increase both domestic and foreign investment, and to enhance its contribution to local economic development. There is a strong rationale for conducting investment promotion activities at a sub-national level (region, state, province or city) for four main reasons:

- *Development objectives:* sub-national governments and the central government may have different economic development objectives and competitive advantages;
- *Knowledge of their location:* sub-national governments have greater knowledge of their area's strengths and weaknesses, and are thus better able to market them by providing accurate information to investors;
- *Facilitation on the ground:* as sub-national governments are closer to local decision-makers, they are better positioned to assist investors in their establishment and post-establishment phases; and
- *Attracting domestic investment:* for many decentralised entities, attracting companies from the same country can be as important as attracting foreign investors. Sub-national governments can apply the same principles and techniques as those used to promote FDI as well as more successfully link their operations to the local economy (MCI and VCC, 2009).

In Viet Nam, provincial DPIs perform various functions pertaining to investment attraction, such as marketing their location as an investment destination, conducting promotional missions in overseas markets and organising site visits for prospective investors. Some provinces also have dedicated Investment Promotion Centres, which are either located under the DPI or directly under the authority of the People's Committee. For example, the Investment and Trade Promotion Centre of Ho Chi Minh City is the provincial agency specialised in facilitating investment and trade. It provides local and foreign companies with required information and consulting services, and arranges match-making between domestic businesses and foreign affiliates. Similarly, the Da Nang Investment Promotion Centre is meant to provide support and information through the enquiry, establishment and realisation phases of investments in the province. Some provinces, such as Hanoi City and Ho Chi Minh City, have opened representative offices overseas.

Decentralisation of investment promotion can bring advantages for the reasons mentioned above. It can provide an incentive for provincial authorities to become more efficient in their efforts to promote investment. It also comes with certain risks, however, such as duplication and overlap of activities, potentially harmful competition between provinces, possible lowering of environmental standards and growing regional inequalities as a result. Co-ordination between the central government and provincial authorities is a key element to minimise these risks and maximise the benefits FDI can bring to the country as a whole. Until recently, poor co-ordination on investment promotion has brought confusion to investors and has sometimes even sent negative signals (JICA, 2013; OECD, 2009; UNCTAD, 2008).

The government is aware of the negative effects of unsynchronised investment promotion and the need to provide overall co-ordination with a national perspective. The situation improved with the issuance of the Prime Minister's Decision 03/2014 promulgating the regulation on state management for investment promotion activities, which sets the bases for better co-ordinated actions. Among others, the decision makes it mandatory for Provincial People's Committees to report, on a yearly basis, to the MPI on their planned and realised investment promotion activities. The objective is for the MPI to harmonise the different initiatives and messages stemming from the provinces, and to make all the provinces' overseas missions more coherent and co-ordinated.

The MPI/FIA is also increasingly focusing its efforts on the poorer provinces, which have less institutional capacities and resources to undertake promotional activities and, as a result, tend to be left behind. The agency provides training to these provincial authorities, mostly through its three regional centres, and organises overseas missions with their DPI representatives. It is essential that the FIA keeps a national perspective for investment promotion with its regional centres offices acting as focal points for effective co-ordination with – and support to – provincial authorities.

Attracting FDI in special economic zones[4]

An important characteristic of investment promotion in Viet Nam is the development of SEZs, the management of which falls under provincial responsibility. Many countries across the world opt for special economic zones to attract investors, create jobs and increase export earnings. Common features of SEZs include a geographically defined area, streamlined procedures – such as for customs, special regulations, tax holidays – which are often governed by a single administrative authority. A zone-based strategy may be effective in attracting investors in the short-run by offering adequate infrastructure, services and duty-free access for capital goods and other inputs (OECD, 2015a).

The first zone was developed in 1991 in Ho Chi Minh City and there were 326 industrial parks and 4 export processing zones in Viet Nam by the end of 2017. There were also three technology parks and 17 economic zones, which have been developed to attract high-tech and large-scale projects in key industries (Table 6.1). The authorities estimate that over 60% of total FDI and 80% of manufacturing FDI is located in SEZs. They also report that SEZs contribute to 40% of national industrial output and over 50% of export value, as the majority of SEZ investments is export-oriented. Zones in Viet Nam aim to encourage foreign and domestic investment to boost local industrial activities and, in some cases, serve to bring together projects that otherwise could affect the environment or the local communities.

Table 6.1. **Special economic zones in Viet Nam, 2017**

	Industrial parks and export processing zones	Economic zones	Technology parks
Number of zones	326	17	3
Number of employees	3.23 million	174 623	26 836
Number of projects	Domestic: 7149 Foreign: 7559	Domestic: 1243 Foreign: 392	192
Total FDI attracted (2000-14)	USD 161.1 billion	USD 85.5 billion	USD 10.16 billion

Source: Government of Viet Nam (Department for Economic Zones Management, MPI).

According to the authorities, the number of workers in SEZs grew from 2.28 to 3.4 million over 2014-17, representing roughly 6% of the workforce in 2017. When compared to other large ASEAN economies, the share of workers in SEZs is similar to Indonesia but higher than in the Philippines and Thailand (Table 6.2), suggesting that zones have been a key driver of growth and job creation in Viet Nam. Although SEZ investments are labour-intensive, they are also characterised by low-technology manufacturing operations and tend to concentrate low-skilled workers (UNIDO, 2011b).

Table 6.2. **Employment in SEZs across selected ASEAN countries, 2015**

	Indonesia	Philippines	Thailand	Viet Nam
Number of employees	4 000 000	735 000	513 000	2 500 000
Share of total workforce	2.46%	1.24%	1.09%	2.50%

Source: Authors' calculations based on UNIDO (2015) and World Bank.

Provincial authorities are responsible for developing SEZs, with day-to-day administration in the hands of the Boards of Management of Industrial Parks and Economic Zones. Most zones are managed by the private sector, while some have been created by public developers or under public-private partnerships. Boards of Management are responsible for considering and approving investment certificates in zones located within their provincial territory. Zones not only make land – and sometimes basic infrastructure – more easily accessible to investors, they also offer tax incentives (Chapter 5 on Tax Policy provides additional information and analysis on the investment incentives provided in SEZs). Boards of Management have the authority to withdraw licences if investors do not meet the conditions that are tied to their certificates or incentives.

SEZs have been extensively used as investment promotion instruments by provinces, as they have proved to be an effective tool to attract FDI, generate growth and create jobs. Provincial authorities are allowed to create new industrial parks, as soon as at least 60% of land space in all existing zones of the same province has been used. As a consequence, SEZs have proliferated all over the country, inevitably leading to fierce competition between provinces as well as a misuse of land and resources when zones are only partially occupied. According to the authorities, only about 51% of space in industrial parks is currently occupied. Although the percentage is higher for those in operation (74%), it is still leaving over a quarter unused (World Bank and MPI, 2016).

The Department for Economic Zones Management at the MPI is in charge of overall co-ordination on SEZ development. Although there is no separate law regulating SEZs in Viet Nam, the legal framework for SEZ planning, operation and management include several legal documents.[5] The MPI's role is meant to support the development of a national strategy through the design of policies and guiding principles. In this light, a master-plan was issued by the Prime Minister's office in 2008 for developing SEZs, adjusted in 2014, reflecting the central government's ambition to keep SEZ development at the centre of FDI attraction and industrialisation. The occupancy rate of existing zones suggests however that their rate of growth may not be proportional to the demand from investors as they are built ahead of demand (OECD/World Bank, 2014; World Bank and MPI, 2016).

In the light of the above discussion, Viet Nam has adopted a clear long-term and country-wise vision for inward investment attraction, reflecting the country's economic development priorities. It will be important, however, to design a precise strategy, translating this vision into an action plan and defining more precisely the model of collaboration between the central government and provinces to successfully carry out provincial investment promotion. A well-delineated division of labour with efficient co-ordination mechanisms amongst implementing agencies will be key. As the bulk of FDI and most SEZs are concentrated in richer provinces, central agencies such as the FIA and the Department for Economic Zones Management at MPI should continue and increase their efforts aiming at guiding and supporting the poorest provinces in their efforts to attract FDI. A number of efforts are currently underway to develop new models of zones that better respond to socio-economic and environmental challenges.[6]

Investment facilitation and the business environment

Recent reforms to reduce administrative burden

The government is aware of the constant need to improve the business environment so that the private sector can effectively contribute to economic growth. Recognising that high administrative costs and risks reduce the benefits of market reforms, promote corruption and informality, and reduce productivity, the government started ten years ago to put strong emphasis on administrative reform. A major milestone was the preparation and implementation of an ambitious programme of administrative simplification, also known as Project 30, which received high political support (OECD, 2011). The Master Plan to Simplify Administrative Procedures in the fields of the State Governance was adopted in 2008, following which the Prime Minister's Special Task Force was established as the main co-ordinating body.

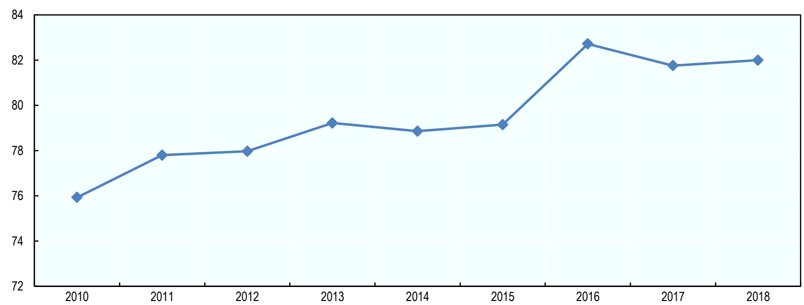
Among a wide range of reform objectives, Project 30 aimed to simplify at least 30% of administrative procedures and reduce administrative costs by at least 30%, as well as reduce the implementation gaps in the domestic regulatory system with WTO and international trade agreements. The government also created the Administrative Procedure Control Agency, a permanent body in charge of reviewing the flow of new regulations and managing a newly created centralised database of administrative procedures. Over 5700 procedures at all levels of government have been compiled in the database and will be reviewed, using the principles of regulatory impact analysis, to assess their legality, necessity and business friendliness, before they are eliminated, simplified or retained (OECD/World Bank, 2014).

Project 30 came at a critical time, as the number of regulations affecting businesses has increased radically since 2005. Over 2005-08, Viet Nam issued more legal normative documents that affect business than in the previous 18 years (1987-2004), while at the same time the number of official letters containing legal standards more than tripled (Ketels et al., 2010). Although the concrete impact of Project 30 is still to be properly assessed, the government's efforts to introduce measures, build capacities and train civil servants to improve the quality of regulation have put the country on the right path to an improved business environment (OECD, 2011). Viet Nam's global ranking with regard to the burden of government regulation, as measured by the World Economic Forum, improved from the 120th position in 2010-2011 to the 90th in 2015-2016, out of 140 countries.

In the past few years, government measures have also focused more specifically on the transparency and simplification of business registration. Decrees have been passed to continuously simplify business registration procedures[7] and other measures taken, such as the establishment of the Agency for Business Registration – formerly known as the Business Registration Division[8] – as an empowered country-wide entity under the MPI. The government has also taken a whole-of-government approach to business environment reform, with the issuance of Resolution 19 by the government on a yearly basis since 2014. Each consecutive resolution provides a number of specific targets and instructions for line ministries, agencies and local authorities to improve Viet Nam's position on international economic rankings. While the third version, issued in 2016, focused on concrete actions to properly implement the new investment and enterprise laws, the fifth and most recent version (May 2018) puts emphasis on improving business environment indices, eliminating investment and business related procedures and widening the use of ICT in public services – with transparency and e-government as horizontal leitmotivs.

These policy reforms are reflected in the World Bank *Doing Business* indicator, where Viet Nam's score on 'starting a business' has improved gradually if fitfully since 2010 (Figure 6.1). Notable progress can be observed in 2016, reflecting the changes provided in the new *Investment Law* and *Enterprise Law* that came into force in 2015. These reforms have helped make the establishment of a new company easier by reducing the time required to register a business. Other improvements which were well received by the private sector include the authorisation for companies to have more than one legal representative as well as multiple company seals.

Figure 6.1. **Viet Nam's progress on Starting a Business, 2010-2018**



Note: These scores represent the distance to frontier, which aids in assessing the absolute level of regulatory performance and how it improves over time. An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier, *i.e.* the best performance observed on each of the indicators across all economies in the *Doing Business* sample since 2005.

Source: World Bank

One questionable aspect of the new regime, which exclusively affects foreign investors, is the rule requiring them to apply for both an investment registration certificate and an enterprise registration certificate, whereas they were allowed to go through a single investment registration process before. Although making it potentially a bit more cumbersome for foreign investors, this new measure will not necessarily lengthen the establishment phase, as the deadlines for granting both certificates are approximately equivalent to the deadline to issue an investment certificate under the previous law (see Chapter 2).

Looking at the *Doing Business* indicator from an international perspective, Viet Nam's ranking at the 123rd place on 'starting a business' in 2018 is still relatively weak on a global scale, despite the recent reforms. When compared to other economies of the region, Viet Nam ranks fairly well, however, with the exceptions of Thailand and Malaysia (Table 6.3). Overall, Viet Nam ranked 68th for the ease of doing business in 2018, a substantial improvement over earlier years, behind Malaysia, Thailand and China. While the *Doing Business* indicator does not portray a comprehensive image of the business environment in Viet Nam, it illustrates both the efforts undertaken in the recent past and the necessity to address certain remaining shortcomings to ease the establishment of new companies.

Table 6.3. **Doing business in Viet Nam and competitor countries, 2018**

(ranking out of 190 countries)

	Thailand	Malaysia	**Viet Nam**	China	Indonesia	Philippines	Cambodia
Ease of doing business	26	24	**68**	78	72	113	135
Starting a business	36	111	**123**	93	144	173	183

Source: World Bank (2017)

Improving the business environment at provincial level

The notable improvements in Viet Nam's business environment are not only the work of the central government. Parts of these good results have been the consequence of a decentralisation process of some government functions initiated in 2005.

The *Investment Law* of 2005 (since superseded by the *Investment Law* of 2014) transferred the authority to issue investment certificates and business registration certificates, among other things, to the provinces. Following these reforms, provincial authorities were formally empowered to improve their own investment climate. Teams were charged with facilitating FDI in each provincial DPI and many provinces were able make significant changes in the rules and regulations governing business activities. With little capacity, provinces embarked upon a process of learning by experimenting, with some provinces making the most of their new policy space by building up their governance capacities and learning from other provinces, while others lagged behind. Reform efforts varied a great deal among different provinces, as did the pace of investment climate improvements (Schmitz et al., 2012).

Generally, delegating licensing to the provincial level contributed to swifter management of investment applications in Viet Nam. Experience has been mixed, however, with significant challenges remaining in the co-ordination of the different agencies, while aiming to be consistent with the national and provincial development plans. The delegation of managing procedures linked to investment was not accompanied by sufficient capacity building of local officials, hence hampering an effective decentralisation strategy (Schmitz et al., 2012). The central government also faced difficulties in monitoring investment flows in the overall territory, as provinces were inadequately reporting on investment figures. MPI's efforts, among others, aim to support local capacities at provincial level so as to overcome these challenges.

While competition between provinces can be potentially unhealthy when it comes to investment attraction (as seen above), it can nonetheless be a catalyst for bottom-up business environment reforms as suggested by the case of Mexico (Box 6.2). The example of Indonesia, although to varying degrees, also shows that business facilitation is an area where reforms at the provincial level can yield results. Following the decentralisation process initiated in 2001, provinces obtained increased autonomy and policymaking space. Local authorities that sought to attract investment and that have been successful in improving their province’s business climate have focused on investment facilitation measures, in particular on simplifying procedures to obtain a business permit (Oktaviani and Irawan, 2009).

Box 6.2. **Mexico: Unleashing regulatory reform at sub-national level**

The regulatory reform initiative in Mexico was not a one-time initiative, but instead an effort that has strengthened with continued benchmarking in all 31 States and Mexico City to stimulate change and to support co-ordination with and within federal, state and municipal governments. Regulatory reform efforts started as early as the 1980s but it is only in 2000 that the Federal Commission for Regulatory Improvement was established. While this agency became the main driver of change, political obstacles limited its effectiveness and reforms failed to pass.

While states were benefitting from peer-learning and experience sharing during the entire reform process, competition between states was the biggest catalyst for reform. Faced with almost identical federal regulations, governors had difficulty explaining why it took longer or cost more to start a business in their state and were inspired by the reform efforts of other states. Consequently, Mexican states were improving their regulatory environments and the impulse for reform persisted even through changes in government. The pace of reform was maintained thanks in part to the regulatory reform units that had been created by states and that were receiving technical assistance from the federal government.

Delegating the reform agenda proved to be an essential part of the national reform effort. It fostered commitment, a sense of collaboration and better communication among federal, state and municipal authorities. Early on in the reform process, the federal government collaborated with the states to improve business registration through the creation of one-stop shops. After a few years of steady improvement at the state and municipal levels, the federal government saw a need for broad regulatory reforms at the federal level, a process which started in 2009.

Source: World Bank (2012), Doing Business 2012: Doing Business in a More Transparent World, Washington.

Following the 2005 reforms, peer-learning and benchmarking among Vietnamese provinces helped boosting regulatory reform at local level. This is illustrated by the *Provincial Competitiveness Index*, first published in 2005, which assesses and ranks the economic governance quality of provincial authorities (Malesky, 2016). It is mostly based on annual business surveys of the local business environment but also on data from official sources regarding local conditions. The *Provincial Competitiveness Index* series is administered by the Vietnam Chamber of Commerce and Industry (VCCI) with support from the United States Agency for International Development (USAID). It has been increasingly used as a reference for authorities to conduct reforms.

The *Provincial Competitiveness Index* is divided into ten sub-indices: *(i)* entry costs for business start-up; *(ii)* access to land and security of business premises; *(iii)* transparency of the business environment and equitable business information; *(iv)* existence of informal charges; *(v)* time required for bureaucratic procedures and inspections; *(vi)* crowding out of private activity from policy biases toward state, foreign, or connected firms; *(vii)* proactivity and creativity of provincial leadership in solving problems for enterprises; *(viii)* existence and quality of business support services; *(ix)* existence and quality of labour training policies; and *(x)* fairness and effectiveness of legal procedures for dispute resolution.

The 2015 version of the *Provincial Competitiveness Index* respectively points to Da Nang, Dong Thap, Quang Ninh, Vinh Phuc and Lao Cai as the top-five performing provinces. Ho Chi Minh City follows at the 6th place, down from the 4th place in 2014. These scores are explained by concrete measures taken by their People’s Committees to create a favourable environment for business development while maintaining a constructive dialogue with the business community (Malesky, 2016). For example, Da Nang effectively implemented the “Year of Enterprise” programme, which includes removing administrative barriers to investment, improving the security of land and business properties, and facilitating access to credit financing. Lao Cai’s provincial authorities created their own district competiveness index based on feedback from the private sector and Quang Ninh established a Public Administration Centre, which contributes to downsizing bureaucracy and regular expenditure savings while also reducing transaction costs for businesses.

On the other end of the *Provincial Competitiveness Index*, the bottom tier includes five provinces from the northern mountainous area bordering China, one of the poorest regions of Viet Nam. Many other poor provinces (in the Northern regions, the Central Highlands and the Mekong River Delta) also feature among the least performing provinces on the Index.

Supporting provinces and strengthening institutions

While the correlation between poor provinces and low competitiveness does not seem to be systematic – Lao Cai featuring as one outstanding exception – it is still arguable that decentralisation has increased competition among provinces and that those with the least resources are also the least effective investment regulators and service providers (Malesky, 2015 and 2016; UNCTAD, 2008). Increased competition and lack of co-ordination across provinces not only affects the competitiveness of poorer provinces but also investors with offices in different areas of the country, which report that they are treated differently from one place to another as laws are applied inconsistently (VBF, 2015; Eurocham, 2014).

In terms of facilitating investment, provinces are increasingly under pressure as the new Investment Law and Enterprise Law provide for tighter deadlines although local administrations have to work with the same resources. At the moment, most investment promotion and facilitation measures undertaken at provincial level are financed from the provinces' own budgets. Poorer provinces hence have fewer resources and institutional capacities to properly implement national policies and regulations. Inadequate human resource capacity, both in terms of number of employees and their skill level, is a problem for many provinces' DPIs and SEZ Management Boards. There is often inadequate funding and consequently many provincial staff lack the necessary training (OECD, 2009).

This aspect is illustrated by the gradual creation of one-stop shops in all provinces to facilitate investment (Box 6.3). Although they have generally been well received by the business community, the one-stop shops' efficiency depends on the local authorities' actual capacities and resources to implement the administrative requirements. One-stop shops tend to be more efficient in richer provinces as a result. Additionally, the establishment of one-stop shops has not necessarily eliminated unnecessary administrative procedures, and has thus not systematically reduced the burden on businesses, especially in poorer parts of the country.

Adapting to the rapid pace of reforms – such as the successive revisions of the Investment and Enterprise Laws over the past decade, among many other new legal documents – is not an easy task for both central and provincial administrations. It is only by building strong institutions that Viet Nam will manage to sustain the results of its reforms. According to the World Economic Forum (2016), there is scope for improving Viet Nam's institutions when compared to regional peers (Figure 6.2). Improving market institutions is one of the three "breakthrough areas" defined in the Socio-Economic Development Strategy 2011-2020 and a key pillar of the government's long-term policy vision *Vietnam 2035: Toward Prosperity, Creativity, Equity, and Democracy*.

Box 6.3. **Establishment of one-stop shops in provinces**

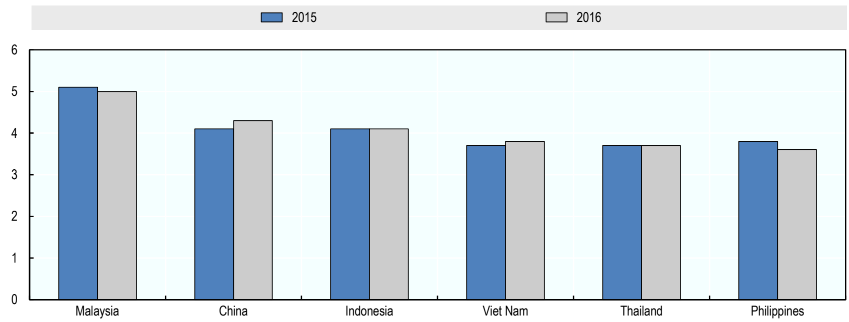
Decentralisation of administrative procedures started in the 1990s and received a very strong push from top government authorities in the mid-2000s, when Viet Nam was about to join the WTO. The first set of reforms sought simply to make it easier for citizens and firms to deal with the state through the introduction of one-stop shops. As the name suggests, the idea was to save citizens and firms from having to visit multitudes of agencies for their administrative tasks, from notarising documents to registering land to business registration. The first one-stop shop was piloted with donor support in 1996 in Ho Chi Minh City, covering a range of services: business registration, construction permits, land use right and house ownership certificates, cultural activity licenses, notarisation, legal counselling and advice, citizens' complaints and denunciations, and social affairs.

In the late 1990s and early 2000s, additional pilots were established in Quang Binh, Quang Tri, and Ninh Binh provinces. By 2003, the concept had taken off. In that year, the Prime Minister issued a decision to make one-stop shops compulsory in all 11 000 districts and communes of Viet Nam, covering four departments at the province level, six procedures at the district level and four procedures at the commune level. Later in 2007, the one-stop shop initiative was scaled-up to all departments and procedures at local levels and was made mandatory for the central level too. Importantly, the 2007 regulations allowed and encouraged the introduction of "inter-linkage" one-stop shop initiatives, which link different administrative levels and sectors, thereby further simplifying procedures for citizens and enterprises.

Implementation has steadily improved and, as of end 2009, nearly 99% of departments at the district level and 96% of departments at the commune level had applied the one-stop shop model. The improvements resulting from the adoption of the one-stop shop do, however, come with certain caveats. One is that even if there is only one stop, for complex administrative procedures the burden can still be formidable. Especially in the poorer rural communes, facilities are often inadequate and the lack of full-time staff can still lead to delays and frustrations. The business community generally reported improvements in the business environment stemming from administrative reforms although the improvement was felt somewhat more strongly in the richer provinces. Compared to the poorer third of provinces, firms in the richer third were more likely to report improvements in paperwork, costs, numbers of visits required, and helpfulness of staff.

Source: World Bank (2010), *Vietnam Development Report 2010: Modern Institutions*, Washington.

Figure 6.2. **Quality of institutions in Viet Nam and regional peers**



Note: The quality of institutions is a composite index capturing property rights, ethics and corruption, undue influence, public-sector performance, security, corporate ethics and accountability of private institutions. It is based on the responses of business leaders to the World Economic Forum's Executive Opinion Survey. Values are on a 1 to 7 scale, with 7 the highest.

Source: World Economic Forum (2015; 2016), *The Global Competitiveness Reports 2015-2016 and 2016-2017*, Geneva.

The central government should thus focus its efforts, on the one hand, on building modern market institutions at the central level and, on the other, on supporting the poorest provinces coping with rapid reforms, including by building capacities of local administrations and providing them with adequate tools and resources to facilitate investment and apply laws properly. Different initiatives have emerged from the central level in this regard. For example, the Central Institute for Economic Management, under the MPI, is monitoring the implementation of the Enterprise Law 2014 in provinces. It conducts surveys to understand the main implementation challenges and provides training accordingly.

The FIA has also facilitated the creation of the e-regulation programme in seven provinces, consisting of an Internet portal with a step-by-step guide on investment procedures describing, from the user's perspective, the institutions involved, the expected results, the requirements, the average duration and the legal justifications to start a business.[9] This initiative is a good step towards increased clarity and transparency in these provinces, reducing uncertainty for investors and facilitating their establishment

Consultation with the private sector

Public-private dialogue mechanisms

The government has established, with the support of the World Bank Group, a public-private dialogue platform called the Vietnam Business Forum (VBF) that serves as a regular and high-level channel of communication between the business community and the government. It allows the government to involve the private sector in policy design and to collect their feedback on issues affecting their operations (Box 6.4). While the VBF Secretariat is led by the business sector, the FIA is the contact point in the government, in charge of redirecting issues raised during the meetings to the relevant parts of the MPI and other ministries.

Box 6.4. **The Vietnam Business Forum**

The Vietnam Business Forum (VBF) was established in 1997 as a not-for-profit, non-political channel for nurturing public-private dialogue to develop a favourable business environment that attracts domestic and foreign private sector investment and stimulates sustainable economic development in Viet Nam. This is done primarily through high profile bi-annual Forums between the business community and Vietnamese leadership and through specialised Working Groups cutting across sectors (agribusiness, automotive, banking, capital market, customs, education & training, governance & integrity, infrastructure, investment & trade, mining, and tourism).

Key VBF objectives include working with the government to create pathways to long-term and sustainable business performance as well as to promote the interests of national and international business community in Viet Nam and enhance investment and trade in local and overseas markets. The VBF works to provide research, legal analysis, identification of problems and practical solutions.

In early 2012, the co-ordination function of the Forum’s secretariat was transferred from the World Bank Group to a Consortium of international and local business associations and chambers of commerce to allow the private sector to play a bigger role in the Forum's sustainable development. The bi-annual Forums are co-chaired by Viet Nam's Minister of Planning and Investment, the World Bank's Viet Nam Country Director, IFC's Regional Manager for Viet Nam and Co-chairmen of the Consortium.

The Consortium is led by five Consortium Members and supported by 11 Associate Members which are foreign and local business associations and chambers of commerce in Vietnam.

Source : Vietnam Business Forum (vbf.org.vn)

Although the VBF was created two decades ago, the foreign investment community reports that it is only since WTO accession that the central government consults them more systematically and is truly attentive to their concerns. WTO transparency commitments have helped, with their insistence on making draft laws and regulations readily available for public comment before they are enacted. Project 30 emerged in this context and constituted an important milestone in the growing role of the private sector in policymaking (OECD, 2011).

Public-private dialogue reached a new level beginning in 2014 when former Prime Minister Nguyen Tan Dung started participating personally in the bi-annual Forums. The Prime Minister’s participation in the bi-annual forums since then has been very well received by the private sector, as it sent a strong signal of the government’s commitment to a constructive partnership with the business community. Since then, the private sector reports that it fully recognises the VBF as a useful mechanism to interact with the government and suggest reforms that can provide concrete results towards delivering a better business environment.

The VBF is the largest and most organised public-private dialogue platform in Viet Nam but other less formal meetings are also organised. A positive result is that foreign investors consider their ability to influence policies in Viet Nam as one of the country’s greatest competitive advantages, according to the survey of foreign-invested enterprises conducted to prepare the *Provincial Competitiveness Index* (Malesky, 2015). This ability to influence policies also exists at provincial level but less systematically, as some provinces are much more reactive than others in responding to investors’ concerns. Some investors also reported that provincial administrations are increasingly reluctant to take decisions independently from the central government.

Aftercare

An efficient public-private dialogue platform is an important element to collect feedback from businesses on the investment climate but is not sufficient to retain investors or encourage them to expand their activities. The FIA is recognised as a trustful government interlocutor, which shows responsiveness and effectiveness when concerns are reported by investors, but more can be done to increase all potential services that can be offered at the company level in Viet Nam. Little proactive and systematic aftercare is currently offered, such as regular individual consultations to identify and enquire on recurrent problems faced by investors.

While the government has put impressive efforts into reducing the regulatory burden on foreign firms, especially when they start their activities, businesses still suffer from the regulatory burden after registration, such as complying with business regulations, inspections and customs procedures (Malesky, 2015). In this context, aftercare can help investors navigate these administrative obstacles after their establishment. Good aftercare programmes include regular follow-up with targeted investors throughout the duration of their investment projects and sound relationship management with relevant line ministries and agencies to find rapid solutions (Box 6.5). The impact of aftercare activities on retaining investors and encouraging reinvestment should not be underestimated. It is also a more resource-efficient function than investment generation, as it is less costly to win reinvestments through aftercare than to generate investments from new firms (UNCTAD, 2007). Satisfied investors can in turn enhance the FIA's promotional activities and help convince other investors consider Viet Nam as a profitable investment destination.

Box 6.5. **Aftercare in Canada and the United Kingdom**

Invest in Canada's aftercare programme

Invest in Canada's aftercare programme regularly follows up with investors throughout the duration of their investment projects. The Department of Foreign Affairs, Trade and Development's network of investment officers overseas undertake regular 'back-to-back outcalls' to targeted investors, to discuss project status and needs for other services and support. These often involve an Ambassadorial level meeting at investor headquarters, and an Invest in Canada or regional IPA meeting with the CEO and top management of the investors' local subsidiaries.

These visits allow Invest in Canada to maintain dialogue and a good relationship with investing companies after the investment decision at both the operational level, where investors are dealing with operational and administrative hurdles, and at the headquarters level, where larger investment/reinvestment decisions are often made. They also help detect investor irritants, which may hinder smooth operations and become potential obstacles to reinvestment.

UK Department for International Trade's key account management

The UK Department for International Trade has set up a key account management system for target companies that have been identified as important for the country's economic growth. The Department for International Trade builds relationships and exchange with different branches and agencies of government to be able to consider the priorities and needs of major investors. Strategic relationship management techniques are used to collect and create a collective understanding of the operations of the target company, and to establish common, long-term strategies vis-à-vis major investors to promote positive impacts on the UK economy.

To co-ordinate the relationship, and to improve the communication between investors and government, major companies have dedicated account teams that are tasked with responding to investor queries, providing information about government services, and co-ordinating the contact with relevant government departments.

Source: OECD (2015b), *Strengthening Chile's Investment Promotion Strategy*, OECD Publishing, Paris.

Aftercare can also provide opportunities for the FIA to strengthen foreign investors' links to local suppliers and encourage them to increase their roles in MNEs' supply chains (see section on business linkages below). There is evidence that long-lasting foreign investors, by knowing the local context better, are more inclined to use domestic suppliers instead of sourcing internationally (Farole and Winkler, 2014). Aftercare thus supports the double purpose of better anchoring foreign investors in the local economy and enhancing their positive spillovers.

Enhancing the development impact of FDI through business linkages

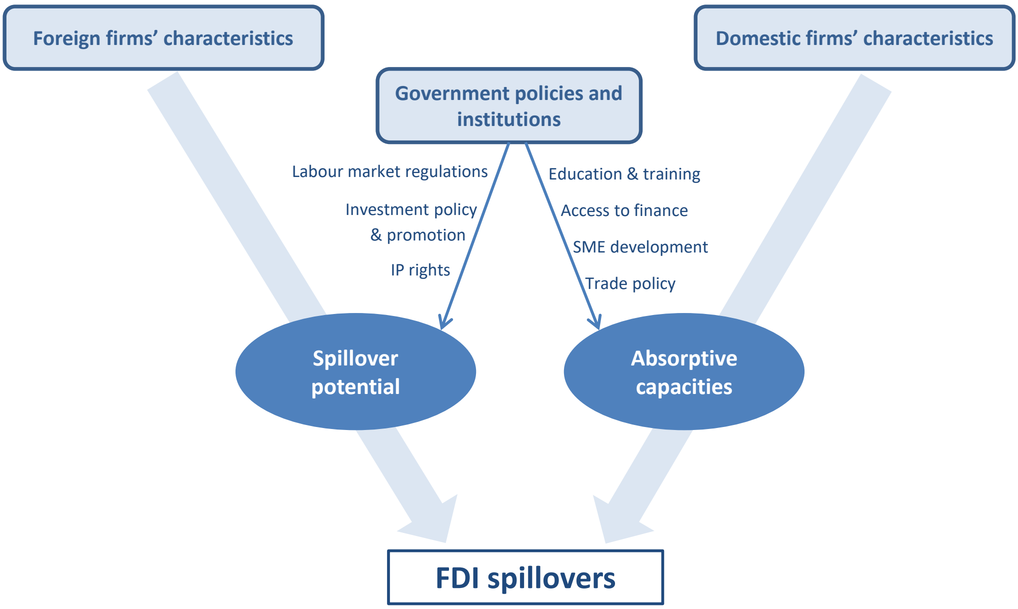
Better understanding FDI spillovers and linkages

FDI spillovers encompass all sorts of long-lasting, structural benefits that foreign investments can bring to the host country, be they on the quality of the workforce, on the competitive environment in the economy, or on the creation of supply chain linkages with domestic firms. Business linkages between foreign and local companies are the channel through which FDI spillovers can be maximised, owing to the productivity gains resulting from the transfer of knowledge and technology from foreign affiliates to domestic companies and workers (Farole and Winkler, 2014). Determinants of FDI spillovers can be divided into three broad categories as follows:

- *foreign companies' characteristics* – including their global production strategy, the degree and structure of foreign ownership, the entry mode (whether greenfield or M&A), and the determinants of FDI (whether resource, efficiency, market or asset-seeking);
- *domestic companies' characteristics* – notably their size, their geographic location, the sectors in which they operate, their capacities to overcome the technology and productivity gap, and the availability of adequate skills; and
- *host country's institutions and policies* – such as labour market regulations, intellectual property (IP) rights, access to finance, education and training facilities, investment and trade policies and promotion as well as SME development policy.

While foreign companies will generate spillovers depending on the spillover potential of the particular type of foreign investment in the host economy, domestic firms will benefit from them if they have sufficient absorptive capacities. To a certain extent, host countries can influence these two transmission channels – foreign firms' spillover potential and domestic firms' absorptive capacities – with appropriate policies and institutions (Figure 6.3). The purpose of this section is to support the Vietnamese government to develop the latter.

Figure 6.3. **Determinants of FDI spillovers**



Source: Authors adapted from Farole and Winkler (2014); and Paus and Gallagher (2008)

Business linkages occur along the supply chain and can be either backward or forward. Backward linkages refer to upstream sectors and occur when domestic firms become suppliers or subcontractors of MNEs. Forward linkages arise in downstream sectors, when the MNEs' goods and services are used as inputs in local companies' operations or activities. Low and middle-income host countries tend to focus, in a first step, on promoting the former as they can more easily foster the potential of local SMEs. Creating linkages also serves the purpose of investment attraction and retention, as it allows foreign investors to be more firmly anchored in the local economy, to adopt a longer-term investment strategy in the country and be inclined to reinvest or expand activities.

Business linkages are determined by a number of external factors and do not necessarily occur automatically. However, as highlighted in Figure 6.3, adequate government institutions, policies and measures can influence the creation of linkages. Business linkages depend first and foremost on the availability and capacity of domestic companies. Creating a business environment that is favourable for both domestic and foreign firms, supplemented by SME development policies and programmes to maximise their absorptive capacities, is an important first step. Other, more proactive, measures can also be taken by the government to encourage linkages and interactions between MNEs and SMEs – and attract FDI with a higher spillover potential. The role of SEZs and progressive cluster development is also key in the transformation of the economy. Lastly, education and training policies and institutions to develop human resources is essential to ensure FDI activities benefit the rest of the economy. These different points are analysed here below.

SME competitiveness and the emergence of supporting industries in Viet Nam

According to the Asian Development Bank (ADB), Vietnamese SMEs account for over 97% of all firms in the country and employ approximately 47% of the labour force (ADB, 2015).[10] Viet Nam's share of SME employment is significantly lower than in its ASEAN peers, however – Indonesia (97%) and Thailand (81%) at the top of the list, while the Philippines (65%) and Malaysia (58%) at the bottom, yet well above Viet Nam. The number of SMEs in Viet Nam has nonetheless dramatically increased over the 2000s with yearly growth rates between 15% and 30% over 2007-11, suggesting that SMEs play an increasingly central role in the economy. This is confirmed by the fact that SMEs now contribute 40% of national GDP (Phan et al., 2015). Wholesale and retail trade is the dominant economic sector for SMEs, accounting for 40% of total active SMEs in 2012, followed by services at approximately 20% and manufacturing at 16% (ADB, 2015).

After the beginning of the *Doi Moi* in 1986, SMEs started booming in Viet Nam, as they benefitted from market-oriented reforms, including those related to macroeconomic and prize stabilisation, foreign trade, state-owned enterprises and the financial market. But it is only over a decade after that the number of SMEs started booming, once the first Enterprise Law was promulgated in 1999, making the private sector a cornerstone of the national economy. In 2001, the first legal document aiming at boosting SME development and providing an official SME definition was born.[11] It was the starting point of a more targeted approach to SME development in Viet Nam. In parallel, SMEs have also greatly benefitted from the extensive administrative simplifications and regulatory improvements conducted by the government over the 2000s, as described above (Tran et al., 2008).

More recently, SME policy has been guided by two successive five-year SME Development Plans in 2006-10 and 2011-15, which aimed at enhancing the development and competitiveness of SMEs, including by creating favourable business conditions for SMEs. The second plan also set a comprehensive programme to support SMEs access finance and credit sources and improve efficiency of capital use; to support SMEs in technology innovation and application; and to provide information to assist them expand their production and markets (ERIA and OECD, 2014). The formulation and implementation of SME-related policies has been undertaken by many institutions in the past, although the Agency for Enterprise Development under the MPI is now the leading SME supporting agency.

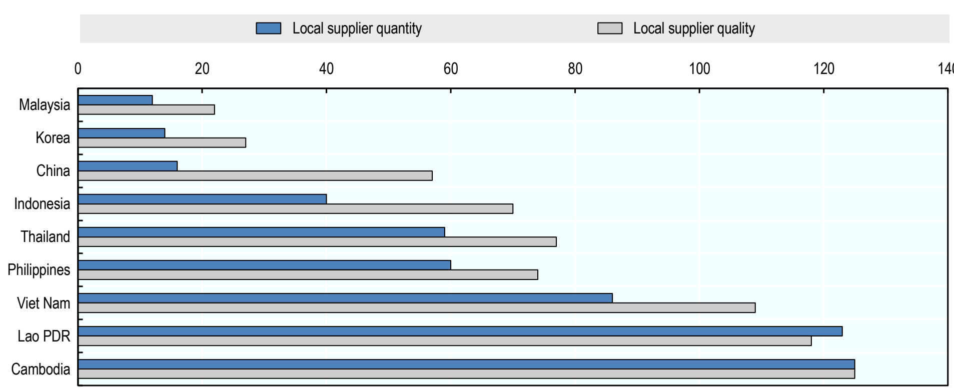
The government intends increasingly to put the development of supporting industries at the centre of its SME strategy. The Prime Minister's Decision No. 12/2011/QD-TTg sets the basic framework for government action to promote supporting industries, which include the following economic sectors: manufacturing mechanical engineering; electronics and informatics; manufacturing and assembly of automobiles; textile and garment; leather and footwear; and hi-tech industry development. These policies range from information provision to financial support (including tax incentives) and training programmes, but with no clear targets and activities. In 2014, the government adopted the Master Plan on Supporting Industry Development to 2020, vision 2030, which sets an ambitious agenda for the development of supporting industries. Among other objectives, it aims to ensure that supporting industries meet 45% of domestic demand of the processing and manufacturing industry by 2020 and 70% by 2030. The Master Plan also aims to increase the number of supporting industries supplying MNEs up to 1000 in 2020 and 2000 in 2030. Detailed targets and plans are provided for each area of the supporting industries, including spare parts, textile/footwear and high-tech industries. More recently, the government issued Decree No. 111/2015/ND-CP on Development of Supporting Industry, which elaborates on the incentives regime for supporting industries and clarifies related roles and responsibilities within government.

Currently, there are still few business linkages occurring between foreign affiliates and domestic SMEs in Viet Nam (JICA, 2013; Ketels et al., 2010; OECD/World Bank, 2014; Tran et al., 2008) and this is particularly the case for MNEs operating in SEZs (UNIDO, 2011b). Linkage creation opportunities mainly depend on the availability of an adequate domestic supply-side capacity. The extent to which SMEs are capable of responding to the needs of MNEs determines their ability to serve as domestic suppliers. Those that strive to become suppliers of world-class corporations frequently face challenges related to their size, their own organisational capacity (i.e. qualified human capital, quality control and international certifications), external conditions in the economy that are particularly constraining for small firms (such as access to finance), and the high cost of upgrading production processes to meet the needs of MNEs.

For these reasons, there are at the moment still few SMEs than can qualify as supporting industries in Viet Nam and, as a consequence, foreign firms operate as part of their own global or regional value chains and have shallow roots in the local economy (Ketels et al., 2010; Tran et al., 2008). The relatively weak level of SME development in Viet Nam is also linked to the fact that SMEs have *de jure* freedom of doing business only since 1999. SMEs must also compete with state-owned enterprises, which continue to receive various subsidies and preferences from the state (see the discussion in Chapter 4 on Corporate Governance). Additionally, even when supporting industries exist – which is increasingly the case – large productivity and quality gaps with foreign firms impede forward and backward linkages (OECD/World Bank, 2014). As explained in the following sections, SMEs suffer from low levels of technology and absorptive capacities and hence have difficulties to meet the quality and standard requirements of MNEs.

Comparing Viet Nam globally and regionally is illustrative in this regard. According to the World Economic Forum *Global Competitiveness Index 2016-2017*, Viet Nam is ranked respectively 86th for the quantity of its local suppliers and 109th for their quality, out of 138 economies, which is a poor performance both on a global scale and also compared to most of its neighbouring and regional peers (Figure 6.4). It is particularly striking in the case of local supplier quality, where Viet Nam lags behind its competitor economies, including Malaysia (22nd), Korea (27th), China (57th), Indonesia (70th), Thailand (77th) and the Philippines (74th). The only exceptions in the region are Cambodia and Lao PDR against which Viet Nam ranks fairly well, particularly as regards the quantity of local suppliers, owing to its much larger market size.

Figure 6.4. **Ranking of local suppliers in Viet Nam and selected regional economies, 2016**



Note: Rankings are out of 138 economies and based on the responses of business leaders to the World Economic Forum's Executive Opinion Survey.

Source: World Economic Forum (2016), *The Global Competitiveness Report 2016-2017*, Geneva.

Promoting backward linkages

Building SMEs' absorptive capacities

Vietnamese SMEs face many difficulties in terms of access to finance, technology and information as well as the quality of managerial skills and human resources (Phan et al., 2015). A dynamic SME sector is a central part of a prosperous and innovative economy. Absorption of existing knowledge and technology by SMEs is central to achieving productivity improvements and, through backward linkages, SMEs can expand domestic supply chains, take part in GVCs and move to higher value added activities. The capacity of firms to absorb knowledge and technology is determined by both the ability and willingness of management to mobilise resources and the characteristics of the firms' organisation and labour force. Talented managers can be fundamental for recognising opportunities arising from the adaptation of knowledge and to invest in this activity. There is some evidence, nonetheless, that poor managerial skills are a drawback for all firms in Viet Nam but most seriously for SMEs, as only a very small share of their managers have tertiary-education qualifications (OECD/World Bank, 2014).

According to a recent study, 56% of SME employers are classified as below the intermediate level of education, among which 43% have only a primary education degree (Phan et al., 2015). The OECD *SME Policy Index* points to Viet Nam's low performance in the promotion of entrepreneurial education mainly due to the weak support for entrepreneurial learning in basic education and the lack of a proper entrepreneurial promotion policy (ERIA and OECD, 2014). The link between entrepreneurial performance and absorptive capacities is also illustrated by the low level of technology readiness of Vietnamese firms, attributed to the slow speed at which they adopt new technologies for business use (WEF, 2015). The section below (Increasing labour productivity and adapting skills) addresses education and skills in more details.

As highlighted above, mobilising financial resources is also a condition for SMEs to build absorptive capacities and seize the opportunities from new technology and knowledge. Access to finance is a common challenge for SMEs worldwide, but it is considered as the most problematic factor for doing business in Viet Nam according to a survey conducted for the *Global Competitiveness Index 2015-2016*. The government has taken several measures in this regard, such as establishing in 2013 the SME Development Fund under the MPI to support SMEs to conduct feasible business plans in priority sectors. The State Bank of Viet Nam created the Credit Information Centre in charge of collecting, processing, storing, analysing and forecasting credit information. Despite these worthy initiatives, they still do not adequately respond to SMEs' financing needs. A more in-depth restructuring of the banking sector will be necessary to ensure that SMEs can develop absorptive capacities and play their role in a more innovative economy (OECD/World Bank, 2014).

In this context, a horizontal, whole-of-government approach to SME development is central to strengthening the competitiveness of small businesses and helping them tackle the challenges they face. The priority should be on establishing a sound SME investment environment while specific SME support initiatives should supplement, not substitute, these efforts. The government should consult SMEs regularly to collect their views on the business environment and better understand the issues affecting their operations. They can also provide feedback to the government on the level of outreach and relevance of its SME support activities.

Building absorptive capacities of Vietnamese supporting industries and enhance MNE-SME linkages not only requires a horizontal approach to SME development but also industry-specific capacity-building to help SMEs achieve technological upgrading and meet quality standards. Small businesses in Viet Nam are heterogeneous and the potential to become a supplier to a foreign affiliate varies immensely across companies and industries. While it is important to help SMEs meet international quality standards (e.g. ISO), it might be more critical to help them meet industry-specific standards, as the latter are more inclined to help SMEs become sound supporting industries and integrate GVCs (Farole and Winkler, 2014). Technical support and training also need to involve industry associations and MNEs themselves, which can play a key role in both the design and the delivery of such training, and ensure their relevance. These aspects also highlight the importance of adapting the country's human resource development strategy with national economic priorities.

The government could design systematic and well-institutionalised industry-specific training programmes for supporting industries, in collaboration with the business community and educational institutions, in line with a more focused and articulated cluster approach (see below). It could focus on certain key economic sectors, such as those targeted by the Master Plan on Supporting Industry Development, namely spare parts, textile/footwear and high-tech industries.

Adapting investment promotion and making better use of SEZs

The government is increasingly focusing its investment promotion efforts on high-tech investors that can generate higher domestic value, create quality jobs and generate spillovers on the rest of the economy. Yet, in order to set pragmatic targets, the government needs to recognise that FDI spillovers and linkages might remain limited, at least in the short run, until SMEs have upgraded their capacities and establish themselves as a solid network of supporting industries. The different determinants of FDI spillovers presented above (i.e. foreign firms' characteristics, domestics firms' characteristics, and government policies and institutions) also have implications for the government's FDI attraction strategy. Promotion efforts should ideally target investors with a tradition of working with and supporting local suppliers; market-seeking FDI with a long-lasting interest in the ASEAN Economic Community; export-oriented investors that export to mature markets; and MNEs that operate in industries and activities that can rely on local inputs (Farole and Winkler, 2014). FDI attraction and supporting industry strategies should clearly be designed, implemented and monitored jointly.

As highlighted at the beginning of this chapter, Viet Nam is strongly relying on SEZs to attract investment and boost industrial development. In general, economic activities within SEZs, allowing for import and export cost reduction measures, nevertheless tend to generate weak linkages with domestic firms if not firmly embedded in a wider development agenda, including appropriate connectivity to the rest of the economy and reduced barriers to investment (OECD, 2015a). Viet Nam is no exception to this trend and evidence on the impact of industrial parks in strengthening linkages is lacking (OECD/World Bank, 2014; UNIDO, 2011b). There are some interesting examples of more elaborate approaches to SEZ development, however, such as the Saigon High-Tech Park (SHTP), which adopts a more targeted cluster approach and contributes to Viet Nam's integration in GVCs (Box 6.6).[12]

The example of SHTP also illustrates how important it is that local companies are allowed to participate in the activities within SEZs, especially manufacturing activities (about half of realised investments are Vietnamese in the case of SHTP). SEZs are usually primarily targeting foreign investors and may have obstacles to domestic firm participation. Yet, if the government is willing to promote linkages, it needs to create a conducive environment for both foreign and domestic companies and not target exclusively the former while jeopardising the productivity of the latter – for example through a particular incentives scheme. Promoting zones where foreign and Vietnamese companies operate on a level playing field will facilitate FDI integration through geographic proximity and networks (Farole and Winkler, 2014).

Box 6.6. **Technology parks in high-technology industries: Saigon High-Tech Park**

The Saigon Hi-Tech Park (SHTP) was established in 2002 with the strong support of the Ho Chi Minh City government and the Vietnamese government, SHTP boasts a number of foreign companies, including Intel (United States), Nidec (Japan), Sanofi (France), Datalogic (Italia) and Sonion (Denmark) as well as leading domestic educational institutions and companies. As of 2014, there were **77** projects of manufacturing, research, training and services in hi-tech sectors licensed in **SHTP**. They employed 18 000 workers and accounted for a total invested capital of **USD 2.4 billion**, among which 74% of FDI.

SHTP has been quite successful in integrating Viet Nam in knowledge-intensive GVCs. The transport infrastructure features harbours and airports within a half-hour drive, which lowers the cost of accessing export markets. In addition, it has an adequate skill endowment; the park is located near downtown Ho Chi Minh City and its universities. SHTP has targeted skill enhancement through the creation of an on-site training and research centre, where newly recruited employees of tenant companies receive job-preparation courses. SHTP has also established research laboratories with funding from the Ho Chi Minh City government to invest in technical infrastructure and equipment. The research laboratories are managed as business units that receive contracts from the government and tenant companies. Finally, institutional improvements have been instrumental in facilitating SHTP's integration into value chains: the government grants SHTP companies a "one-stop-shop" to ease business transactions and channel tax incentives.

The SHTP has been effective in attracting foreign companies, stimulating economic activity, including employment, and integrating Viet Nam in GVCs. There is some debate, however, about the extent to which SHTP has helped shift Viet Nam's industrial structure towards higher-value-added and skill-intensive sectors. This is one of the government's goals and an important reason why the SHTP was originally set up. Many tenant companies continue to concentrate on lower value activities (even in higher-technology industries). Technology parks that are isolated from the developmental challenges affecting the rest of the economy may be too limited a tool. For example, the SHTP's advanced training centre and research laboratories contrast sharply with the level of human resources and technological capabilities found elsewhere in the country.

Source: Adapted from OECD (2013b), *Interconnected Economies: Benefiting from Global Value Chains*, OECD Publishing, Paris; and www.eng.shtp.hochiminhcity.gov.vn/

Countries across the world, including in Southeast Asia, are increasingly following a more elaborate and comprehensive strategy of cluster development, providing a less trade-distorting framework for the support of strategic sectors. A stronger emphasis is given to SME development in an attempt to link industrial and enterprise policies (OECD, 2007). An example is Penang, which is hosting one of Malaysia's most developed technology clusters in the manufacturing of semiconductor-based electronic components. The Penang SME Centre was established to act as an incubator for SMEs, providing them with rental subsidies to help them take advantage of the facility. Similarly, the national IPA in the Czech Republic (CzechInvest) has established a cluster support programme for clusters with at least 60% SME participation. The programme includes sector mapping, feasibility studies, co-operation platforms between companies, training infrastructure, innovation facilities and subsidies on certain running costs.

Clusters programmes generally tend to concentrate on strategic sectors for national growth, foster industries in transition, support SMEs overcome technology absorption, and create competitive advantages to attract FDI and promote exports (OECD, 2007). Such an approach in Viet Nam would be aligned with the need to further develop SMEs' industry-specific absorptive capacities to boost MNE-SME linkages as pointed out above. Conversely, the existence of industry clusters at the local level also represents an important location factor for many MNEs. Dynamic clusters rely on the smooth interaction of a number of pillars, combining public policies and initiatives at the firm-level. Successful clusters typically entail the following characteristics, critical for their generation of new technology, innovation, and firm creation:

- Strong role of government (national or sub-national) in promoting stability and basic infrastructure;
- An institutional environment that stimulates technological acquisition and transfer, including the protection of intellectual property rights, well-designed science and technologies policies and the involvement of research and development institutions;
- Global connectivity of clusters through value chains and markets;
- Competent intermediary organisations to promote horizontal connectivity and co-ordination among actors and stakeholders (OECD, 2015a).

Building on the success of the SHTP and drawing on the experience of other countries, Viet Nam should ensure that its investment promotion efforts through SEZ development adopt a cluster focus with a greater ambition to create productive linkages with domestic supporting industries. Critical elements include well-functioning inter-agency co-ordination both at national and provincial level, private sector commitment, facilitation of information exchange (see below) and industry-specific capacity-building for SMEs in line with MNE standards.

Filling information gaps

MNEs do not necessarily engage in linkages with domestic suppliers automatically – even when local SMEs are competitive enough and technology-ready. Many MNEs are bound by international contracting arrangements that tie them to international suppliers, offsetting the effectiveness of public policies to promote linkages. In some other cases, MNEs rely on their usual overseas business partners for convenience or because of lack of information, and do not make the effort to look for local firms that can act as suppliers. In this case, the government can bridge information gaps with targeted measures to facilitate exchange of information. Governments can, on the one hand, inform MNEs on potential local suppliers and their expertise, and, on the other hand, inform SMEs on foreign investors' needs in terms of products and services, standards, delivery expectations, etc. In concrete terms, these activities can take the following two forms:

- *Information dissemination*: domestic suppliers' databases are compiled to inform foreign investors on the availability of existing supporting industries for their activities; and

- *Matchmaking*: matchmaking meetings between foreign investors and SMEs that could act as suppliers or local partners are organised to help create linkages and business partnerships.

The FIA and provincial DPIs, by directly and regularly interacting with foreign investors, are particularly well-positioned to understand MNEs' supplying needs and requirements. Interesting first steps in this direction have been taken by the FIA. For example, a database of 500 existing firms in supporting industries has been developed with the help of the Japanese International Cooperation Agency, has recently been put online. A similar database for the agriculture sector is now envisaged and UNIDO is also supporting similar initiatives. It is important that such domestic suppliers' databases are established in close co-operation with relevant stakeholders, such as the VCCI and industry associations as well as the Ministry of Industry and Trade and other relevant line ministries. Databases should respond to MNEs' most common requirements in terms of products and services. They should be regularly updated and made available online for foreign investors to access easily and reduce their transaction costs. Databases should be industry-specific and, as a first step, the FIA could focus on existing Vietnamese SMEs in those sectors and industries prioritised for FDI attraction and supporting industry development.

Similarly, matchmaking meetings could take the form of large promotional exhibitions or of industry-specific roundtables at a smaller scale. The former should involve relevant government stakeholders, such as the Agency for Enterprise Development and the Ministry of Industry and Trade, as well as the business community, while the latter are typical activities that could be organised at provincial level. Central and provincial authorities' role in these undertakings should be proactive, constructive and neutral, as linkage promotion activities can only function in an environment of trust.

In the medium term, the FIA – and some DPIs in provinces hosting high FDI inflows – could envisage fully integrating linkages promotion in their mandate as part of their facilitation and aftercare activities – for which regular interactions with MNEs are maintained – as it would contribute to the country's supporting industry development strategy. While information exchange facilitation is typically a function that can be led by IPAs, experience worldwide shows that successful linkage programmes require strong inter-agency co-ordination and a genuine engagement from the private sector.

Increasing labour productivity and adapting skills

Policies that develop and maintain a skilled and adaptable workforce, and ensure the full and productive deployment of human resources, support a favourable investment environment. If a country is willing to use FDI as a catalyst for economic development through the creation of productive business linkages, a skilled labour force, tailored to private sector needs, is vital. Human resource development policies should be designed in light of the country's broader development objectives and investment policies.

In Viet Nam, there is a long-standing consensus across society on the importance of education. Since the beginning of the *Doi Moi*, the share of the population with less than primary school qualifications has dropped and those individuals born in the period that followed have achieved higher levels of education than any other generation in the history of the country. Viet Nam's economic success since *Doi Moi* reforms is associated with substantial labour productivity increases, as agricultural efficiency improved and employment shifted from agriculture to higher productivity sectors (World Bank, 2013). As a consequence, the GDP per person employed has more than doubled between 1990 and 2010.

Economic activity in recent years has been mostly driven by capital accumulation, rather than by productivity growth. Labour productivity remains low relative to regional competitors. According to the latest figures of the MPI, Singaporean labour productivity is 18 times higher than Vietnamese, while Malaysia and Thailand are 6.6 and 2.7 times higher, respectively. Similarly, Viet Nam's labour productivity is 1.8 times lower than those of the Philippines and Indonesia.[13] Although high-tech investors have increasingly invested in Viet Nam, evidence suggests that productivity gaps between MNEs and domestic SMEs is one of the greatest obstacles to the creation of business linkages (OECD/World Bank, 2014).

Investment in education has increased over time, as the state budget for education rose from 15% in 2001 to 20% in 2010 (ERIA and OECD, 2014). The World Bank (2013) points out that the Vietnamese education system has a solid track record in producing basic skills, but faces greater challenges in generating the advanced skills that will be increasingly required in coming years. Its survey found that 80% of employers think that applicants for positions as professionals and technicians lack the required skills. Over 60% of international firms consider the lack of available labour skills as an obstacle to their business activity. The same trend can be found in SMEs, for which a recent study points out that up to 75% of the workers are not adequately trained for technical functions (Phan et al., 2015). A comparative look at the quality of higher education and training in the region shows a relatively weak position of Viet Nam (Table 6.4).

Table 6.4. **Quality of higher education and training in selected ASEAN countries, 2016**

(ranking out of 138 economies and percentage)

	Indonesia	Malaysia	Philippines	Thailand	Viet Nam
Higher education and training (overall assessment)	63	41	58	62	83
Quality of the education system	39	12	44	67	76
Quality of management schools	49	25	41	77	122
Local availability of specialised training services	49	17	48	93	110
Tertiary education enrolment rate	31%	30%	36%	53%	31%

Source: World Economic Forum, *Global Competitiveness Report 2016-2017*, Geneva.

Higher education and vocational training are important means for acquiring technical skills that workers need in their given profession. With all forms of education and training, policy action can help ensure that programmes are of good quality and accessible, meet business needs and are regularly reviewed. Policy can further promote integrated and ongoing links between education and training institutions and providers, businesses and industry to tailor educational programmes to business needs and to provide young people with the information needed to make realistic choices about their studies for future employment.

Recognising the need to further improve the quality of the education system and develop adequate skills in Viet Nam, human resource development policies are articulated in several ten-year strategy documents, including the Education Sector Development Strategy 2011-20, which provides the overall education policy, as well as the Vocational Training Development Strategy 2011-20 and the Human Resource Development Strategy 2011-20, which mostly focus on reducing skills mismatch through training. The HRD Strategy, for example, aims to increase trained workforce from 40% in 2010 to 55% in 2015 and 70% in 2020. Unsurprisingly, the development of quality human resources and skills features as one of the three “breakthrough goals” of the country’s overarching Socio-Economic Development Strategy 2011-20. In addition, the Higher Education Reform Agenda 2006-20 is an ambitious and well-accomplished reform effort that illustrates the government’s commitment to higher education. It aims to increase access and quality to higher education, while reinforcing its institutional framework, better aligning it with international standards and making it increasingly research-oriented (ADB, 2012).

Creating the environment for increasing the supply of qualified individuals not only requires sound educational policies and reforms but also private sector involvement. The government acknowledges – and states it in its strategy documents – the need to involve the private sector in the design and implementation of the country’s human resource development strategy, especially for higher education and vocational training, so as to ensure the relevance of existing curricula *vis-à-vis* the needs of the labour market. Currently, higher education and vocational training programmes do not correspond to the actual requirements of the labour market even if they have been designed recently (ADB, 2012).

The quality of vocational training is considered as particularly poor, according to the *Provincial Competitiveness Index*’ enterprise survey, and is increasingly causing skills mismatch (Malesky, 2015). The lack of engagement from the private sector, but also from trade unions, in both policy making and the provision of training, partly explains this result. It also affects the effective development and implementation of the qualifications framework.

Partnerships exist, nonetheless, between leading companies and universities in Viet Nam, but the challenge ahead will be to draw the lessons of this experience and replicate it more systematically. The government is still little directly involved in such partnerships, although international experience suggests that the facilitation role of central or sub-national governments is fundamental to yield and sustain results (World Bank, 2013). Greater efforts should be made to involve business representatives in the development of skills standards and training curricula. It is hoped that vocational learning will also benefit from the new Law on Vocational Education and Training adopted in 2014 and in force since 2015. The law not only simplified the landscape of programmes that are offered, but also streamlined the institutional landscape by consolidating most responsibilities under the Ministry of Labour, Invalids and Social Affairs. It also introduced reforms in several vocational learning areas, including teachers' and trainers' careers, support for vocational students and examination arrangements.

While formal education equips individuals with the skills needed to learn, new recruits tend to lack the firm-specific knowledge that businesses require to unlock an employee's full productive potential. This is particularly salient in Viet Nam, where the Ministry of Education and Training recognises that a central issue with the current curriculum is that it remains too much focused on content and knowledge and not enough on providing self-study skills, applying practical and developing cognitive and behavioural abilities (World Bank, 2013). Internships and co-operative programmes with educational institutions are proven strategies, and businesses should also be encouraged to help develop the skills of their employees through, for example, on-the-job training or by funding specialised education to benefit both the company and the employee. Training programmes can increase productivity and the spillovers from MNEs to local firms with higher absorptive capacity for new knowledge and technology.

Many Vietnamese firms report that they provide on-the-job training. According to the *Provincial Competitiveness Index*' survey, foreign-owned companies had to provide further training to 20-35% of newly hired workers over 2010-14, accounting for some 3.6-7.8% of business costs. Across almost all provinces, the survey shows that the better quality of the vocational training, the less foreign investors have to retrain their new recruits (Malesky, 2015). The majority of training provided by companies is internal, however, while external training is limited to few companies and workers, often those that are already relatively well educated and trained (World Bank, 2013). Further encouraging training by companies is thus another measure that the government needs to address in the short term.

Other aspects of investment promotion

Promoting outward investment

Viet Nam's economic success is not only reflected in the high levels of FDI inflows received, but also by the increased internationalisation of its firms. Vietnamese investors are becoming increasingly important players in the region and beyond. As of mid-2018, Viet Nam had 988 investment projects in 68 countries and territories, accounting for roughly USD 20 billion, mostly in the mining, agro-forestry, fisheries, energy, telecommunications, trading, banking and manufacturing sectors. The largest markets are neighbouring Lao PDR and Cambodia, accounting for respectively 24% and

18% of the total investment made abroad. Viet Nam is the second largest source of FDI in Lao PDR, accounting for over a quarter of total FDI. In Cambodia, Vietnamese companies are mostly present in agricultural projects. Vietnamese investors have also gone beyond the region to countries like Russia, Venezuela and Peru, which combine 26 projects and account for a total capital of over USD 4 billion. Other host economies include Germany, Myanmar, Singapore and the United States.

Various factors lead companies to invest abroad, including limited home market size, the search for efficiency and the exploitation of natural resources. Trade liberalisation also contributes to cross-border investment. While a great deal of outward investment is driven purely by market considerations, government policies can play a very important role in promoting outward FDI. Usually, three main measures can be implemented by governments to promote outward investment: information provision and consultancy services, fiscal and financial incentives, and investment insurance and guarantees.

In Viet Nam, overseas investments are partly the result of an active government strategy to promote outward FDI. Not only has Viet Nam taken a proactive approach in the conclusion of bilateral investment treaties, double taxation treaties and free trade agreements with an investment chapter, but it has also established institutions to support outward FDI. Viet Nam's national IPA – the FIA – is not only mandated to attract and facilitate FDI into Viet Nam, but also to promote overseas investments by Vietnamese companies. The FIA not only provides direct support to Vietnamese firms planning an investment abroad or encountering problems in their overseas activities, but it is also the focal point in government for designing and implementing policies specific to outward investment. The examples of the Japanese External Trade Organisation (JETRO) and the Korean Trade and Investment Promotion Agency (KOTRA) show that providing sophisticated information and services to home companies, including through overseas offices, can prove successful (Box 6.7).

The FIA also has a more regulatory role, as it is responsible for receiving the documents from companies, approving their projects, and hosting their registration. The *Law on Investment* provides for general regulatory framework on overseas investment and Decree No.83/2015/ND-CP (September 2015) on foreign investment regulation aims at speeding up and diversifying investments as well as making the management of overseas investment activities more effective.[14]

Box 6.7. **Proactive outward FDI promotion: The examples of JETRO and KOTRA**

The Japanese External Trade Organisation (JETRO) was established in 1958 to promote trade and investment relations between Japan and the rest of the world. Since the early 2000s, JETRO's core focus is on promoting inward FDI and on helping SMEs maximise their global export potential. JETRO also assist Japanese firms, especially SMEs, to expand overseas by offering prompt business support services both in Japan and abroad. JETRO advises Japanese companies about business opportunities abroad, facilitates business linkages through exhibitions and trade fairs, and provides investment information through publications and seminars.

Similarly, the Korean Trade and Investment Promotion Agency (KOTRA) was established in 1962 to contribute to the development of the Korean economy by facilitating trade and investment between Korea and other countries. Initially, it aimed to create new export markets and expand Korea's trade. In the late 1990s, the agency started its FDI promotion division and this has helped Korean firms seeking overseas investment by providing country-specific investment information and by assisting overseas investment procedures in both home and host countries. KOTRA has created the Overseas Investment Information System, which provides a range of information about investing overseas, from the latest news about investment activities worldwide to country-specific investment information. The system also offers search services to look up Korean firms based in various world locations, and publishes global investment statistics and columns on investment-related.

JETRO and KOTRA are quite similar in terms of their philosophy, organisational structure and operations. Both agencies have a large network of overseas offices – 73 offices in 54 countries in the case of JETRO and 125 trade centres in 85 countries in the case of KOTRA.

An empirical study by Hayakawa et. al. (2014) found that the outward FDI promotion activities undertaken by JETRO and KOTRA have a significant positive impact on realised overseas investments by Japanese and Korean companies respectively. The analysis indicates that the returns to JETRO and KOTRA are higher for assisting small, less productive firms and for promoting investment in politically risky countries – the level of political risk being strongly correlated with that of business risk. In this context, it is interesting to note that encouraging SMEs to venture abroad has recently emerged as one of JETRO's and KOTRA's key policy objectives. Larger and more productive firms have greater internal capacity and resources to navigate the turbulent waters of high-risk markets. This study thus suggests that it is more productive for IPAs to locate their offices in high-risk countries and to target SMEs as they would more greatly benefit from their assistance.

Source: JETRO ((www.jetro.go.jp/en), KOTRA (http://english.kotra.or.kr) and Hayakawa K., H.-H. Lee and D. Park (2014), *Are Investment Promotion Agencies Effective in Promoting Outward Foreign Direct Investment? The Cases of Japan and Korea*, Asian Economic Journal 2014, Vol. 28 No. 2, 111–138.

Vietnamese investors also have access to domestic institutions to obtain financing support, as in most OECD countries but also in emerging economies such as Brazil, China, India and Malaysia that have taken a proactive attitude in outward FDI promotion. The Bank for Investment and Development of Viet Nam, for example, offers financial support and incentives for outward investments in agro-forestry, fisheries and power production.[15] Specifically, it offers loans to Vietnamese companies of at least 30% of the total investment that receive a preferential interest rate and are not mortgaged by assets. The government also offers tax incentives, including corporate tax exemptions for repatriated benefits to companies investing in certain industries, such as mining, as long as the outputs are imported by Viet Nam (Economou and Sauvant, 2013).

Attracting FDI into ASEAN

Viet Nam joined ASEAN on 28 July 1995. Member States signed the ASEAN Comprehensive Investment Agreement (ACIA) in 2009, which entered into force in 2012. ACIA provides for the general investment framework in ASEAN countries and covers a broad range of issues – from investment liberalisation and protection to promotion and facilitation. It aims to create a free, open and transparent regime for investment in the region in order to achieve economic integration under the ASEAN Economic Community (AEC) in line with the AEC Blueprint. Among other objectives, it aims to strengthen the promotion of ASEAN as a single investment destination. The AEC Blueprint 2025 reiterates the importance of joint activities to promote FDI into the region as a whole.

In this light, the ASEAN Secretariat is taking the lead in building the image of the ASEAN investment destination, while promoting country-level initiatives to facilitate investment. ASEAN's dedicated website in this regard (http://investasean.asean.org) is a good repository of regional investment information, including information on regulatory and legal frameworks and company testimonies. Similarly, the ASEAN Investment Forum has been created to implement ACIA's objective of promoting the region as an integrated investment destination. By bringing together the heads of the region's national IPAs, it provides a good platform to discuss joint projects and initiatives. While promoting investment jointly, greater convergence in investment promotion instruments would help to instil greater transparency. These would need to include measures aimed at overcoming protectionism, rivalries and lack of trust, which are inherent to any regional investment approach (OECD, 2014).

There is a clear interest of MNEs to invest in ASEAN economies owing to the regional market and the expected further integration through the ASEAN Economic Community. The ASEAN regional value chain offers opportunities for companies to distribute design, R&D, manufacturing, sales and services across the region. The prospects of a harmonised ASEAN wide custom system greatly enhance the potential of integrated supply chains across the region, facilitated by an unrestricted movement of goods across borders.

Although Viet Nam's direct competitors for FDI are mostly other ASEAN Member States (see above), there is a strong rationale to promote FDI into ASEAN as a whole. Participating in the regional FDI promotion efforts can help strengthen the national investment climate, while offering investors the differentiated opportunities of a market of 600 million consumers. ASEAN has a number of factors in its favour to successfully promote itself as a regional investment destination. Using these to develop regional guidelines and associated indicators agreed at the ASEAN level could set the region apart from other regional economic communities and would greatly benefit Viet Nam.

Notes

1. In this report, Special Economic Zones refer to the generic denomination the OECD uses to qualify all types of zones, including industrial zones, economic zones, technology parks and export processing zones.
2. According to data collected from an enterprise survey, about half of the foreign investors currently in Viet Nam considered other countries before investing in Viet Nam – most commonly China, Thailand, Cambodia, Indonesia and Malaysia (Malesky, 2015). Each of these shares has increased since 2013, while the Philippines and Lao PDR have been identified as emerging regional competitors for FDI.
3. For some countries, FIA representatives abroad can also be in charge of outward FDI promotion.
4. As reported above, Special Economic Zones refer to the generic denomination the OECD uses to qualify all types of zones, including industrial zones, economic zones, technology parks and export processing zones.
5. These include the Law on Investment, special Decrees of the Government on Industrial Parks and Economic Zones and special regulations of related laws governing the operation of projects inside SEZs (e.g. land, construction, environment, taxation, customs, etc.).

6. To enhance vertical linkages in industrial activities, use resources more efficiently in manufacturing, minimise adverse environmental impacts and improve labour conditions in the industrial sector, the government encourages new models of industrial park models (Decree No.82/2018/ND-CP dated 22nd May 2018) as follows:

- Eco-industrial Park is an industrial park in which firms are engaged in resource efficiency and cleaner production activities and co-operate with each other during the manufacturing process to establish industrial harmonisation to increase the economic, environmental and social efficiency of the firms themselves.
- Industrial – Urban and Service Complex Zone combines industrial activities and a residential complex to ensure the sustainable development of the zone. The zone also includes other functional areas such as an R&D centre, an incubation center, schools and educational institutions, a healthcare centre and recreational areas.
- Supporting Industrial Park specialises in attracting investors in supporting industries. The ultimate goal of this park is to level up supporting industries and thus boost the competitiveness of the domestic industry and its integration in global value chains.

The aim of these new models of zones is to ensure that the domestic industry keeps up with the current global trend of Industry 4.0, meets the sustainable development goals and increases the contribution of industrial zones to socio-economic development.

A new high-level SEZ, called “Special Administrative – Economic Zone (SAEZ)”, will soon be promulgated and piloted in three provinces. It will enjoy special mechanisms to avoid current administrative barriers and the under-compilation law will govern the operation of the three selected SAEZs with innovative policies: a master and development plan for SAEZq; a more liberalised investment environment (i.e. market access, reduction on the “negative list”, streamlined business procedures); a liberalised access to land, real estate mortgage and pledge; mobilisation of capital from the private sector for SAEZ infrastructure; tax breaks and reduced land using fees; loose visa and aviation policies to boost up the tourism and service industry.

The more transparent and streamlined local government administration of SAEZ aims to level up the decisive role of the SAEZ’s head. Its prosecuting agencies will also be given special powers to administer the special civil issues within the SAEZ such as issues related to the citizens, investors and workers; reclamations on the head of the SAEZ’s decisions; reclamations on competition decisions; and bankruptcy settlement.

7. Government Decree 43/2010/ND-CP (April 2010) on Business Registration, defining and specifying the system and procedures pertaining to the registration of businesses and amendments in business registration; MPI circular 14/2010/TT-BKH (June 2010) guiding the process of business registration as per Government Decree 43/2010; Government Decree 102/2010/ND-CP (October 2010) on the implementation of the 2005 Enterprise Law (UNIDO, 2011a).

8. This division was under the Agency for SME Development (now renamed Enterprise Development Agency).

9. https://vietnam.eregulations.org/.

10. Figures on SME employment are very inconsistent depending on the sources. The authorities reported to the OECD that SMEs employ 62% of the workforce while working papers report very different shares of SME employment – around 50% in some cases (ERIA and OECD; Phan et al., 2015) and 84% in some others (Tran et. al., 2008).

11. Government Decree on Supporting the Development of Small and Medium Enterprises (90/2001/ND-CP).

12. While there is a critical debate about the definition of clusters, they can be broadly defined as geographic concentrations of companies, academic and research institutions, and other public and private entities that facilitate collaboration on complementary economic activities, and can be harnessed to promote exchanges and mutually beneficial co-operation.

13. www.thanhniennews.com/business/vietnam-labor-productivity-still-far-behind-asean-countries-ministry-50665.html.

14. http://english.vietnamnet.vn/fms/business/146773/vietnam-licenses-102-investment-projects-abroad.html.

15. The Bank for Investment and Development of Viet Nam is a large state-owned bank. Its mission, among many others, consists in enhancing trade and investment promotion in overseas markets. As such, the Bank is chairman of the Association of Vietnamese Investors in Lao PDR, Cambodia and Myanmar.

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Chapter 7

Infrastructure connectivity in Viet Nam

This chapter examines the current context of infrastructure development in Viet Nam. It reviews connectivity challenges and recent reforms to boost infrastructure investment, including private participation in infrastructure through public-private partnerships. It also proposes recommendations to overcoming the remaining obstacles to improving the legal and institutional framework for private investment in infrastructure.

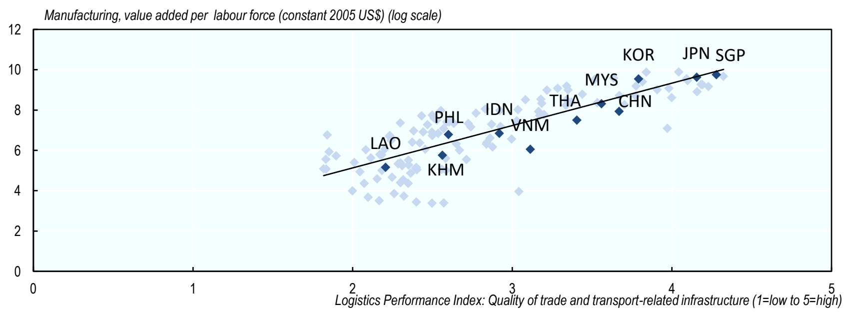
Viet Nam has been one of the world's fastest growing economies over more than two decades, resulting in significant economic transformations and social progress. Greater integration with the world economy and expanding production networks in the region and domestically have played an important role in this process. But rapid industrialisation and urbanisation are putting a strain on Viet Nam's infrastructure. Demand for new and improved infrastructure and related services will require investments estimated by the government at around USD 170 billion in 2011-20, on top of investment in cross-border infrastructure projects. Mobilising the required resources to implement the governments' ambitious infrastructure plan and meet Viet Nam's infrastructure needs is a challenge, but the payoff from successfully improving infrastructure connectivity can be large.

Infrastructure connectivity will be key to support Viet Nam's economic development strategy of raising industrial productivity and is crucial to raise the access of rural populations to social and economic opportunities. According to the Vietnamese Academy of Social Sciences (2006), an increase in spending in infrastructure by an additional 1% of GDP is associated with a reduction in the poverty rate by 0.5%, with the impact being larger in poorer provinces. Viet Nam is also becoming more manufacturing-intensive and is trading and consuming products with higher value-added content, which are more sensitive to infrastructure connectivity shortcomings (World Bank, 2014).

Better logistics systems would, therefore, help Viet Nam to continue moving into higher-value added industries due to increased competitiveness and greater investment and trade opportunities and can have important long-term effects in terms of access to technology and know-how associated with these flows (Figure 7.1) (WEF, 2008). Improved infrastructure connectivity may also help maximise the benefits of Viet Nam's increased participation in global value chains (GVCs). Recent OECD research shows that GVCs are much more sensitive to infrastructure bottlenecks than overall trade. Poor infrastructure systems are a major determinant of overall logistics costs, which in turn are among the primary causes of trade costs. In Viet Nam, Portugal-Perez and Wilson (2010) estimate that improving physical infrastructure to the level of Malaysia could boost exports by almost 30%, which would be equivalent to 20% reduction in the value of tariffs on goods. The impact of improved regional road connectivity and trade facilitation, for instance, is estimated to boost Viet Nam's GDP by 3.6%, notably due to improvements in its links with China (Stone *et al.*, 2012).

Figure 7.1. **Manufacturing value added per worker**

(constant 2005 USD, log scale)



Source: World Bank Development Indicators.

Investment in infrastructure quality has not kept pace with the growth in exports and the current infrastructure shortcomings of the main economic corridors constitute an important barrier for connecting Viet Nam into higher-value added GVCs, which require faster and more reliable logistics environments. Road expansion is still needed to ease congestion on the main corridors in some cases, but the condition of existing roads should not be neglected as a large part of the road network remains substandard and needs upgrading. There is evidence that the limited quality of infrastructure networks is holding back investment and economic growth (World Bank, 2014).

As elsewhere in the region, Viet Nam increased investment in infrastructure following the 2008 financial crisis as part of economic stimulus packages (Abidin, 2010), but large investments are still needed. The government estimates that about 50% of the financing for infrastructure investment needs between 2010 and 2020 will have to come from the private sector. To support greater private sector participation in infrastructure, the government implemented a new public-private partnership (PPP) regulatory framework in 2015 which, together with the new 2014 *Law on Public Investment*, brings some important regulatory and institutional mechanisms to improve Viet Nam's infrastructure delivery capacity. Some important challenges remain, however, to mobilising investments, not least the government's relatively limited experience with PPPs. The effectiveness of the government's strategic orientation will depend greatly on the appropriate implementation of the new framework. Notably, government efforts are needed to clarify in upcoming rules and guidelines some specific issues of concern for investors in the new regulatory framework (*e.g.* the conditions for government guarantees, and the rules for project termination, the standard guidance for risk allocation, among other).

Efforts are also required to improve the broader framework for investments in infrastructure so as to secure value for money in infrastructure delivery. Integrated multi-modal infrastructure planning and a robust value-for-money assessment process are needed for projects to be appropriately prioritised according to their socio-economic and sustainability characteristics, and to ensure that the choice of infrastructure delivery mode is not biased by fiscal motivations. In the past, some infrastructure projects were poorly prioritised, implemented in a un-coordinated fashion and with questionable economic benefits to society (World Bank, 2014). The government needs also to continue its efforts to bring prices to cost-reflective levels in infrastructure markets, notably in the electricity sector, and to move forward with the SOE reform programme to ensure a level playing field for investors in infrastructure sectors. The high number of SOEs in transport infrastructure and power generation sectors, and their relatively weak corporate governance practices (see Chapter 4), are likely to constitute a further barrier for private investments in infrastructure.

Policy recommendations

- Implement integrated multi-modal infrastructure planning to stimulate project complementarities and facilitate a more coherent and welfare-enhancing infrastructure development programme. Strengthen efforts to build capacity in designing a clear and coherent strategic vision for infrastructure.

- Continue to improve the assessment and prioritisation of infrastructure projects so as to secure value for money in infrastructure delivery, including to better balance the need of expanding infrastructure networks and maintaining the quality of existing assets. In the past, some infrastructure projects have been implemented in a un-coordinated fashion and with limited benefits. The new Law on Public Investment and the new framework for PPPs should help address such shortcomings: it establishes a more robust value-for-money assessment process and allows for the government to draw on the recently created project development facility to structure project proposals.

- Ensure that the choice of delivery mode is grounded on a robust value-for-money analysis not biased by fiscal motivations. Under adequate competition and an appropriate regulatory environment, private investment can help to enhance the efficiency of infrastructure, but it should not be used to escape budgetary discipline, notably when the government still bears significant risks and faces potentially large fiscal costs.

- Ensure that upcoming regulations and guidance address specific concerns of investors in the new regulatory framework, such as the scope and conditions of government guarantees, rules for project termination and standard guidance for risk allocation.

- Continue the reform efforts to bring prices to cost-reflective levels in infrastructure markets and to move forward with the SOE reform programme to ensure a level playing field for investors in infrastructure sectors. Removing Viet Nam Electricity's (EVN) cross-ownership of the single buyer and power generation companies, for instance, should facilitate the establishment of the competitive wholesale power market under the 7th Power Development Master Plan and help to secure investments into power generation in the longer run.

Viet Nam's infrastructure connectivity development strategy

The Socio-Economic Development Strategy 2011-20 and the Master Plan on Economic Restructuring

Infrastructure development is high on Viet Nam's agenda. In its ten-year Socio-Economic Development Strategy (SEDS) 2011-2020, infrastructure development was one of three priority areas to achieve its development objectives, alongside developing human resources and skills to support the development of a modern industry and innovation and improving market institutions to maximise the positive effects of planned structural reforms. The five-year Socio-Economic Development Plan 2011-2015 further elaborates the planned reforms for the first five years of the SEDS 2011-2020, including, *inter alia*, to strengthen environmental protection and mitigate and prevent adverse impacts of climate change (see Chapter 8 for Viet Nam's strategy on Green Growth).

The Master Plan on Economic Restructuring for 2013-2020 reinforces the SEDS' focus on improving infrastructure development and identifies the need to create economic conditions for the private sector, including foreign investment, to develop infrastructure. Among other measures, it establishes the need to review and modernise the regulatory framework for private participation in infrastructure, bringing infrastructure prices to cost recovery levels, and explicitly tasks the Ministry of Planning and Investment (MPI), in coordination with other ministries, to identify and publish the list of feasible projects in which invested capital can be recovered to facilitate mobilising private sources of capital. It also stresses the need to promote a level playing field between private and state-owned enterprises; including by further opening monopoly markets or those in which state-owned groups hold a dominant position.

Sectoral strategies and programmes also allude, among the several measures identified, to the need of raising capital for improving infrastructure connectivity. In the case of transport, for instance, the Prime Minister's Decision No. 355/QD-TTg adjusting the Strategy on Development of Viet Nam´s Transport through 2020, with a vision toward to 2030, lists the issue as one of the ten priority policies needed to implement the strategy successfully.

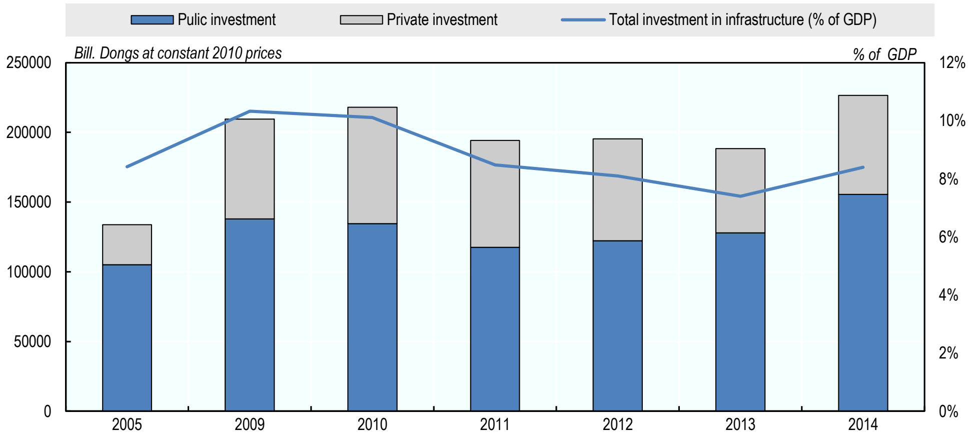
Estimated infrastructure investment needs amount to 10-11% of GDP

Historically, infrastructure investment in Viet Nam has essentially been state-led, with levels particularly high as a percentage of GDP by international standards (World Bank, 2012). Total state investment has been above 10% of GDP in the last 10 years according to the General Statistics Office data, of which 50% or more came increasingly from local authorities. Total investment in economic infrastructure assets has been around 7-10% of GDP in most recent periods, with state investment accounting for the largest share (about 60-80% of total investment) (Figure 7.2).

Despite the many attempts to boost private participation in infrastructure, it seems that relatively little private investment has gone into infrastructure so far according to one measure compiled by the World Bank (Figure 7.3a). Private investments in infrastructure seem also to have disproportionally gone into electricity generation both in value and number terms (Figure 7.3b). From 2000 to 2014, the World Bank reports 65 projects reaching financial closure in the electricity sector, against only two projects in roads, five in seaports, three in telecoms and three in water and sewage infrastructure.

Government statistics, however, show that private participation may actually be greater than what is reported by the World Bank. According to the authorities, the number of transport projects with private participation is much higher. The Ministry of Transport alone, by 2015, reported 80 projects with the total expenses reaching approximately 10 billion USD. As such, authorities suggest that overtime more and more private investment is likely to be channelled to sectors other than power generation, pointing out to 19 build-operate-transfer (BOT) and 2 build-transfer projects completed or under operation in the transport sectors, for instance.

Figure 7.2. **Private and public investment in economic infrastructure assets**

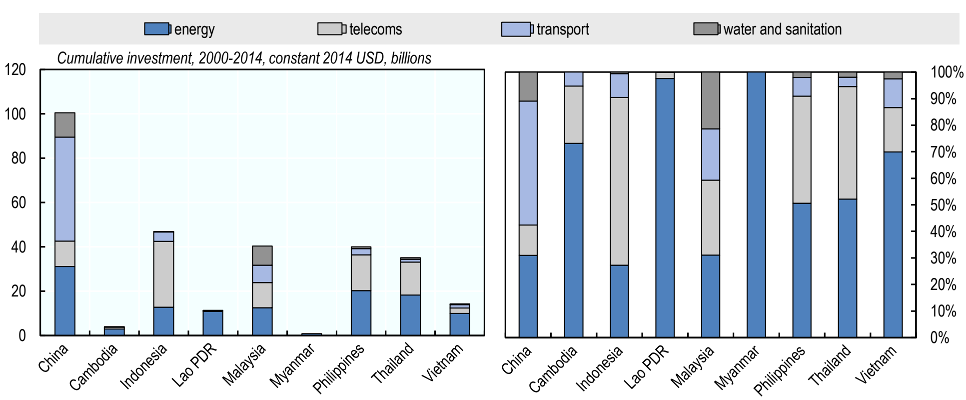


Notes: (1) Economic infrastructure covers investments classified in the national account under "Electricity, gas, stream and air conditioning supply", "Water supply, sewerage, waste management and remediation activities", "Information and communication" and "Transportation and Storage".

Source: General Statistics Office database.

Figure 7.3. **Private participation in infrastructure in Viet Nam and regional peers, 2000-14**

(2014 USD billion, percentage)



Dollar amounts are in 2014 USD. Nominal figures have been deflated using the U.S. consumer price index.

Source: World Development Indicators database.

In the past, private investors, notably foreign ones, may have shied away from projects in sectors other than power due to their relatively greater risks. Power BOT projects present lower risks for investors and lenders because the off-take contract with the single-buyer company, Electricity of Viet Nam (EVN), partly isolates them from demand risk in comparison to user-fee based projects. The risk depends essentially on the extent to which the off-taker is financially capable of meetings its obligations under the off-take contract. And in this case, the Vietnamese government sometimes provided guarantees against such risk, as well as against the risks of early-on project termination. Foreign-owned BOT projects, for instance, were guaranteed to sell all their output to EVN (ERIA, 2014). Other investments by domestic independent power producers (IPPs) under the form of joint-stock companies have not benefited from such extensive guarantees, but often involved state-owned companies (ADB, 2015b).

These arrangements may partly explain the relatively greater success in attracting investments into power generation in the past as suggested by the World Bank data. Since 2009, investments in the power sector have also benefited from increasing adjustments to retail electricity prices. Although these remain relatively low compared to other countries in the region (Table 7.1), these adjustments contribute to the financial sustainability of the entire power sector and helps to instil greater investor confidence.

The Ministry of Planning and Investment (MPI) officially estimates that, during 2011-20, approximately USD 170 billion is needed in infrastructure investment to develop essential infrastructure in Viet Nam, such as electricity, water supply and sewerage and transport (ADB, 2014a). Independent estimates of Viet Nam’s infrastructure investment needs to satisfy consumer and producer’s demand for infrastructure services, assuming specific economic and demographic growth rates, suggested that Viet Nam needed to invest nearly USD 110 billion in infrastructure between 2011 and 2020 (Battacharaya, 2010). This is equivalent to over 8% of the estimated GDP for 2010-20. Around 53% of this is estimated to be needed to build new infrastructure capacity and 47% to maintain existing capacity. Regional infrastructure projects to which Viet Nam is a party would require additional investments.

More recent estimates suggest even higher levels of investment needed. The World Bank (2013) estimates that Viet Nam needs to invest about 10-11% of its GDP in order to implement the SEDP 2011-2020 successfully and maintain its average growth rate of 8% per year with a target to reach a GDP of USD 300 billion by 2020. From 2016 to 2020, the World Bank (2013) estimates that roughly USD 167-172 billion is needed in economic infrastructure investment: 61-63% in transport, 15% in electricity, 6% in ICT and 5% in water & sanitation. With regards to transport infrastructure, the government adjusted in 2013 its strategy to develop its transport infrastructure through 2020, with a vision toward 2030 (Decision No 355/QD-TTg). Among other measures to improve the efficiency of investments in transport infrastructure, ameliorate the development of transport services and ensure more sustainable transport systems development, the government proposes to increase annual investments in transport infrastructure from the state budget and government bonds to reach 3.5-4.5% of GDP.

Private participation in infrastructure is expected to meet nearly half of the needed investments…

The government estimates that capital from the state budget, state-owned enterprises, official development assistance, and government bonds can meet only half of the required investments in infrastructure without compromising the public debt limit stipulated by the National Assembly at 65%.[1] The government's capital spending is currently constricted by a persistent fiscal deficit, which averaged 5% of GDP in 2010–13 (ADB, 2014a). The rest of the financing is expected to come from the private sector, of which an important share is likely to have to come from foreign sponsors and lenders due to the limited depth of the domestic financial market. The government has ambitious expectations that PPPs will effectively mobilise the necessary resources and expertise from the private sector to deliver on infrastructure investment needs. In April 2014, the Prime Minister issued a list of 127 projects to be developed by 2020 with foreign investment support, 41 of which are expected to be developed under BOT or PPP contracts according to the authorities.

…but this should not be grounded on a fiscal motivation

The apparent fiscal motivation behind such policy orientation towards fostering greater use of PPPs may prove costly to Viet Nam in the long-term if it prevails over proper value for money assessments. PPPs *per se* do not expand available resources for funding infrastructure investments, and therefore do not expand the number of projects that a government can undertake. Instead, while the government saves on investment outlays up-front, it relinquishes future user-fee revenue (if the PPP is financed with user fees) or future tax revenues (if financed with budget payments) which should be equivalent in present value terms (Engel *et al.*, 2007).[2]

Moreover, it is rather unlikely, if not undesirable, that Viet Nam will be able to mobilise the needed additional resources from private commercial sources without any government financial involvement. In most PPP projects, the optimal risk allocation requires the government to bear the risks for which it is better placed to manage, mitigate and absorb it (OECD, 2007, OECD, 2012). Excessively transferring these risks to the private sector will likely erode part of the potential benefits of using PPPs in the first place due to the high risk premiums involved.

The case for PPP should rely on its ability to generate greater value for money than the public provision alternative based on its capacity to generate productive, allocative and dynamic efficiency gains (Engel *et al*., 2007). The use of PPPs as a vehicle for escaping budgetary discipline by hiving financial commitments off public sector balance sheets often leads to problems. Contingent liabilities and other fiscal risks associated with PPPs can sometimes be significant. It is internationally recognised that any fiscal implication of infrastructure projects should be reflected in public sector budgets unless all relevant risks truly reside with the private sector. If risks are mitigated by public guarantees, placing them off budget becomes even more questionable (OECD, 2007, OECD, 2012).

Key infrastructure bottlenecks for Viet Nam's enhanced competitiveness

The extent to which countries can provide the necessary conditions for global production networks to operate efficiently is a key determinant of their success in exploiting the channels of productivity gains associated with global value chains. Location decisions of multinational enterprises have become more influenced by their need and ability to ensure predictable and reliable supply-chains, capable of delivering effectively on each stage of the chain (Taglioni and Winkler, 2014). The costs of delays, for instance, can be substantial for the more time-sensitive product categories, such as coffee, fruits and vegetables, telecommunications equipment and road vehicles (a tariff equivalent of 1% or more). In Viet Nam, the tariff equivalent of the time to export associated with inland transport is estimated at an *ad valorem* rate of 0.7 (Hummels, 2007).

Improving infrastructure connectivity is thus necessary to enhance Viet Nam's competitiveness and development opportunities. Rapid economic growth has increasingly put existing infrastructure at strain. Partly as a result, the contribution of productivity to growth has continuously declined over the last decade (World Bank, 2012). Better – instead of more – infrastructure is needed to make the most efficient use of the relatively large amount of investments that Viet Nam dedicates to infrastructure and to support greater productivity gains.

Viet Nam has progressed greatly in terms of infrastructure network roll out…

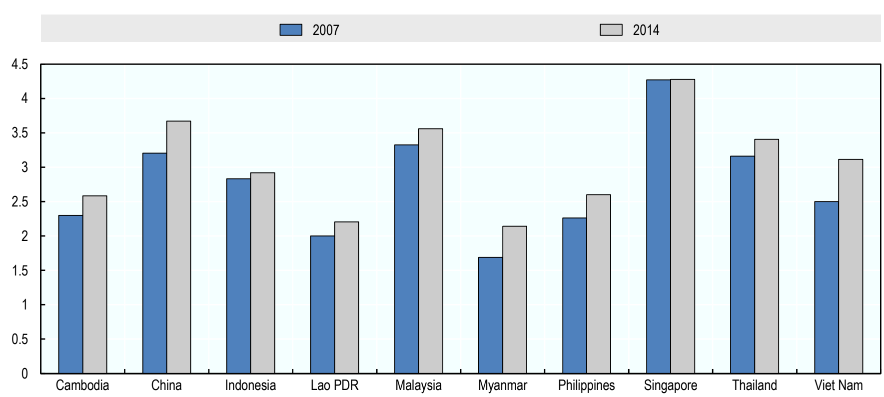
Viet Nam has significantly improved its performance under the indicator of "quality of trade and infrastructure" (*e.g.* ports, roads, airports, information technology) of the World Bank's *Logistic Performance Index* between 2012 and 2014 (Figure 7.4). It made great strides between 2012 and 2014, where its scores improved by 16%, from 2.68 to 3.11 on a scale from 1(worst) to 5 (best), moving up in the worldwide ranking from the 72nd position in 2012 to the 44th position in 2014. But despite the significant progress achieved in the past two decades, Viet Nam still faces some important infrastructure shortcomings as reflected in a number of infrastructure stock indicators and perception assessments (Table 7.1).

…but quality improvements are sometimes lagging behind

Nonetheless, in comparison to its ASEAN peers in the infrastructure component, it still falls behind of Singapore, Malaysia and Thailand. China also compares more favourably than Viet Nam in this regard. The logistic firms and practitioners respondents to the *Logistics Performance Index* survey identified significant quality differences across the different connectivity infrastructure sectors. For instance, while only 15% responded that the quality of telecommunications infrastructure was low or very low, roughly 72% of the respondents answered that rail and road infrastructure were of low or very low quality and almost 58% and 43% felt the same way of Viet Nam's port and airport infrastructure, respectively.

Figure 7.4. **The World Bank's Logistic Performance Index, Infrastructure Indicator**

(score from 1 to 5 (best))



Source: World Bank Logistics Performance Index database.

Table 7.1. **Selected infrastructure indicators across ASEAN countries and China**

	BRN	CHN	KHM	IDN	LAO	MYS	MMR	PHL	SGP	THA	VNM
Electricity											
Access to electricity (% of population) 2014	100	100	56.1	97	78.1	100	52	89.1	100	100	99.2
Electric power transmission and distribution losses (% of output) 2014	6.4	5.5	23.4	9.4	..	5.8	20.5	9.4	2	6.1	9.2
Access to non-solid fuel (% of population) 2014	100	57.2	13.4	56.6	4.6	100	9.1	44.8	100	75.9	50.9
Quality of port infrastructure, 1-7 (best), WEF[1] 2015		5.34	3.11	4.13	4.71	5.78	2.72	4.03	6.74	5.22	4.11
ICT											
Mobile cellular subscriptions (per 100 people) 2015	108.1	92.2	133	132.3	53.1	143.9	75.7	115.8	146.5	152.7	130.6
Individuals using the internet (% of population) 2015	71.2	50.3	19	22	18.2	71.1	21.8	40.7	82.1	39.3	52.7
Fixed broadband subscriptions (per 100 people) 2014-15	8	19.8	0.5	1.1	0.5	10	0.1	4.8	26.4	9.2	8.1
Transport											
Ratio of paved roads to total road length (%) 2012-14	93	-	11	57	16	79	52	86	100	83	66
Asian highway, Primary and Class I as a share of total Asian highway (%) 2012	-	70	-	25	-	51	6	0.5	100	63	13
Quality of roads, 1-7 (best), WEF[1] 2015		4.6	3.3	3.7	3.6	5.7	2.3	3.3	6.2	4.4	3.3
Liner shipping connectivity index (maximum value in 2004 = 100)[3] 2016	3.9	167.5	5.6	27.2	..	106.8	6.4	17.8	122.7	44.3	62.8
Quality of port infrastructure, 1-7 (best), WEF[1] 2015		4.5	3.7	3.8	2.2	5.6	2.6	3.2	6.7	4.5	3.9
Growth of Container port traffic (TEU: 20 foot equival. unit, CAGR, %) 2008-14	5.1	7	1	6.5	-	4.9	4.4	4.6	1.4	2.3	10.8
Quality of air transport infrastructure, 1-7 (best), WEF[1] 2015		4.8	3.7	4.4	3.8	5.7	2.6	3.7	6.8	5.1	4.2

Source: World Bank World Development Indicators database, UNESCAP online statistical database, ASEAN-Japan Transport Statistics database and WEF (2015).

The limited quality of road infrastructure is particularly important because around 76% of transported goods freight on a tonnage basis is carried over Viet Nam's road infrastructure according to the General Statistics Office 2014 data.[3] Inland-waterways are also important, accounting for another 17%. Maritime transport accounted for another 5% (but coastal shipping is much more significant on a ton-km basis as it generally handles longer haul traffic) and rail for the remaining.

The World Economic Forum's (2015) *Global Competitiveness Report* also attests to the improvements made in Viet Nam's infrastructure network since 2006 (the first year for which data are available), but also points to significant differences in firms' perception of the quality of Viet Nam's infrastructure systems compared to some regional competitors, as well as across infrastructure sectors within Viet Nam (Table 7.1).

Differences in perception in the quality of connectivity infrastructure in Viet Nam reflect to some extent shortcomings in the stock of infrastructure, which in turn reflect past investment priorities and some of the limitations of policies adopted in the past. While Viet Nam has progressed greatly in terms of infrastructure network roll out, the quality of the infrastructure network has not always improved commensurately.

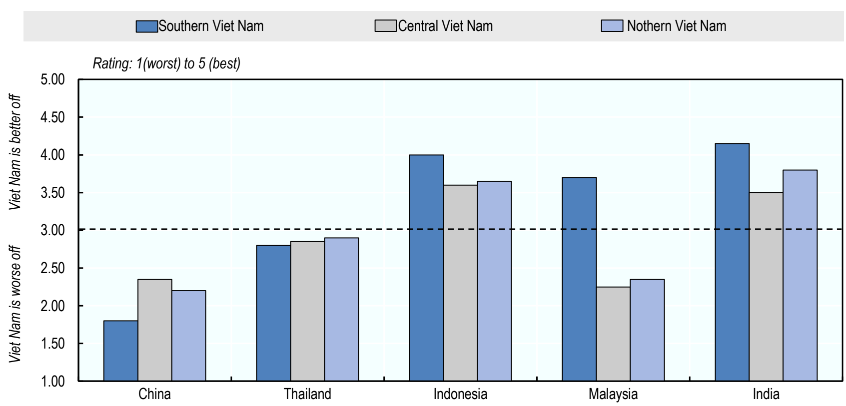
Transport connectivity

Limited road capacity and poor transport planning have led to significant congestion and delays

Road transport infrastructure still lags behind some of the more advanced regional competitors, such as Malaysia and Thailand. Viet Nam's total road network consists of 200 000km, of which only about 65% are paved, compared to above 77% in its peers. In addition, only roughly 14% of Viet Nam's Asian Highway route network – which provides the backbone national road links to neighbouring countries and within Viet Nam – conform to Class I or above standards (*i.e*. access-controlled or four lanes or more highways).[4] Nearly 93% of national roads are only two lanes wide (including for the most part the NH 1, the main national road linking Hanoi and Ho Chi Minh City (HCMC)), and more than 63% of the entire 256 000 kilometres network has fewer than two lanes (ADB, 2012).

Limited road network capacity is aggravated further by inadequate highway and road intersections and some incomplete sections in key economic corridors, resulting in significant congestion and increasing both delays and the cost of transport (intercity truck speeds in Vietnam average 35 km per hour). The overall economic cost of congestion is estimated to be around USD 1.7 billion on the Vietnamese economy. Most highways intersect with other highways at traffic circles instead of through overpasses or flyovers, which allow traffic in one highway system to merge with another highway system while maintaining traffic flow. Access roads mostly use traffic lights instead of ramps, which further impedes regular traffic flow (World Bank, 2014). Viet Nam's expressway network needs also to be further developed. Recent estimates show that 7% of Viet Nam's planned expressway network has been built; roughly 15% is under construction and another 8% is at the detailed design stage (Le Thi Lan, 2012). Viet Nam's road infrastructure shortcomings are reflected in the relatively high level of highway congestion perceived by regional and international logistics companies operating in Viet Nam (Figure 7.5). Meanwhile, the authorities note that some roads have very low utility rates, such as Ho Chi Minh highway and provincial highways in the Northwest and Central Highland regions. Improving resource allocation is, therefore, needed to enhance highway and road capacity. This is critical in the rapidly growing HCMC and Hanoi area in order to enhance Viet Nam's relative competitiveness vis-à-vis other regional peers and to maximise the benefits of increased economic integration.

Figure 7.5. **Logistics companies' perception of the level of highway congestion in Viet Nam relative to regional peers**



Source: World Bank (2014).

The rail sector is not competitive. Limited investment in the past in maintaining and upgrading the existing railway network has left the network in poor condition

Despite a long north-south railway network, the railway sector remains small compared to other transport modes. The sector accounted for only 6% of passenger transport and 2% of total freight movements in 2014, constantly declining since the mid-2000s. The railway network length also declined 25% between 2000 and 2011 (ADB, 2015a). Despite being internationally recognised as a relatively less expensive transport mode for shipping products over long distances, limited investment in the past in the maintenance and upgrading of the existing railway network has left the network in poor condition relative to alternative transport modes, such as roads and coastal shipping, which provide greater flexibility and faster transport. Currently, the average speed of freight trains is estimated at 15 to 20 km/hour (Banomyong *et al*., 2015), which is roughly 43-57% lower than the average inter-city truck speeds (World Bank, 2014). Vietnam's railway network uses mostly meter gauge (85% of the network), instead of standard gauge (1.435m), which does not support high-speed, high-stability, or double-stacked container trains. The conversion to standard gauge would require significant investment (UMIASIA, 2014). Most of the existing network is also below international standards; rolling stock is relatively old (average of 20 years) and carrying capacity is limited, both in terms of wagon capacity (which is even more limited for containers – only 10% of the wagons are designed for container carriage) and train length and traction power (Banomyong *et al*., 2015). This likely represents a sizeable cost for Viet Nam given its distribution of economic activity spread over HCMC in the south (where the majority of non-imported consumer goods are grown or manufactured), the central region and Hanoi in the north, which is 1 137 km from HCMC (World Bank, 2014).

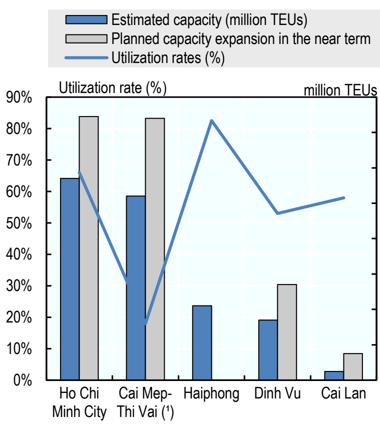
Port capacity expansion has taken place in an un-co-ordinated fashion, resulting in a fragmented port and maritime terminal system with considerable excess capacity

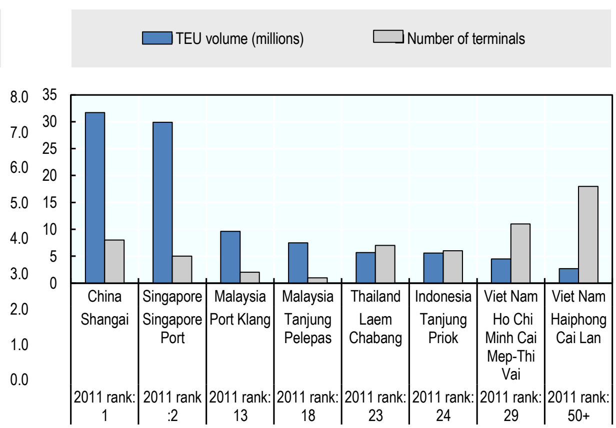
In contrast to railroads, port infrastructure has received considerable attention and funds from the government in the past decade. But the lack of a co-ordinated port (and multimodal) transport planning and development strategy has led to an excessive focus on expanding capacity rather than on improving the quality of existing port infrastructure, resulting in a fragmented port and maritime terminal system with considerable excess capacity even in some key economic regions, such as the Southern region (World Bank, 2014).

Port infrastructure in Viet Nam currently consists of 228 port terminals (Viet Nam's Maritime Administration, 2016), which are geographically distributed across six groups of ports covering the entire territory. Most of the activity takes place in two of those groups, notably the northern (Haiphong, Dinh Vu and Cai Lan) and southern (HCMC and Cai Mep-Thi Vai) ports, which accounted for roughly 29% and 58% of total cargo throughput in 2014 and 26% and 70% of total container throughput in 2014, respectively (Viet Nam's

Seaport Association, 2016). Aside from the Haiphong port which is operating at almost full capacity, overcapacity is currently a problem for most of the other major ports and this problem is expected to continue or increase in the medium to long-term if already planned capacity expansion materialises (Figure 7.6a). Illustrative of Viet Nam's port system fragmentation is the high number of terminals at the most important ports compared to some of the world's major container ports in the region, even though Vietnamese ports handle much lower volumes (Figure 7.6b).

Figure 7.6. **Port utilisation rates[1], current and planned capacity[2] and number of terminals[3]**





1. Data for utilisation rates and estimated capacity as of September 2012.
2. Data for planned capacity estimated at the time for 2013-2014. Two more terminals (SSIT and CMICT-ODA) are due to open in 2013, which will bring a further 2.2 million TEUs of capacity to Cai Mep-Thi Vai in the very short term.
3. Data for the number of terminals as of 2011.

Source: World Bank (2014).

The lack of an integrated multimodal planning only exacerbates such problems as in some cases road connections to ports have deteriorated and become congested, hindering port competitiveness. This is particularly a challenge for some of the newer ports, such as Cai Mep-Thi Vai, which are relatively further away from the major industrial zones. Their associated higher inland transport costs diminish their potential competitiveness vis-à-vis other ports, even in the case of Cai Mep-Thi Vai, which has the capacity to receive larger container vessels and can potentially provide more reliable services. In the northern region too, there is a need to increase ports' channel depth to allow for larger containerships to berth. Most of the other ports in Viet Nam have insufficient water depth for larger modern vessels and have outdated container-handling facilities. Therefore, container services are mostly served by feeder vessels and then transhipped to larger mother vessels at major deep-sea ports in the region (*e.g* Singapore, Malaysia and Hong Kong, China), which may lead to additional delays. Cai Mep-Thi Vai has partially managed to divert the more time-sensitive, higher-value consumer goods cargo, but most of containers handled at Cai Mep-Thi Vai are barged to or from HCMC (World Bank, 2014).

Inland waterways are another particularly important transport mode in Viet Nam, accounting for 17% of transported goods freight on a tonnage basis in 2014 according to General Statistics Office data. There are around 109 inland waterways ports with 3 111 landing points throughout the country, which are often used to move container and foreign trade cargo before the main sea transport leg. Trade with Phnom Penh, Cambodia, for instance, is largely carried by this mode of transport using barges. However, limited investment has been allocated to the development and maintenance of inland waterways, which are seldom regularly dredged and navigable all year round (only about 40% of the inland waterways are) (Banomyong *et al.*, 2015). The need for improved inland waterway infrastructure will only mount with the expected increase in container trade flows in Viet Nam, and will require investments to allow larger ships to navigate in the network to reduce transport costs and delays. Current expenditure in maintenance is estimated to cover only 50% of the costs of proper channel maintenance (World Bank, 2013).

Power and ICT connectivity

Electricity prices have been kept at historically low levels, affecting the industry's capacity to upgrade and maintain the existing electricity system

Access to electricity has become almost universal in Viet Nam, but limited funding has been directed in the past towards upgrading and maintaining existing electricity systems. As a consequence, the system suffers from important electric power transmission and distribution losses, which amount to over 10% of total electricity output. Power shortages are notably an issue during the dry season due to the water shortages for hydroelectric projects. The price of obtaining an electricity connection for businesses is also relatively more expensive in Viet Nam than in some of its peers in the region, which imposes a burden particularly for new Vietnamese SMEs. For instance, the price of electricity per kWh as a share of income per capita is more than 4 times higher in Viet Nam than in Malaysia, 2 times higher than in Thailand, 1.6 times higher than in Indonesia, and 3 times higher than in China.

The commencement of operations of the Mong Duong II coal-fired thermal plant, the largest private sector power project in Viet Nam, and the Song Hau I power plant in 2015 is expected to ease some these shortcomings in power infrastructure in the country, most notably power shortages in the south (ASEAN, 2015). The rapid increase in demand for electricity has outpaced production, diminishing Viet Nam's energy self-sufficiency (JICA, 2014). However, attracting further investments to enhance the quality and capacity of Viet Nam's electricity network will require addressing the historical low level of electricity prices, which have undermined the industry financial sustainability and capacity to meet increasing investment requirements. Electricity prices remain among the lowest in the region (Table 7.2) and exert considerable pressure on the governments' fiscal stance, which has to compensate for Electricity of Viet Nam's financial losses. The state-owned company holds the monopoly over transmission and distribution, besides being responsible for about two-thirds of Viet Nam's electricity generation market (ADB, 2015b).

Table 7.2. **Electricity tariffs in Viet Nam and ASEAN, USD¢/kWh, 2014**

	Residential		Commercial		Industrial	
	Low	High	Low	High	Low	High
Brunei	3.82	19.11	3.82	15.29	3.82	3.82
Cambodia	8.54	15.85	11.71	15.85	11.71	14.63
Indonesia	4.6	14.74	5.93	12.19	5.38	10.14
Lao PDR	3.34	9.59	8.8	10.36	6.23	7.34
Malaysia	7.26	11.46	9.67	11.1	7.83	10.88
Myanmar	3.09	3.09	6.17	6.17	6.17	6.17
Philippines	21.1	24.83	19.93	22.94	18.15	19.37
Singapore	19.76	19.76	10.95	18.05	10.95	18.05
Thailand	5.98	9.9	5.55	5.75	8.67	9.43
Viet Nam	2.91	9.17	4.38	15.49	2.3	8.32

Source: JICA (2014)

Moving forward with planned reforms under the 7th National Power Development Plan, which aims at allowing electricity tariffs to move towards cost-recovery and market-based pricing by 2020 is thus critical to enhancing Viet Nam's power-generating capacity and the industry ability to support industrial development. Access to reliable and affordable electricity is a key criterion for investors in higher-value added industries where electricity is a major component of their cost structures. Power shortages require companies to rely more often on costly generators and increase the risk of damage to electronic equipment.

ICT infrastructure has expanded rapidly since its liberalisation in 2002. Investments are now required to further expand broadband access in the country

The telecommunication network expanded rapidly after Viet Nam ratified its bilateral trade agreement with the United States in November 2011. The agreement triggered the start of gradual liberalisation in 2002 and set a framework for future reforms with a view of establishing a competitive regulatory framework for the sector in light of Viet Nam's accession to the WTO. The reforms that followed improved the sector's institutional and regulatory environment, contributing to the entry of new players, reduction in prices and increased investment in the development of the network (Chun Lee, 2011). But significant investments are still required to expand broadband access. Roughly 7 people in every 100 have fixed broadband internet subscriptions, which is about 20% and 35% less than in Thailand and Malaysia, respectively, although still higher than other CLMV countries. Mobile broadband services, however, is likely to provide some alternative to achieving a widespread access to faster internet speeds, notably into the less economical areas and market segments. The penetration of mobile broadband services has grown much faster than fixed broadband. By 2013, 19 people in every 100 had a mobile broadband subscription, which is almost 3 times higher than the penetration of fixed broadband services (ITU, 2013).

The framework for private investments in infrastructure

The government's goal of making infrastructure networks attractive for private participation is made easier when infrastructure policy priorities are fully embedded in the country's economic development strategies and are supported by a clear regulatory and institutional environment. This helps to secure greater policy co-ordination and alignment across levels of government and to assure investors of the long-term political commitment to infrastructure development.

The regulatory environment

Following the SEDP 2011-20 policy orientation to enhance private sector participation in infrastructure, the MPI was tasked to revise and modernise the regulatory framework for investment in infrastructure projects. The government seeks to build a credible environment for PPPs and has passed a number of reforms in recent years to create a more competitive and transparent legal PPP regime to attract qualified international and domestic investors.

The previous framework for private investment in infrastructure lacked clarity on key regulatory issues

The previous regulatory framework consisted mainly of Decree 108 of 2009, as amended in 2011, and the Decision 71 of 2010. Decree 108 (the BOT Decree) regulated investments into Build-Operate-Transfer, Build-Transfer-Operate and Build-Transfer projects. Decision No. 71 on Pilot Investment in the form of Public-Private Partnership and its implementing regulation represented, as the name suggests, a pilot attempt by the government to attract private investments in other forms of PPP contracts than the ones governed by Decree 108, which provided only for projects that allowed investors to charge off-takers or end-users for the goods or services provided.

Viet Nam's BOT regulation dates back to the early 1990s and has governed most of the infrastructure projects that have taken place so far. But despite the relatively more established framework, only a few projects have actually reached financial closure as mentioned above. The number of projects which have attracted qualified foreign investors interest is even more modest. This is an important shortcoming since qualified international and domestic investors are likely to deploy more efficient technologies and management practices, which can potentially translate into efficiency gains and long-term cost reductions. In addition, most of the infrastructure projects undertaken to this point have not been subject to competitive tendering (EUROCHAM, 2014), increasing the risks of poor outcomes.

Decree 108, as amended in 2011, marked the government's renewed attempt to mobilise private investment for infrastructure projects and, despite some regulatory shortcomings, provided for an improved BOT framework than under the previous BOT regime.[5] Partly as a result, it successfully attracted two new power projects involving foreign investors, most notably the Mong Duong II coal-power plant in 2011 and the Vinh Tan I Coal Plant in 2014, which are the two largest BOT projects to reach financial closure in Viet Nam according to World Bank Private Participation in Infrastructure database. Important improvements brought by Decree 108 were, *inter alia*, the establishment of an open tendering process as the general rule for selecting investors in infrastructure projects[6]; the more transparent and detailed procedures for formulating and reviewing project proposals and feasibility reports; the lower minimum equity requirement imposed on the private concessionaire[7]; the increased limit on state participation[8] and the removal of the previous prime ministerial approval requirement for granting guarantees to projects before contract negotiation, which prevented the government from indicating up-front in the project documentation the guarantees to which the project was entitled (ADB, 2012).

Several key issues remained unaddressed, however. Foreign lenders to PPP projects continued to be restrained from mortgaging a project's land use right as foreign established enterprises were not entitled to land use rights in Viet Nam. In addition, the legislation remained unclear to what extent investors in BOT projects were entitled to full currency convertibility. The Prime Minister's Official Letter 1604 of September 2011, limited foreign exchange guarantees to 30% for BOT power projects. Decree 108 also continued to impose a 10%-15% minimum equity requirement without any consideration for projects' different financial feasibility levels. It also required that all the conditions, procedures and contents of the step-in-rights exercised by lenders be approved by the state authority, but provided no guidance on the conditions and procedures for such approval.

Decision 71 complemented Viet Nam's PPP framework. It constituted a pilot regulatory framework for developing PPPs beyond BOT-type projects, but it suffered from many of the same regulatory uncertainties observed in Decree 108/2009/ND-CP (BOT Decree), besides constituting a newer and less established legal regime for investors and state agencies. As a consequence, the pilot PPP programme failed to attract private investors. Only one of the five project proposals (a waste treatment plant in An Nghiep industrial zone, Soc Trang province) approved by the Prime Minister out of the 24 preliminary PPP projects identified under the pilot PPP programme took off according to the authorities. The regulation provided for only a basic PPP framework, failing to address with clarity some important issues, such as: currency convertibility, the application of foreign governing law and the availability of government support and guarantees, among other things (EUROCHAM, 2014). In comparison with the BOT decree, it provided for more stringent conditions in some cases, such as with regards to state participation which was limited to 30% of total investment regardless of differences in projects risks and financial viability. The framework also imposed a 30% minimum equity requirement on the private concessionaire, which was higher than in the BOT regime and limited investors' ability to adjust the project's financial structure to changing risks and financial needs over its lifetime.

The new framework for private investment in infrastructure brings some important improvements compared to the previous regime…

In February 2015, the government issued Decree 15/2015/ND-CP establishing Viet Nam's new PPP framework. The new decree replaced both Decree 108 and Decision 71, providing for a unified regulatory regime for investments in infrastructure, and ending an important source of uncertainty for investors. On March 2015, the government also issued Decree 30/2015/ND-CP (the Investor Selection decree) providing guidance for implementing provisions in the *Law on Public Procurement*, which was amended in 2013 to provide for the procurement of PPP projects in addition to the procurement of goods and traditional construction services. Other relevant legislation include: the new *Law on Public Investment* of 2014, which unified the previous scattered regime for public investments and provided clearer guidance for its implementation; the *Law on Construction*, which was amended in 2014 to better align with the new *Law on Public Investment*; the new *Law on Investment* and the *Law on Land* (ERIA, 2015). The framework is complemented by a number of guiding documents issued in 2015 and early 2016.[9] This new PPP framework brings about many important improvements to Viet Nam's regulatory framework for investment in infrastructure.

Expanded contract type and sector coverage. The new framework provides for both availability-payment and user-fee type PPPs, and expands the types of contracts previously permitted under the former BOT Decree to include investments in Build-Own-Operate, Build-Transfer-Lease, Build-Lease-Transfer and Operate-Manage contracts. Decree 15 also expands the sectors where PPPs are allowed, now encompassing a broader set of economic and social infrastructure and agricultural infrastructure facilities. It does not expressly provide for PPPs in some other traditional sectors, such as oil and gas and mining, but it allows PPPs in these and any other sectors to be decided by the Prime Minister.

Clearer project formulation and implementation procedures. The new framework establishes a clearer and more predictable process for preparing and implementing PPP projects. It introduces a PPP project life-cycle approach and provides guidance in each step, including on the institutional role of each state agency involved, ranging from the conditions, content and procedures for identifying, preparing and approving project proposals and feasibility studies, passing through project procurement and negotiation of the investment agreement and project contract, issuance of investment certification and incorporation of the project company, and finally the implementation and transfer of the project facility at the end of the contractual term.

All projects proposed under the PPP framework must be implemented in accordance with the above procedures, with the exception of projects classified under group "C". Project classification is aligned with the classification under the *Law on Public Investment*, which categorises projects into those of national importance or pertaining to group "A", "B" or "C". Smaller-sized projects, notably those under group "C", are subject to simplified procedures. There is no requirement for establishing a project company, nor is a feasibility study needed. Only the project proposal, which serves as a pre-feasibility study, is required to be approved by the relevant ministry or the People's Committee. Feasibility studies of "A" and "B" projects (except for projects using ODA or concessional loans in security, national defence and religion-related activities) need the approval of Ministers, head of Ministerial-level agencies and the Chairman of Provincial People's Committees, while those projects of national importance need the approval of the Prime Minister.

The decree also establishes guidance for which projects are eligible for PPPs, notably those (*i*) conforming to master plans, plans for development of the sectors and regions and the socio-economic development plans of the localities; (*ii*) those in the investment sectors where PPPs are allowed as set out in the decree; (*iii*) those capable of attracting commercial financing, technology and experienced investors; (*iv*) those capable of steadily and continuously providing products and services which satisfy the quality standards and meet demands of the users; and those (*v*) where the total investment capital is equal to or above VND 20 billion, except for operate and manage-type projects and those in agricultural sectors. Furthermore, the decree also establishes that projects which are potentially more capable of recovering capital from the business activities shall be prioritised. Unsolicited project proposals which do not conform to sector and regional or local development plans may also be allowed upon approval by the competent authority, following the procedures established in the legislation.

State capital contribution allowed with more flexibility. One of the characteristics of the previous PPP framework was its limit on state participation up to 30% of the total investment costs of a project regardless of the project's risk profile. The new framework now allows the level of state participation to vary depending on the project's financial viability. State participation is to be pre-approved at the project proposal phase in accordance with the regulations on public investment, and the amount of viability gap funding allocated to the project is to be determined during the feasibility study phase on a case-by-case basis. Adequate value for money assessments will therefore be crucial for an efficient use of public money. Viability gap funding is allowed in the form of (*i*) capital support to the construction of infrastructure facilities in the case of user-fee PPPs which do not generate sufficient revenues to recover invested capital, (*ii*) availability-payments to the project company, (*iii*) and support for the construction of ancillary facilities, to organise compensation, land clearance and resettlement. Unsolicited project proposals are not entitled to state support in the first two forms, except when the proposed project involves ODA sources and concessional loans of foreign donors.

The new framework demonstrates the government's increased commitment to provide funding to PPP projects that have strong economic returns but may not be commercially viable. Greater clarity is needed on the rules governing the allocation of public support to those projects in order to support appropriate project proposals and ensure value for money. The government may also wish to set up a dedicated fund to help assure PPP investors of its capacity to meet its commitments beyond the budget cycle and enhance the transparency and management of associated fiscal obligations. Discussions in this regard have taken place. JICA has provided technical assistance for studying the potential establishment of a Viability Gap Fund. But, according to the authorities, at this stage the government will not address this issue. As such, the general rules on the use and management of state capital contribution to PPP projects remains those provided in Circular No. 55/2016/TT-BTC of 10 March 2016. In this context, while the introduced flexibility in the use of state capital to support PPPs is welcome, it is critical that commitments be also thoroughly monitored, potentially with limits on the overall accumulation of PPP liabilities to minimise fiscal risks (IMF, 2015).

A new project development facility introduced. These funds will assist the Authorised State Agencies (*i.e.* the contracting agencies to PPP projects) in identifying and preparing bankable project proposals and feasibility studies and supporting competitive tender processes. They can be used to cover the costs involved in these activities, including the costs of hiring external consultants to support their implementation under the supervision and responsibility of the relevant authority. An initial USD 30 million project development facility is expected to be created for this purpose with the assistance of partner development agencies, notably the Asian Development Bank and the *Agence Française de Développement*. The legislation provides for winning bidders to reimburse the costs incurred in project preparation, which will be made available up-front in the tender documentation and will be included in the total project investment.

The role of this new project facility is crucial to help build a credible pipeline of projects. Legal practitioners have called attention to the difficulties and length of negotiations in the past for projects proposed for tender. Often the negotiations blocked on determining key commercial variables such as pricing and, consequently, on the required level of state capital support. If appropriate feasibility studies are prepared, these decisions should likely be made easier. Establishing a credible pipeline of projects is an important step towards attracting investors and facilitating competition for the market. It allows potential investors to build their strategies upon a sizeable portfolio of opportunities rather than on a project-by-project basis, thereby allowing the amortisation of some of the costs associated with assessing infrastructure opportunities in Viet Nam.

Improved framework for unsolicited proposals. The new framework provides a more detailed framework for preparing and implementing unsolicited proposals, aligned with the one for projects identified and published by the competent authorities. Projects requiring state capital contribution for the construction of infrastructure facilities or in the form of availability-payment are not permitted to be developed through unsolicited project proposals. The cost of preparing an unsolicited proposal shall be borne by the proponent investor. If the project proposal is approved, the proponent may be assigned by the competent authority to undertake a feasibility study upon agreement. Such written agreements must provide for the purposes, requirements, costs for formulating the feasibility study report, and the costs for hiring independent consultants for the appraisal of the feasibility study and the principle for handling the case where another investor is selected to implement the project. Costs may be recovered from the winning bidder if different from the proponent or from the project development facility in case the project is not approved. The proponent investor is also entitled to a 5% preference over other bidders' proposals during the tender process in accordance with the *Law on Public Procurement* and Decree No. 30 on Investor Selection.

International competitive bidding as the general rule. The new framework provides for the selection of investors through open bidding or direct appointment, in accordance with the *Law on Public Procurement*. The general rule is the application of international competitive bidding for investor selection in PPP projects on the basis of the approved feasibility study. Previously, under the BOT Decree, international bidding was only applicable to projects in which no domestic investor registered to participate or for which a domestic bidding process had been organised but no investor had been selected. In practice, most of the projects undertaken under the previous BOT framework were directly negotiated often with state-owned enterprises. Under the new framework, domestic bidding is constrained only to those cases where (*i*) foreign investment is restricted by law or international agreements to which Viet Nam is a signatory; (*ii*) foreign investors do not participate in or fail the pre-qualification stage; and (*iii*) group "C" (small-scale) projects, but domestic investors can partner with foreign investors where advanced technologies or international management experience is needed.

Direct appointment is reserved only for those cases where a single investor registers and satisfies the requirements for pre-qualification or is capable of executing the project due to intellectual property, commercial secret or funding arrangements, or when an unsolicited proposal is considered feasible and most efficient following the Prime Minister's consideration and decision. In this respect, the law establishes that these projects must have their feasibility study reports (for PPP projects) or project proposals (for PPP projects of Group C) approved and that the service prices, state contribution, social benefits, or state interests proposed by the investors is reasonable. No guidance is provided on the criteria for determining such reasonable levels, and it remains to be seen how the new framework will be applied in this respect.

These established procedures follow general international best practices, including a pre-qualification phase where investors are shortlisted based on eligibility, capacity and experience and the assessment of the financial proposals only of those pre-qualified bidders whose technical proposals satisfy the technical requirements established in the tender documentation (Gide Loyerrete Nouel, 2015).

The government has also worked to issue guidelines and standardised documentation to reduce the transaction costs of competitive bidding in comparison to direct negotiations.[10] Tenders are normally burdensome on the government capacity, requiring it to address the many enquiries from potential bidders and lenders about project documents' contents. Investors need some clarity on the conditions and government preferences which a project may be subject to. Detailed guidelines help to ensure the quality of bidding documentation for investors and to limit to a reasonable level the issues open for negotiation. Otherwise these issues may undermine the potential for competitive tendering to deliver greater value for money.

Minimum equity requirement at lower levels. The new framework now aligns the minimum required equity from investors into PPP projects with the levels previously applied to projects under the BOT Decree. A project with total investment below or equal to VND 1 500 billion, the investor(s) must contribute at least 15% as equity. For larger projects, the equity contribution must comprise 15% of VND 1 500 billion plus 10% of the amount in excess of VND 1 500 billion. Under the previous PPP pilot regulation, a 30% minimum equity requirement applied regardless of the projects financial characteristics and risks. This imposed a burden on project sponsors and increased the financing costs of such projects. PPP projects are typically highly leveraged and their financial structure is often adjusted to accommodate greater debt levels after the construction phase, at the moment when the project risk is normally reduced. The legislation now brings the requirements closer to equity levels normally observed in PPP projects.

Improved lenders rights. PPP projects are normally large and highly leveraged. Lenders to PPP projects seek, therefore, to ensure that the project revenue stream is protected and that the project company continues to meet its financial obligations. Step-in-rights is one important mechanism which allows lenders to take full control of the PPP project company when it is not performing, putting at risk its capacity to meet its debt service obligations. Most notably, in such situations, lenders would like to appoint a third entity to take over the project company (Gatti, 2013). Under the previous PPP framework, this was not permitted. Lenders were required to take over the project themselves and such step-in rights had to be approved by the state authority. The new framework finally allows them to mandate another entity to take over the project in such situations and removes the approval requirement. However, the triggering conditions and timing for the exercise of step-in-rights is subject to an agreement between the lender and the authorised state agency responsible for the project. In addition, lenders are now allowed to take security over the project company's right to commercially operate the project facility, in addition to land use rights and other assets of the project. This was not permitted under the previous framework (Mayer Brown, 2015).

Clearer dispute settlement provision. The new framework provides greater clarity on the rules governing dispute settlements involving foreign investors. It sets out clearly that any dispute arising between the authorised state agency and a foreign investor or the project enterprise established by a foreign investor, during the implementation of the project contract and the guarantee agreements, can be settled by arbitration or by local courts or by an arbitral tribunal established on the basis of an agreement between the parties. It establishes that disputes to be settled by arbitration as agreed under the project contract and other relevant contracts are commercial disputes, and recognises that awards of foreign arbitrations shall be recognised and enforced in accordance with the laws on recognition and enforcement of foreign arbitral awards. Legal practitioners have welcomed this development since it addresses an important area of concern under the previous regime. In some situations, under the previous framework, Vietnamese courts interpreted that disputes did not constitute a "commercial dispute", which sometimes made the recognition and enforcement of foreign arbitral awards difficult (Gide Loyrette Nouel, 2015; Duane Morris, 2015).

But some remaining challenges might still deter qualified private investors

Most of the remaining concerns for investors are not new. To begin with, some concerns remain about the nature of the legal framework regulating PPPs. PPP implementation is regulated at the Decree level only, and being still subject to some overlapping laws and regulation according to the authorities, which leads to difficulties in implementation. There are also some more specific concerns that need to be addressed in upcoming regulations and guidelines. Some of these issues are discussed below, but do not represent an exhaustive list. While the government is right to accord certain flexibility to the negotiation of many of these issues under project contracts, the framework would benefit from more transparent guidance on the broad conditions and rules the government seeks to implement.

Risk allocation is insufficiently addressed. Risk allocation is a key aspect in ensuring value for money and risk allocation principles give visibility to investors on the government's standard approach to risk sharing, notably with regard to the risks which it is likely to retain itself (*e.g*. political and regulatory risks), risks which are expected to be shared by the parties and those which the private investors are expected to assume (OECD, 2012). The new framework is relatively silent on risk allocation guidelines. It requires that project proposals identify the risks foreseen during project implementation, and propose their allocation between the authorised state agency and the investor, but no guidance to support such risk allocation has been developed (Frasers, 2015).

Inappropriate risk sharing imposed on the private sector raises project costs, potentially rendering a project un-bankable or reducing its potential value for money. Risk allocation guidelines can support authorised contracting state agencies in developing bankable PPP projects, as well as enhancing transparency for investors and lenders, allowing them to better harness investment opportunities. In addition, while the new PPP framework provides that contract negotiations after the bidding award should not fundamentally change the bidding offer and previously agreed contractual contents, it lacks sufficient clarity with regards to the potential items which can be subject to negotiation to ensure this does not affect the projects' value for money potential. Risk allocation guidelines would likely help to limit such risks. In either case, all short and long-term fiscal risks shouldered by the government, including contingent liabilities, should feature in the cost-benefit analysis and should be managed transparently in the budget process (OECD, 2012). The authorities are aware of the need of appropriately addressing risk allocation. A recent circular providing guidance for preparation of PPP contracts should help in this regard.[11]

Currency convertibility remains a concern. Viet Nam's financial sector capacity is still relatively underdeveloped to finance large and long-term PPP infrastructure projects (ADB, 2012). For large PPP projects, investors may still have to recourse to foreign bank loans denominated in foreign currency, which exposes them to important currency risks since projects' revenues are normally denominated in Vietnamese Dong. Investors and lenders, therefore, seek government guarantees against limitations on currency convertibility and remittance. Investors may also seek protection against exchange rate fluctuations because of limited hedging options available in the market.

The new framework lacks clarity on the right and extent to which projects will be entitled to "foreign currency balance guarantees" (Frasers, 2015). Uncertainty also arises with regards to the powers of the authorised agency to issue government guarantees for PPPs, which is not delineated in the current legislation (Freshfields Bruckhaus Deringer, 2015). Together these may prove an important impediment to the development of PPPs in Viet Nam. Development agencies and export credit agencies may play a key role in supporting PPP projects in Viet Nam in this regard.

The framework establishes that only those projects requiring National Assembly approve-in-principal, infrastructure construction projects within the government investment programme and other important projects as decided by the Prime Minister shall be considered for satisfying their needs of foreign currency. The Prime Minister shall decide on and appoint an agency to be responsible for providing the foreign currency convertibility guarantee for the project. In the past, as mentioned in the previous section, foreign currency convertibility guarantees had been limited to 30% of revenues in the case of BOT power projects in accordance with the Prime Minister's Official Letter 1604 of September 2011. The new legal framework does not follow this practice. No statutory limit on currency convertibility guarantees has been set.

While the approach of limiting the government's guarantees to PPP projects is a valid one, as full guarantees may create perverse incentives to the detriment of value for money, this approach needs to be balanced against the different types of risks involved. In principle, risks should be allocated to the party best capable of managing, mitigating and absorbing them in order to deliver the best value for money from the project (OECD, 2012). Currency convertibility is unlikely to be a risk that the private sector can efficiently manage, and therefore transferring such risk to the private party will entail a high premium without much compensating efficiency gains. At the same time, a currency convertibility and transferability guarantee for an infrastructure project by the government cannot prevent the country from running out of foreign exchange, and its efficacy depends upon the government not having too great a share of its foreign currency supply subject to guarantees (Matsukawa *et al.*, 2003). Bilateral and multilateral agencies could play an important role in this case by backing the undertakings of the government.

Therefore, the government may wish to maintain a certain policy space in this respect, but the new framework could establish better guidance on the conditions for guarantees to be provided on currency convertibility and transferability. This would enhance the transparency of Viet Nam's PPP framework and help minimise the costs of transferring too much risk to the private party. The government may also consider establishing a dedicated fund to support government guarantees, such as the Indonesia Infrastructure Guarantees Fund, which operates as a commercial entity to structure and provide government guarantees for PPPs (World Bank, 2013).

Lengthy land clearance and compensation processes. In Viet Nam, the Provincial People's Committees are responsible for carrying out the site clearance and completing the procedures for land allocation and lease to carry out the project according to the laws on land, project contracts and relevant contracts. The authorised state agency counterpart to the PPP project shall co-operate with provincial People's Committees in this respect. The government may also contribute to a PPP project by paying for land compensation and resettlement costs. The new PPP framework also provides for a guarantee against changes in land use purpose during the entire execution of the project period, even when the project lender exercises the right to take over the project. Nonetheless, site clearance and compensation processes have been notably lengthy in the past, taking between four and five years for investors in BOT projects to complete such procedures (Frasers, 2012). Obtaining land-planning and environmental permits and obtaining compulsory land expropriation clearance from the responsible judicial and administrative authorities before calls for tender are made would likely help to mobilise the private sector investment more effectively by diminishing uncertainty and negotiation delays. The government should also engage early in consultations with any affected party to mitigate any adverse social impact associated with land requirements by PPP projects (OECD, 2009, 2012).

Land use rights limit foreign lenders financing. In Viet Nam, land is property of the state. Private investors are entitled to land use rights and credit institutions, including foreign bank branches, can take security over land-use rights and assets attached to it, but land-use rights cannot be mortgaged to foreign institutions without a local presence. Notably in the case of PPP projects, which are particularly large and may likely require the involvement of foreign financial institutions, this can be a deterrent to reaching financial closure.

Lack of guidance on project termination and renegotiations. The long life-span of infrastructure assets normally surpasses the contract duration, imposing an additional constraint for investors to recover their capital during the contract period depending on the regulatory regime. The mechanisms for early-on project termination and residual value repayment at end of concession if any, as well as the ability to solve any disputes arising throughout the concession period in a timely and impartial manner, are thus critical for investors and may work to attenuate their propensity to underinvest in some cases (World Bank, 2015b). Viet Nam’s new framework remains basic with regards to the rules governing the termination of PPP projects by any of the contracting parties to a PPP project contract. The framework only establishes that the contracting authority and the private party to the project shall agree on the conditions and procedures for handling the termination of the project contract, but no guidance is provided to support the conduct and determination of termination compensation. The lack of clarity in this regard raises uncertainty for investors on the extent to which they will be able to recover their capital and reimburse all outstanding debt and financial costs incurred by the project, and may lead to lengthy project negotiations.

The new PPP framework also provides only limited guidance on the circumstances and the extent to which renegotiations are permitted, leaving a large scope for these issues to be negotiated and stipulated by the parties in the contractual agreements. While it is good practice to incorporate explicitly in contracts the conditions under which they may be reconsidered or renegotiated, the lack of appropriate initial guidance to support such agreements may increase the risks of opportunistic renegotiations by the parties. Renegotiations have been common for PPP projects worldwide, often shortly after contracts are signed and to the detriment of initial value for money assessments, commonly resulting in greater direct and contingent liabilities for the government and lower efficiency and quality for users. Most have been initiated by the private sector, and only a minority have been commonly agreed or initiated by the government (Guasch *et al.*, 2014). Contracts renegotiations will occasionally be necessary in long-term infrastructure projects, but it is important that the outcomes of any renegotiation do not substantially modify the project's original risk allocation and jeopardise value for money. Ideally it should have no impact on the net present value of the project's benefits (Guasch *et al.*, 2014).

Political commitment and institutional delivery capacity

The government is seeking to build credibility with the private sector and has set up a number of institutional mechanisms to ensure an adequate framework is in place for developing and implementing PPP projects. A PPP steering committee – currently chaired by the Deputy Prime Minister Trinh Dinh Dung and including representatives from the relevant Ministries and regulatory bodies – has been established to supervise the implementation of PPP policy and projects on a national basis.[12] In late 2016, the government further issued Decision No. 2048/QĐ-TTg and regulations updating its functions to reinforce the work of the Steering Committee on PPP.

The MPI has been tasked to co-ordinate and assist the PPP steering committee and has created a dedicated PPP unit to act as the government central PPP unit. It shall assist Ministries, branches and provincial People's Committees in identifying, structuring, procuring and monitoring PPP projects. It is also tasked to be the main government interface for investors. Ministries, ministerial-level agencies and the provincial people's committee have been tasked to assign a subordinate unit to be their focal point on PPP depending on their needs and management conditions. According to the authorities, about 51 PPP focal points have already been established or assigned by both Ministries and provinces, such as the Ministry of Transport, Ministry of Agriculture and Rural Development and Ho Chi Minh City People's Committee.

The MPI is also responsible for managing the recently created Project Development Facility fund, which serves to fund the expenses of formulating, evaluating and approving project proposals and feasibility study reports, and the expenses incurred during investor selection processes. Authorised state agencies are allowed to draw on the project development fund, including hiring specialised consulting firms to assist them in these activities. It is expected that these resources will help to overcome some of the capacity shortcomings within Ministries, agencies and provincial Peoples' Committees. In the past, limited delivery capacity of state agencies, both in terms of dedicated staff and sufficient budget for PPP preparation, contributed to some extent to the limited number of bankable project proposals and internationally competitive tenders for infrastructure projects in Viet Nam. Most of the PPP projects developed so far have been directly negotiated, failing to benefit from enhanced value-for-money arising from greater competition (World Bank, 2013).

The government has invested in capacity building by establishing a PPP capacity building programme (Decision 1086/QD-BKHDT, dated 14 August 2014) and has organised, with the support of donor agencies, a series of technical workshops to train government officials and raise overall awareness on PPPs. Over 600 public officials have received training under the programme (Frontier Law & Advisory, 2016). It has also engaged in enhancing the transparency and communication with regards to PPPs and is developing a PPP portal which will concentrate relevant information on Viet Nam's PPP programme, including a database of PPP projects and relevant regulations.

Infrastructure planning and project prioritisation and monitoring capacity

Viet Nam's limited efficiency in infrastructure investments arises partly from the lack of an integrated infrastructure planning process across sectors and levels of government. The observed overcapacity in the ports sector is a clear example of the shortcomings of a fragmented and decentralised planning, budgeting and investment process (World Bank, 2014). The Transport Master Plan to 2020 is also weakly articulated with the industrial development plan and trade competitiveness strategy. The necessary investments in transport infrastructure to improve the main economic corridors' access to their trade gateways, for instance, have lagged behind the growth in demand, while investments have been channelled to other infrastructure projects with relatively limited socio-economic impact. The lack of a multi-modal approach to infrastructure planning within the Ministry of Transport and the poor co-ordination with the relevant provincial governmental agencies has also resulted in complementary infrastructure projects being developed in a time-inconsistent fashion, undermining their potential economic impact (World Bank, 2014).

Poor project prioritisation also leads to investment in infrastructure projects with relatively low economic returns. An example was the priority focus of the Master Plan for the Development of Viet Nam's Seaport System through 2020, with orientation towards 2030, to develop the Van Phong international trans-shipment port in central Viet Nam, despite limited demand for such a port. The government finally stopped its construction in 2012, in part because of the financial difficulties of the SOE involved (Vinalines), but the government seems still to be pursuing the idea of developing the transhipment port at Van Phong (World Bank, 2014). According to the authorities, the government decided to continue with the construction of Van Phong in 2016.

An integrated planning and decision-making framework should help to better prioritise investments according to their socio-economic importance, environmental sustainability and financial feasibility. In this respect, the 2014 Law on Public Investment and the 2015 Decree on Public-Private Partnerships may address many of the earlier challenges leading to inefficiencies in public investment, including through PPPs. The procedures for selecting, approving, budgeting, implementing, monitoring and evaluating projects have been clearly stipulated in these laws. The planning for state capital investments, as per the revised *Law on State Budget*, has also been adjusted from an annual approach to a five years cycle to align with the 5-year national Socio-Economic Development Plan. The budgeting constraints have also been more firmly incorporated in project selection and prioritisation, with the Ministry of Planning and Investment required to cooperate with the Ministry of Finance to appraise the investment portfolio and the capability of projects under MPI responsibility to be financed through the state budget or other forms of funds. A similar process also applies to projects under the responsibility of the provincial People's Committee (*i.e*. those classified into Group B and C as per the *Law on Public Investment*). It remains to be seen how effective these co-ordination efforts will be in ensuring projects' alignment with national priorities.

The government also needs to strengthen its value for money framework. In the past, infrastructure projects have been prioritised and structured around weak feasibility assessments (*e.g.* Cai Mep-Thi Vai port) and were also rarely put to competitive pressures through international tendering. The new regulatory framework will help in this regard. The *Law on Public Investment* specifically establishes that infrastructure projects should be selected and prioritised based on their financial efficiency and social and environmental sustainability. The new *Decree on Public-Private* Partnerships further establishes a common framework for PPP project proposals and feasibility studies, which will facilitate project comparison and prioritisation. It requires that project proposals justify the need for the investment, the advantages of the PPP in comparison with other forms of investment and the proposed type of project contract. Nonetheless, more detailed guidelines and standards are needed to ensure project proposals and feasibility studies' quality and comparability, and that the selection of projects and of their delivery mode – either through traditional public procurement or PPP – are grounded in reliable value for money analysis by the responsible government agencies.

The government needs to ensure that any fiscal motivation for mobilising private investment into infrastructure does not bias the results of such assessments. This may be a challenge as the Socio-Economic Development Plan 2011-20 emphasises creating the conditions for private investment in infrastructure and the government expects that half of the financing for infrastructure investments shall come from the private sector due to fiscal constraints. But the selection of infrastructure projects and the choice between public and private provision should be guided by an impartial assessment of what best serves the public interest. This is best achieved through full cost-benefit analysis taking into account the entire project lifetime, all alternative modes of delivery and affordability to ensure value for money. All relevant aspects of sustainable development should also be taken into account, including through environmental and social impact assessments, and incorporating climate resilience considerations. Private participation should also not be used as a vehicle for escaping budgetary discipline, and any direct or contingent budgetary implication of such projects should be appropriately scrutinised and transparently treated in the budgetary process (OECD, 2007, 2012). This was not the case under the previous *Law on State Budget* in Viet Nam (World Bank, 2014b).

Furthermore, PPPs also require active monitoring of their implementation, which implies additional co-ordination needs by involved authorities and relevant agencies. In this respect, implementing effective internal control and monitoring procedures by authorised state agencies and other relevant authorities is important and should facilitate the monitoring of projects' budgetary implications by the Ministry of Finance, as well as the *ex post* evaluation of infrastructure projects' performance, finance and compliance by the State Audit Office of Viet Nam as foreseen in the new *Law on Public Investment* and *Law on State Audit*.

Price regulation

Recent regulatory reforms and institutional commitments represent an important step forward in building the government's credibility to deliver on infrastructure PPP projects, but other important complementary issues need also to be addressed. For instance,there had been an impression that some toll road PPP projects had been proposed with too low toll rates, making returns feasible only over an excessively long-term period from investor and lender perspectives, rendering these projects un-bankable (Thanh Nien News, 2015). According to the authorities, however, an investigation by an inspection committee has found that in many PPP road projects the opposite was true. This misperception may be due to the lack of transparency with PPP projects and the fact that prices are set in these contracts. Whichever the case, infrastructure prices need to be set at cost reflective levels for projects to be bankable and attractive to private investment, and greater transparency helps to ensure that this occurs in practice.

In the electricity sector, the government will need to sustain its commitment to bring tariffs to cost-recovery levels to mobilise the estimated needed investments. In the past, the government has been reluctant to do so. Electricity prices have long been kept at low levels, undermining the industry financial sustainability and capacity to meet investment requirements. Despite an increase in the average retail tariff by 79% in nominal terms during 2007–13, it has decreased by 15% in real terms. As of August 2014, the average electricity price was USD 0.0714 kWh, much lower than its estimated long run marginal cost of USD 0.08-0.09 kWh (ADB, 2014b). Gradual tariff increases are required to ensure the long-term financial sustainability of the power sector. Low prices exert considerable pressure on Viet Nam Electricity's (EVN) financial position, and therefore on its capacity to invest in new generation capacity and in the transmission and distribution network (ADB, 2015b).

It also affects the market for private investment into electricity generation. Independent power producers need to be assured that EVN's single buyer subsidiary – the Electricity Power Trading Company – has the capacity to buy the produced electricity at generation cost-recovery levels. But with such low prices, investors' returns may be excessively pressured downwards. To date, most of the power generation capacity has been developed by EVN's generation subsidiaries and other state-owned companies, such as Vinacomim and PetroVietnam. Private domestic and foreign-owned investors are limited to only 16% of the installed capacity (ADB, 2015b). Foreign investment in the sector has only taken place through full government guarantee of EVN's off-taker commitments under the purchase power agreements (ERIA, 2014).

Since 2009, however, the government has been promoting price reforms to mobilise investment and instigate a more efficient use of power to keep up with rampant demand. Electricity prices have been adjusted in accordance with the government's price reform (established by Decision No. 21/2009/ QD-TTg) to allow tariffs to reflect changes in costs, following a more transparent process, while recognising the need for social protection schemes for the poor. In 2011, the Decision No. 24/2011/ QD-TTg dated 15 April 2011 clarified that electricity retail prices would be adjusted in accordance with changes in its fundamental costs, such as fuel costs, exchange rate fluctuations, and generation capacity charges. Increases in excess of 5% would require the endorsement of the Ministry of Industry and Trade and the approval of the Prime Minister. Another important government commitment came with 7th National Power Development Master Plan, which expressed the government commitment to allow electricity prices to gradually increase to cover the long run marginal cost of the electricity system by 2020 amounting to USD 0.08-0.09 kWh (ADB, 2015b). Such tariff reforms are need to provide generation investors with reasonable comfort that EVN as the single-buyer will be able to pay generators in the competitive market and BOT investors (World Bank, 2012).

In preparing for the competitive generation market established in 2012, the government implemented reforms to enhance the transparency and competitiveness of the power generation sector. In 2010, Circular No. 41/2010/TT-BCT dated 14 December established the method and procedures for determining power generation prices under new standard power purchase agreement (PPA) contracts and for the conversion of existing PPA contracts. Accordingly, the Electricity Regulatory Authority of Viet Nam, which is an entity under MOIT, shall set annually price brackets to be used in negotiating PPA contracts based on benchmarked costs for each type of power plant according to fuel, technology, and size of plant, and following a standard regulated return on equity (10% for the state capital contribution share and a 5-year Government bond yield average over the previous five years plus 3% for private investors' equity stake). Before, prices were freely negotiated between parties without any standard guidance and transparency. BOT and small power plants are not required to participate in the competitive market and are exempted from the application of Circular No 41. BOT investors continue to sell all their output to the single buyer at prices set in their PPAs negotiated directly with the MOIT (ADB, 2015b).

Since the competitive generation market became operational in 2012, power plants have been able to sell their electricity to EVN on the basis of competitive bids in the market. So far, for prudential reasons, the Electricity Regulatory Authority has allowed only 10%-15% of the total generated power to be traded at spot market prices. The rest of purchases by EVN are still covered by the PPA contract prices. The establishment of the standard PPA contract with a standard pricing methodology was intended to increase the transparency of power generation price formulation and help to ensure a similar treatment for generation investors independent of ownership. The regulated price caps by type of power plant based on benchmark costs also helps to ensure that bidding prices reflect actual costs, and stability in the spot market is further assured by contracts for difference between the power plant and the single buyer, which compensates for differences in the market and PPA contract price and volume (World Bank, 2012).

Level playing field between state-owned and private enterprises, and statutory barriers to foreign investment in infrastructure sectors

Where privately-owned infrastructure providers coexist with state-owned incumbents, particular measures to maintain a level playing field are needed to safeguard a healthy competitive environment and reduce concerns over regulatory discretion and risks, including corruption. Adopting strong corporate governance standards for state-owned enterprises also helps to ensure they operate on an equal footing with the private sector (OECD, 2015).

State-owned enterprises play a dominant role in Viet Nam’s infrastructure markets, especially in strategic and capital-intensive industries. In the transport sector, for instance, there are still 37 SOEs under the auspices of the Ministry of Transport, despite the government SOE equitisation programme underway (MOT, 2016). There are also SOEs under the responsibility of provincial authorities. In the power generation sector, the three large SOE groups, namely EVN’s three subsidiaries, PetroVietnam and Vinacomin, dominate more than 75% of total electricity output. The three fully-owned subsidiaries of EVN are responsible for roughly two-thirds of the installed capacity. They are expected to be fully separated from EVN once the wholesale competitive market initiates, which is expected in 2017. EVN is also the owner of the National Power Transmission Company, the single-buyer of electricity in the country, and of five other power distribution companies (ADB, 2015b).

Reforming the SOE sector is necessary for Viet Nam to improve the efficiency of infrastructure investments and, where appropriate, generate space and confidence for greater private sector participation. Many of Viet Nam's SOEs are less productive than their private counterparts. On several occasions they have ventured outside their core business, with investments backed by subsidised credit (World Bank, 2012, 2014; Matheson, 2013). Overinvestment in the past resulted in low capital productivity of SOEs in many sectors, including ports, where overcapacity has been particularly acute. In airports too, it seems that both SOE-managed cargo terminals in HCMC and Hanoi airports could be operated with much greater levels of efficiency and contribute to important logistics and operating costs gains (World Bank, 2014).

Moreover, the dominance of SOEs in many infrastructure sectors crowds out private investment in these sectors and the weak governance structures of SOEs only compound private investors' concerns over the lack of level playing field (World Bank, 2014). In the electricity sector, for instance, private investors have major concerns over the extensive role played by EVN. While it has gone through structural reforms – the company was legally unbundled and ceased to exist as a vertically integrated utility in 2009 – it remains present in all stages of the power sector value chain through its various subsidiaries and owns the national transmission company (ADB, 2015b). This current cross-ownership integrated structure does not assure investors of a fair, efficient and non-discriminatory trading environment and access to the grid. In the past, independent power producers complained that EVN refused to buy their electricity despite power shortages, or only accepted to buy at very low prices. They found themselves at important disadvantages vis-à-vis EVN-owned power plants which have already recovered their capital and can thus offer more competitive prices (UNDP, 2012).

The government's gradual approach to reforming the company's structure, allowing it to retain cross-ownership over these core business assets, may have posed only a limited challenge during the development of the competitive generation market, as the priority rested in moving forward with price reforms (World Bank, 2012). But it will become increasingly more of an issue for the government to attract new investment into the power generation market in the future. To some extent, price reforms were also a priority to move forward with the full separation of EVN's power generation companies, because the equitisation of EVNs generation companies would only likely be attractive once the industry's financial prospects recovered. But removing EVN's cross-ownership of the single buyer and power generation companies will become indispensable for the government to successfully implement the planned competitive wholesale power market as indicated in the 7th Power Development Master Plan and attract more IPPs and BOTs into power generation in the longer run.

Improving the governance of Viet Nam's SOEs along the lines established in the OECD *Guidelines on Corporate Governance of State-Owned Enterprises* would go a long way in achieving a level playing field for investors (see Chapter 4 on Corporate Governance). As identified in the 2012 SOE reform plan, shortcomings in the governance of Vietnamese SOEs relate to the limited disclosure of financial information, the lack of transparency with regard to the state's ownership and regulation responsibilities, inadequate oversight of SOE management and investment plans, and unclear lines of state authority (Matheson, 2013). The government's plan to reform the SOE sector is in line with international standards and includes the objective of further separating the state regulatory functions from the exercise of state ownership, improving SOE management practices and board professionalism, and separating SOE commercial objectives from their social obligations. The government also plans to step up the pace of the SOE equitisation programme (partial privatisation), which has been lagging behind targets in recent years (World Bank, 2015a).

Continued progress in implementing these reforms will be crucial to improve the productivity of infrastructure providers and enhance private participation where appropriate. In this regard, it is a welcoming development that, under the Decree No. 15/2015/ND-CP on PPPs, SOEs have now been requested to partner with a private enterprise to be eligible to propose PPP projects.

Going forward, the government may also wish to reassess if the current regulatory restrictions to foreign investment in infrastructure sectors continue to serve the broader public interest. Statutory barriers to foreign investment exist in the railway and port sectors, and on all transport services and services auxiliary to all modes of transport (excluded services provided at airports), as well as on non-facilities based telecommunications (see Chapter 2). In these sectors, foreign investors are not allowed majority ownership, considerably diminishing their interest in these assets and potentially limiting foreign investors' incentives to deploy newer technologies and modern management and organisational practices. Allowing majority-owned foreign investment could also enhance their participation in the government's SOE equitisation programme and help to secure greater value for money of infrastructure PPP projects by exposing such projects to greater competition during the bidding stages. Taken together, these measures can be important contributors to improve the efficiency of infrastructure investments and services in Viet Nam.

Notes

1. Resolution No. 10/2011/QH-13 of the National Assembly on the 2011-2015 Socio-Economic Development Plan; World Bank (2013).

2. Investment in infrastructure projects is a matter of project cash-flow, *i.e.* the capacity to generate risk-adjusted returns through user fees or taxes, regardless of how it is financed. In the case of availability-payment PPPs, in which private investors "lend" capital to the state, they will only do so if the state has the ability to repay them, in which case the state is not fully credit-constrained and public provision is potentially an option (although statutory limitations on public debt may impede such investments). But even in the case of PPPs funded partially or totally by user-fees, if the government can protect the project's revenue stream from other uses, these revenues could likewise be used to repay the project's debt under public provision as well. The perceived financial benefit of PPPs happens only because accounting rules have allowed PPPs to go off the balance sheet, allowing governments to anticipate spending and sidestep normal budgetary processes since future obligations associated with PPPs do not have to be recorded on the public accounts (Engel *et al.*, 2007).

3. Data is accessible through the GSO website: [https://www.gso.gov.vn/default_en.aspx?tabid=781].

4. "The Asian Highway network consists of highway routes of international importance within Asia, including highway routes substantially crossing more than one sub-region; highway routes within sub-regions that connected neighbouring sub-regions; and highway routes located within member States that provide access to: (a) capital cities; (b) main industrial and agricultural centres; (c) major air, sea and river ports; (d) major container terminals and depots; and (e) major tourist attractions. The total Asian Highway network is divided into five major classes (primary, I, II, III, below III) that conform with road design standards. Primary class refers to access-controlled highways, which are used exclusively by automobiles. Access to the access-controlled highways is at grade-separated interchanges only. Mopeds, bicycles and pedestrians should not be allowed to enter the access-controlled highway in order to ensure traffic safety and the high running speed of automobiles. Class I refers to asphalt, cement or concrete roads with four or more lanes. Class II refers to double bituminous roads with two lanes. Class III is also regarded as the minimum desirable standard. Roads classified below class III are road sections below the minimum desirable standard" (UNESCAP, 2015).

5. Decree 108 replaced Decree 78 of 2007 (the previous BOT decree), which failed to address several key regulatory issues for private infrastructure delivery. Among other issues, for instance, it did not provide for adequate

guidelines for project preparation and tendering processes; lacked clear provisions regulating the use and extent of government guarantees; imposed high minimum equity requirements on concessionaires without any consideration for differences in projects risks and returns; failed to provide a sound basis for tariff setting and adjustment; and did not provide for other forms of PPPs such as performance-based contracts, leases, and concessions (ADB, 2012).

6. Before, any approved unsolicited proposal was directly negotiated with the proposing investor without the need to publicise it and tender it for other potentially interested investors.

7. Despite it remained an important barrier for investment, as a minimum equity requirement is not reflective of projects' different risk profiles, Decree 108 reduced the minimum required equity from private investors from 20%-30% under the previous regime to 10%-15 of the total investment capital expenditure of the project.

8. State participation was enhanced from the previous limit of 49% of the project company's equity to 49% of total investment capital for the project.

9. Decision No. 23/2015/QĐ-TTg dated 26/6/2015 providing the mechanism whereby the state uses land to make payments to investors implementing construction investment projects in the form of BT; Circular No. 38/2015/TT-BCT dated 30/10/2015 providing detailed guidance on some contents of investment in the form of PPP projects under management of Ministry of Industry and Trade; Circular No. 86/2015/TT-BGTVT dated 31/12/2015 providing detailed guidance on sector and contents of feasibility study of transport PPP Projects; Circular No. 02/2016/TT-BKHĐT dated 01/3/2016 on screening, preparation, appraisal and approval of PPP project proposal and feasibility study; Circular No. 55/2016/TT-BTC dated 23/3/2016 on financial management and costs for investor selection of PPP Projects; Circular No. 06/2016/TT-BKHDT dated 28/6/2016 providing detailed guidance for some articles of Decree No. 15/2015/ND-CP on investments under PPP form; and finally Circular No. 15/2016/TT-BKHDT dated 29/9/2016 on standardised request for qualification and request for proposal for investor selection for PPP projects.

10. For example Circular No. 15/2016/TT-BKHDT dated 29/9/2016 on standardised request for qualification and request for proposal for investor selection for PPP projects.

11. Circular No. 06/2016/TT-BKHDT of 28 June 2016.

12. Decision of the Prime Minister 1624/QD-TTg dated October 29, 2012.

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Chapter 8

Investment policy framework for green growth in Viet Nam

This chapter assesses the investment framework for green growth in Viet Nam. It looks at challenges and opportunities for sustainable economic growth and provides an assessment of the regulatory framework for green investment, focusing notably on environmental protection, climate change, renewable energy and energy efficiency. It also reviews the institutional capacity to design and implement green growth policies as well as financial policies and instruments for green growth and investment.

Scaling up investment for green growth, by promoting green investment in targeted areas and improving the environmental performance of investment overall, can support economic growth, development and environment goals in Viet Nam. This chapter describes Viet Nam's investment framework for green growth, providing an overview of the elements of the policy framework that have been instituted, with a special focus on renewable energy and energy efficiency.[1] It is structured around the questions on green growth and investment raised in the updated OECD *Policy Framework for Investment* and the OECD *Policy Guidance for Investment in Clean Energy Infrastructure*.

Viet Nam is facing several key challenges in its efforts to promote green growth and combat climate change. The country's rapid economic growth has relied on natural resources, and environmental degradation and pollution are now threatening future growth. The national energy mix is increasingly focused on fossil fuels, which exposes Viet Nam to fluctuations in global oil prices and comes with high environmental costs. The looming threat of climate change is exacerbating existing issues: Viet Nam is particularly vulnerable to climate change, with its long coast line, a population heavily dependent on agriculture, forestry and fishing for its livelihood, and infrastructure that is exposed to climate change-induced events, such as floods and storms.

Addressing these challenges provides opportunities for Viet Nam to mobilise green investment, particularly in the energy sector. The need for clean infrastructure, particularly solar and wind energy, and the potential for energy efficiency and technological innovation, provide entry points for private sector participation. Increasing demand for environmental services, such as waste and water management, also create opportunities for private investment, both foreign and domestic. In this regard, a balanced policy framework that promotes investment in green sectors and facilitates the greening of investment overall is crucial to Viet Nam's efforts to promote green growth.

Viet Nam has made great strides in instituting an overarching policy framework for green growth and investment. A vision for low carbon and climate resilient growth has been established, a framework for environmental protection has been put in place, targeted incentives and efforts to promote energy efficiency and renewable energy have been introduced, and the country has begun addressing fossil fuel subsidies. Viet Nam's Green Growth Strategy (VGGS), the National Climate Change Strategy and the more recent Intended Nationally Determined Contribution (INDC), submitted to the UNFCCC in 2015, collectively signal the intention of the government to pursue low carbon and climate resilient growth. In the energy sector, the revised Power Development Plan VII[2] describes ambitious goals for electricity production from renewable sources to make up over 10% of the electricity mix by 2030. These are supported by specific feed in tariffs for different renewable resources and support for energy efficiency programmes.

Despite this, implementation of the policy framework is still a work in progress. Policies on green growth and climate change have overlapping, inconsistent targets for emissions reductions, largely due to differences in methodologies applied in different strategies and policy documents, which can create confusion amongst investors about the government's ambitions to tackle climate change. For example, while the VGGS and the INDC lay out greenhouse gas emissions targets, this is not reflected in the overarching socio- economic development plan of the country which instead includes a target on reducing energy intensity of the economy. The targets for emissions reductions from the energy sector vary by policy documents, which have been issued at different times (Table 8.2). In addition, while green growth is reflected in policy documents, the level of ambition to take action on climate change and green investment varies. There is a lack of institutional capacity and human resources in key policy and decision making units and a need to strengthen enforcement capacity so that regulations are complied with.

In addition, several constraints still hamper both foreign and domestic firms investing in renewable energy and energy efficiency. Electricity tariffs are regulated and capped, which lowers the returns on investment for renewable energy and acts as a barrier to energy efficiency investment. The feed-in-tariff for wind is too low to spur significant investment and a new feed-in-tariff for solar is also quite modest. Fossil fuels are subsidised indirectly through support for state-owned enterprises in the energy sector which are investing in fossil fuels. The government has initiated plans to remove all fossil fuel subsidies by 2020 and to reform the tariff regime, but the process has been challenging and slow, with several setbacks.

Policy recommendations for mobilising green investment in Viet Nam

- *Improve clarity and consistency of long-term goals on green growth and climate change, especially in relation to greenhouse gas emissions and energy sector reform*. To create predictability and long-term visibility for investors interested in green growth opportunities, Viet Nam needs to align and clearly communicate its long-term greenhouse gas emission reduction targets. National targets should be aligned with international commitments and embedded into the main frameworks for planning and investment in the country, *i.e.* the SEDP and policies on investment. National targets should be translated into sector level targets which are, in turn, embedded in sector master plans. Clear, consistent and ambitious national and sector level targets could be a powerful complement to investment incentives in renewable energy and energy efficiency and create demand for green technology development.

- *Invest in building the institutional and technical capacity of key government institutions, at national and subnational levels.* The political commitment to green growth needs to be accompanied by efforts to build the human resources required to co-ordinate, implement and monitor policies. Departments and units in charge of green growth policies at national and sector levels lack the human resources and capacity required to mainstream and implement climate initiatives, which in turn effects co-ordination between ministries. Adequate capacity at the provincial level is also needed to ensure compliance with environmental protection legislation.

- *Carefully consider increases in coal-fired power, and ensure effective policies and measures for renewable energy and energy efficiency.* The newly-adjusted Power Development Plan VII increases targets for renewable energy for the next 15 years but also affirms that coal power will continue to increase, despite the need for coal imports, and that will make up over half the country's electricity supply in 2030. It is important that Viet Nam evaluate and clearly identify the range of costs associated with coal-based energy, including the impact climate change and air pollution is having on its development trajectory. A clear, credible and long-term price on carbon emissions across the economy, through market-based instruments such as emission trading schemes or carbon taxes, could help ensure that the full range of impacts from fossil fuel based power are accounted for. Viet Nam should also strive to meet its targets on renewable energy and energy efficiency. Policies and incentives on renewable energy need to be refined in order to spur investment, and financing needs to be made available to demonstrate and pilot the feasibility of new technologies.

- *Phase out fossil fuel subsidies by reforming electricity pricing and improving competition in the energy sector.* Measures to reduce fossil fuel subsidies should be continued and scaled up in order to spur private investment in renewable energy and energy efficiency. The government’s efforts to liberalise the energy production and distribution market under the *Law on Electricity* 2004, and increase private investment in the energy sector will go some way in reducing indirect fossil fuel subsidies. Despite social and political pressure, the government should abide by its plan to phase out all fossil fuel subsidies by 2020 in order to make green investment attractive. It could also consider introducing carbon pricing in order to catalyse investment in energy efficiency and renewable energy.

- *Establish programmes to mobilise international support for green growth, and clearly establish roles of different ministries.* Focused government programmes emerging from the SEDP, i.e. national target programmes that are prioritised for support from the state budget, can be a useful way of mobilising international support for green growth and investment. Clearer mandates and responsibilities among government ministries will help avoid overlaps and duplications in implementing of donor financing. As many bilateral donors are transitioning away from more concessional support taking into account Viet Nam's income status, it is especially important that donor support should be programmed and deployed effectively in order to have a lasting impact.

- *Diversify financing sources for climate change, and actively engage the private sector.* While new multilateral sources of climate finance, such as the Green Climate Fund, offer more opportunities to support Viet Nam’s green growth objectives, this finance will not be enough to meet the investment gap required to transition to a low carbon and climate resilient economy. Considering the potential to engage the private sector in sectors such as renewable energy, energy efficiency and waste management, it is important to use concessional climate finance to actively promote responsible private sector participation in key sectors. Efforts to promote green finance through the banking sector should also be scaled up.

- *Consider adhering to the OECD Green Growth Declaration*, as 42 OECD and non-OECD countries have done so far. The *Declaration* highlights that growth and sustainable management of natural resources are complementary and points out key policy approaches that can support a green growth agenda. These include supporting market-based instruments and policies to change behaviour and expanding incentives for green investment in areas such as low-carbon infrastructure. Adhering to the *Green Growth Declaration* not only signals Viet Nam’s support for green growth but could also pave the way for additional co-operation with the OECD on the issue. Viet Nam could thereby benefit from an understanding of how other countries, with similar developmental challenges, have been able to green their economies and societies.

Green growth and investment in Viet Nam: challenges and opportunities

Viet Nam's efforts to promote green growth face several challenges including a high dependence on and increasing demand for natural resources (energy, land, water), rising costs of environmental degradation, and vulnerability to climate change. Addressing these challenges also provides opportunities for investment. The need for energy security, demand for clean infrastructure and improving the efficiency of how natural resources are used, coupled with high potential for renewable energy, illustrate the potential for green investment in Viet Nam. A measured and inclusive approach, based on a sound policy framework that promotes investment in green sectors and facilitates the greening of investment overall, can help address challenges and exploit opportunities on the path to sustainable development for Viet Nam.

Economic growth fuelled by natural resources at a high environmental cost

Viet Nam's rapid economic growth and progress in addressing development challenges has been largely supported by its natural resource base, but in order to ensure future growth and development, drivers of environmental degradation need to be addressed. Low cost hydropower has facilitated the expansion of industry, natural resources have supported much of exports over the last two decades, and primary sectors continue to employ the majority of the labour force. In 2014, for example, just under a third of Viet Nam's exports were from primary sectors and the agriculture, forestry and fishing sectors employed 46% of the workforce (ADB, 2015c).

The environmental costs of growth have also been high. While forest cover has increased over the past decade, largely due to secondary forest expansion, the quality of forest resources has deteriorated significantly since the 1950s, with the loss of mangrove forests estimated to result in losses of USD 34 million a year. Poor urban drainage and untreated waste water has affected water quality levels, and air pollution is increasingly posing a health risk, especially near Hanoi and Ho Chi Minh City (World Bank/MPI, 2016). With a growing population and rapid urbanisation expected over the next two decades, pressures on natural resources and costs of environmental degradation will only increase. Viet Nam will need to better manage its natural resources and reverse negative trends in environmental quality in order to support future growth and development.

Increasing demand for resources and vulnerability to climate change

With ever increasing pressures on natural resources, the need to improve and optimise the way resources are used is critical. Rapidly increasing demand for energy and other natural resources, supported by an increasingly carbon intensive energy supply is a challenge to achieving energy security and green growth. Demand for energy in Viet Nam is expected to continue to rise at a rapid pace, and the share of fossil fuels (largely coal) in the energy mix is expected to increase. Energy sector assessments also show that coal will increasingly be imported to support existing and new thermal power plants (ADB & ADBI, 2016). Carbon emissions have tripled in the past decade and the carbon intensity per unit of GDP has grown by 48% in the same period which is faster than in other countries in the region. The high energy intensity of Viet Nam's industrial output also highlights the need to improve the way it manages its energy resources by scaling up energy efficiency and demand side management (Audinet *et al.*, 2016).

Increasing vulnerability to climate change is exacerbating existing environmental and development trends. Viet Nam’s dependence on natural resources for economic growth and development along with its long coastline makes it particularly vulnerable to climate change. Increasing temperature and changes to rainfall patterns are expected to influence agricultural productivity and water availability, sea level rise will affect coastal cities and ports, including Ho Chi Minh City, and increasing frequency and intensity of extreme weather events are already having an impact on infrastructure and agricultural production across the country. Overall, the cost of climate change in Viet Nam is estimated to reach over 2% of GDP by 2050 (ADB, 2009; World Bank, 2010).

Increasing investment gap to deliver sustainable development

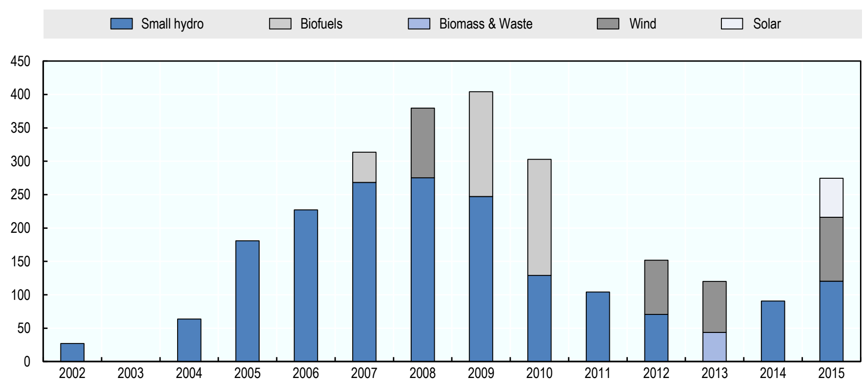
Estimates of the investment needs to green Viet Nam's economy show that the scale of investment needed is immense and that public sector finance will need to leverage private investment to ensure green growth. The government estimates that around USD 31 billion will be required in order to meet its targets on green growth, of which over 70% will need to come from the private sector (Trinh, 2015). Currently, less than half the actions defined by the government in order to deliver its Green Growth Strategy are funded, with support coming largely from the public sector. Similarly, assessments of climate finance needed to deliver Viet Nam’s commitments under the Paris Agreement show that private finance will be essential in delivering low carbon and climate resilient development. The government estimates that the national budget will be able to finance only a third of adaptation measures needed between 2011 and 2030, and that international support and private sector investment will be needed for the remainder (World Bank *et al*., 2016).

Significant potential for green investment, particularly in the energy sector

The need to reduce greenhouse gas emissions and environmental degradation, contribute to energy security and support climate change adaptation all provide potential opportunities for investment. Current trends illustrate that while green investment flows from the private sector are still quite low, levels have been increasing slowly. Figure 8.1 shows trends in private investment for renewable energy projects between 2002 and 2015, and illustrates an increasing diversity in the types of energy sources supported.

Figure 8.1. **Private investment in renewable energy in Viet Nam**

Million USD, constant 2010 prices



Source: OECD analysis, constructed using BNEF 2016 data.

There is still a lot of potential for green investment, particularly in terms of renewable energy and energy efficiency. Viet Nam has abundant alternative and renewable energy resources distributed throughout the country, providing it with great capacity to develop an effective national energy plan. Much of this resource is as yet unexploited, partly due to a lack of an investment policy framework for green investment. Box 8.1 illustrates the current potential and installed capacity for the major sources of renewable energy in Viet Nam.

Similarly, the need to optimise the use of energy in the face of increasing energy demand and consumption demonstrates the potential for investment in energy efficiency technologies. Between 2000 and 2013, final energy consumption grew at around 6% per year, and forecasts show that demand is likely to triple by 2030 (IEA, 2015). Energy savings potential is highest in energy intensive industries such as cement, steel, textiles and paper. For example, iron and steel plants in Viet Nam are estimated to use twice as much energy as similar plants around the world, and with investment in clean technologies energy savings could be as high as 30% in the steel sector by 2030 (Audinet *et al.*, 2016; ADB, 2015b). The transport sector also contributes significantly to energy demand and imports, making up close to a quarter of energy sector emissions in 2010. With a strong bias towards road transport, increasing trends in vehicle ownership, and an inefficient freight sector, the transport sector could also deliver significant energy savings with increased investment in cleaner fuels and vehicle technologies.

Box 8.1. **Potential for renewable energy development in Viet Nam**

Small hydropower has significant potential, exceeding 7200 MW. Under a third of these resources have been exploited so far, with the installation of small hydropower plants supported by private investment estimated at around 1984 MW in 2014.

Wind power is another promising renewable energy resource. The 3400 kilometres of coastline provide abundant wind energy at an estimated potential of 500-1000 kWh/m^2 annually. Wind energy potential has been estimated at 27 750 MW, however only three wind power plants are currently in operation, with a combined capacity of 52 MW. The country plans to build the first offshore wind farm in Asia.

Solar energy also holds significant opportunity for Viet Nam, with an average solar radiation at 5kWh/m^2 annually. The total solar energy potential is estimated at 13 000 MW but currently only 4 MW has been exploited, mostly by small scale rural electrification schemes and other off-grid applications, and for demonstration projects.

Biomass from agricultural products and residues is available at equivalent to 10 million toe/year. Biogas energy potential is approximately 10 billion cubic metres a year, which could be collected from landfills, animal excrements and agricultural residues (Viet Nam Investment Review, 2015). Dependence on traditional biomass for domestic thermal energy use (cooking, heating) in rural areas still remains very high, with 44% of total energy needs covered by solid biomass.

Source : ADB & ADBI, 2016; Nam et al., 2013

Viet Nam's commitment to green growth

A strong government commitment to support green growth objectives and set clear targets to reach such objectives provides encouraging signals to investors. Establishing national green growth policies or economic development plans which integrate environmental concerns and opportunities and allocating adequate public funds and other resources show the government's determination to achieve green growth objectives and can help raise investors' confidence. Setting clear, long term, and legally binding frameworks to mainstream and encourage green growth are also key to attracting private investment.

Viet Nam has made major strides in this area by putting in place and implementing an overarching umbrella strategy for green growth, supported by specific strategies for climate change and other environmental issues. Viet Nam's Green Growth Strategy (VGGS),[3] the National Climate Change Strategy and the more recent Intended Nationally Determined Contribution to the UNFCCC in 2015 collectively signal the intention of the government to pursue low carbon and climate resilient growth. Furthermore, clear signs of political commitment to the green growth agenda are evident. In 2013, the ruling Communist Party of Viet Nam passed a resolution which outlines objectives and targets for the government on climate change, natural resource management and environmental protection. In addition, the constitution, which was also passed in 2013, includes a specific article on the environment and climate change (Nachmany *et al.*, 2015).

Going forward, in order to attract more and better green investment, there is a need to better translate this commitment into action – specifically, clearer communication and coherence among policies on green growth and climate change is needed, and green growth ambitions should be better reflected across sector and subnational policies and plans.

Regulatory framework and policies for green growth and investment

A policy and regulatory framework conducive to green growth is critically important to promote and mitigate the risks related to investment in green infrastructure and new technologies. Important aspects of such a framework include a coherent and comprehensive framework of policies and regulations related to the environment and green growth, the engagement and commitments to the relevant multilateral environmental agreements, and the inclusion of environmental considerations in multilateral and bilateral trade and investment agreements (OECD, 2012).

Viet Nam recognises the importance of instituting a policy framework to address environmental issues, with a number of policies being developed and implemented over the past decade, supported by legislation and regulations, and addressing different environmental issues (Table 8.1). While some of these provide opportunities to promote foreign and domestic green investment (*e.g.* green growth, climate change strategies), others facilitate the greening of investment overall by establishing an environmental safeguards system which applies across all investment and putting in place economic instruments to reduce environmental impacts. Despite the extensive coverage of the environmental policy framework, implementation remains a challenge, especially with respect to policy coherence across different environment policies, integration of environmental considerations into development planning and budgeting, and compliance with and enforcement of environmental legislation (Government of Socialist Republic of Viet Nam, 2012; Bass *et al*., 2010).

Table 8.1. **Summary of selected national policies and regulations related to green growth and environment**

Policy/ Legislation	Main Features
Law of Environment Protection (2014)	The Law specifies that environmental protection should be in harmony with economic development, social and biodiversity protection and adaptation to climate change. The revised law replaces a 2005 version and recommends that developing and using clean and renewable forms of energy be encouraged to reduce GHG emissions and to protect the ozone layer. It also specifies that a road map is to be developed so that Viet Nam may take part in global GHG mitigation activities that are appropriate with respect to its socio-economic circumstances and the international treaties of which Viet Nam is a member. The law requires the development of a National Environmental Protection Plan to assess current environmental status, and environmental and climate change forecasts. Seven decrees are currently being developed by the Ministry of Natural Resources and Environment to guide the implementation of the law.
Law on Natural Disaster Prevention and Control (2013)	It provides natural disaster prevention and control activities; specifies the rights and obligations of agencies, organisations, households and individuals engaged in natural disaster prevention and control activities; and details the state management of, and assurance of resources for, natural disaster prevention and control. It specifies that natural disaster prevention and control activities must be based on scientific grounds, protect the environment, and recognises the importance of adapting to climate change. It requires the creation, every 10 years, of a National Strategy on Natural Disaster Prevention and Control which must include results of any climate change-related risks. District level and provincial natural disaster prevention and control plans must identify potential climate change-related impacts on socio-economic activities.
National Strategy for Climate Change (2011)	It states that "responding to climate change must be associated with sustainable development towards a low carbon economy" and provides a strong foundation for formulating long-term socio-economic development plans amid climate change challenges. The strategy outlines overall objectives, prioritised projects to be implemented in 2011-15, and plans for 2016-25 as well as a vision to 2100.
National Strategy for Green Growth (2012)	Overall objective of the Viet Nam Green Growth Strategy is to promote green growth as a means to achieve a low carbon economy and to enrich natural capital. It aims at achieving sustainable economic development; reduction of greenhouse gas emissions and increased capability to absorb greenhouse gas. Three strategic tasks outlining the scope of the strategy are Low Carbon Growth, Greening of Production and Greening of Lifestyles. Targets include reduction of energy consumption per unit of GDP by 1.5% to 2% per year, reduction of intensity of greenhouse gas emissions per unit of GDP by 8-10% or doubling the target with international support. For the year 2030, it aims at reducing total GHG emissions by at least 1% per year on its own and 2% with international support and by 2050 aims to mainstream Green Economic Development.
National Action Plan on Green Growth in Viet Nam 2014-2020 (2014)	The plan sets out a framework and actions to implement the main pillars of the VGGS and also includes specific activities to promote the implementation of the VGGS across sectors and at subnational levels. Implementation of the VGGS is further supported by circulars and decisions regarding different areas, such as Decision No. 2183/QD-BTC issues in October 2015, which calls for an action plan for the finance sector to implement green growth until 2020, Decision No. 1456/QD-BGTVT, issued in May 2016, that sets out an action plan for the

Policy/ Legislation	Main Features
	government's response to climate change and green growth in the period of 2016-20, and Decision No. 13443/QD-BCT, issued in December 2015, which sets out a green growth action plan for trade and commerce sectors for 2015-20.
National Action Plan for Climate Change 2012-20 (2012)	To implement the National Strategy for Climate Change, the National Action Plan was issued in 2012. It sets out objectives and lists 65 programmes, projects and proposals, the timeline for their implementation and the agencies responsible. One task is to determine the grounds for developing a law on climate change.
National target programmes on climate change	The National target programme to respond to climate change (NTPRCC) under MONRE was initiated in 2008 and mainly dealt with assessing regional and sectoral climate change impacts, awareness raising and developing short-term action plans for climate change response. Even though the NTPRCC also contains a long term component that identifies the need to develop towards a low carbon economy, the allocation of funds for the NTP"RCC clearly reflects the adaptation focus by attributing only about 2% of the overall resources to mitigation activities. The new national target program on climate change and green growth in the period 2016-20, issued in 2016, addresses both climate change and green growth. Resource allocation shows a more balanced approach to mitigation and adaptation, with roughly a third of the resources being allocated to green growth related issues.
Environmental Protection Tax Law (2010)	Passed at the end of and entering into effect in January 2012, it imposes a tax on several environmentally harmful substances such as pesticides and plastic bags but also on a broad range of fossil fuels like coal, gasoline and oil. Within the context of this law, Decree No. 12/2016/ND-CP, issued in February 2016, puts in place environmental protection fees for the mining sector, and Decree No.154/2016/ND-CP issued in November 2016 levies fees on individuals and industry for discharging wastewater.
Law on Economical and Efficient Use of Energy (2010)	Covers all areas of the economy, and specifically: the industrial sector, including users and producers of energy, through to cottage industries; and the transport sector, including the manufacturers and importers of transport equipment and vehicles; and the national transport infrastructure. It also sets out the state's responsibilities for the economical and efficient use of energy. Decree 21/2011/ND-CP on the Law and its Implementation assists in the regulation of the law. The mandatory energy labelling regulations are specified further in Circular No. 07/2012/TT-BCT (2012). In addition the National Renewable Energy Development Strategy and Vision to 2050 (Decision No.2068/QĐ-TTg) issued in November 2015 sets out targets for renewable energy generation as well as for renewables in the share of final energy consumption in the country.

Sources: Government of Socialist Republic of Viet Nam, 2012b; Nachmany et al., 2015; Đạt & Trường, 2013

National policy framework for green growth and climate change

The VGGS is the cornerstone of Viet Nam’s efforts to transform itself into a low carbon economy. Approved by the Prime Minister, the strategy is legally binding and was developed by an inter-ministerial working group led by the Ministry of Planning and Investment, the lead agency in charge of developing national socio-economic development plans (OECD, 2014). The

VGGS focuses on three main areas: reducing greenhouse gas (GHG) intensity and increasing clean energy, greening production by improving the efficiency of natural resource use and scaling up green technologies, and promoting sustainable consumption and urbanisation. Efforts to sustain the natural resource base, *i.e.* by conserving and promoting sustainable use of natural capital and ecosystem services, is not included in the strategy.

The 2014 National Action Plan on Green Growth (VGGAP)[4] sets out a framework and actions to implement the main pillar of the VGGS and also includes specific activities to promote its implementation across sectors and at subnational levels. One of the areas of action identified is to build up a financial policy framework to enable green investment. In terms of turning rhetoric into action, the country has also made significant progress in implementing the VGGS and VGGAP. With guidance from the MPI, sectors and provinces have begun preparing sector-specific and province-level action plans on green growth, and efforts are underway to provide guidance on what projects should qualify as green public investment. Currently, just over half the provinces have prepared, or are in the process of preparing, green growth action plans (Trinh, 2015).

While stand-alone green growth strategies play an important role in reconciling environment and development agendas, their effectiveness is determined to some degree by the extent to which green growth objectives are integrated into other national policies, plans and budgets (OECD, 2014). The VGGS and other strategies, such as the National Climate Change Strategy and the INDC, collectively signal the intention of the government to pursue low carbon and climate resilient growth, but the targets and benchmarks in these vary in terms of baselines and ambition (Table 8.2). Viet Nam’s new Socio-economic Development Plan (2016-20) includes an overarching target of reducing energy intensity of per capita GDP by 1-1.5% annually within its nine economic targets for the next five years, but does not specify an emissions reduction target. The plan also specifies the government's intention to revise legislation and policies to attract more environmentally sound foreign investment such as cleaner technologies, while avoiding more polluting and energy-intensive technologies. Within the energy sector, the Power Development Plan VII does not set emissions targets, while the new National Renewable Energy Development Strategy[5] sets targets to reduce GHG emissions which are less ambitious than those specified in the VGGS.

Table 8.2. **Timelines and baselines for targets on green growth and climate change across different strategies**

Type of target	Strategy	Target	Timeframe
Economy wide emissions intensity	VGGS	Reduce GHG emissions intensity by 8-10% compared to 2010 levels	By 2020
	INDC	Reduce emission intensity per unit of GDP by 20% compared to 2010 levels, which could be increased to 30% with international support	By 2030
GHG reductions	VGGS	Reduce annual GHG emissions by 1.5-2%	By 2030
	INDC	Reduce GHG emissions by 8% compared to BAU, which could be increased to 25% with international support	By 2030
GHG reductions from energy activities	VGGS	Reduce GHG emissions from energy activities by 10% compared to BAU, which could be increased to 20% with international support	By 2020
	NREDS	Reduce GHG emissions from energy activities by 5% compared to BAU	By 2020
	NREDS	Reduce GHG emissions from energy activities by 25% compared to BAU	By 2030
Energy intensity	VGGS	Reduce energy consumption per unit of GDP by 1-1.5% annually	By 2011 - 2030
	SEDP (2016-2020)	Reduce energy consumption per unit of GDP by 1-1.5% annually	2016 - 2020

Note: Viet Nam Green Growth Strategy; INDC: Intended National Determined Contribution of Viet Nam; NREDS: National Renewable energy Strategy to 2020, with outlook to 2050.

Source: Government of Viet Nam .

Despite positive steps in developing and implementing the VGGS, mainstreaming green growth across different strategies and plans still poses a challenge. As shown in Table 8.2, the targets for emissions reductions given in the VGGS and other strategies, such as the National Climate Change Strategy and the INDC, are not aligned with each other due to differences in methodologies and assessments used,[6] which make them difficult to compare. In addition, the Socio-economic Development Plan, which sets the national development agenda for the next five years, does not include an emissions reduction target despite the INDC having been prepared in parallel. Collectively, this suggests a lack of coherence across different decision making processes. In terms of ambition, the National Climate Change Strategy commits to reducing greenhouse gas emissions only with international support, while the VGGS and more recent INDC both outline unconditional targets, which can be achieved using domestic resources, and more ambitious conditional targets which are dependent on international support.

National policy framework for environment protection

In terms of greening investment, Viet Nam's successive *Laws on Environment Protection* (LEP) lay the groundwork to reduce pollution and degradation, and outline policies, measures and resources for environmental protection and the roles and responsibilities of different stakeholders. The latest LEP (2014)[7] emphasises that those benefitting from the environment should contribute financially towards its protection and, conversely, that pollution and damages to the environment should be compensated. One example of the latter is the introduction of Extended Producer Responsibility in LEP (2005) which obliges producers of electronics, chemicals, tyres and others to dispose of these products in an environmentally friendly manner – these regulations are in the process of being rolled out (Nguyen, 2014). The Environment Protection Tax is another effort to reduce consumption of materials that have significant environmental impacts (Box 8.2).

Importantly, Viet Nam’s successive *Laws on Environment Protection* establish a framework for strategic environmental assessment (SEA) and environmental impact assessment (EIA) which forms the basis of the national safeguards system related to the environment. LEP (2014), along with supporting decrees, identifies the types of investment projects requiring an EIA both by the type of project (such as most large infrastructure projects such as hydropower, mining, and economic land concessions) as well as the scale and size of project. Under LEP (2014), the remainder of projects are required to develop environment protection plans. Project developers are required to prepare the EIA in parallel with the project feasibility study and submit these for review by the Ministry of Natural Resources and Environment (MONRE), either at the national or provincial level.[8] The LEP states clearly that obtaining required investment licences and permits for construction depends on the EIA having been approved. While the policy framework is clearly evolving, there is a need to strengthen the implementation of safeguard mechanisms and compliance with regulations.

Despite a long history in conducting SEA and EIA in Viet Nam, several challenges remain which in turn affect the impact of the EIA policy framework (Clausen *et al.*, 2011; Tuan *et al.*, 2012). First, EIAs are conducted too late in the investment decision-making process to really mitigate the impacts of the investment. EIAs are carried out at the same time as the project feasibility study, while many of the decisions for the project, including discussions on potential location, have been taken before the detailed feasibility study is initiated. Further, there is a major lack of established, consistent and easily accessible data on environmental quality which makes it difficult to analyse the severity of the impact of the project. This is further exacerbated by a lack of capacity, both in terms of professionals to carry out the assessments and government staff to review the EIA, especially in the provinces. Together, these result in weak projections of impact which in turn hinders the development of well targeted mitigation options within the EIA. For example, a review of 269 EIAs carried out in 2005-09 in Viet Nam found that a third were based solely on qualitative assessments of environment impact, with no underlying quantitative assessment methodology being used (Tuan *et al.*, 2012). Lastly, procedures for open, public consultation are weak and often rely on top down mechanisms to engage community leaders rather than openly engaging all stakeholders in the decision making (Baird and Frankel, 2015).

Box 8.2. **Viet Nam's Environmental Protection Tax - balancing environmental costs and development**

Viet Nam is one of the first countries in the region to develop an environmental tax instrument as a way of promoting green growth. Viet Nam's Environment Protection Tax Law (2010) came into force in 2012, and established a tax on the use of products with 'negative environmental impacts' in Viet Nam. The tax is applicable to fossil fuels (coal and gasoline), as well as other environmentally harmful goods such as pesticides and herbicides, HCFCs and plastic bags.

The tax was designed to reduce the amount of these commodities used; therefore it was designed as an absolute tax per unit of the product consumed rather than a percentage of the price. This means that those who use more of the commodity will have to pay higher amounts of the tax, irrespective of its price. When established, tax values varied for different products - for example, the tax for petroleum products was VND 1000 per litre and VND 10 000-20 000 for lignite and anthracite coal, which worked out to an *ad valorem* tax rate of around 4% for petroleum products and 0.4% for coal. The tax rate has now been revised in 2015, with a tax of VDN 3000 per litre being levied on petroleum products.

Ex ante assessments of Viet Nam's Environment Protection Tax (EPT) forecast that while the tax would contribute significantly to the state budget and to reducing greenhouse gas emissions, fuel intensive sectors could be negatively affected in terms of output and employment. A more recent *ex post* assessment of the impact of the tax has confirmed these findings. In 2012, the government received 1-2% higher revenues with the tax than they would have without it, and carbon emissions dropped by 1.7% compared with a BAU scenario. While fuel intensive sectors (such as construction, transport, fisheries) have been affected, the impact has been judged as 'marginal' from a macro perspective. However, as the major burden of the tax has fallen on individuals and households, including those living in poverty, the tax has been seen to contribute to a slight slowing in poverty reduction rates.

Source: Johannes & Olearius, 2011; N. A. Minh, 2015; Nga, 2015; Huong, 2014.

International commitments in favour of green growth objectives

Viet Nam has ratified the three Rio Conventions including the United Nations Framework Convention on Climate Change (UNFCCC) and the United Nations Convention on Biological Diversity in 1994, and the UN Convention on Combatting Desertification in 1998. On commitments related to climate change, Viet Nam also ratified the Kyoto Protocol on greenhouse gas emissions in 2002. More recently, it submitted an INDC to the UNFCCC in 2015 and signed the Paris Agreement in April 2016. It is also a signatory to several other prominent MEAs including the Convention on International Trade in Endangered Species in 1994, the Stockholm Convention on Persistent Organic Pollutants in 2002 and Hyogo Framework for Action in 2005.

Viet Nam has made limited efforts to promote trade and investment that mutually supports environmental protection so far, as illustrated by only two existing trade agreements making references to the environment (Box 8.3). More recent agreements awaiting ratification do include extensive environmental chapters, however. The EU-Viet Nam Free Trade Agreement includes several provisions calling for parties to adhere to multilateral environmental agreements, address climate change, promote biodiversity and reduce illegal trade in wildlife, and engage in sustainable trade in forest and other natural resources (European Commission, 2016). The Trans-Pacific Partnership was to include enforceable commitments across a range of environmental issues *e.g.* wildlife trade, law enforcement, MEAs, elimination of environmentally destructive subsidies.

Policies and incentives to promote green investment in key areas

Policies for green investment are context-specific but common formulations include a mix of market instruments such as taxes and levies on pollutant activities; targeted subsidies that shift incentives towards more environmentally-sound products and practices; measures to improve competition in electricity and water sectors; and financial incentives to stimulate investment in green infrastructure (OECD, 2011). Viet Nam has instated economy-wide incentives to encourage investment in environmental protection, as well as incentives for different sectors to promote green investment. This section will discuss incentives for environmental protection, specific efforts to promote investment in renewable energy and energy efficiency, and fossil fuel subsidy reform.

Box 8.3. **Environmental provisions in BITs and FTAs signed by Viet Nam**

Viet Nam is a member of ASEAN Free Trade Area and has participated in ASEAN Free Trade or Comprehensive Partnership Agreements with Australia, China, India, Japan, Korea and New Zealand. These agreements have not included an environmental chapter. Viet Nam has also engaged in more than 70 bilateral trade agreements with its trading partners, with only two provisions on environmental protection or cooperation, except the Bilateral Trade Agreement with the United States referring to Article 20 of GATT and the Bilateral Trade Agreement with Japan referring to Article 21 which state that "it is inappropriate to encourage investment by investors of the other Contracting Party by relaxing environmental measures." Viet Nam is also a member of about 20 Multilateral Environment Agreements where some trade-related environmental restriction provisions are applied.

Viet Nam started WTO accession negotiations in 1995. The first offer was made in 2001 but no environmental offer was presented. In 2004, Viet Nam concluded a WTO accession negotiation package with the EU at the margin of the ASEM summit in Hanoi. The package included environmental services which paved the way for the Ministry of Environment to make an offer on environment services to be included in Viet Nam's General Agreement on Trade in Services offer in 2005.

Source: Hang, 2007; Government of Socialist Republic of Viet Nam, 2015.

Incentives for investment in environmental protection and green growth

Viet Nam's 2005 *Investment Law* (superseded by the 2014 *Investment Law*) categorised areas related to the environment as "especially encouraged" sectors and provided incentives to attract investment in these areas, including production of renewable energies; ecological and environmental protection; research and development; forestry, agriculture, fishery industries and animal husbandry. Investment incentives were in the form of favourable income tax rates, low import duties and fees; loss transfer; accelerated depreciation of assets; preferential land rights; and special cases entitled to extended investment incentives.

The revised 2013 Law on Enterprise Income Tax and guiding documents further enumerates these incentives: companies engaging in environmental protection activities can avail of a favourable tax rate (10% compared with normal rate of 20%), taxable income from the first four years of operation tax is exempt from tax, and tax is further reduced to 50% for the next five years. Land can also be rented or is granted from the government at a subsidised rate (Baietti *et al*., 2013). Table 8.3 illustrates the range of existing incentives in the context of renewable energy. A new decree is also currently under discussion which will provide further investment incentives for companies engaging in environmental protection services, including waste and water management (N. Minh, 2015). This will include zero value added tax to be applied on imports required for research and development in the environmental industry, zero import duties for materials and equipment, and priority access to state investment credit and foreign concessional loans.

Table 8.3. **Incentives offered for renewable energy companies**

	Standard government rates for enterprises	Preferential treatment for renewable energy enterprises
Import duties	There are three import duty rates in Viet Nam: ordinary rates, preferential rates and special preferential rates (PwC, 2012) In calculating import duties, Viet Nam follows the WTO Valuation Agreement. Value of dutiable imported goods is based on the transaction value (PwC, 2012).	Exemption from import tax on machines, equipment, tools and materials imported for production activities. Available for the first four years of operation.
Value Added Tax (VAT)	Viet Nam has three VAT rates: a) 0% for exported goods such as those sold to firms without a permanent legal base in Viet Nam. b) 5% is applied to enterprises that provide essential goods and services such as books, clean water, etc. c) 10% for all other activities subject to VAT.	a) Purchase of investment equipment is exempted from VAT. b) 0% VAT for renewable energy projects.
Corporate Income Tax (CIT)	Standard corporate income tax for enterprises is 20%. However, enterprises in oil and gas industry have to pay tax ranging from 32% to 50% depending on the geographic location.	a) Tax rate: 10% for 15 years for newly established renewable energy enterprises. If the project employs advanced technology or is large-scale, CIT rates can be extended up to 30 years with a tax rate of 10%. b) Tax exemption and tax reduction: for the first four years, enterprises receive a tax exemption. For the next nine years, enterprises may also receive a tax reduction of up to 50%.
Soft loans	Companies borrow from commercial sources based on market rates.	Investors are supplied with preferential loans of up to 80% of the investment cost of projects. In addition, Government Decree 75/2011/ND-CP (August 8, 2011) stressed wind power projects were eligible for government credit incentives.

Source: Nam et al., 2013.

Efforts to promote investment in renewable energy

The changing face of Viet Nam's energy sector highlights the need for renewable energy. Viet Nam needs to continue to meet growing energy demand from a burgeoning economy while addressing the twin challenges of energy security and environmental sustainability. Electricity consumption grew steadily at around 12% per annum between 2005 and 2013, with a heavy reliance on fossil fuels. In 2013, coal and oil together made up 52% of the total primary energy supply, and natural gas constituted another 14% (IEA, 2015). Renewable energy plays a relatively minor role in power supply at present, comprising around 6% of the power generation mix,[9] which included a small share (0.3%) of wind and biogas, with solar installations limited to demonstration projects.

National policies lay out targets and goals for renewable energy

A new National Renewable Energy Development Strategy has made significant strides in scaling up the targets for renewable energy, as are also reflected in a recently revised version of the Power Development Masterplan VII (2011-20) (PDP VII), which was released in early 2016.[10] The original version of the PDP VII (released in 2011) aimed to increase the share of renewable power generation, from 3.5% in 2010 to 4.5% by 2020, and to 6% by 2030. The new version now scales this up to 7% by 2020 and over 10% by 2030. Box 8.4 presents headline targets for renewables in the revised PDP VII. With a combination of efforts on balanced development of power sources, investment in energy efficiency and power market liberalisation, PDP VII represents the government's efforts to attract renewable energy investment in the long term, providing a legal framework for introducing investment incentives, such as feed-in tariffs, tax incentives and a subsidised electricity price.

The increasing focus on coal-fired power plants could send a mixed signal to renewable energy investors. Both the National Socio-Economic Development Plan and the PDP VII clearly state that coal-fired power plants will remain the main source of energy, largely depending on imported coal from neighbouring countries on a long-term basis. While hydropower has historically supported power supply (over half of the power generation mix in 2014), its share is expected to drop to 15% in 2030, with the share of coal fired power expanding to make up over 55% of the power mix by 2025. According to the revised PDP VII, Viet Nam aims to build high-efficiency coal-fired power plants with total installed capacity of 45 800 MW by 2030, an almost fourfold increase from the current installed capacity for coal (around 9 800 MW).[11]

Box 8.4. **National renewable energy development targets by source**

Overall targets

- New and renewable energy to make up about 5% of total commercial primary energy by 2020; and about 11% by 2050
- 10.7% of electricity from renewables by 2030

Targets by type of energy

- Wind: From 140 MW (2015) to 800MW by 2020, 2000MW by 2025 and 6000MW by 2030; with percentage of electricity produced from wind power increasing from 0.8% in 2020 to 1% in 2030.
- Solar: From negligible (2015) to 850MW by 2020, 4000MW by 2025 and 12,000MW by 2030; with percentage of electricity produced from solar power increasing from 0.5% in 2020 to 3.3% in 2030.
- Hydropower: 27,800MW by 2030 (15.5% of electricity produce in 2030), with a focus on small and multi-purpose hydropower
- Biomass: Share of total electricity increasing from 1% in 2020, to 1.2 % in 2025, and 2.1% in 2030.
- Biofuels: Increase share of transport sector fuel demand from 5% in 2020, to 13% in 2030 and 25% in 2050.

Source : Pham, 2016; Nangluong VN, 2016; Neefjes, 2016.

Incentives have been introduced to catalyse renewable energy investment

The government has introduced some key incentives to support prices for renewable energy which include avoided cost tariffs for small hydropower and renewables, feed-in tariffs for wind and bioenergy, and a Standardised Power Purchase Agreement for small renewable energy plants. Table 8.4 summarises Viet Nam's policy framework for renewable energy and energy efficiency in comparison to other countries in the region.

Table 8.4. **Summary of renewable energy and energy efficiency policies in selected ASEAN countries**

Policy area and instrument		Indonesia	Philippines	Singapore	Viet Nam	Malaysia
Renewable energy						
Tax incentives		Full	Full		Full	Full
Capital subsidies / grants		Full	Full		Full	Full
Policy distortions		Yes	Yes		Yes	Yes
Feed-in-tariffs		Full	Full		Full	Full
Concessional financing	Domestic					Full
	Foreign	Full	Full		Full	
Partial risk guarantee		Full			Full	
Renewable portfolio standard			Partial			Partial
Energy Efficiency						
Tax incentives		Full	Full	Full	Full	
Capital subsidies / grants		Full	Full	Full	Full	
Concessional financing	Domestic	Partial	Partial	Full	Partial	Full
	Foreign	Partial	Partial		Partial	
Partial risk guarantee			Full		Full	
Green labelling		Full				
Awareness campaigns		Full	Full			

Source: Baietti et al., 2013.

The ***avoided cost tariff*** was introduced by the Ministry of Trade and Industry (MOIT) for electricity generated by small-scale hydropower plants in 2009. This tariff, along with a standardised power purchase agreement (PPA), has enabled hydropower plants to sell electricity at a higher price compared with retail electricity prices (Nam *et al*., 2013). The avoided cost is defined as "the production cost per 1 kWh of the most expensive power generating unit in the national power grid, which would be avoided in case the buyer purchases 1 kWh of electricity from a small renewable energy power plant instead". The standardised PPA provides more opportunities for power producers to negotiate with the state-owned electricity company, EVN, on the purchase price of electricity; in 2012, the MOIT approved an increase of 5% in the purchase price of electricity compared with 2011 prices for more than 10 small hydropower plants. Overall, the avoided cost tariff has been seen to be successful in generating investment for hydropower, with over 200 small-scale hydropower projects registered for development (with total capacity of 4 067 MW) in 2013 (Nam *et al*., 2013). From 2009, grid-connected renewable energy projects with an installed capacity lower than 30 MW have also been allowed to apply for the avoided cost tariff, but the tariff is too low to cover the costs of generating wind or solar power, which has led to the introduction of feed-in-tariffs.

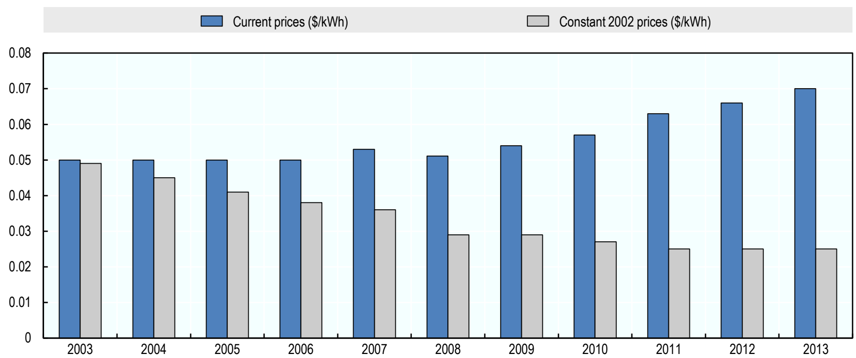
Feed-in-tariffs (FiTs) were introduced in Viet Nam in 2011 for grid connected renewable energy projects. The FiT for wind power was introduced in 2011 and set at USD 0.07 per kWh[12]. FiTs were also introduced for biomass power and waste-to-energy plans in 2014, ranging from USD 0.058 for bagasse power to USD 0.10 per kWh for power from waste-to-energy (GIZ, 2014; Nam *et al.*, 2013). Although it was initially expected that these tariffs would have a significant impact, particularly for wind power, the tariff is too low to attract much investment – in neighbouring Thailand, for example, the comparable FiT for wind power is USD 0.22 per kWh (Baietti *et al.*, 2013). A new FiT for solar[13] includes modest tariffs for grid connected solar power (USD 0.0935 per kWh) and net metering for rooftop solar power, alongside other existing incentives. Initial reactions to the draft decision indicate that proposed solar FiTs are also likely to be too low (Neefjes, 2016). Despite the relatively limited impact of the FiTs to date, these instruments highlight the commitment of the government to scale up clean energy investment.

Electricity tariff regime and lack of competition hinder renewable energy investments

The current investment incentives supporting renewable energy deployment in Viet Nam have not been effective in attracting investors due to a tariff-regime that is not cost reflective and a lack of competition in the electricity market. Low prices for renewable electricity negatively affect returns on investment and hamper the participation of independent power producers (IPPs) in the electricity market (REN21, 2015). At present, Viet Nam continues to regulate electricity prices, putting in place a price ceiling (on average, about USD 0.07 per kWh) and differentiating tariffs by types of users. The price at which Electricity of Viet Nam (EVN), the state-owned electricity utility, buys electricity from renewable energy projects is at present lower than costs of electricity production for wind or solar PV. Moreover, investors in electricity generation from biogas do not benefit from any price support from the government.

The *Law on Electricity* 2004 put in place a framework for electricity tariff reform, including moving towards cost recovery. As part of this, the government plans to gradually abolish price subsidies on electricity tariffs and raise the electricity tariffs to USD 0.08-0.09 per kWh by 2020 in order to bring them closer to market prices to ensure adequate returns for investors. By doing so, it hopes to exert pressure on household consumers and companies to use electricity more efficiently. As an initial step, EVN has received government permission to increase electricity prices on a quarterly basis by a maximum of 20% per year, but maximum permitted price increases have not been realised yet due to social pressure.[14] Figure 8.2 illustrates that while average electricity retail prices have increased in the last decade, electricity retail prices, in constant terms, stayed the same in 2008-13 and were lower than those in 2002-07 (Neefjes *et al.*, 2014).

Figure 8.2. **Average retail electricity prices in Viet Nam, 2003-13**



Source: Neefjes 2016

A predictable electricity market with a high level of market competition is a crucial factor in attracting renewable energy investors including independent power producers. The electricity sector in Viet Nam lacks predictability, with limited market competition, which lowers investor confidence. EVN has historically had a monopoly on electricity generation and distribution, resulting in inefficiencies in energy supply and demand, and acting as a barrier to the development of alternative energy. Viet Nam has started to make progress in this area. The *Law on Electricity* (2004) outlines steps towards the creation of competitive electricity markets over a 20-year time frame. The government initiated efforts to pilot competition in power generation in 2012, and plans to start piloting in wholesale and retail distribution markets in order to achieve a fully competitive electricity sector by 2024 (Neefjes *et al.*, 2014; ADB, 2015a). These efforts need to be continued and implemented as planned in order to ensure renewable energy sources can compete with conventional energy.

High administrative barriers obstruct more investment in renewable energy

Investors also suffer from onerous administrative procedures for establishing renewable energy plants as the country still does not have a clear legal framework on renewable energy projects, including the process of registration and licensing. Different laws separately stipulate the policies causing confusion in their application, and some laws and regulations are contradictory. For example, although a hydropower project can be exempt from duties on imported machinery and equipment, investors usually face significant red tape relating to customs processes. In some cases, costs arising from red tape and unofficial fees overwhelm the benefits from the import tax exemption. Moreover, although a project is exempted from certain taxes, these entitlements could still be subject to government approval (Nam *et al*., 2013; USAID, 2013).

Procedures for investors to apply for incentives are often neither transparent nor well communicated. Project developers are required to interact and communicate with a number of government ministries and agencies for starting and operating renewable energy projects, which increases their transaction costs (GIZ, 2016c). Effective co-ordination and clarification of responsibilities among stakeholders is required to reduce the existing fiscal and technical barriers facing the renewable energy sector. Also, investors complain that an excessive amount of information is required to submit an application for a price subsidy. The application system for investment incentives should be transparent and easy to understand (Nam *et al*., 2013; USAID, 2013).

Enhanced access to finance is needed to scale up investment in renewable energy

Limited access to investment capital also hinders private investment in the green infrastructure sector. A private company is required to have equity capital equivalent to at least 20% of the total investment for an IPP project, which means the remaining 80% of the required capital has to be financed by bank loans from the Viet Nam Development Bank or foreign commercial banks supported by the government’s credit guarantee scheme (Nam *et al*., 2013). A 2006 decree makes provisions for the government to support investment and export credits for small hydropower projects, and this was extended to all renewable energy projects in 2008[15]. Through this support, a project can be given a loan up to 70% of the total capital required and the government could provide loan guarantees in cases where investors are asked to acquire loans from other financial institutions. In practice, investors have faced challenges in applying for and receiving government loans and guarantees, despite meeting the eligibility criteria (Nam *et al*., 2013; World Bank, 2015).

Efforts to promote investment in energy efficiency

The government has put in place several policies and initiatives to promote energy efficiency. The *Law on Economical and Efficient Use of Energy* (2010)[16] is the cornerstone of efforts in this area, establishing energy efficiency incentives and measures for cleaner production. The law covers a range of focus areas including: industry, public lighting, construction, household appliances, and vehicles. The government has subsequently issued secondary legislation (*i.e*. decisions, decrees and circulars) to support the implementation of the law (MONRE *et al*., 2014). The Law applies measures that are mandatory for government facilities and companies and buildings that use energy intensively (*e.g*. industrial factories, transport hubs, public buildings), and voluntary for other users (such as households and SMEs). The Law also introduces a standards and labelling programme to improve the performance of equipment and appliances, and a building energy code which provides a mandatory standard for energy efficiency in new buildings and retrofits with a gross floor area of 2 500 m2 or larger (APEC, 2016).

Prior to establishing the Law in 2010, the government set up the 10-year Viet Nam Energy Efficiency Programme (VNEEP) for 2006-15[17]. As a national target programme, VNEEP received priority support from the government and development co-operation providers. The programme helped to establish an institutional base for energy efficiency within MOIT, and set in place a target of securing energy savings of 3-5 % (2006-10) and 5-8 % (2011-15), compared with a business-as-usual scenario. These targets were subsequently reflected in the VGGS, and the 2011-15 target was also allocated to provinces. In addition, the programme has rolled out labelling across 13 different types of equipment, and set up 12 energy efficiency centres across the country (ADB & ADBI, 2016). The government has also complemented VNEEP with financing support. A USD 1 million energy efficiency subsidy fund was put in place, which would support up to 30% of the cost of energy efficiency projects (up to a ceiling of USD 250 000 for each project) (Audinet *et al*., 2016).

Despite the policy and legal framework being in place, energy consumption in Viet Nam has been increasing year on year, and energy elasticity was around 1.8 in 2011, which highlights challenges in achieving energy efficiency goals (Audinet *et al*., 2016). The two major barriers to the uptake of energy efficiency policy, and investment in energy efficiency technologies, are the low price of electricity which in turns affects the payback period for clean technologies, and a lack of enforcement of mandatory requirements largely due to weak enforcement and implementation capacity in the government (MONRE *et al*., 2014; ADB, 2015b).

A lack of financing also affects the roll out of energy efficiency measures. Small and medium sized enterprises (SMEs) lack the finance to invest in cleaner equipment, and the low electricity prices act as a disincentive for potential efforts. While the government funds energy audits and training, and promotes energy efficiency, incentives are limited and difficult to access, and as interest rates are high there is limited project financing available for energy efficiency (MONRE *et al*., 2014). In addition, the dominance of SOEs and disparities in accessing finance between state owned and other companies affects the ability of those offering energy efficiency services to survive. For example, deployment of Energy Service Companies was a pillar in VNEEP, but this model has not yet flourished (Audinet *et al*., 2016).

Fossil fuel subsidy reform

Distortionary subsidies for fossil fuel consumption and production, especially with regard to electricity and oil products, are an important barrier to private investment. Such non-cost reflective tariffs create market distortions which contribute to renewable energy projects not being seen as economically viable, and prevent renewable energy from achieving a decent level of market share. Historically, conventional fuel and electricity subsidies have been common across Viet Nam[18] In 2014, these subsidies were estimated to be around USD 1 billion, going mostly to natural gas and electricity. Fossil fuel subsidies in Viet Nam are largely indirect and are the result of the cap on electricity prices, as well as support channelled towards energy provision and distribution, mostly to SOEs in the energy sector. Such support includes corporate concessions and tax breaks, discounted resources and land, and access to preferential loans and guarantees from state-owned banks (Neefjes *et al*., 2014).

In this regard, the National Climate Change Strategy plans to implement an appropriate pricing system by 2020 and the Green Growth Strategy envisages a road map to phase out subsidies for fossil fuels by 2020. The government's efforts to liberalise the energy production and distribution market under the *Law on Electricity* 2004, and increase private investment in the energy sector will go some way in reducing indirect fossil fuel subsidies. Despite social pressures, the government needs to abide by its plan to phase out all fossil fuel subsidies by 2020 in order to make green investment attractive. The government could also consider introducing carbon pricing – either in the form of taxes or market based systems (*e.g.* cap-and-trade mechanisms) – in order to catalyse investment in energy efficiency and renewable energy.

Institutional capacity to design and implement green investment policies

A critical aspect of implementing green growth policies and stimulating green investment is to develop adequate institutional mechanisms and capacity to implement and co-ordinate such policies which span across sectors, and from national to subnational levels. Such institutional mechanisms can include multi-level governance and co-ordination, comprehensive capacity development efforts, monitoring and evaluation of progress, and education and awareness raising (OECD, 2013). Viet Nam has made significant progress in designing and introducing a policy framework and legislation to support green growth and investment. In order for such efforts to be scaled up and have their intended impact, however, there is a need for better co-ordination mechanisms between ministries, enhanced technical capacity at the national level, and improved human resources, technical capacity and awareness at the province level.

Better alignment, co-ordination and oversight on green growth and climate change is needed

Several inter-governmental co-ordination and planning mechanisms have been put in place to implement climate change and green growth policies in Viet Nam. The National Committee on Climate Change is chaired by the Prime Minister and brings together the key ministries to co-ordinate and review the design and implementation of climate change programmes. The Ministry of Natural Resources and Environment (MONRE) acts as the standing office for the committee and MPI co-ordinates an Inter-ministerial Co-ordinating Board under the committee which oversees the implementation of the VGGS (World Bank *et al*., 2015). The responsibility for climate change is also distributed and overlaps between the two ministries, which requires close co-ordination and collaborative action. While MONRE is in charge of the country's climate change response in terms of adaptation, and acts as the focal point for UNFCCC and for several climate funds (such as the GEF and the Climate Investment Funds), MPI is responsible for climate change mitigation and acts as the focal point for the new Green Climate Fund – which is one of the main financing channels under the UNFCCC – and is the lead agency in charge of co-ordinating the VGGS.

Despite inter-ministerial co-ordination processes being in place, decision making and policy design needs to be more coherent in order for the government to project a clear message about its vision for low carbon and climate resilient development. Several key strategies – such as green growth, climate change and the country's INDC – include emissions reductions targets that differ in terms of baselines and assumptions, and are often overlapping or even unrealistic considering the country's development trajectory (World Bank *et al*., 2016). Furthermore, the Socio-economic Development Plan, which sets the national development agenda for the next five years, includes an emissions intensity target but does not include an emissions reduction target despite the country's INDC having being prepared in parallel. Sector level plans either do not include a target or outline emissions reduction targets which differ in ambition from the VGGS and INDC, largely due to differences in the underlying methodologies used. Collectively, this suggests a lack of coherence across different decision making processes, and a greater need for alignment. A clear signal from the government is necessary to promote confidence in its green growth agenda, and mobilise green investment.

Green growth promotion requires strengthening of subnational capacity

Without proper recognition of the role that sub-national governments can play (*e.g.* as an interface with local communities), and proper allocation of resources and responsibilities, national governments may miss important opportunities to drive green growth at the province and city level (OECD, 2014). Viet Nam has introduced measures to support provincial action on green growth that is aligned with national targets and peoples' committees are responsible for formulating programmes and action plans on green growth. Provinces need to have adequate capacity to monitor and implement Green Growth Action Plans, however, and to promote green investment in different areas. In addition, with increasing decentralisation and increased responsibility for EIA review and monitoring at the province level, there needs to be adequate capacity to ensure that adverse impacts of investment in infrastructure and development are mitigated.

Human resources and technical capacity for renewable energy and energy efficiency hinders investment

Within the energy sector, there is a lack of human resources and capacity to design, implement and monitor policies on renewable energy and energy efficiency. For both areas, several ministries are involved in formulating and implementing policies: at the national level, MOIT, MPI and the Ministry of Finance are involved in renewable energy policy, and MOIT, MPI, Ministry of Construction are involved in designing and implementing energy efficiency initiatives. Within MOIT, policy making units on renewable energy and energy efficiency are understaffed considering the scale of work required to implement national strategies in these areas. Particularly for energy efficiency, MOIT needs to build up its capacity to monitor compliance with energy efficiency standards.

There is also a need to increase awareness and build technical capacity in the areas of renewable energy and energy efficiency. Wind and solar are relatively new technologies to Viet Nam and the awareness of these is low. Technical capacity needs to be built up to promote these technologies, both at the national level and province levels, and across different stakeholder such as EVN, project developers, local banks, and vocational training courses need to be established and institutionalised (GIZ, 2016b). For energy efficiency, the situation is equally complicated, with little awareness of the opportunities from energy efficiency in companies in energy intensive sectors such as steel and ceramics, especially considering that many of the companies in these sectors are SMEs. Some programmes and initiatives, such as the VNEEP, have tried to tackle this issue by providing training and awareness raising seminars, but these efforts need to scaled up and existing efforts strengthened (MONRE *et al*., 2014).

Financing for green growth and investment

Financial policies and instruments are a key part of promoting green investment as they can help increase access to finance (*e.g.* for clean infrastructure projects), mitigate the risks of new green technologies and solutions, and increase the payback and returns on green investment so as to make them viable (Corfee-Morlot *et al*., 2012).

Viet Nam has had mixed experience with the Clean Development Mechanism

Viet Nam has promoted efforts to mobilise private investment for green growth through the Clean Development Mechanism (CDM). It had 257 CDM projects accredited and registered as of October 2015, and has the 4th largest CDM portfolio in terms of number of projects (Nguyen *et al*., 2015). The majority of the projects have been from the energy sector, largely hydro power projects supported by the private sector. The government estimates that CDM has resulted in a reduction in greenhouse gas emissions of around 137 million tCO_2e in the crediting period. The main challenge with the CDM has been a long validation and registration process which resulted in projects taking a long time to be registered, sometimes as long as 4 to 6 years. This in turn has meant that many of Viet Nam’s CDM projects were registered late and only when the prices of Certified Emissions Reductions were already declining, which resulted in monetary losses for the project developers (MONRE *et al*., 2014).

New initiatives on green finance are underway

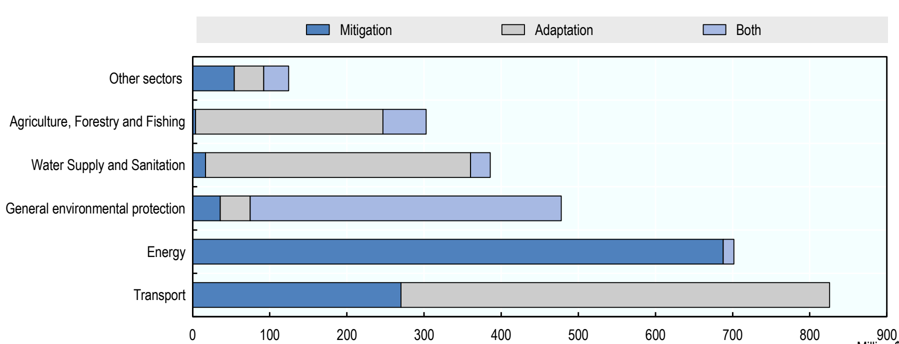
Access to finance is a major constraint for Vietnamese companies interested in investing in renewable energy, energy efficiency or environmental protection, and in response to this, the State Bank of Viet Nam (SBV) has initiated efforts to promote green financing. Green banking guidelines have been introduced through a recent SBV directive[19] which encourages all commercial and state owned banks to introduce green financing initiatives, and promote efforts to integrated environmental performance as criteria in granting credit. The directive also requires all state owned banks under the SBV to develop and implement an environmental and social risks management system, and requires bank branches in provinces to identify initiatives to actively promote green credit. Implementation of these guidelines will now require efforts to raise awareness and develop incentives and ownership within commercial and state owned banks.

Development financing still plays an important role for green growth in Viet Nam…

Donor financing and development co-operation has been a major source of support for green growth in Viet Nam. According to OECD Development Assistance Committee statistics, in 2014, just over USD 1.5 billion in development finance flows supported climate change projects in the country, with around half (47%) focusing on climate change mitigation, a third supporting climate change adaptation (34%) and the rest supporting both mitigation and adaptation[20]. The top five development partners in terms of volume of support for climate change in 2013-14 were Japan, Germany, World Bank, Asian Development Bank and the Climate Investment Funds. The majority of this support went towards reducing emissions from and improving the resilience of energy and transport infrastructure (Figure 8.3).

Figure 8.3. **Climate-related development finance to Viet Nam, 2013-14**

Current USD commitments



Source: OECD DAC Statistics

Box 8.5. **Donor support for the mobilisation of green investment in Viet Nam**

How bilateral and multilateral development partners are supporting Viet Nam to mobilise green investment:

Mitigating risks of new technologies and incentivising green investment:

KfW is supporting the development of a 24 MW **wind farm in Phu Lac** in central Viet Nam through a concessional loan to a state owned enterprise, Thuan Binh Wind Power Company, partly owned by EVN. The project is currently under construction, and serves as a pilot for project developers and EVN to develop industrial scale wind power. The project agreement also includes provisions for the manufacturer of the turbines to train and gradually hand over responsibility for maintenance to local staff.

The **Low Carbon Energy Efficiency Project and Green Investment Facility** is a Danish government backed initiative that is providing guarantees to SMEs in the ceramics and brick industry to enable them to invest in more efficient technologies (e.g. converting coal kilns to gas fired kilns) and efficient production processes. As of early 2016, 36 project proposals had passed the eligibility criteria for the project, six guarantees had been issued, and one project had been completed. The project also includes support for policies and capacity building to implement a new building energy code.

The **Viet Nam Climate Innovation Center** is an initiative under the World Bank's Information for Development program which is incubating climate technologies and providing early stage financing to Vietnamese entrepreneurs and innovators, with support from Australia and the UK. Launches in 2016, the center will provide seed financing to companies, garner relationships with investors and build capacity to help commercialise technology solutions.

Supporting the enabling environment for green investment:

GIZ’s **Support for Scaling Up Wind Power** programme is working with MOIT to refine and develop the policy framework for wind power in Viet Nam. The project is providing technical advice and analysis to the government to enable them to further refine the FiT for wind power, and works with investors, EVN and other stakeholders to identify the barriers to wind power investment. The programme is also helping to develop vocational and academic training to develop the skills required to operate and use wind power.

Strengthening Capacity and Institutional Reform for Green Growth and Sustainable Development in Viet Nam is a partnership between MPI, UNDP and USAID to support implementation of the VGGS by helping MPI to track and monitor progress on the VGGS and developing province level action plans for green growth and also supporting the government to identify how best to access international climate finance (both public and private) and to analyse what is required to mobilise green investment in different sectors.

The GIZ-supported **Macroeconomic Reforms / Green Growth Programme** is working with the MPI to support the implementation of the VGGS, but focuses more on fiscal planning and policies. The programme works with, among others, the State Bank of Viet Nam and the Ministry of Finance to design and implement environmentally friendly fiscal policies, such as supporting the implementation of the Environmental Protection Tax.

Source : KfW, 2015; Information for Development / World Bank, 2012; MOIT & Embassy of Denmark, 2016; GIZ, 2016a; UNDP, 2016.

…and future efforts should better engage the private sector

International support for climate change in Viet Nam through donors or multilateral climate funds needs to include a focus on engaging the private sector more broadly so as to diversify support for climate change. Globally, with an increasing recognition of the scale of investment needed to deliver environment and development goals, there is an expectation that development cooperation will need to mobilise private investment in order to deliver on climate and development outcomes. Box 8.5 presents examples of donor programmes that are being used to mobilise green investment in two ways. First, this financing is being used to mitigate investment risks and directly facilitate investment at the project level, such as for the development of wind and solar power. Second, development co-operation providers are supporting the government to build the required policy, regulatory and institutional frameworks to enable green investment in various sectors through technical assistance.

Lastly, the effectiveness and impact of donor financing is now more important than ever for Viet Nam as many bilateral donors are transitioning away from concessional support to the country due to its improved income status. Viet Nam's green growth agenda has served as a way to leverage and attract donor financing, but co-ordination and harmonisation of such support still varies widely, and there is no single streamlined mechanism in place to strategically co-ordinate development partner efforts for green growth. Such a mechanism needs to be government-led and with good engagement by sector ministries. Some examples of good practice have been seen in the context of national target programmes for climate change. The Support Program to Respond to Climate Change, for example, which is loosely aligned with the national programme to respond to climate change, has helped co-ordinate action among donors and provide financing to the government[21] along the lines of climate policy priorities, as annually agreed by donors and the government (World Bank *et al.*, 2015).

Notes

1. A green investment framework has much in common with a general policy framework for investment, but to ensure that it is conducive to green growth, certain additional elements must be also in place. These include: a strong commitment at both the national and international levels to support green growth and to mobilise private investment for green growth; policies and regulations to provide a level playing field for more environment-friendly investments; policies to encourage more environmentally responsible corporate behaviour; an institutional capacity

to design, implement and monitor policies to foster green growth objectives; financial mechanisms for green investment; and policies to support private sector involvement in green infrastructure projects (OECD 2015).

2. Decision No.: 428/QD-TTg issued on 18 March 2016.

3. Decision No: 1393/QĐ-TTg

4. (Decision No: 403/QĐ-TTg, entitled 'Approval of the National Action Plan on Green growth in Vietnam For the Period of 2014-2020'

5. Decision No: 2068/QD-TTg entitled 'Approving the Viet Nam's Renewable Energy Development Strategy up to 2030 with an outlook to 2050'

6. The emissions reduction target in the INDC includes land use, land use change and forestry section (LULUCF) while the VGGS target does not.

7. Decision No. 55/2014/QH13

8. Baird and Frankel (2015).

9. Renewable energy includes small hydropower plants below 30 MW of capacity (ADB & ADBI 2016)

10. Nangluong VN (2016); Pham (2016).

11. ADB & ADBI (2016); Nangluong VN (2016).

12. Decision 37/2011/QD-TTg of 2011 provides a feed-in-tariff mechanism to support the development of wind power projects in Viet Nam. Decision 31/2014/Qd-TTg provides a feed-in-tariff mechanism to support the development of biomass cogeneration and waste-to-energy power projects.

13. Decision No. 11/2017/QD-TTg.

14. Zimmer et al. (2013); MONRE et al. (2014); ADB & ADBI (2016).

15. Decree 151/2006/ND-CP.

16. Resolution 50/2010/QH12 promulgates the Law on Economical and Efficient Use of Energy in Viet Nam.

17. Decision 79/2006/QD-TTg approved the National Target Programme on Efficient Use and Saving Energy

18. According to the IEA, subsidies on fossil fuels in Viet Nam fluctuated between USD 1.2-4.5 billion annually from 2007 to 2012. Subsidies are mostly on coal and other fuels for electricity generation.

19. SBV Directive No: 03/CT-NHNN on Promoting Green Credit Growth and Environmental – Social Risks Management in Credit Granting Activities

20. The OECD Development Assistance Committee (DAC) statistics track development finance from DAC members, non-DAC providers, multilateral development banks and climate funds to developing countries in support of climate change mitigation and adaptation. Bilateral flows are measured using the 'Rio Markers' approach. These statistics include data on Overseas Development Assistance (ODA) (i.e. concessional finance, including grants and concessional loans) and as well as Other Official Flows (OOF) (i.e. non-concessional developmental finance such as loans provided at market rates).

    While the OECD DAC statistical system provides the most consistent source of data on climate-related development finance across bilateral and multilateral providers, it is important to note the difference between climate-related development finance and climate finance as reported by parties to the UNFCCC. Whilst party reporting is often based on climate-related development finance statistics, not all climate-related development finance is reported as climate finance as some members may apply additional quantitative methodologies to identify climate finance. Hence the two are not directly comparable.

21. Mostly concessional loans from JICA, AfD, WB, CIDA, AusAID, and Korea EXIM Bank.

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Chapter 9

Policies to promote and enable responsible business conduct in Viet Nam

This chapter provides an overview of the responsible business conduct landscape in Viet Nam, outlining the actions the government has taken to facilitate, promote, enable, co-operate on and exemplify responsible business practices. It also provides recommendations for how the climate for responsible business conduct in Viet Nam could be further enhanced with a view to promoting sustainable development.

Responsible business conduct (RBC) principles and standards set out an expectation that all businesses avoid and address negative impacts of their operations, while contributing to sustainable development where they operate. Promoting and enabling RBC should be of central interest to those policymakers wishing to attract quality investment and ensure that business activity in their countries contributes to broader value creation and sustainable development.

In principle, the legal framework that protects the public interest and underpins RBC has been partially established in Viet Nam, although more efforts are needed to ensure implementation and enforcement of relevant laws. Awareness of international RBC principles and standards is not yet wide-spread, but the economic and social reforms currently being implemented as a result of Viet Nam's international commitments (particularly in areas related to labour relations and human rights), represent a positive step in strengthening Viet Nam's overall policy framework that enables RBC. This is an important signal for investors, as certain RBC-related risks in Viet Nam are perceived to be high.

Much of FDI in Viet Nam so far has come from Asia, suggesting that investors from Europe and North America have substantial scope to expand their presence. Mainstreaming RBC at a government level and clearly communicating RBC priorities and expectations would go a long way in overcoming country risk perceptions, maximising the development impact of FDI, attracting quality investment and promoting linkages with MNEs, and creating a level-playing for business (particularly important in light of increasing RBC expectations in the supply chains, which can include legal obligations for some investors).

Policy recommendations

- Implement the reforms in the areas of labour relations, transparency, corporate governance, human rights, and environment that have been agreed to in the recent international agreements.

- Develop a *National Action Plan on Responsible Business Conduct,* in collaboration with stakeholders and in line with international good practices. Clearly communicate expectations on RBC, provide guidance on accepted practices, and promote policy coherence and alignment on RBC. Support awareness raising events. Consider establishing a focal point on RBC in the government.

- Actively promote RBC among Vietnamese businesses. Encourage the establishment of firm-level grievance mechanisms as a complement to government complaints mechanism in order to strengthen the capacity of workers to voice concerns. Encourage cross-sectoral learning for addressing RBC risks.

- Include RBC in the efforts to promote linkages between MNEs and domestic industries, in line with recommendations from Chapter 6. Include RBC principles and standards in the design of the systematic and well-institutionalised industry-specific training programmes for supporting industries, in collaboration with the business community and educational institutions. Consider how social enterprises can be promoted through these programmes.

- Include RBC expectations in FDI attraction efforts and as one element in efforts by central and provincial investment promotion authorities to facilitate information exchange between foreign and domestic firms. Include RBC criteria in supplier databases and in matchmaking events.

- Involve the private sector in human resource development policies and encourage internal and external training by employers. Communicate to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC - and recognise those that do it.

- Communicate the extent of business responsibilities for protecting the environment in strategic documents on the environment at both national and provincial levels.

- Improve the implementation of the regulations on environmental impact assessments by clarifying exact mandates and direct responsibilities for follow up and monitoring activities of national and provincial authorities. Improve technical capacities of responsible authorities, particularly for industries new to Viet Nam.

- Establish expectations on RBC for SOEs and publicly disclose them.

- Consider strengthening disclosure requirements for non-financial information in line with international best practice.

- Implement broader reforms that support entrepreneurship, such as developing an entrepreneurship promotion policy. Promote social entrepreneurship as one component of promoting responsible business practices across the entire economy.

Box 9.1. **A primary reference for responsible business - OECD Guidelines for Multinational Enterprises**

The OECD Guidelines for Multinational Enterprises are the most comprehensive recommendations on what constitutes responsible business addressed by 46 adhering governments to businesses operating in or from their territories conduct on:

- disclosure
- human rights
- employment and industrial relations
- environment
- combating bribery, bribe solicitation and extortion
- consumer interests
- science and technology
- competition
- taxation

Their purpose is to ensure that business operations are in harmony with government policies; to strengthen the basis of mutual confidence between businesses and the societies in which they operate; to improve investment climate; and to enhance the contribution of the private sector to sustainable development. The Guidelines, together with the UN Guiding Principles on Business and Human Rights and core ILO Conventions, are one of the main international instruments on RBC.

The Guidelines reflect good practice for all businesses and do not aim to introduce differences of treatment between multinational and domestic enterprises. The adhering governments wish to encourage their widest possible observance to the fullest extent possible, including among small- and medium-sized enterprises, even while acknowledging that these businesses may not have the same capacities as larger enterprises. Accordingly, multinational and domestic enterprises are subject to the same expectations wherever the Guidelines are relevant to both.

Each adhering country sets up a National Contact Point (NCP) tasked with promoting RBC and the Guidelines, as well as helping resolve issues in case the Guidelines are not observed. NCPs have considered over 360 such instances since 2000.

Scope and importance of responsible business conduct

RBC principles and standards set out an expectation that all businesses – regardless of their legal status, size, ownership structure or sector – avoid and address negative impacts of their operations, while contributing to sustainable development of the countries in which they operate. This expectation is affirmed in the main international instruments on RBC, notably the OECD *Guidelines for Multinational Enterprises* (OECD Guidelines) (see Box 9.1) and the UN *Guiding Principles for Business and Human Rights* (UN Guiding Principles), and, increasingly, in international trade and investment agreements and national development strategies, laws, and regulations.

RBC means considering and integrating environmental and social issues within core business activities, including throughout the supply chain and business relationships. A key element of RBC is risk-based due diligence – a process through which businesses identify, prevent and mitigate their actual and potential negative impacts, and account for how those impacts are addressed. RBC is a term sometimes used interchangeably with corporate social responsibility (CSR), although it is understood to be more comprehensive and integral to core business than what is traditionally considered CSR (mainly philanthropy). Increasingly, CSR is being used in a similar way to RBC.[1] Many businesses find that responsible business is good business, in addition to ensuring that they respect human rights and comply with laws and regulations of the countries in which they operate. Understanding, addressing, and avoiding risks material to business operations in a more comprehensive way – that is, beyond financial risks – can often lead to a competitive advantage.

Promoting and enabling RBC is of central interest to policy-makers that wish to attract quality investment and ensure that business activity in their countries contributes to broader value creation and sustainable development. According to the OECD *Policy Framework for Investment*, governments can promote and enable RBC in several ways through:

- *Regulating* – establishing and enforcing an adequate legal framework that protects the public interest and underpins RBC, and monitoring business performance and compliance;
- *Facilitating* – clearly communicating expectations on what constitutes RBC, providing guidance on specific practices and enabling enterprises to meet those expectations;
- *Co-operating* – working with stakeholders in the business community, worker organisations, civil society, the general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC;
- *Promoting* – demonstrating support for best practices in RBC;
- *Exemplifying* – behaving responsibly in the government's role as an economic actor.

Since the 2011 update of the Guidelines and the adoption of the UN Guiding Principles, there has been a significant increase in government policies and initiatives promoting RBC and better environmental and social conditions in global supply chains (see Box 9.2). Businesses, trade unions and civil society have welcomed these efforts. Many of the persistent challenges in the supply chain cannot be solved by any one actor alone, as demonstrated by several high profile accidents such as the Rana Plaza factory collapse in Bangladesh or the recent cases of human trafficking and modern slavery on fishing boats, cocoa plantations, and cotton farms.

Box 9.2. **Recent policy innovations on RBC**

Recognising the importance of RBC in international agreements

The agreement on Sustainable Development Goals (SDGs) and the historic Paris agreement on climate change have recognised and given renewed attention to the role of the private sector in development. A number of SDGs refer to responsible production patterns, inclusive and sustainable economic growth, employment and decent work for all, while the Paris agreement underlines the critical role of business in tackling climate change, including through reducing greenhouse gas emissions and improving environmental performance. There is much to be gained from promoting and enabling RBC in pursuit of the SDGs. The 2016 Development Co-operation Report: The Sustainable Development Goals as Business Opportunities outlines policy reasons for promoting RBC as a way to mobilise necessary resources for financing the development agenda, while improving access to markets and participation in value chains for domestic industries and increasing accountability and inclusiveness (OECD, 2016c).

Another high-level commitment that made it clear that RBC issues were a top priority in the international agenda was the June 2015 G7 Leader's Declaration. G7 pledged to lead by example to promote international labour, social and environmental standards in global supply chains; to encourage enterprises active or headquartered in the G7 to implement due diligence; and to strengthen access to remedy (G7, 2015). Specific encouragement was given to international efforts and promulgating industry-wide due diligence standards in the textile and ready-made garment sector. The need to help small and medium-size enterprises (SMEs) develop a common understanding of due diligence and responsible supply chain management was also highlighted.

Promising national developments

More and more countries are also using RBC principles and standards to frame domestic law. In March 2015, the UK enacted the Modern Slavery Act, mandating that commercial organisations prepare an annual statement on slavery and human trafficking and report on their due diligence processes to manage these risks within their operations and supply chains (UK, 2015). France has introduced a similar but broader proposal to mandate supply …/

Box 9.2. **Recent policy innovations on RBC** (cont.)

chain due diligence in accordance with the OECD Guidelines, which, if enacted, would require all French companies with more than 5000 domestic employees or more than 10 000 international employees to publish a due diligence plan for human rights and environmental and social risks or face fines of up to EUR 10 million (France, 2014).

RBC criteria have also been included in economic instruments. The OECD Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence was revised in April 2016 to strengthen RBC considerations in export credits and to promote policy coherence (OECD, 2016a). Canada has enhanced its strategy Doing Business the Canadian Way: A Strategy to Advance Corporate Social Responsibility in Canada's Extractive Sector Abroad to allow for withdrawal of government support in foreign markets for companies that do not embody RBC and refuse to participate in the dispute resolution processes available through the Canadian government, including National Contact Points (NCPs) for the OECD Guidelines.

Due diligence requirements for minerals supply chains have been integrated into Section 1502 of the 2010 United States Dodd–Frank Wall Street Reform and Consumer Protection Act. More recently, Federal Acquisition Regulation was revised in 2015, establishing a number of new safeguards to strengthen protections against trafficking in persons in federal contracts (United States, 2015a). Additionally, the 2015 Trade Facilitation and Trade Enforcement Act eliminated the exceptions to the prohibition on import of goods into the United States - it is now illegal to import goods made, wholly or in part, with convict, forced and indentured labour under penal sanctions. In March 2016, US border agents withheld goods tied to forced labour on the basis of the new Act (United States, 2016).

In 2014, the EU passed a directive on promoting disclosure of non-financial and diversity information with the aim to promote more transparency on environmental and social issues across sectors and companies over a certain size incorporated in EU member states and listed on regulated EU exchanges (EU, 2014). It is currently in the process of being transposed into national law and first reports are expected in early 2018. Recently, an agreement on a framework to stop the financing of armed groups through trade in conflict minerals was reached at an EU level, with the aim that EU companies source tin, tantalum, tungsten and gold responsibly. These minerals are typically used in everyday products such as mobile phones, cars and jewellery (EU, 2016a).

China is also increasingly incorporating RBC into its national initiatives. In 2015, OECD and China signed a comprehensive programme of work, setting out the strategic vision and activities in a number of topics, including RBC. Several joint activities have been undertaken under the programme. Notably, at the end of 2015, on the basis of OECD RBC instruments, China Chamber of Commerce Metals, Minerals & Chemicals Importers and Exporters adopted the Chinese Due Diligence Guidelines for Responsible Minerals Supply Chains.

Responsible business conduct in Viet Nam – an opportunity

Importance of RBC has been recognised in ASEAN

Many regional and local civil society networks and non-governmental organisations (NGOs) have called on ASEAN to take more strategic measures to speed up action on RBC and to emphasise company responsibility for economic, social and environmental impacts. A 2014 study on CSR and human rights commissioned by the ASEAN Intergovernmental Commission on Human Rights (Thomas & Chandra, 2014) found that RBC is a relatively new subject in ASEAN in general, with a low level of awareness among business leaders and policy makers. Majority of CSR activities remain philanthropic in nature, although awareness seems to be increasing.

References to RBC have been included in new ASEAN blueprints. The ASEAN Socio-Cultural, Economic, and Political-Security Community Blueprints 2025 all mention CSR. The Economic Blueprint specifies that enhanced stakeholder engagement is key to promoting transparency and making progress in ASEAN integration. One of the strategic measures identified is to work closely with stakeholders towards promoting CSR activities (ASEAN, 2016a). The Socio-Cultural Blueprint also builds on the idea of multi-sectoral and multi-stakeholder engagement and calls for promotion and integration of Sustainable Consumption and Production strategy and best practices into national and regional policies or as part of CSR activities (ASEAN, 2016b). The Political-Security Blueprint calls on strengthening collaboration with the private sector and other relevant stakeholders to instil CSR (ASEAN, 2016c).

More recently, at the 24th ASEAN Labour Ministerial Meeting on 15 May 2016 in Lao PDR, ASEAN labour Ministers adopted the *Guidelines for Corporate Social Responsibility (CSR) on Labour.* These guidelines aim to provide broad guidance to governments, enterprises/establishments, employers' and workers' organisations on raising awareness, proactively encouraging engagement, and promoting social dialogue and compliance with core labour standards (ASEAN, 2016d). This is an important signal by ASEAN member states that CSR issues are increasingly relevant for the region.

As ASEAN members move toward a unified regional approach and in light of the ongoing policy dialogue on investment between OECD and ASEAN, there is significant scope to increase dialogue and cooperation on RBC issues. Specific policy dialogue between ASEAN and the OECD Working Party on Responsible Business Conduct, the only inter-governmental policy body in the world that focuses exclusively on RBC issues, could be institutionalised and strengthened. Peer learning and experience sharing on lessons learned from recent policy innovations (Box 9.2) could be particularly useful.

Awareness of RBC in Viet Nam is low but increasing

Awareness of international RBC principles and standards is not yet widespread in Viet Nam. However, although there is no comprehensive national strategy or policy on RBC, Viet Nam's recent international commitments and the economic and social reforms currently being implemented as a result of these commitments (particularly in areas related to labour relations and human rights), represent a positive step in strengthening Viet Nam's overall policy framework that enables RBC. This is an important signal for investors, as certain RBC-related risks in Viet Nam are perceived to be high.

Notwithstanding these commitments by the government, RBC-related activities in Viet Nam so far have mostly been undertaken by international organisations, the private sector and civil society. The Vietnam Chamber of Commerce and Industry (VCCI), together with the UN Global Compact and UNIDO, has been maintaining a local UN Global Compact network since 2007. Global Compact aims to promote alignment of business strategy with ten principles on human rights, labour, environment and anti-corruption. The network has contributed to promotion of CSR in Viet Nam, through for example the CSR Calendar Forums, which meet on a regular basis and focus on thematic issues. A recent forum in April 2016 discussed the contribution and needs of the private sector in Viet Nam to implement the SDGs (VCCI et al, 2016). Beyond promotional activities, however, participation by local businesses in the network appears to be quite limited considering the size of the Vietnamese economy. The Global Compact website lists only 28 active participants, but it should be noted that this level of participation is comparable with other ASEAN economies, with the exception of Myanmar (UN Global Compact, 2016).

Nevertheless, results of other targeted projects such as the 2009-13 UNIDO project on *Helping Vietnamese SMEs Adapt & Adopt CSR for Improved Linkages with Global Supply Chains in Sustainable Production* do point to an increasing awareness of CSR issues among domestic enterprises (TNS Vietnam, 2013). Foreign chambers of commerce have also been active, particularly on promotion. The American Chamber of Commerce in Viet Nam has established a CSR group that focuses on networking, information-sharing, and community development. A CSR recognition award programme was launched in 2015 (AmCham, 2015). The European Chamber of Commerce reports over 20 CSR and philanthropic programmes of varying sizes across the country over the last three years

(EuroCham, 2016). Some sectoral initiatives like the Fair Labour Association/VCCI joint project to assess compliance with labour standards in 31 garment and footwear factories (FLA, 2014) have gone beyond promotional efforts, but such initiatives are generally not widespread.

Certain technical assistance programmes that have been implemented or are ongoing are also relevant. For example, ILO is implementing several projects, including projects to promote socially responsible labour practices in the electronic sector; the Decent Work country programme; Better Work programme in the textile and garment sector, together with the IFC; and projects to prevent forced and child labour.

Consolidating efforts – the role of the government

The Vietnamese government could consider building on these existing efforts and working with stakeholders to develop a *National Action Plan on Responsible Business Conduct*, in line with international good practice (see Box 9.3). Clearly communicating expectations around RBC, providing guidance on accepted practices and enabling enterprises to meet those expectations, can be the deciding factor in scaling up better business practices among local enterprises.

The government has already recognised the importance of balancing economic prosperity and fast growth with environmental sustainability and social inclusion, both in the ten-year national strategy plan *2011-2020 Socio-Economic Development Strategy* and in the recently launched policy vision *Vietnam 2035: Toward Prosperity, Creativity, Equity, and Democracy*. The government has also consistently stated its objective to deepen global integration and move up the global value chain. These broad commitments have translated into several specific policies, laws and initiatives to promote better business practices and improve Viet Nam's overall business environment. Notably, Viet Nam recently concluded two major treaties, the EU Free Trade Agreement (EU FTA) and the Trans-Pacific Partnership (TPP) which has not entered into force. Both include specific language on RBC/CSR and sustainable development. This follows dominant treaty practice in recent years. OECD research shows that more than three-fourths of international investment agreements concluded between 2008 and 2013 include language on RBC (mainly free trade agreements with investment protection provisions) and virtually all of the investment treaties concluded in 2012-13 include such language (Gordon et al., 2014).[2]

Box 9.3. **Using National Action Plans as Tools for Promoting RBC**

Many countries are developing or have developed national action plans (NAPs) on RBC or business and human rights, following a recommendation by the UN to do so as part of the state responsibility to disseminate and implement the UN *Guiding Principles*. Governments are using NAPs to highlight their policies on RBC and signal the needs for future action. NAPs are useful tools for promoting policy coherence within the government, engaging with stakeholders, and demonstrating commitment to RBC. The UN Working Group on Business and Human Rights has set up a dedicated webpage to provide easy access to existing plans, as well as key public information and analysis on the various stages of NAP development, implementation and follow up (UN OHCHR, 2016).

A notable example of an NAP is the draft United States *National Action Plan on Responsible Business Conduct*, expected to be adopted in 2016. Announced by President Obama as one of the core activities under the US Global Anti-corruption Agenda, the US NAP on RBC will be consistent with the OECD Guidelines and the UN Guiding Principles and is expected to address ways in which the US government can promote and encourage established RBC norms related to, but not limited to, human rights, labour rights, land tenure, anti-corruption, and transparency (United States, 2015b; White House, 2014).

Table 9.1. **Status of Development of National Action Plans in ASEAN Member States**

	Malaysia - in the process or committed to it
	Myanmar - in the process or committed to it
	Philippines - promoted by the National Human Rights Institution or civil society
	Indonesia - promoted by the National Human Rights Institution or civil society
X	Viet Nam - none
X	Lao PDR - none
X	Thailand - none
X	Cambodia - none
X	Brunei Darussalam - none
X	Singapore - none

Source: UN OHCHR, 2016

Specifically, the EU FTA references the promotion and co-operation on CSR in the Trade and Sustainable Development chapter (art. 9 and 14), with OECD Guidelines specifically mentioned in art. 9 as a relevant international standard. Other chapter that includes provisions related to RBC is the State-owned Enterprises (SOEs) chapter (art. 5), underlining co-operation efforts to ensure that SOEs observe internationally recognised standards of corporate governance. RBC and corporate governance are intrinsically linked as, on the one hand, RBC affects the company's decision-making processes, risk management, disclosure and transparency, and relationships with investors and stakeholders; and, on the other hand, the actual process of undertaking due diligence is closely related to the corporate governance framework and the relationships between company management, board, shareholders and other stakeholders.

TPP also referenced CSR in several chapters, for example: Investment, art. 9.17; Labour, art. 19.7 and 19.10.6(t); and Environment, art. 20.10 (USTR, 2015a). Other broader provisions related to RBC, for example on improving transparency and fighting against corruption (chapter 26) or improving corporate governance of SOEs (chapter 17.11). These chapters were subject to dispute settlement mechanisms under the agreements and signalled the willingness of parties to meet these commitments. Viet Nam also committed to specific labour reforms in a separate but related bilateral agreement with the United States, *Plan for Enhancement of Trade and Labour Relations*.

Viet Nam's existing investment treaties, as noted in Chapter 3, also include language on sustainability. The Japan-Viet Nam agreement recognises that "it is inappropriate to encourage investment by investors of the other Contracting Party by relaxing environmental measures".[3] Another example is the Vietnam-Eurasian Economic Union agreement, which includes a chapter on Sustainable Development (Ch. 12) focusing particularly on environmental and labour issues, but that chapter is not subject to the dispute settlement mechanism (UNCTAD, 2015).

These agreements demonstrate that Viet Nam is committed to more transparency and deep reforms; however, the reforms will have to swiftly follow in order to address concerns raised by the civil society during the negotiations period concerning investment, human rights, and environmental and social impacts of business activities.[4] Some similar concerns have recently been raised during the ongoing negotiations of the Regional Comprehensive Economic Partnership (RCEP), particularly around access to medicine for vulnerable populations.[5]

The process of developing a *National Action Plan on Responsible Business Conduct* would be a concrete way for the government to demonstrate both to its international partners and domestic constituencies what are the economic and social reforms it has undertaken to promote and enable better business practices and improve the overall business environment, while also highlighting future steps to ensure that these reforms are actually implemented on the ground. The process could also be a good way to engage with stakeholders and the wider public, including foreign investors and domestic private sector, to understand and eventually remove barriers that influence the uptake of RBC by business. The government has an important role as a convener and can facilitate collective initiatives to promote RBC. Finally, as this review highlights, policy reforms needed to move up the value chain are cross-cutting by definition and, thus, policy coherence and effectiveness are important factor. Developing a NAP on RBC would be a good way to promote policy coherence and alignment in a number of topics related to the implementation of the SDGs and the contribution of the private sector to development.

Building on existing initiatives

Several recent promising initiatives and areas that could speed up the uptake of RBC principles and standards by Vietnamese companies could be highlighted in the NAP. These areas are by no means exclusive and the broad reforms that will apply to all sectors and areas of business operations are also relevant.

Promoting social entrepreneurship is important, but broader action on RBC would be beneficial

As discussed in Chapters 2 and 4, the 2014 Law on Enterprises has introduced new and comprehensive provisions related to corporate governance of enterprises in Viet Nam. The law includes a new legal form and definition for registering a *social enterprise* (art.10), setting out the criteria, rights and obligations for its operation. Any enterprise with an objective to resolve social and environmental problems or to serve the public interest, which reinvests at least 51% of its annual profits for these purposes, can now be considered a social enterprise. Notably, the law stipulates that the government will introduce policies to encourage, support, and boost the development of social enterprises.

This is an important and encouraging development. Social impact investment and entrepreneurship is a growing global trend according to the 2015 OECD report on *Social Impact Investment.* Foundations, high net worth individuals, philanthropists, and international aid agencies are looking to increase the effectiveness and long-term development impacts of their interventions by using new tools, e.g. results-based financing, outcomes-based approach, market-based solutions and different forms of public-private partnerships (OECD, 2015a). An explicit commitment by the government to promote such efforts has been welcomed by civil society and entrepreneurs working toward social change.

Nevertheless, although the social impact investment market has been growing worldwide and has drawn interest from policy makers, it is still in the early stages of development and is only a small share of global capital markets today (OECD, 2015a). This is also the case in Viet Nam. For example, the prevalence of nascent social entrepreneurial activity - that is, individuals of working age who are trying to start some social entrepreneurial activity – is fairly low in Vietnam at approximately 1% against an average of 3.2% across the 58 economies examined in a 2016 report by the Global Entrepreneurship Monitor. By comparison, the average rate of start-up commercial entrepreneurship in the world is 7.6%, with a slightly higher range in Viet Nam at 13.7% (Niels *et al*., 2016).

The limited size of the social impact investment market implies limited impact on social outcomes. Additionally, engaging mainstream investors in this area will be more difficult, due to the lack of high quality investment opportunities with the right risk profiles to which large amounts of capital could be channelled (OECD, 2015a). Although there has been a notable change over the past decade in how mainstream investors consider environmental, social and governance (ESG) issues, some continue to perceive structural and legal barriers to investing for social outcomes, i.e. that there is a misalignment between fiduciary duties to generate a return on clients' assets and responsibilities for addressing ESG risks. These perceptions are changing. Policymakers in major economies have clarified and made explicit that investors may take ESG factors into account in certain circumstances. Stakeholders, including investors themselves, are increasingly arguing that failing to consider all long-term investment value drivers, including ESG issues, is actually a failure of fiduciary duty and considering ESG issues can lead to better investment decisions consistent with the fiduciary duties.[6]

As with any new or inefficient market that may benefit from direct government intervention, a number of challenges and issues need to be carefully considered when designing new policy interventions. Chapter 6 of the *Social Impact Investment* report discusses policy implications related to social entrepreneurship in more detail and can serve as a useful reference. These challenges, among others, include the need to develop common definitions globally and nationally around what is impact; defining, measuring and understanding the extent of the impact on both social and broader development outcomes; collecting more and better data; and understanding the expected and unintended spill-over effects on the economy. Broader reforms, for example, reforms that support entrepreneurial finance markets, can also have an indirect, but significant, influence on the social entrepreneurship market and could be more efficient than direct policy intervention. As noted in Chapter 6, a lack of a proper entrepreneurial promotion policy is one of the main barriers to improving Viet Nam's low performance in the promotion of entrepreneurial education identified in the OECD *SME Policy Index* (ERIA and OECD, 2014), so this type of broader reform could also bring additional benefits.

Therefore, promoting social entrepreneurship should be treated as one component of promoting responsible business practices across the entire economy. RBC principles and standards are focused on addressing the environmental and social impacts of business operations regardless of whether the business is a traditional business or a social enterprise. There could also be opportunities to promote the integration of social enterprises into certain mainstream supply chains through targeted programmes, led by either government or civil society. For example, the Clinton Foundation runs a programme that sets up depots and collection centres for small-scale farmers, buys their produce, and aggregates this into quality controlled, reliable supply chains for large purchases under contract. This hybrid and innovative approach addresses the concerns of many large MNEs and food retailers about the associated risks with sourcing from small-scale farmers, such as operational complexity, unreliability, and inconsistent, substandard produce (Clinton Foundation, 2016). Promotion of social enterprises could be treated as one component of the broader efforts to promote more linkages between MNEs and domestic industries, discussed in more detail in the section below.

Benefiting from global value chains – promoting linkages through RBC

Expectations that businesses observe RBC principles and standards cover the entire supply chain and affect suppliers and exporters. Suppliers that integrate internationally recognised environmental and social practices have a comparative advantage over those that do not as they can more easily address concerns about environmental, social, human rights or labour issues that may come up in the due diligence processes of MNEs when assessing country and supplier risks. Additionally, MNEs are increasingly basing their decisions about where to do business on the ability to ensure predictable and reliable supply chains, capable of delivering effectively at the each stage (Taglioni and Winkler, 2014; OECD, 2014a: 27). It is estimated that costs of delays can be substantial for certain product categories and any delays due to, for example, labour unrests or environmental damage, contributes to those costs. (Hummels, 2007; OECD, 2014a: 27).

One of the key recommendations of this Investment Policy Review is related to enhancing the development impact of FDI by encouraging business linkages between foreign investors and domestic industries through primarily focusing on strengthening SME performance and competitiveness (see

Chapter 6). Few linkages exist currently, mainly due to productivity and quality gaps. Additionally, even when qualified SMEs exist, these linkages might not happen automatically. Promoting RBC among domestic enterprises can go a long way in addressing some of the concerns identified (Box 9.4).

Box 9.4. **Responsible business is good business**

RBC can contribute to reducing costs and avoiding legal liability. In one study, nearly 20% of the 2,500 sampled companies were found to be subject to sanctions related to their social or environmental performance between 2012 and 2013, amounting to penalties upwards of EUR 95.5 billion (Vigeo, 2015). Likewise, a recent Harvard University study found that for a mining project with capital expenditure between USD 3-5 billion the costs attributed to delays from community conflicts can be on average USD 20 million per week due to lost productivity from temporary shutdowns or delays (Davis and Franks, 2014). RBC can also lead to increased returns, lower cost of capital, and higher employee retention. One study found that better business practices have the potential to reduce the cost of debt for companies by 40% or more and increase revenue by up to 20% (Rochlin et al., 2015). More broadly, a cross-sector study tracking performance of companies over 18 years found that high sustainability companies - that is those with strong environmental, social, and governance (ESG) systems and practices in place - outperform low sustainability companies in stock performance and real accounting terms (Eccles et al, 2011).

Suppliers of multinational enterprises (MNEs) may find that following RBC principles and standards gives them an advantage over businesses that do not, as they are able to respond to and address concerns that may come up in due diligence of the MNE when evaluating risks associated with its supply chain. Investors from the 46 countries that adhere to the OECD Guidelines (see Box 9.1) are subject to them wherever they operate, including throughout the supply chain and in relation to business relationships. This means that a large majority of the global supply chain is covered by the OECD Guidelines as these investors account for 75% global foreign direct investment (FDI) outflows and 58% of global FDI inflows between 2010 and 2015, as well as 81% of global FDI outward stock as of end 2014 (OECD/IMF, 2016). Similarly, businesses that want to access markets of these 46 countries are also subject to the OECD Guidelines, and, in some cases, actual regulation related to RBC (see Box 9.2).

The economic sectors on which Viet Nam is basing its strategy to promote supporting industries – namely manufacturing, mechanical engineering, electronics and informatics, manufacturing and assembly of automobiles, textile and garment and leather and footwear, and hi-tech industry development - are sectors in which environmental and social risks can be fairly high. For example, the textiles and garment sector has been the focus of much discussion since the April 2013 Rana Plaza factory collapse in Bangladesh. In addition to risks related to labour and human rights (for example, child or forced labour, discrimination, restrictions on the right to join a trade union, low-wages, excessive hours of work), occupational health and safety and environmental risks are prevalent (such as use of hazardous chemicals, water consumption and pollution or high energy use). The latest compliance report by Better Work Vietnam (2015) demonstrates that these are persistent challenges in Viet Nam's garment industry as well. Most businesses that operate in the sector are SMEs and issues with occupational health and safety, compensation, freedom of association and collective bargaining, and working time continue to be observed.

Some problems may result from practices in the supply chain and may require multi-stakeholder action. This is where active promotion by the Vietnamese government of RBC expectations can make a marked difference. For example, poor purchasing practices are one of the most common ways in which brands, retailers, buyers or buying agents can contribute to labour and human rights issues in garment factories. These include, for example, late placement or payment of orders; modified or cancelled orders; rush orders placed during peak times or holidays; and lead times that are shorter than feasible production time. While it is the primary responsibility of factory owners to comply with the law, these buyer practices can be a factor in decisions to require excessive or forced overtime and can also lead to illegal subcontracting. In order to help address some of these practices in the sector that may not be solvable by one actor alone, the OECD is currently leading a multi-stakeholder project based on the OECD Guidelines to agree on practical sector guidance. For example, one of the proposed due diligence points is that in instances in which the buyer changes the specifications of orders, it should also amend the lead time to reduce the risk of unauthorised subcontracting (OECD, 2016b).

These challenges are, of course, not endemic to this one particular sector, but rather stem from general non-compliance with the 2012 Labour Law, weak labour inspections, and in some cases also from the fact that the law itself is not fully aligned with international standards, particularly around the questions of freedom of association and assembly. Viet Nam has committed to significant labour reforms as part of the EU FTA and TPP commitments and the related bilateral agreement with the United States, *Plan for Enhancement of Trade and Labour Relations*. These reforms are expected to be based on major revisions to the law, as well improved enforcement measures, such as building the capacity of the labour inspectorate or establishing a complaint mechanism at the Ministry of Labour, Invalids, and Social Affairs and Departments of Labour, Invalids and Social Affairs (USTR, 2015b). For example, the number of permanent labour inspectors is expected to increase to 750-800 by the end of 2016 and to 1200 by the end of 2020, up from 500 at present.

Combined with these reforms, actively promoting RBC among Vietnamese businesses and raising awareness about the obligations that their international patterns are under, can be decisive for ensuring better conditions and maximising the development potential of FDI in Viet Nam. Strengthening the capacity of workers to voice concerns, through promoting, for example, firm-level grievance mechanisms as a complement to the complaints mechanism by the Ministry and the Departments of Labour, Invalids and Social Affairs, is also important. Although resources, knowledge and capacity to implement RBC principles and standards may be more limited in SMEs compared to larger businesses, it can also be more straightforward and easier to implement.

Building on the recommendations from Chapter 6, the government should consider including RBC principles and standards in the design of the systematic and well-institutionalised industry-specific training programmes for supporting industries, in collaboration with the business community and educational institutions. This could encompass everything from promotion to capacity building exercises to supporting cross-sectoral learning efforts (for example, supporting cost-sharing efforts within and among industries for specific due diligence tasks, participation in initiatives on responsible supply chain management and cooperation between industry members who share suppliers).

RBC expectations should also be included in FDI attraction efforts and may help attract MNEs that are more inclined to source locally. One element of supplier databases and matchmaking events could be RBC, in line with the recommendation from Chapter 6 that central and provincial investment promotion authorities increase efforts to facilitate information exchange between foreign and domestic firms. Additionally, training and awareness-raising with business leaders could also be useful in promoting a wider understanding and recognition of the importance of RBC. Educational institutions such as business schools and existing business initiatives pursing social objectives can also be important platforms. Finally, the authorities should make educational and training programmes more market driven by increasingly involving the private sector in human resource development policies and encouraging internal and external training by employers. Communicating to enterprises that contributing to human capital formation (in particular by creating employment opportunities and facilitating training opportunities for employees) is a pillar of RBC – and recognising those that do it – can serve as a good incentive.

Protecting the environment without hurting competitiveness

Chapter 8 describes in detail the extent of Viet Nam's legislation related to protecting the environment and recent measures to promote green growth.

The 2014 Law on Environmental Protection represents a significant improvement in the legislative and regulatory framework related to the environment. Several provisions and key concepts were enhanced and include more details, for example, provisions related to strategic environmental planning and assessments or the extent and division of responsibilities of different authorities for regulating environmental impact.[7]

In general, legislation on environmental protection is considered to be advanced in Viet Nam; however, environmental damage remains an issue, mainly due to weak enforcement and monitoring, as well as low levels of awareness and compliance with laws and regulations. Viet Nam ranks 131 out of 180 on the 2016 Yale *Environmental Performance Index* which ranks countries' performance on high-priority environmental issues in two areas: protection of human health and protection of ecosystems - suggesting an urgent need to close the enforcement and compliance gaps. Although this ranking is fairly low, among ASEAN member states, Viet Nam has the highest 10-year percentage change (see Table 9.2). Recent environmental damage, allegedly connected to industrial activity and FDI, have featured prominently in domestic and international news.[8] Adding to the urgency of the issue, Viet Nam is also particularly vulnerable to climate change impacts.

Table 9.2. **Rank of ASEAN members, 2016 Yale Environmental Protection Index**

Rank	Country	2016 Score	10-year percent change
14	Singapore	87.04	-0.43
63	Malaysia	74.23	13.05
66	Philippines	73.7	16.36
91	Thailand	69.54	17.68
98	Brunei Darussalam	67.86	19.28
107	Indonesia	65.85	10.45
131	**Viet Nam**	**58.5**	**20.67**
146	Cambodia	51.24	17.52
148	Lao PDR	50.29	8.52
153	Myanmar	48.98	1.3

Source: 2016 Yale Environmental Protection Index

One policy area where more clarity, better practice and better co-ordination between relevant authorities could bring immediate benefits is the implementation of the regulations on environmental impact assessments (EIAs). EIAs are an important tool for examining, mitigating and preventing potential environmental impacts of business activity. Under the 2014 Law on Environmental Protection, all projects that could have a significant environmental impact are required to undertake an EIA in the project preparation stage. Project owners are required to consult with regulatory agencies and directly affected communities. The Ministry of Natural Resources and Environment has the authority to verify EIAs when it comes to investment projects subject to National Assembly, Government and the Prime Minister approval, as well as any interdisciplinary or inter-provincial projects (See Chapter 2, Table 2.1, on Investment registration and approval under the 2014 Investment and Enterprise Laws). Ministries and quasi-ministerial agencies also have the authority to inspect the EIA when it comes to projects linked to their area of authority. Similarly, provincial authorities should verify the EIA when it comes to investment projects within their territories.

In practice, however, it has been reported that this process is not straightforward and that the administrative complexity and sometimes discretionary decision-making impedes the correct assessment of the true extent of possible environmental impacts of proposed projects.[9] The mandates of national and provincial authorities overlap and remain unclear in practice, as do the direct responsibilities for follow up and monitoring activities. Additionally, awareness of community members and stakeholders about good project management practices and environmental protection seems in general quite low. Exacerbating the issues is also the non-uniform quality of EIAs themselves and the lack of a database or monitoring system to track them. Concerns have also been raised around limited technical capacities of the authorities particularly when it comes to projects in industries that are new in Viet Nam (MONRE, 2015). The result is that projects may be approved without having met the necessary legal requirements.

Taking due account of the need to protect the environment and public health and safety is a pillar of acting responsibly under international RBC principles and standards (see OECD Guidelines Chapter V). This entails sound environmental management that aims to control direct and indirect environmental impacts of business activities; establishing and maintaining appropriate environmental management systems; improving environmental performance; being transparent about the environmental impacts and risks, including also reporting and communicating with outside stakeholders; being proactive in avoiding environmental damage; working to improve the level of environmental performance, even where this may not be formally required; and training and education of employees with regard to environmental matters, particularly when it comes to human health and safety. The private sector could also advise on the technical requirements and capacities for in designing and implementing industry-wide environmental standards.

Box 9.5. **Debunking the Pollution Haven Hypothesis**

2016 OECD report *Do environmental policies affect global value chains? A new perspective on the pollution haven hypothesis that* examined the impact of environmental policies on global value chains has shown that countries that implement stringent environmental policies do not lose export competitiveness when compared to countries with more moderate regulations. High and low pollution industries and trade in manufactured goods between 23 advanced and six emerging economies from 1990-2009 were examined, and data on the domestic value added in exports from the OECD-WTO Trade in Value Added (TiVA) dataset was included in the analysis.

The findings suggest that emerging economies with strong manufacturing sectors could strengthen and implement environmental laws without denting their overall share in export markets. High-pollution or energy-intensive industries would suffer a small disadvantage, but this would be compensated by growth in exports from less-polluting activities. These results are compelling evidence against the so-called Pollution Haven Hypothesis, which suggests that tightening environmental laws often prompts manufacturers to simply relocate some production stages to countries with lower regulations.

Source: Koźluk and Timiliotis, 2016

In addition to improving how projects are assessed, the authorities should communicate the extent of business responsibilities for protecting the environment in strategic documents on the environment, for example in the strategic and environmental protection plans, at both national and provincial levels.

Finally, it should be noted that environmental and social risks are not exclusively connected to low value-added industries. This is of particular relevance to Viet Nam as it continues to promote higher value-added industries. International organisations and academics have expressed concerns about how understudied environmental and occupational health and safety impacts associated with high-tech and electronics industry are. Concerns permeate the entire supply chain and include everything from worker exposure to hazardous and toxic chemicals during the production process to the associated risks with an ever-increasing volume of industrial and hazardous waste (such as electrical and electronic waste).

For example, a recent epidemiologic review published in the *International Journal of Occupational and Environmental Health* looked at health impacts of semiconductor production. Most evidence suggests reproductive risks (*e.g*. congenital malformation and reduced fertility) from fabrication jobs, while noting that, although chemicals are suspected as causal agents, knowledge about the likely contributions from specific exposures is still limited. The study also looked at available studies of cancer risks and did not necessarily find a causal relationship, but nevertheless cautioned that available studies had serious limitations, such as information bias, that could be associated with underestimation of the risks (Kim *et al*, 2014). Similarly, a 2012 ILO study on e-waste raised serious concerns with the way that e-waste is managed globally, noting that developing economies are disproportionately affected by the environmental and health risks linked to its recycling and disposal. The "hazardous, complex and expensive to treat in an environmentally sound manner" recycling and disposal process, combined with general lack of e-waste regulation, prevalence of informality in employment and manual disassembly and recovery of materials, has serious implications for the environment and the health of workers on this end of the value chain. There are also concerns about the prevalence of child labour in the sector (ILO, 2012).

Viet Nam is unfortunately not immune to these issues. Hazardous working conditions and adverse environmental impacts related to e-waste have been reported despite existing regulations (IndustriALL, 2015; VN News 2014; ILO, 2012). The government is taking measures to address the problems. In addition to the broader labour reforms, the new Law on Occupational Safety and Health, in effect as of July 2016 and applying to the informal economy, has been lauded by the ILO as a significant milestone but enforcement will be a challenge (ILO, 2015). Viet Nam is also phasing in programmes such as the Extended Producer Responsibility programme that gives producers the responsibility – financial and physical – for the treatment or disposal of post-consumer products.

Some characteristics of the electronics supply chain are similar to textiles and garment supply chain, such as short product and production cycles, fast-changing and sometimes seasonal consumer demands, and high incidence of temporary and other forms of employment. This is why promoting better business practices broadly and encouraging cross-sectoral learning, as mentioned in the previous section, can be beneficial. For example, solutions and measures proposed for the electronics sector echo discussions in other sectors, i.e. better co-ordination between buyers and suppliers, paying attention to peaks in demand and improving planning and others (ILO, 2014).

Leading by example – RBC and the practice of state-owned enterprises

Governments should lead by example and model RBC principles and standards in their own practices, *i.e.* as employers, business partners, through procurement and contracting practices, and in commercial activities, including activities of SOEs. Not only is this in the public interest, it also enhances the government's legitimacy when making recommendations on

RBC to businesses. The OECD Guidelines apply to all entities within the enterprise in all sectors, whether of private, state or mixed ownership. The same is true for the UN Guiding Principles, which apply to all states and all enterprises. UN Guiding Principle 4 even stipulates that "States should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State agencies such as export credit agencies and official investment insurance or guarantee agencies, including, where appropriate, by requiring human rights due diligence" (UN, 2011).

A 2016 report by the UN Working Group on Business and Human Rights examined the practices with respect to current RBC and business and human rights practices of SOEs and found that there is a general lack of attention to RBC issues and that policies, guidelines and good practices are lacking at both the international and national levels (UN, 2016). Considering the significant role that SOEs play in the Vietnamese economy, explicitly integrating RBC in SOE operations would be a good way to address some of the governance and reputational challenges identified in Chapter 6. Not only would this set an example for other enterprises, it would also increase disclosure and transparency, and could help address some concerns in priority sectors such as infrastructure. For example as already noted in this review, the number of SOEs in the infrastructure sector is high and their relatively weak corporate governance practices are likely to constitute a further barrier for private investments in infrastructure. Integrating practices like due diligence for environmental and social risks, improving processes related to stakeholder engagement, and promoting disclosure and transparency, could go a long way in mitigating risks associated with this sector in Viet Nam, particularly related to conflicts that have been reported around land allocations or lack of engagement with affected communities (US Department of State, 2015).

The importance of RBC in SOE activities has been recognised beyond OECD Guidelines and the UN Guiding Principles. The 2015 OECD *Guidelines on Corporate Governance of State-Owned Enterprises* (SOE Guidelines) recommend that the state ownership policy fully recognise SOE responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders, as well as to make clear any expectations the state has in respect of RBC by SOEs (OECD, 2015b: V). The SOE Guidelines further recommend (and rely on the Board of Directors to the executive management) extensive measures to report on foreseeable risks, including in the areas human rights, labour, the environment, and risks related to corruption and taxation. The government should establish expectations on RBC and should publicly disclose these expectations, as well as establish mechanisms for their implementation.

Box 9.6. **Protecting World Heritage Sites in Viet Nam**

According to the UNESCO *Convention concerning the Protection of the World Cultural and Natural Heritage,* World Heritage Sites (WHS) are considered to be of outstanding universal value to humanity and of "significance which is so exceptional as to transcend national boundaries and to be of common importance for present and future generations of all humanity" (UNESCO, 2012).163 States, including Viet Nam, are parties to the UNESCO Convention. Each State identifies and nominates properties on their national territory to be included on the WHS list. 1031 properties are currently protected under the convention, including 229 natural and mixed sites.[10]

A 2016 report by the global conservation NGO, World Wildlife Fund (WWF), has found that almost half of these natural and mixed sites face significant threats from industrial activity in and around the sites. The report lists 114 sites with either overlapping oil, gas or mining concessions or listed as being under "high threat" or "very high threat" from at least one harmful industrial activity by the International Union for the Conservation of Nature, an advisory body to UNESCO. According to the report, these activities are often, but not exclusively, conducted by MNEs and their subsidiaries, with impacts often long-term or permanent. Examples include oil and gas extraction using large drills and platforms; large-scale mechanized mining; illegal logging; large-infrastructure projects; overfishing through the use of large vessels and machinery; and unsustainable water use, such as from the construction of poorly planned dams (WWF, 2016).

Two sites in Viet Nam were identified as under threat, namely the Phong Nha - Ke Bang National Park and Trang An Landscape Complex, respectively from logging/wood harvesting/infrastructure projects and dams/water management/water use (unsustainable water use). The 2014 Viet Nam Law on Environmental Protection recognises the importance of wildlife sanctuaries, national parks, historical and cultural monuments, world heritage sites, biosphere reserves, scenic beauty areas, and has several safeguards to protect them; however, enforcement is a known challenge.

WWF has called on governments to take a leading role in ensuring that these sites are protected though integrating a long-term and sustainable development perspective in their management; incorporating ecosystem and biodiversity value into national and local planning and development strategies; ensuring that local populations who depend on these sites are in full agreement with any proposed projects; defining clear buffer zones for extra protection; and ensuring accountability for businesses. WWF has also called on businesses to act as responsible stewards of natural capital and comply with recognised RBC principles and standards, such as the OECD Guidelines and IFC Performance Standards (particularly Standard 6 on biodiversity conservation and sustainable management of living natural resources).

Finally, as also noted in Chapter 4, Viet Nam should consider strengthening disclosure requirements and rules for non-financial information in general.

SOEs should lead by example. Clear and complete information on the business is important to a variety of users, from shareholders to workers, local communities, governments and society at large. Many businesses already provide information on a broader set of topics than financial performance and consider disclosure of non-financial information a method by which they can demonstrate a commitment to socially acceptable practices. Additionally, the process of gathering and thinking through data pieces needed for effective non-financial disclosure is not only relevant for communication and reporting, but also serves as invaluable input for strategic planning, decision-making, and risk management. Information on environmental and climate change matters should also be incorporated into these requirements. Corporate climate change reporting is relevant for design and implementation of long-term actions aimed at reducing greenhouse gas emissions. A majority of G20 countries have some kind of mandatory corporate reporting scheme in place or in preparation that requires disclosure of some climate change related information. This information can be used for multiple policy purposes, from informing consumer decisions to assessing performance against policy objectives, investment analysis and risk analysis (OECD, 2015c).

Notes

1. For example, the latest strategy of the European Commission, *A renewed EU strategy 2011-14 for Corporate Social Responsibility*, uses CSR in broad terms in line with RBC. In practice, the difference is an issue of semantics. Both RBC and CSR (if used beyond philanthropy) aim to promote the same idea - that businesses should consider the impact of their activities beyond just the impact on the company itself.

2. The research shows that the major functions of such treaty language are, in the order of prevalence: (i) to establish the context and purpose of the treaty and set forth basic responsible business conduct principles through preamble language; (ii) to preserve policy space to enact public policies dealing with responsible business conduct concerns; and (iii) to avoid lowering standards, in particular relaxing environmental and labour standards for the purpose of attracting investment.

3. Japan-Viet Nam IIA, Art. 21.

4. See the case submitted by the International Federation for Human Rights and the Vietnam Committee on Human Rights in front of the European Ombudsman regarding the European Commission's alleged failure to carry out a specific human rights impact assessment in relation to Vietnam:

www.ombudsman.europa.eu/en/cases/decision.faces/en/64308/html.bookmark#hl4; https://www.fidh.org/en/international-advocacy/european-union/joint-fidh-vchr-observations-on-the-opinion-of-the-commission-on-the.

5. See the recent civil society letter sent to the negotiating partners related to intellectual property and access to medicine, www.msfaccess.org/content/civil-society-letter-countries-negotiating-regional-comprehensive-economic-partnership-rcep.

6. See Session Note from the 2016 Global Forum on Responsible Business Conduct on Aligning Fiduciary Duty And Responsible Business Conduct In Institutional Investment, http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/2016-GFRBC-Session-Note-Fiduciary-Duty.pdf.

7. Notably, instructions on environmental impact assessments were included and expanded on in Decree No. 18/2015/ND-CP *On Environmental Protection Planning, Strategic Environmental Assessment, Environmental Impact Assessment And Environmental Protection Plans*.

8. See recent news coverage around mass fish deaths along the central coast, https://www.theguardian.com/environment/2016/apr/21/vietnam-investigates-mass-fish-deaths-pollution; http://atimes.com/2016/05/vietnams-mass-fish-kill-isnt-simply-an-environmental-disaster/.

9. See recent news reports: Loose management of FDI blamed for environmental disasters,http://english.vietnamnet.vn/fms/environment/156965/loose-management-of-fdi-blamed-for-environmental-disasters.html; and Alarm Sounds on Environmental Pollution Caused by FDI Firms, https://www.vietnambreakingnews.com/2016/05/alarm-sounds-on-environmental-pollution-caused-by-fdi-firms/.

10. As of 16 June 2016; http://whc.unesco.org/en/list/.

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