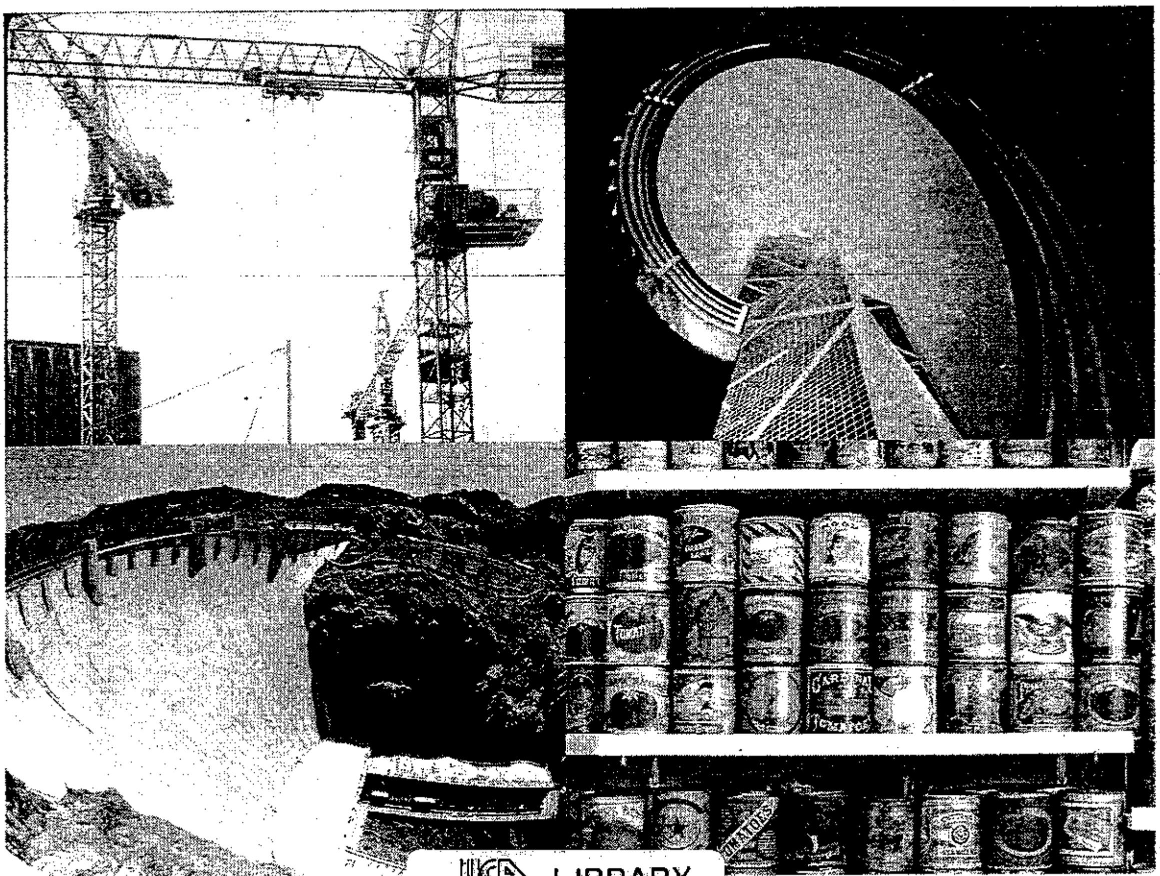
MPI Ministry of Planning and Investment

JICA Japan International Cooperation Agency

The Study on FDI Promotion Strategy in the Socialist Republic of Vietnam



FINAL REPORT

March 2003

Ministry of Planning
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TABLE OF CONTENTS

Abbreviations and Acronyms

ADB	Asia Development Bank
AFTA	ASEAN Free Trade Area
AIC	Administration for Industry and Commerce
APEC	Asia Pacific Economic Co-operation
APP	Annual Priorities Plan
ASEAN	Association of South East Asian Countries
BCC	Business Cooperation Contract
BOT	Build - Operate – Transfer
BSP	Bangko Sentral ng Pilipinas
BT	Build – Transfer
BTO	Build - Transfer – Operate
BUILD	BOI Unit for Industrial Linkage Development Project
CCM	Consultive Committee Meeting
CEE	Central Eastern Europe
CEPT	Common Effective Preferential Tariff
CJV	Contractual Joint Venture
CKD	Complete knock down
CEO	Chief Executive Officer
COFERT	Commission for Foreign Economic Relations and Trade
CRD	Commercial Registration Department
DPI	Department of Planning and Investment
ECA	Eastern Europe and Central Asia
EPZ	Export Processing Zone
EU	European Union
EVN	Electricity of Vietnam
FAO	Food & Agriculture Organisation
FCDU	Foreign Currency Deposit Units
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprises
FOB	Free On Board
FOE	100% foreign owned enterprise
GDI	German Development Institute
GDP	Gross Domestic Product

GIZ	General Industrial Zone
HCMC	Ho Chi Minh City
HCMC ITPC	Ho Chi Minh City Trade and Promotion Centre
HEPZA	Ho Chi Minh City Export Processing and Industrial Zones Agency
HR	Human Resource
HTZ	High Technology Zone
IBID	International Bank Investment Development
ICA	Industrial Co-ordination Act
ICT	Information and Communication Technology
IEAT	Industrial Estate Authority of Thailand
IKD	Incomplete knock down
IMF	International Monetary Fund
IPA	Investment Promotion Agency
IPC	Investment Promotion Council
ITPC	Investment and Trade Promotion Centre
IZ	Industrial Zone
JBIC	Japan Bank for International Cooperation
JETRO	Japan External Trade Organisation
JV	Joint Venture
KISC	Korea Investment Service Center
KOTRA	Korean Trade Investment Promotion Agency
LAC	Latin America and Caribbean
LUR	Land Use Rights
M&A	Merger and acquisition
MB	Management Board of Industry Zones and Export Processing Zones
MENA	Middle East and North Atlantic
MIDA	Malaysia Industrial Development Authority
MIGA	Multilateral Investment Guarantee Agency
MITI	Ministry of International Trade and Industry
MNC	Multi national company
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MoT	Ministry of Trade
MPI	Ministry of Planning and Investment
MSC	Multimedia Super Corridor
NEDA	National Economic Development Authority
NET	Natural Economic Territories
NIE	New Industrial Economies

OCC	Open Coastal City
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PC	People's Committee
PERC	Political and Economic Risk Consultancy
PIT	Personal Income Tax
PwC	PricewaterhouseCoopers
RO	Representative Office
RTF	Revolving Trade Facility
SAFE	State Administration for Foreign Exchange
SBMA	Subic Bay Metropolitan Authority
SEC	Securities and Exchange Commission
SEZ	Special Economic Zone
SOE	State Owned Enterprise
Thai BOI	Thai Board of Investment
TI	Transparency International
TNC	Transnational companies
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organisation
VAT	Value Added Tax
VNPT	Vietnam Post and Telecom
WAIPA	World Association of Investment Promotion Agencies
WTO	World Trade Organisation

TABLE OF FIGURES

PREFACE

In the socio-economic development strategies and plan of Vietnam, Foreign Direct Investment (FDI) is considered as an integral part of Vietnam's economic development. However, FDI inflow over the past five years has been lower than expected while administration and management in this field had some impediments and weaknesses. Although investment environment in Vietnam tends to be improving after 1997 when Asian currency crises assaulted the regional economy, the level of FDI inflow is still modest if compared with neighboring countries. It is, therefore, indispensable for the Government of Vietnam to formulate a new and effective FDI promotion strategy in line with industrialization policy of the country.

Amongst investors in Vietnam, Japan is the 3rd largest country in terms of licensed investment capital and even the largest in term of capital disbursement, while Japan is the largest trade partner and the top bilateral official development assistance (ODA) donor with Vietnam. Thus, Japan is expected to continue to play a leading role in investing in Vietnam as well as assisting the country in promoting FDI.

Under such circumstances, the Ministry of Planning and Investment (MPI) of Vietnam and the Japan International Cooperation Agency (JICA) signed an agreement for the implementation on the Study on FDI Promotion Strategy in the Socialist Republic of Vietnam. For an effective implementation of the study, JICA Vietnam commission to an Expatriate Consultant (GlobalGroup21 Japan Inc.) and a Local Consultant (PriceWaterhouseCoopers (Vietnam) Ltd.) to carry out this study.

The study focuses on developing an investment promotion strategy in Vietnam through the assessment of the investment environment in comparison with neighboring countries. In this study, industry sector analysis and legal framework is also conducted aiming at (i) improvement in the investment environment and (ii) effective marketing activities.

For the improvement of the investment environment, one of the key issues is laws and regulations related to FDI. Whereas consistent and continuously improved laws and regulations secure investors' confidence, it matters more that the actual application and implementation of such laws and regulations are properly carried out. Another key issue is the difference of problems faced by investors according to industry sectors. The study touches upon the above issues and identifies types and kinds of industries that have comparative advantages hence to be promoted with priority and at the same time targeted to specific country's investors including Japan.

Given the importance of the FDI promotion activities as special kinds of goods that need to be advertised, an Investment Promotion Agency (IPA) was highly recommended in the study. A clear marketing strategy with a concrete action plan is preceded by effective methodology based on the clear understanding of advantages and disadvantages of industries in Vietnam, comparing amongst the regional countries.

In completion of this work, we would like to express our sincere thanks to those who deeply devoted to the development of this study. These include Mr. Izumi Sakaya, the Expatriate Consultant; the Local Consultant Team, headed by Mr. Kenneth Dewoskin;

and the MPI Task Force and JICA Project Team, especially Mr. Nguyen Bich Dat and Mr. Akira Matsumoto who all the time had provided the team with their valuable comments. The role of the MPI, particularly, was not only limited to providing necessary information, review and comments on the report. The MPI was also actively involved in developing of the strategy and action plan. In order to have an objective assessment and to make appropriate recommendations, various interviews with certain foreign investors, industrial zone developers, industrial management boards and also investment promotion agencies were carried out to identify the perception gaps between the Government and the foreign investors. Special thanks are due to those interviewers who honestly provided us with their views and opinions. They are in the following provinces: Ho Chi Minh City, Hanoi, Dong Nai, BaRia-Vung Tau, Binh Duong, Haiphong, Vinh Phuc and Da Nang. Last but not least, our appreciation is also for those international organizations that provided us with their previous related studies, such as Embassy of Japan, JETRO, MIGA, UNIDO, JBIC, World Bank etc.

Our hope is that this study will be a useful reference for the relevant Vietnamese agencies in theirs efforts of improving the FDI promotion activities. We highly expect to continuously receive the support of the concerned agencies in the course of implementation of the results and recommendations in this study.

M. Kanamaru

Morimasa KANAMARU
Resident Representative
JICA Vietnam Office

EXECUTIVE SUMMARY

1. With total registered capital reaching over US$39 billion by 2002, foreign direct investment is critical to Vietnam's economic development. Japan is the largest investor in terms of implemented capital. However, Vietnam has recently experienced a decline in foreign investment and this issue needs to be addressed.

2. Vietnam's investment environment remains characterised by a number of competitive impediments hindering the ability of Vietnam to attract foreign investment. This includes China's rapid pace of development, and the need to implement tariff reductions required by AFTA. Immediate and sustainable solutions are required to continue to address these matters. While the implementation of the Vietnam-US bilateral trade agreement and commitment to economic reform should put Vietnam in a position to exploit its competitive advantages, this requires a sound and well-implemented foreign investment promotion strategy.

3. The main conclusions of this report are:

   (i) Vietnam needs to set up national IPA to effectively carry out promotion activities;
   (ii) The national IPA should be empowered to drive the image of the country and monitor the promotion activities of agencies designated to carry out investment promotion;
   (iii) There is an urgent need to improve the image of Vietnam as a destination for FDI;
   (iv) Commitment from the highest political leaders is necessary to improve the image and attract more FDI;
   (v) All relevant investment promotion agencies need to improve the quality of promotional tools;
   (vi) Investment generation techniques should include the targeting of investment; and
   (vii) Investor's services as well as the investment environment will need to be improved if FDI promotion hopes to be successful.

This report highlights specific activities that should be done for a foreign investment strategy to be successful.

OVERVIEW OF THE REPORT

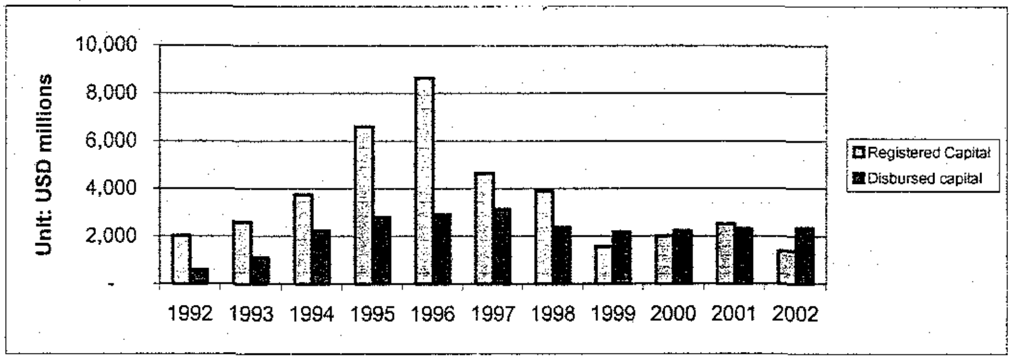
Part I – Assessment of FDI Trends and the Vietnamese Investment Environment

FDI Trends

4. Over the past decade foreign investment has played a key role in the industrial development of Vietnam. Beginning in 1992, the amount of registered FDI increased at a rapid pace reaching its peak in 1996 with total registered capital of US$8.6 billion. This significant increase in FDI reflected the optimistic outlook of foreign investors on Viet Nam as an increasingly attractive destination for investment. During the period 1997-1999, however,

Vietnam experienced a substantial drop in registered FDI, primarily due to the Asian financial crisis. In 2000 and 2001, registered FDI began to pick up, but to levels significantly less than the peak of 1996. A sharp decline occurred again in 2002 (by almost 50% compared with the 2001 level). Although external factors influence foreign direct investment decisions, low local market demand, high business cost and complicated administrative procedures have all contributed to the slowdown in FDI inflows.

FDI inflows in Vietnam from 1992-2002

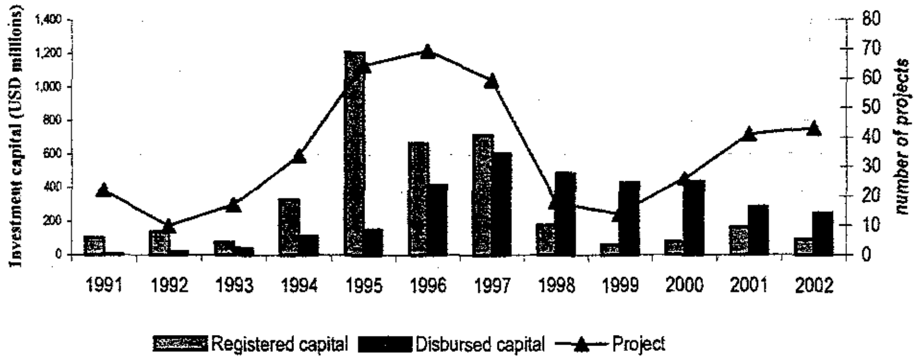


Source: MPI

5. In recent years, the foreign invested sector has accounted for a quarter of the country's total investment and contributes to 34% of industrial output, 23% of the national export (excluding oil and gas), and 13% of GDP. By the end of 2002, foreign investors from over 50 countries and territories have invested in Vietnam with Asia, Europe, and the United States accounting for 60.8%, 23%, and 7% of total investment, respectively. The top five foreign investors are all Asian countries; Singapore, Taiwan, Japan, Hong Kong, and South Korea. However, a portion of the investment from Singapore and Hong Kong actually originated from US and European transnational companies. In 2002, Japan ranked third in terms of registered investment, but in first place for implemented investment. Total implemented capital by Japanese investors is approaching US$ 4 billion.

6. The present amount of Japanese FDI flows into Vietnam, however, is significantly less than before the Asian crisis. FDI inflows increased from 1992-1997, but fell sharply from 1997. In 2002, the total registered capital from Japan accounted for US$ 95 million, which was around 13% of the 1997 level. Although registered capital from Japan has risen over the past three years, it has not recovered to the levels of the earlier period. Japanese FDI in Vietnam is concentrated in all the main industrial sectors and the total share of Japanese FDI in the manufacturing and construction sectors accounts for 71.8% in terms of number of projects and 75.2% in terms of registered investment. The service sector accounts for 21.1% in terms of number of projects and 23% in terms of registered investment. The number of projects has increased, but the average size of each project has declined.

Japanese FDI inflows to Vietnam, 1991 - 2002

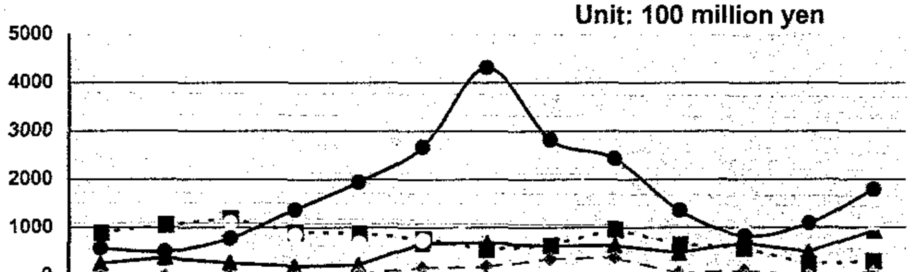


Source: MPI

7. However, compared with other ASEAN countries, the amount of Japanese FDI in Vietnam is still very low. The amount of registered capital from Japan has not only been reduced in absolute terms, but also in relation to other East Asia countries. After the crisis, many East Asia countries implemented more aggressive plans to attract FDI, in particular Japanese FDI, which has been the main the key foreign investor in Asia. This places more pressure on Vietnam to competing with these countries in attracting Japanese investors.

Japanese FDI inflows in selected countries during 1989 - 2001

Unit: 100 million yen



	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Malaysia	902.5	1067	1202	918.7	891.7	771.8	554.6	643.8	970.8	658.1	586.2	256.2	320
Philippines	269.3	383.1	276.5	210.4	235.6	683.4	691.9	629.7	642.5	485	687.9	505.8	945.9
Thailand	1703	1696	1107	848.9	679.6	749.2	1196	1581	2291	1755	909.9	1029	1102
Vietnam	0.23	0.63	0.32	12.69	51.73	177.3	192.4	359.1	381.4	65.25	110	23.64	97.45
China	586.8	511	786.9	1381	1954	2683	4319	2828	2438	1363	837.5	1099	1802

Source: MITI

8. FDI inflows into Vietnam have been affected by declining global trends. The collapse of the high-tech bubble in the United States in mid 2000 resulted in an economic recession in the United States and in the world. The world recession coupled with persistent recession in Japan has particularly affected countries in Asia. The terrorist attack in the United States on

11 September 2001 further exacerbated the global recession. These factors have significant impacted on world FDI inflow, which is an indicator of global economy health and stability.

	1991-1995	1996-2000	1999	2000	2001
	(Billions of U.S. dollars)				
World	1224.2	4626	1320.4	1632.7	851.9
United States	349.1	647.1	155.4	152.4	156
Japan	103.4	127.9	22.3	31.5	38.5
Europe	642	2660.2	762.4	1011.7	394.1
Newly industrialised Asian economies	34.3	72.1	12.6	16	8.1

Source: World Investment Report 2002

Factors affecting foreign expansion plans and site selection

9. Access to the customer is the most critical factor cited by companies in determining their investment decisions.

Critical Factors Determining Investment Location Decision

Access to customer	77%
Stable social and political environment	64%
Ease of doing business	54%
Reliability and quality of infrastructure and utilities	50%
Ability to hire technical professionals	39%
Ability to hire management staff	38%
Level of corruption	36%
Cost of labour	33%
Crime and safety	33%
Ability to hire skilled labour	32%

Source: MIGA – Foreign direct investment Survey – January 2002

10. Over the past few years, Vietnam has made a number of improvements in its investment environment. A recent survey of business sentiment revealed the majority of respondents believe the business outlook will improve in the future. Close to 80% plan to expand in the next three years mainly due to the positive long-term outlook, growing local market and political stability. Over half of the respondents believe it is now easier to do business in Vietnam. There have been significant improvements in exchange rate management and efforts to remove the dual pricing system, as well as improvements in the cost of doing business.

11. Despite the positive outlook, the cost of doing business remains high. An investment cost analysis is set out below. (1 is most expensive and 4 is least expensive)

COSTS OF DOING BUSINESS	Vietnam	China	Thailand	Malaysia	Philippines
Cost/Quality of Power Supply	1	2	3	3	3
Cost/Quality of Water Supply	2	3	3	3	3
Cost of Telecommunication	1	3	3	3	4
Cost of Maritime Transport	1	3	2	3	2
Labour Cost (workers)	4	2	2	1	3
Labour Cost (Mid – level)	2	3	2	1	2
Rental Cost/Quality (Office)	2	1	3	3	4
Rental Cost/Quality (Land Rental in IZ and EPZ's	2	2	4	3	2
Unofficial Costs (administrative fees, corruption)	1	1	3	3	2
Personal Income Tax	1	2	2	3	3
Effective Tax Rate	1	2	2	3	3

PwC' assessment based on results of various studies

12. A SWOT analysis of the overall Vietnamese economy reveals the following:

Strengths	Opportunities
• Favourable geographical location • Abundant natural resources • Abundant low-cost labour • Political stability • General stability	• New Market Access • Possible accession to WTO • China's accession to WTO
Weaknesses	**Threats**
• Impact of geographical location on economic activities • Scattered Natural Resources • Low quality of labour • Backward technology and low productivity of firms • Poor physical infrastructure • Poor institutional capability • Lack of stability, predictability and certainty of policies • Lack of domestic intermediate inputs	• Reduction in tariffs due to regional and global integration • China's accession to WTO • Environmental Impacts

13. Based on an overall assessment of the investment environment, the key impediments reducing the competitiveness of Vietnam and hindering FDI attraction are:

- Lack of comprehensive and consistent legal framework,

- Uncertainty in the tax and legal framework which leads to inconsistent implementation and enforcement practices,
- Lack of long-term planning leading to unexpected changes in policies – the recent motorbike issue has particularly harmed the investor's confidence,
- Lack of transparency leading to corruption and red tape,
- Lack of problem-solving and cooperative attitude among administrative authorities
- Lack of accurate and timely information and statistics affecting business decisions and long term planning by business,
- Poor quality of physical infrastructure
- Limited access to local parts, raw materials and supporting industries leading to high cost of doing business.
- Shortage of skilled labour leading to difficulty in hiring technical and managerial staff.

Part II – Analysis of Laws and Regulations on FDI

14. Vietnam has relatively liberal foreign investment laws compared with other countries such as China, Thailand, Malaysia and the Philippines. However, in some respects these laws make Vietnam uncompetitive. There are a number of legal impediments and suggested initiatives that have been put forward for the review and consideration of the Government of Vietnam. Whilst some of these initiatives have been implemented in order to improve Vietnam's business and investment environment, there remain many outstanding issues that require further consideration and attention in order to significantly address the concerns of investors and increase levels of foreign direct investment.

15. Recommendations regarding investment entry requirements are:

    - Endeavour to implement policies that are relatively transparent, procedurally simple, easy to understand and to ~~the extent possible, uniform (in that they do not require~~ individual assessment and the discretionary decisions of officials)
    - Apply simplified registration procedures to more projects, or to allow the application of the registration procedures to all projects with an aim to have only a registration requirement framework (whereas the current framework requires an approval requirement)
    - Improve the promotion, access and quality of information services with respect to FDI policies, procedures and additional investment information.
    - Reduce the number of government approvals
    - Abolish many kinds of sub-licenses (licenses requested by various national or local authorities in addition to the principal investment license granted to the investor)
    - A 'one-shop' service should be introduced at local authority levels

16. Imposing restrictions that are not referred to in Decree 24 causes confusion to investors. All restrictions should be clearly stated in only one or two legal documents. For example:

    - Moving from a 'positive list' approach that requires lengthy approval procedures (subject to the discretion of official) to a more 'negative list' approach

- The Law on Foreign Investment should be revised to broaden the range, nature and flexibility of forms of direct foreign investment that foreign investors may choose from
- The compulsory form for investments should be removed
- The requirement of minimum ratio of legal capital to investment capital should be abolished.

17. The Land Law should be amended to be in line with the Law on Foreign Investment with respect to the handling of Land Use Rights in cases of enterprise's dissolution or bankruptcy, as the Law on Foreign Investment and Decree 24 reflect the more current policy of the State and are most consistent with international practice and the needs of the Vietnamese economy. The Government should:

    - Create a single body of legal rules applying to both foreign and domestic land users to create a level playing field between domestic and foreign investors
    - Land use right granting procedures should be simplified and the administrative procedure reformed
    - Provinces should coordinate and identify land available for projects, and all land clearance and compensation should be undertaken by the Government for land to be identified for FDI projects

18. Incentive policies need to be clear, transparent and simple. This will reduce the often poor and corrupt management of customs procedures, which are often at the discretion of customs officials that hinder the effectiveness and flow of investment. Tax incentives and customs exemptions should be built into the tax and customs codes of the country.

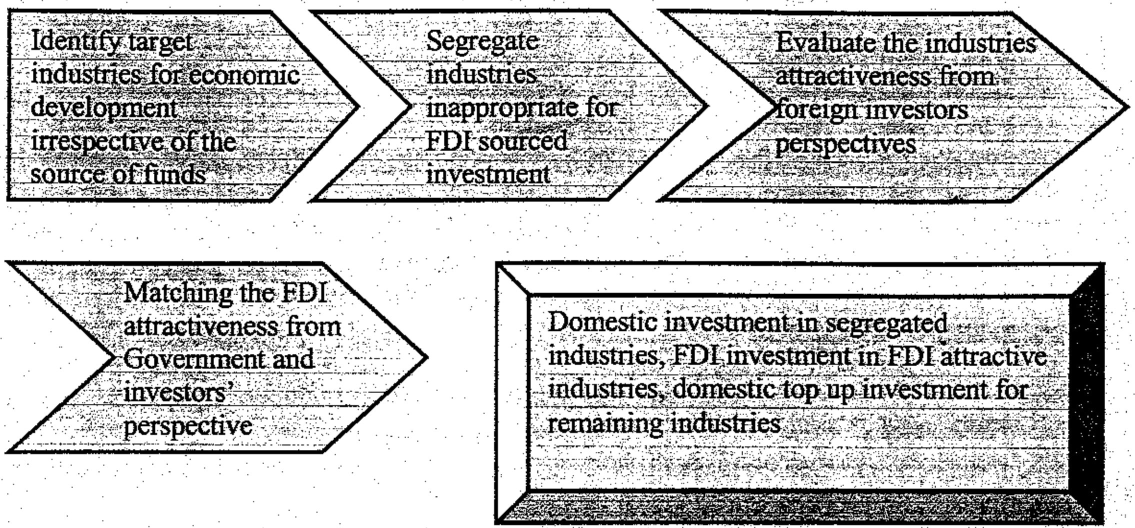
19. The laws, rules and regulations regarding working visas require clarification and the authorities should consider:

    - Issuing longer-term visas for up to 3 – 5 years to ease the administrative burdens of legitimate foreign employees and immigration officials
    - "On arrival" working visas should be available for business people needing to enter Vietnam on short notice and time required to apply should be reduced

Part III – Analysis of Industrial Sectors

20. Allocation of resources for investment promotion will be a fundamental task of the Government. A successful FDI promotion strategy will require a focus on targeting industries. Such a targeted approach can help Vietnam to promote FDI in those areas which best achieve strategic objectives related to such aspects as employment, technology transfer, export and cluster development. This would be in line with Vietnam's industrialization strategy and target to be an industrialized economy by the year 2020.

21. The process of identifying industrial sectors for FDI promotion and overall industry promotion strategy is illustrated in the following flowchart:



22. The industries selected to fall under the category in the first step in the flow chart are ranked and selected by assigning weights and values (High, Medium, Low) for each industry based on the following criteria.

- Essential or crucial to economic development
- Plays a decisive role in implementing socio-economic goals
- Industries will utilise competitive advantages
- Industries can and/or will be able to compete in regional and world markets
- Industries having a high expected growth rate compared with other industries in Vietnam
- Create high value added
- Encourage the utilisation of modern technology
- Should foster job creation
- Must not create negative environment impacts

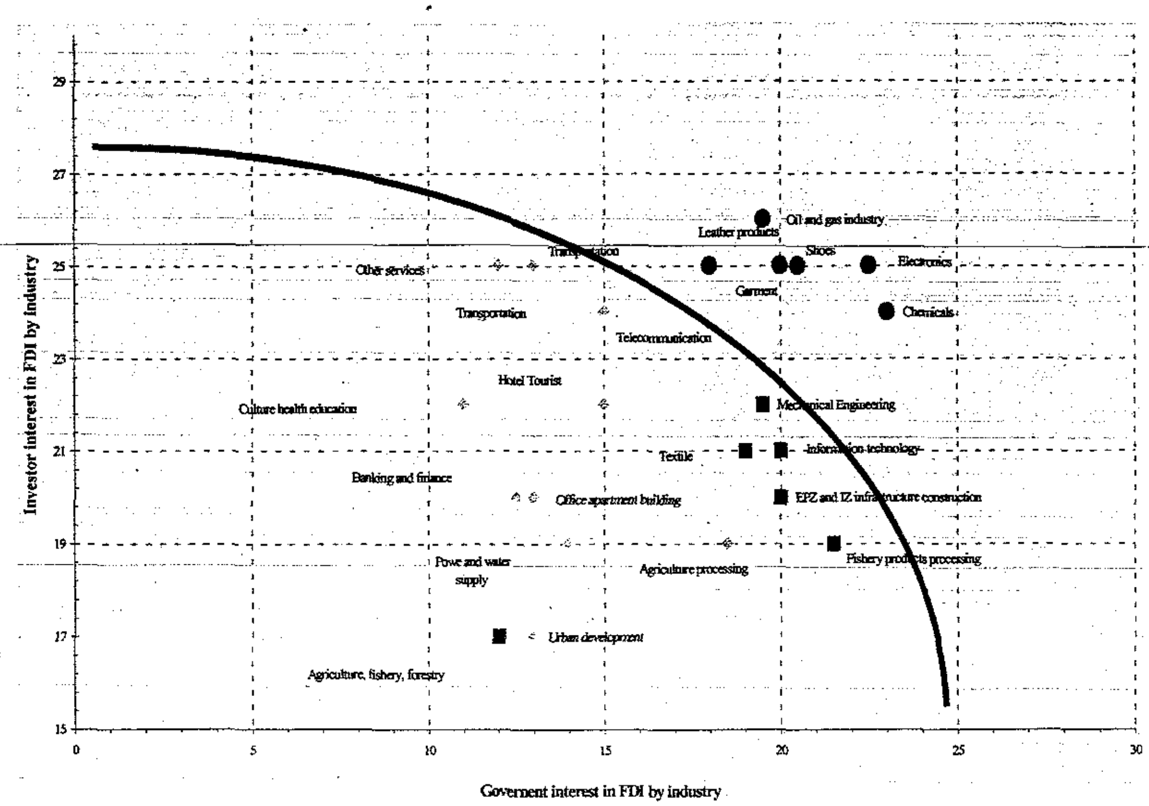
Based on the criteria above and the assigned weights and values, a long list of target industries for economic development irrespective of the source of funds can be determined.

23. The second step in the flowchart is to conduct a similar rating scheme for those industries that could be deemed inappropriate for FDI sourced investment. The criteria used are:

- Control of this industry is in the national interest
- Primary objectives of FDI strategy not met
- Exposes the country to destabilising forces
- Sector already too heavily invested in by FDI

After segregating the industries deemed inappropriate for FDI, the target industries for FDI promotion from the Government perspective can be determined. The third and forth steps are to consider the attractiveness of FDI from the investor's perspective and match these with those industries attractive for FDI funding from the government's perspective. Industries are ranked from the investor's perspective using assigned weights and values based on the following criteria:

- Potential domestic market growth
- Domestic market profitability
- Export potential arising from cost advantages – labour intensive production
- Market access to other countries from this platform
- Alternative countries that meet the same investment objectives - meaning that no investment will ever be required in Viet Nam
- Degree to which FDI is negatively affected by cost of doing business
- Degree to which industry is affected by legal and bureaucratic restrictions
- Estimated pay back period



24. The results of the analysis (outlined in the diagram above) show that the FDI promotion strategy should firstly focus on those industries which are rated High from both the Government's and investors' perspective (above the priority line).

These include:

- Oil and gas exploration
- Electronics
- Chemicals

- Garment
- Shoes
- Leather products

25. Industries which received a Medium rating and may be considered for FDI promotion are:

- Mechanical engineering
- Information technology
- Fishery products processing
- Agriculture products processing
- Textile
- EPZ and IZ infrastructure construction

26. The promotional efforts spent on each of these industries outlined above would depend on the industry specifics. Generally, natural resource-based industries do not require much promotional efforts since not many countries have similar competitive advantages. In addition, companies operating in the natural-resource based industries are mainly large multinational companies, which can easily be identified.

27. For industries that utilise low labour cost, it must be realised that low cost labour is not a sustainable competitive advantage since it can easily be diminished by other high costs of doing business and by increases in productivity. To attract FDI in these sectors, the Government should ensure that it is committed to take appropriate measures to reduce costs of doing business. The FDI promotion strategy should convey this message to foreign investors

28. One additional step that can be used in selecting industries for FDI investment is to identify geographical areas (i.e. the countries) for FDI promotion. The would be based on the following criteria:

- Position of that country in the world and regional market
- Potential plan to expand foreign market of investors
- Possibility to attract new investors
- Cultural and historical ties

29. An rating analysis of the criteria above for Japanese investors reveals that Vietnam should first focus in targeting Japanese FDI into the following industries:

- Mechanical engineering
- Electronics
- Information Technology, and
- Chemicals

Other industries such as oil and gas, garment, shoes and leather products could also be target industries for Japanese FDI.

Part IV - Review of Foreign Direct Investment Promotion Activities in Vietnam

30. In Vietnam, investment promotion responsibility is divided between three different organisations:

    - Ministry of Planning and Investment – responsible for formulating FDI policy and investment promotion strategy for the whole country.
    - Department of Planning and Investment of Provinces and Cities – implements the FDI policy formulated by the MPI and manages the FDI activities within each province, and
    - Management Board of IZs and EPZs (MB) – manages the FDI activities in the IZs and EPZs located in each province.

All three organisations are governmental authorities and have different functions and responsibilities other than investment promotion.

31. There is no single department of the Ministry of Planning and Investment that is responsible for FDI promotion activities. At the provincial Departments of Planning and Investment, a deputy director in charge of FDI heads the foreign investment division, which is responsible for FDI promotion in its location. Ho Chi Minh City has a separate organisation named the Investment Trade and Promotion Centre (HCMC ITPC) and DaNang City has a separate organization called the DaNang Investment Promotion Centre (DaNang IPC). These agencies have been delegated the role of investment promotion in their respective jurisdictions. Management Boards develop and manage the operation of IZs and EPZs, and most divisions in the MB are involved with foreign investors. However, their role in investment promotion is not clearly defined.

32. At present there does not appear to be a clear overall FDI promotion strategy at the national level. There are also coordination problems between the national and sub-national authorities. The Southern provinces seem to be more innovative and creative than the Northern provinces in terms of promotion strategies and programs and place more emphasis on investment promotion (for both domestic and foreign investment). As a result, Binh Duong and Dong Nai, for example, have been more successful in attracting investment.

Examples of Promotion Activities to Promote Foreign Investment

DaNang DPI

- Establishment of DaNang Investment Promotion Centre
- Distribute brochures and CD-ROM
- Organize domestic workshops
- Website
- Overseas mission to Taiwan and Hong Kong

Binh Duong DPI

- Establishment of website
- Overseas missions to EU, Japan, and Korea
- Organise domestic forums
- Pay attention to needs of existing investors

33. The quality of investment promotion activities has been generally low at all levels. Brochures are often poorly designed and information on investment opportunities is difficult to obtain by investors. Whilst many agencies have expressed an interest in setting up a website, many have not yet done so. The websites that are available are often not well maintained and not user-friendly. Although the website of the HCMC ITPC can be regarded as relatively good, the MPI website has only extremely limited information available and quite often out of date. Links do not work or do not contain information claimed to be available. Compared with websites of promotion agencies in the region, the MPI website ranks very low.

34. A number of agencies have participated in overseas seminars, but the cost effectiveness of these seminars is questionable. Most of the agencies realize they do not have the expertise and resources to present quality seminars, and a few individuals even admitted they were somewhat embarrassed at the quality of the seminars presented by Vietnamese authorities when compared to other country presentations. Some agencies have relied on trade organizations in other countries either to help in the organization of seminars or to present the seminars themselves. This method was generally perceived to be a better form of promotion than seminars presented by Vietnamese authorities. One agency in which overseas seminars has been considered an effective promotional tool is the DPI of Vinh Phuc. This success is attributed to the use of successful investors as spokespersons.

35. All agencies recognise the importance of investor services and the fact that satisfied investors are the best promoters. Significant improvements have been made in the pre-licensing process, but post-licensing services are still grossly inadequate and a major impediment to foreign investment. The concept of a one-stop shop does exist, particularly for IPZ's and EPZ's. One factor affecting the efficiency of one-stop shop is the effectiveness of the People's committee that controls the zones. Some People's Committees, such as HCMC and Dong Nai, appear to be quire progressive and relationships between agencies is good. The licensing process is also much simpler as the approval time has been significantly reduced.

36. All agencies reported that they spent significant effort in resolving the difficulties faced by investors. Some DPIs (Binh Duong, Dong Nai, HCMC) hold regular meetings with investors to listen to their problems, but generally issues remain unresolved. Although the investment environment has been improved, the obstacles cited in Part I continue to plague potential and existing investors.

37. The shortage of human resources was pointed out as the main problem of most DPIs and MBs. The Foreign Investment Division of the Hanoi DPI, for example, has only six staff. This division, however, is in charge of all matters concerning FDI, including identifying and attracting foreign investment as well as post licensing services. Qualifications, language capability and lack of marketing skills are also major impediments that diminish the effectiveness of the investment promotion programs. Many staffs at the provincial level do not have an adequate educational background and language skills are in urgent need of upgrading. Most DPIs and MBs recognised the need to further train their staff, but only a few organisations (i.e. Hanoi DPI, HCMC DPI and HCMC ITPC) are able to provide additional training. Financial constraints are cited as the main factor hindering additional training. None of the agencies raised the need for improving marketing skills, although this has been recognised as one of the main weaknesses.

38. Funding is a crucial issue raised by all agencies. All funding for investment promotion at the provincial level comes from the provincial budget. Therefore, the allocation of budget to investment promotion depends on the understanding of the provincial People's Committee of the importance and role of investment promotion and its commitment on FDI promotion. Budget constraints limit the ability of the agencies in carrying out effective promotion activities. In addition, there is no long term budget planning as the budget is only prepared and approved on annual basis. Therefore, it is very difficult for agencies to develop a long-term investment promotion plan.

39. Overall, the effectiveness of most investment promotion programs is very low. This is attributed to:

- No nationally designated investment promotion agency
- No investment promotion strategy at the national or sub-national levels
- Lack of coordination among agencies dealing with foreign investment
- Poor image of Vietnam
- Low quality of investment promotion materials
- Post-licensing services remain weak
- Shortage of qualified staff
- Lack of funding to carry out investment promotion activities
- Poor management of promotion activities.

Part V –Review of Investment Promotion in Selected Countries

40. One of the main issues that governments face in carrying out their investment promotion efforts relates to the nature of the institutional framework that will execute these efforts. In principle, an investment promotion agency can be structured as a government organization, a private sector organization or a quasi - governmental agency. A government could carry out

investment promotion itself (directly as a part of its administrative structure), but this approach has the disadvantage that the government organization may be unable to acquire the skills required to manage the activity properly. The required skills may reside in the private sector and attracting them to the public sector may prove difficult, especially with the salary constraints typical of the public sector. In most countries, investment promotion agencies (IPAs) are part of the government.

41. The mandates and responsibilities of IPAs are varied. In developed countries, the majority of the work of IPAs involves investment promotion. In low and middle-income countries, IPAs may combine domestic investment promotion with export promotion. IPAs in middle and lower income countries also deal with a variety of activities such as image building, investment generation and investor services.

42. Image building can be a useful tool to convey changes in policies and general impressions of a country. A review of image building campaigns from various countries reveals two important aspects:

- Involvement of top political leaders
- Clear and consistent message

In the case where reforms have been implemented image-building activities can correct investors' misperceptions.

43. Investor services are generally divided into pre-investment and post-investment services. The main types of pre-investment services for most IPAs in terms of importance are business matchmaking (strategic alliance, joint ventures, etc), providing domestic market information, and advice on local employment conditions. For IPAs in less developed countries, providing domestic market information is of prime importance. The most important post-investment services for all IPAs are the assistance with registration and licensing followed closely by legal assistance and assistance with obtaining the required work permits.

Part VI – Recommendations to Improve the Effectiveness of FDI Promotion

The Investment Promotion Agency

44. Commitments of the top political leaders and support from all government authorities are crucial for the success of any FDI promotion program.

45. It is highly recommended that Vietnam establish a specific investment promotion agency at the national level to carry out and monitor investment promotion activities. The national IPA, hereafter referred to as the VNIPA, should be a Governmental organisation with ministry status and empowered to drive the image of Vietnam.

46. The VNIPA would function as the main investment promotion agency for the country as a whole. It would also serve as a coordinating agency with local DPI's, People's Committees and management boards of EPZ's and IZ's (hereafter referred to as provincial and local investment promotion agencies) to avoid unnecessary competition and direct investors to local agencies. In addition to the national investment promotion agency, branch offices of the VNIPA should be established in the North, South and Central areas of Vietnam to better

serve the needs of these particular regions. These branch offices would coordinate and assist provincial and local IPAs.

47. The organisational structure of the VNIPA is presented at the end of the summary.

48. The suggested mandate for a national investment promotion agency in Vietnam:

    - Increase contribution of FDI to the economy by informing new investors of the advantages of Vietnam as an FDI destination
    - Facilitate new investments by providing a professional service that enables investors to meet their specific project needs in the various sectors
    - To bring to the attention of the government any actions that could further improve the environment for foreign investors
    - Nurture and assist in resolving problems of existing foreign investors to enable them to expand their current investment

49. The investment promotion agency should also be responsible for working with appropriate policy makers to improve the investment climate. The VNIPA needs to have the authority to make good on promises made to prospective foreign investors.

50. Given the current administrative structure of Vietnam, whereby local government authorities issue most permits and approvals, it would not be feasible for the VNIPA or its branch offices to act as a "One Stop Shop" for approval process. However, it is suggested that the VNIPA should aim to be a "One Stop Facilitation Centre", which provides investors with all information on investment environment, procedures and necessary approvals etc., required for the establishment and operation of their business.

51. The local DPIs and MBs should aim to be "One Stop Approval Centre", which will issue all kinds of license / permits and approvals.

52. A suggested internal structure would consist of the following divisions and associated responsibilities:

DIVISION	RESPONSIBILITIES
Promotion	Investor targeting, conducting publicity and public relations campaigns, producing promotional literature, marketing and advertising. Inward and outbound missions
Investor Services	Investor services and responsibility for individual cases.
Corporate Services	Personnel, training, finance, management information systems, general management
SENIOR MANAGEMENT	RESPONSIBILITIES
Director, Vice-Director Executive Assistant	Strategy, management, relations with other government agencies

It should be emphasized that the quality of staff is more important than the quantity and individuals should be appointed primarily based on their capabilities and less on political considerations. Since the main function of the VNIPA will be to conduct promotion activities, particular attention must be paid to this division. At the national level, all promotion or marketing activities should be done from this division.

53. Since quality of staff is critical to the success of any promotional agency efforts must be made to recruit the best individuals possible, maintain these individuals and improve staff capabilities. The expertise and terms of reference for staff in the promotion division are:

Expertise	Terms of Reference
Information Technology, Marketing	Designing and maintaining VNIPA website.
Economics, Business	Responsible for developing information database. Conduct industrial sector analysis for investor targeting
Marketing, Economics Media	Develop campaigns and investor guides, image building and investment generation. Develop promotional brochure, videos, and CD-ROMs.
Marketing, Politics Media	Responsible for both inward and outbound investment missions. Liaison with potential investment partners.

54. The staff of the investor services division should handle each inward investment case generated by the promotion division or by other means. Ideally a single individual or group should handle each case from start to finish. In addition, the staff of this division should have expertise in the economy, culture, and the language of the investors from a specific region.

55. In order to attract and retain quality staff, the salary offered by the VNIPA should be competitive for the market. It is suggested that a specific salary structure for the VNIPA be developed. This should not be regulated by the salary scheme applicable to state officials. Performance appraisal should also be an important part of the HR policy and compensation system. It is necessary that clear performance criteria be set up for each staff level.

56. It is recommended that an overall training and development program be developed for the VNIPA, which should focus on two areas: technical training and soft skills training. Technical training will aim to improve the technical skills of the staff such as legal, business awareness, language, research techniques, market planning, report writing, analysing techniques, information technology, and marketing techniques. Soft skill training could cover presentation and negotiation, selling and influencing, public relations and handling the media, leadership, management etc.

57. The level of promotion activities carried out by the VNIPA will depend largely on the availability of funding sources. Official development aid and the private sector could be good resources for investment promotion activities. Since investment promotion is a public good, the main funding resource of the VNIPA should be the state budget. Other funding sources should be explored. From international aid these could include:

- Technical assistance in the setting up process, in particular formulating the governance principles, defining the role and responsibility for specific divisions

- Capacity building for the purpose of staff development
- Management information technology to help with improvement of current web sites and the setting up of the investor database

The private sector could provide support in the form of

- Co-operation in issuance of brochures, business guides, newsletters and circulars to be given to potential investors,
- Assist with the maintenance of the websites
- Contributions to the organization of investment seminars and conferences

Investment Promotion Strategy and Activities

58. The recommendation of this report is that there is an urgent need for all institutions in Vietnam designated to carry out investment promotion to adopt and implement an effective FDI promotion strategy. At the national level, the newly established IPA (VNIPA) would undertake this activity, and at provincial and local levels, agencies designated to carry out investment promotion will also need to adopt and implement strategies and promotion activities, albeit at a less extensive level. The VNIPA, however, can play an important role in both coordinating and supporting the activities of provincial and local IPAs.

59. The promotional activities of the VNIPA will involve image-building, investment generation and investor services. The VNIPA is recommended to undertake a high-level image building campaign to dispel negative images and make people, not only investors, aware that Vietnam is open for business and well on its way to integrating into the world economy. The main objective of the image building campaign should be to "*raise the awareness of Vietnam*" and "*improve investors perception*" of Vietnam. This will involve developing a central marketing theme.

60. Active involvement of political leaders in investment promotion will help to improve the image of Vietnam.

61. Additional promotional tools will need to be developed by all IPAs for image building and investment generation. They should develop high quality brochures, investment guides, fact sheets, and newsletters. Priority should be placed on designing and maintaining high-quality IPA websites, as the Internet can be one of the most effective and inexpensive promotion tools. Advertising in foreign media may be advisable, but will depend on cost constraints. Seminars and conferences organized by Vietnamese agencies need to be of a more professional quality. It is recommended that existing investors, who have been successful in Vietnam, be recruited to assist in the activities. The best promotion tool, however, is to restore investors' confidence by improving the investment environment (discussed in Parts I and II).

62. To effectively market Vietnam or a region of Vietnam to specific companies, a database of potential investors should be developed. The VNIPA should be the primary agency involved in the development of the database, but branch offices can serve to provide information. This information should then be utilised by all IPAs, including provincial and local IPAs. To enable better communication between the IPAs, it is suggested that an intranet system be

developed connecting the VNIPA with it branch offices, as well as with overseas branches of the VNIPA (if set up) and/or foreign embassies. This will allow information sharing and better track the progress of potential and existing investors. It will also aid in speeding-up the resolving of issues that may arise.

63. Once potential investors are identified, particular emphasis should be placed on marketing activities directed to these companies. For large or transnational companies, personal contact may be preferable. It is recommended that senior officers in the Government be involved in the development of relationships with these companies. For small and medium size companies, indirect marketing such as mail or the Internet may be more appropriate marketing techniques.

64. Utilizing Vietnamese embassies in foreign countries and professional marketing firms as agents will contribute to a successful promotion program.

65. Pre-licensing services that need to be improved are organizing site visits for investors, provision of information required for site selection and assistance with preparation of investment application documents. All IPAs need to improve the quality of their marketing and business skills to be better able to carry out these activities.

66. For licensing services, the "One-Stop Shop" concept works relatively well, but these services need to be improved for projects where involvement from various governmental authorities is required.

67. Post–licensing services are the most important component of investor services and need to be drastically improved. Aftercare should also be emphasized and suggested activities are conducting regular dialogs with investors, the relevant IPA acting as a "sounding board" and the setting up of an information centre.

68. Since Japan is both currently the largest investor in terms of implemented capital and a priority country for FDI promotion activities, particular emphasis should be placed on attracting Japanese investors. This will involve:

- Improving the investment environment and reduce bureaucracy and administrative burden that plague Japanese investors. Helping existing Japanese investors to resolve their problems is also a useful way to get more commitment from Japanese investors.

- Since Japanese investors prefer to invest in locations where there are a large number of existing Japanese investors, setting up Industrial Zones and Export Processing Zones with good infrastructure, should be a priority.

- Most large Japanese companies have an established supplier network. When production facilities are set up overseas, suppliers often follow. This should be considered in the investment promotion activities of IPAs.

- "Word of mouth" plays a critical role in attracting Japanese investors. Taking care of existing investors will help Vietnam to attract more investment.

- It is recommended that Vietnam have a representative in Japan, whose main duty is investment promotion. That person should have business awareness and marketing skills and understand Japanese culture. Fluency in Japanese is desirable.

- Setting up partnership and networks with business organizations (JETRO, for example), major consulting firms, and Japanese banks will allow Vietnam to build contact with their client base.

- The employment of a Japanese expert as an advisor to the VNIPA

69. On the basis of the FDI promotion strategy for Vietnam as a whole, IPAs specific to each region should adjust their strategy to their specific objectives and situations.

Northern - investment strategies of Northern provinces should place special focus on *image building*, since investors perceive that local authorities in Northern provinces are less pro-active in attracting foreign investment and will need to be aware that authorities are making efforts to increase foreign investment.

Central – investment strategies should focus on investment targeting, since the current economic environment places restrictions on the number and type of investment projects that are feasible. Target industries should focus on niche markets that utilize the competitive advantages of this area. Efforts should be made to increase the establishment of industrial zones to improve the efficiency of the investment and promotion efforts should target industries that can be set up in these zones.

Southern - priority should be placed on investor services and resolving issues of land rights, etc. The focus should be on assisting the existing investors in resolving their problems to facilitate the project implementation.

Proposed Action Plan

70. Set out below is the proposed action plan for the setting up of the national IPA (VNIPA) with the aim to have an established and fully functional IPA by the end of 2004. The proposal is based on the assumption that the VNIPA is first established as a unit under the current MPI.

Immediate action

71. While the VNIPA is being considered and set up, immediate action could be taken by the MPI in improving Vietnam's profile. This includes the development of a national long - term promotion strategy and carrying out investment promotion activities. The proposed key tasks are:

- Improve the quality and effectiveness of the current MPI web sites, brochures, and publications by hiring a professional marketing consultant and providing a dedicated team to support the person. On a national basis this could have immediate results (e.g. by the middle of 2003) plus longer-term results. The marketing consultant would also advise on seminars, media skills. Hiring an experienced image and presentation skills trainer to work with senior public-facing officials would also have immediate results in boosting image and consistent messages,

- Define the marketing theme and develop a comprehensive national marketing strategy – a timeframe of 6-12 months and also the advice of a professional marketing consultant will be required,
- Commence with the design of the investor database. The aim is to have a template by the end of 2003.

From now to June 2003 – Preparation phase

72. The proposed tasks and outcomes for the preparation phase are:

- Preparation and submission of a proposal to the Government for the setting up of the VNIPA and secure the approval thereof,
- Define the legal framework governing the operation, organisation, power and functions/responsibilities of the VNIPA. The aim is to secure a decision issued by the Prime Minister stipulating these areas,
- Develop and obtain approval for the VNIPA's Charter
- Carrying out necessary preparation work.

From June to December 2003 – Setting up phase

73. The proposed tasks and outcome of the setting up phase are:

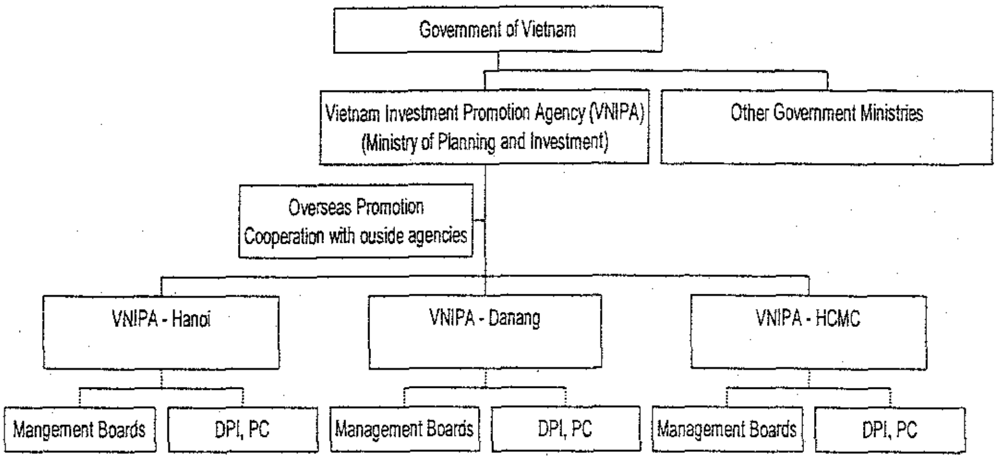
- Appointment of the Advisory Board,
- Appointment of the Director,
- Define the internal structure of the VNIPA including staff requirements, detailed job description, responsibilities and key selection criteria,
- Recruiting key staff (from the current staff at the MPI or new staff),
- Develop the initial framework for human resource policies.

From January to December 2004 – Completion Phase

74. As discussed above, the aim is to have a fully functioning VNIPA by the end of 2004. The main task during 2004 is to continue and complete the work initiated in the setting up phase, including:

- Develop a comprehensive human resource policies including performance management criteria for personnel,
- Carrying out training need assessments, develop and implement a training program. This is an on-going process and needs to be reviewed on an annual basis,
- Define the performance measurement criteria for the VNIPA,
- Building up the network and partnership with other organisations (Vietnamese and foreign) – e.g. IPAs of other countries, business groups in Vietnam such as VCCI, foreign business groups,
- Setting up the branch offices of the VNIPA including detailing powers, responsibilities, and appointment of key personnel..

Proposed Organisational Structure of National IPA (VNIPA)



__________direct control
\-\-\-\-\-\-\-\-\-\-\-\- coordination and assistance role

0 – INTRODUCTION

0.1 Foreign Direct Investment (FDI) and its role in national economic development

0.1.1 Definition of foreign direct investment

Over the past twenty years, foreign direct investment (FDI) has played an increasingly important role in the economic development of a large number of countries. It is now widely recognized that FDI can offer important advantages for the recipient economy. In addition to providing financial resources, FDI can facilitate the transfer of intangible assets such as technology, skills and management know-how, thus helping to directly boost productivity and growth. FDI can also help to secure foreign market access and improve the competitiveness of the local industry.

FDI consist of equity capital, reinvested capital and inter-company debt transaction.

Under the definition and classification of international accounts presented by the International Monetary Fund (IMF) Balance of Payments Manual, foreign investment is classified into the following components: (i) direct investment; (ii) portfolio investment; (iii) other investment.

Foreign direct investment (FDI) is the category of international investment in which a resident entity in one economy obtains a lasting interest in an enterprise resident in another. A lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise.[1]

The OECD Benchmark definition of FDI explicitly specifies that a direct investment enterprise is an incorporated or unincorporated enterprise in which a direct investor owns 10% or more of the ordinary share or voting power. The key feature of direct investment is the intention to exercise control over a firm. However, not all countries use the 10% threshold for defining FDI. Therefore, the statistics on FDI given by different organizations can be different.

There are 3 components of direct investment:

a) Equity capital comprising of legal capital in branches, subsidiaries and other capital contributions.
b) Reinvested earnings in the form of equity or inter-company debt transaction
c) Capital in association with inter-company debt transactions.

There are two basic types of FDI:

[1] See IMF: *Balance-of-Payments Manual*, Fifth edition.

Greenfield investment and M&A are two basic types of FDI.

- Establishment of new company or Greenfield investment (i.e. setting up a new joint venture or wholly foreign owned company).
- Merger and acquisition (M&A) of an existing local enterprise - purchasing shares in equitised and joint stock companies.

This study focuses more on the first type of FDI – i.e. establishment of new companies in Vietnam. In many countries, M&A a very important type of FDI. However, it is not yet a common form in Vietnam due to the restrictions on foreign shareholding in domestic companies. With the reform policies, M&A may become an important type of FDI for Vietnam in the future.

0.1.2 Economic and other benefits from FDI

FDI can bring both direct and indirect benefits to the host country.

FDI can bring to the host countries various benefits. Some are direct and visible. Some are indirect and less easily recognised. The common benefits of FDI include:[2]

- **Job creation** – the most common benefits associated with FDI are increased and protected employment. Together with new employment, additional income and spending power for local residents will come.
- **Revenue benefits** – FDI will widen the local tax base and contribute to Government's revenue. Even if foreign investors are exempted wholly from corporate income tax, the Government can generate revenue from personal income tax and other indirect taxes.
- **Positive impacts on local investment** – FDI inflow will encourage the development of domestic investment since companies have access to distribution channels, or become suppliers or respond to competition from foreign companies.
- **Technology transfer** – FDI can improve a country's access to technology through licensing, joint ventures, and local trade.
- **Improved skilled labour** – Local employees can be exposed to new technical and management skills. This will stimulate higher productivity, entrepreneurship and openness to education.
- **Improved export** – Much FDI is export-oriented. With the size and access to overseas marketing and distribution networks, foreign companies can enter the export market easier than domestic companies. If properly managed, many countries can use FDI as a way to increase their export levels and improve foreign exchange earning.
- **Improved international competitiveness of local firms** – Through the interaction with foreign invested companies, local firms can improve their quality level and reliability and therefore become more competitive in the international market.
- **Increased competition** – FDI can improve the overall economic growth by increasing competition in sectors that are dominated by a small number of local firms.

[2] MIGA – Investment promotion toolkit

0.2 Global and regional development prospects affecting FDI

0.2.1 Global trends

It must be recognised that the globalisation of the world economy has progressed at a rapid pace and firms are able to locate production facilities in many locations in efforts to reduce operation costs.

The globalisation process offers countries with low labour costs such as Vietnam the ability to profit from their competitive advantages and attract more foreign investment. It is important, however, that that countries ensure entry and exist barriers are minimal, other operating costs are reasonable and bureaucratic restrictions of doing business are not excessive. If countries cannot take advantage of these opportunities, they will lose competitiveness and remain behind in global development.

0.2.2 Regional trends

The globalisation process has also resulted in the formation of regional integration schemes such as the EU, ASEAN, APEC etc. These schemes aim to create larger economic areas in which economies of scale can be better realised and comparative advantages improved.

0.2.3 Events that will impact on Vietnam's economy in near future

There are four major changes and events that are currently and will significantly affect the Vietnamese economy in the near future.

- Vietnam's pledge to join ASEAN Free Trade Area and its commitment on tariff reductions
- Vietnam – US bilateral trade agreement
- Vietnam's accelerating WTO accession
- China joining WTO

ASEAN Free Trade Areas (AFTA)

Under AFTA's commitment,[3] Vietnamese tariffs on a vast majority of tariff lines (95%) on ASEAN imports will be reduced to at most 20% by the start of 2003, and to 0-5% by the beginning of 2006. The average tariff on manufactured goods from ASEAN countries will be cut by 50% by early 2004. Average tariff on ASEAN imports of textiles, leather, wood products, non-

[3] Vietnam delivers its Commitments – A Report of the World Bank and Asian Development Bank at the Donors Conference in December 2002.

metallic mineral products (e.g. glass and ceramic products) and food products will fall by more than 60% by early 2004. Other ASEAN countries would also offer the same treatment towards Vietnam imports into their countries. This provides opportunities for Vietnam to have access to the regional market.

The implementation of AFTA commitment is also a threat to Vietnam. Vietnamese companies will have to compete with imported products that have higher quality and lower cost. The Government will no longer impose quantitative measures to protect domestic companies.

Vietnam – US bilateral trade agreement (BTA)

The BTA was ratified in 2001 and is presently being implemented. The BTA calls for a reduction in tariff rates on a limited range of industrial and agricultural products by 30% to 50%, removal of quantitative restrictions on most products in three to seven years, and provisions for more market access by US firms to the service sector. Trading rights for US firms would also be liberalised in three to six years.

Under the BTA, Vietnam has to open up its market including the sensitive sectors such as services, trading, and telecommunication to US companies. Protection of intellectual property rights will have to be enforced. Vietnam will have to eliminate trade-related investment measures (TRIMs) such as local content requirements. Both countries are committed to phase in their obligations on protection of intellectual property rights in accordance with the provisions of Trade Related Aspects of Intellectual Property Rights (TRIPs) Agreement under WTO and other related agreements.

Investment rules will also have to be published in a clear and timely manner with advance notice and time for comment, thus improving transparency of the investment regime. To fulfil the commitments under the BTA, significant changes to the current foreign investment policies are required.

Accelerating WTO accession

Vietnam made its initial offer on specific commitments in services in January 2002. The 5th meeting of the Working Party on accession of Vietnam in April 2002 reviewed the status of Vietnam's bilateral negotiations and action plans for a number of WTO agreements. The 6th meeting held in December 2002 marked the beginning of negotiations for WTO membership.

Accession to the WTO will mean that Vietnam will be committed to the following principles:

- Non-discrimination – all WTO members should enjoy the same Most Favoured Nation status (with some exceptions regarding WTO compliant regional trading agreements) and there is no discrimination treatment between domestic and foreign products, services or nationals;

- Reducing barriers to trade through processes of negotiation;
- Increasing predictability of trade policies by binding commitments to opening markets and reducing barriers, and
- Limiting use of non-tariff trade instruments.

China joining WTO

China officially became member of WTO in 2002.

Global and regional trends, as well as the effect of the events specified above will all have various degrees of impact on attracting and promoting foreign investment. These factors are taken into consideration throughout the analysis in this study.

0.3 Promotion as a tool for attracting foreign investment and implementing FDI policy

0.3.1 The concept of investment promotion

There is a trend to switch from a regulatory to a promotional approach to attracting investment.

FDI inflows cannot be taken as granted. As countries continue to liberalize, transnational companies (TNCs) are attracted to locations that offer the most appropriate conditions. Moreover with an expected downturn in the global FDI flows in the coming years, the competition among various locations for FDI is likely to be more intense.

As a result, there has been a switch from a regulatory to a promotional approach to attracting investment. This has focused on the concept of investment promotion and techniques used and the formulation of strategies to suit different investment requirements and conditions. The increased importance of FDI for economic development and greater competition between locations has made investment promotion a growing activity for not only for developed countries, but also developing countries.

Investment promotion is increasingly sophisticated. It is more than the simple opening up of the domestic market to foreign investors and general promotion of countries. There is no consistent definition of "investment promotion." In a narrow term, investment promotion can be defined as measures to attract foreign direct investment though a marketing mix of product, promotional and pricing strategies.

The product, in terms of investment promotion, is the country – to develop appropriate marketing strategies it is necessary to understand the intrinsic advantages and disadvantages of the country relative to their competitors.

The price is the cost to the investor of locating and operating within the country. This could cover cost of using infrastructure, utilities, tax incentives, tariff protection etc.

Promotion is activities that disseminate information about or attempt to create an image of the country and provide investment services for the prospective investors.

0.3.2 Components of a successful investment promotion

There are three factors influencing a country's ability to win foreign investment:

a) Its policy and market environment
b) Its investment promotion strategies
c) Its institutional structure for implementing these strategies

Investment policy

Investment policy is a combination of economic and commercial policies.

The investment policy environment is determined by a combination of all macroeconomic and commercial policies. However, foreign investors are particularly interested in entry requirements, incentives, foreign exchange and funding policies, access to visas and work permits, land ownership laws, access and availability of physical infrastructure and repatriation and expropriation rights.

In the short and medium term, a separate policy framework for foreign investors may be necessary to attract foreign investors. The trend is to have the same policies for domestic and foreign investors.

Investment promotion strategies and techniques

Investment promotion strategies are concerned with image building, investment generation and investor servicing.

An investment promotion strategy involves the organised use of a range of promotional activities to increase the level of investment in a country.

The investment promotion covers a wide range of activities. However, it can be classified into 3 main groups:

Image building - Image building techniques are used in both domestic and overseas markets to inform investors about a country's investment plans, its policies and incentives, its procedures and requirements and its progress and achievements.

Image building activities include producing and distributing fact sheets, videos, brochures and newsletters, holding briefings and engaging in media relations, public relations and advertising. Image building should be implemented in conjunction with investment generation and investor-servicing activities. Some techniques such as advertising, media and public relations are best implemented by professionals.

Investment generation - Investment generation involves the use of mail and telephone campaigns, investment seminars, missions and direct marketing to individual investors. These techniques can and should be used for audiences both in the host country as well as overseas.

Investor servicing - Investor servicing involves pre-licensing services, licensing services and post-licensing services. These services can be provided in a proactive manner or in a reactive manner.

An investment promotion strategy should combine these techniques in a way that suits the requirements and resources of an individual country. The focus of activities will vary by country and change over time in accordance with changes in the condition and priorities. A common feature of successful investment promotion strategies is a strong emphasis on investor servicing because it is important to ensure that potential projects are translated into actual investment and that satisfied investors attract more investors.

In order to be effective, the investment promotion strategy should be targeted and in line with the overall objective. Targeting involves choosing countries in which to launch the promotion program, sectors and companies. This requires detailed research and planning.[4]

0.3.3 Institutional structure to implement promotion techniques - Investment promotion agency

Setting up an IPA marks the move to the second generation of investment promotion.

As of today, the majority of countries have already moved from the first generation of investment promotion – which mainly involves the opening up of an economy to FDI – to the second generation, in which a Government decides to "market" its location actively. This trend is reflected through the setting up of an investment promotion agency.[5]

According to a survey conducted by UNCTAD in 2001, the number of Investment Promotion Agencies (IPAs) world-wide increased substantially in the 1990s and there are currently 164 national IPAs and well over 250 sub-national IPAs.

IPA is a public organisation and should be supported by the Government.

Investment promotion is not a financially self-sustaining activity. This means resources must come from the Government, although some resources could come from the private sector. This explains why the majority of IPAs are part of the Government.

In promoting specific locations to foreign investors, it is important to have solid

[4] UNIDO – Guidelines for Investment promotion agencies, page 3, 1994.
[5] World Investment Report 2002, Page 221.

knowledge of proposed sites in a particular location and the key factors that may influence investment decisions. Large countries often develop a network of sub-national IPAs, which promote regions, provinces and states within the country.

According to the Survey of Investment Promotion Agencies conducted by UNCTAD in 2000, two thirds of the IPAs surveyed reported a network of sub-national investment promotion offices within the country. Sub-national IPAs are often independent organisations and are not subsidiaries of the national agencies. National IPAs usually play the role of a co-ordinator to avoid unnecessary competition and to direct investors to local agencies. Some of the sub-national IPAs are funded by the national IPA, which receives funding from the central Government. Some are funded from local Governmental authorities.

The core functions of an IPA include investment policy advice and provision of consulting services. Many IPAs are also involved in the licensing process and investment policy formulation.

A favourable investment policy coupled with active & professionally implemented investment promotion is essential to successful investment promotion.

The relative importance of each factor varies from country by country. The policy environment is of paramount importance in a large country with a sizable local market and substantial natural resources. For countries with smaller markets and fewer natural resources, an active investment promotion strategy and having an effective investment promotion agency to implement the strategy is very crucial.

The practice has shown that a favourable investment policy framework coupled with an active and professionally implemented investment promotion strategy are essential to successful investment promotion. The experiences on attracting increased FDI flows of developed and developing countries suggest that there are two issues to be undertaken by the Government:

- Reform investment policy to ease the difficulties foreign investors face in setting up new projects.

- Establish an investment promotion agency with the clout, independence and resources necessary to formulate and implement an investment promotion strategy that suits the requirements, advantages and resources of the country.

0.4 Objectives and structure of the study

0.4.1 Strategic objectives of Vietnam with regard to FDI

Recognizing the important role of FDI in national economic development, the Vietnamese Government for the first time, issued on 28 August, 2001 a separate Resolution No. 9 on further attracting and improving the efficiency of

During the period 2001-2005, newly registered capital should reach US$ 12 billion.

FDI. The Resolution set out the following objectives for FDI attraction in the period 2001-2005:

- Registered capital of newly licensed projects: Approximately US$12 billion.
- Implemented capital: Approximately US$11 billion.
- By 2005, capital contribution of around 15% of GDP, 25% of the total export turnover, and approximately 10% of the total budget revenue for the whole country (excluding petroleum).

0.4.2 Objectives of the Study

The objectives of this study are to:

a) critically examine and evaluate investment environment and FDI marketing policy/systems of Vietnam in comparison with those of neighbouring countries, with particular references to (i) industry sector-wide analysis and (ii) laws and regulations related to FDI.

b) formulate comprehensive and effective investment promotion strategies, presenting realistic recommendations at concrete policy-measures level.

The study focuses on investment promotion activities of Vietnam. In this regard, the assessment of the investment environment, industry sector analysis and legal framework will be conducted from the investment promotion perspective only. Specific attention will be placed on investment promotion strategies, tools and techniques as well as the institutional structures for the implementing these strategies.

0.4.3 Structure of the Report

Part I of this report begins with an overall review and assessment of the Vietnamese investment environment in comparison with China, Thailand, Malaysia and the Philippines. These countries are considered the competitors of Vietnam in attracting FDI, particularly Japanese investment. It will also review the global and regional FDI trends, which can be used as a basis for developing a targeted FDI promotion strategy.

Part II provides a comprehensive analysis of laws and regulations on FDI and analyses the competitiveness of Vietnamese FDI in reference to selected countries.

Part III conducts an analysis of Vietnam's industrial sectors in light of the development strategies of Vietnam and industries to be targeted in the investment promotion strategy.

An assessment of past and current FDI promotion activities carried out in Vietnam is presented in Part IV. Using this information and examples of investment promotion in various countries (Part V), the final section (Part VI) presents recommendations for a foreign direct investment promotion strategy for the relevant investment promotion agencies (IPA).

0.4.4 Study Methodology

The study was conducted over the period October 2002 to March 2003 by PricewaterhouseCoopers (Vietnam). During this time, meetings were conducted with business groups/associations, embassies and Vietnamese government ministries to obtain information and data on the FDI sector, master development plans and status reports on various industries.

An extensive review of documents/information relating to FDI inflows, future prospects of FDI, investment promotion guidelines, and promotion activities in Vietnam and other countries was also undertaken. The main sources are reports from World Bank (in particular Multilateral Investment Guarantee Agency), UNCTAD, UNDIO, JETRO, JBIC, and websites of investment promotion agencies.

Two additional information-gathering methods were employed.

1. A survey sent to 1013 foreign invested enterprises in mid November 2002 to obtain their opinion of FDI environment and promotion policy in Vietnam. The survey consisted of 39 questions. Both structured and open-ended questions were used.

2. A total of 18 in-person interviews were conducted with DPIs, MBs, and Investment Trade Promotion Centers in Hanoi, Hai Phong, Vinh Phuc, Da Nang, Ho Chi Minh City, Binh Duong, Dong Nai and Baria Vung Tau. The purpose of these interviews was to obtain the comments and feedback from the Government's point of view. Sixteen in-person interviews were also conducted with EPZs and IZs to gather the comments and feedback from the investors' point of view.

PART I: ASSESSMENT OF THE VIETNAMESE INVESTMENT ENVIRONMENT

1.1 Overall assessment of FDI inflows into Vietnam in comparison with China, Thailand, Malaysia and the Philippines

This section will analyse the structure of FDI inflows in Vietnam, the future trends of FDI and compares the investment environment in Vietnam with selected countries – China, Thailand, Philippines and Malaysia.

It must be noted that the study utilizes various data resources; previous research and studies conducted by different organisations and the benchmark and assessment criteria of these studies are not consistent. In addition, the compilation of data and statistics is different, and as a result, there are sometimes large discrepancies in the data. This is particularly true for the Vietnam and China data. The data on Vietnamese FDI structure were based on the information provided by the Ministry of Planning and Investment (MPI). It should be noted that the amount of FDI announced by the MPI also includes the contribution of the Vietnamese party in the joint ventures, whereby the IMF only treats the contribution of the foreign party and offshore loan as "foreign direct investment".

1.1.1 Vietnam

Overview of FDI inflows

Committed foreign capital experienced a sharp drop during 97-99 after reaching its peak in 1997. It rose again in 2000 and 2001, but then dropped by around 50% in 2002.

As a result of the open-door policy and the Government's efforts to encourage foreign direct investment, up to December 2002, 3,669 foreign investment projects were licensed with more than US$39 billion registered capital.[6]

In the 1980s and in the early 1990s, FDI inflows into Vietnam were nominal. By 1991, the total FDI stock in Viet Nam was only US$213 million. However, the amount of registered FDI increased rapidly from 1992 and reached its peak in 1996 with total registered capital of US$8.6 billion. This impressive rise in FDI was due to a number of reasons. Foreign investors were attracted by the potential of a transitional economy with its largely untapped market. In addition, foreign investors were attracted by a number of positive factors such as a large workforce with relatively low labour cost and the high literacy level.

In addition to the internal factors, there were certain external factors contributing to the rise in FDI. The first was a flood of foreign capital into the emerging markets during the late 1980s and early 1990s. Within these markets, South East Asia was a major receiver of FDI. In 1990, Southeast

[6] Vietnam Economic Times, February 2003.

Asia countries attracted 36% of all FDI flows to developing countries. The second force was a flow of foreign capital into the transitional economies of the former socialist bloc, where new business opportunities and profits were thought to exist. The third force was that strong countries (in particular Malaysia, Singapore, Thailand etc.) in the region started exporting capital. As a transitional economy located in Southeast Asia, Vietnam was benefiting from these forces.[7]

Between 1991 and 1996, FDI played an important role in financing Vietnam's current account deficits and contributed towards Vietnam's international balance-of-payments position.

During the period 1997-1999, Vietnam experienced a substantial drop in registered FDI, i.e. by 49% in 1997, 16% in 1998 and 59% in 1999 partly due to the Asian financial crisis. The 5 largest foreign investors in Vietnam were from the Asian region and faced significant difficulties in their home countries. In order to secure business in their home country, they were forced to cancel or delay foreign expansion plans. The crisis also forced the investors to revise downward their expansion to Asia. The crisis also led to the devaluation of East Asian currencies. Accordingly, Vietnam became less attractive for those investment projects focusing on export. In addition, foreign investors realised that the previous forecast on market demand was exaggerated. The hurdles to business also became more apparent.

The amount of registered FDI rose again in 2000 by 25.8% and in 2001 by 22.6%, but this was still less than one third of the 1996 level. The increase in registered FDI in 2000 and 2001 was the result of the Nam Con Son pipeline project (2000) with total investment of US$2.43 billion, and the Phu My BOT Power Plant (2001) with total investment of US$0.8 billion. In 2002, the registered FDI went down to approximately US$ 1.4 billion, representing 54.5% of the 2001 level.

There are various reasons for the FDI decline. Firstly, the global economic recession following the collapse of the high-tech bubble in the United States coupled with persistent recession in Japan seriously impacted the Asian countries.

After the crisis, many ASEAN countries introduced additional incentives and implemented more aggressive investment promotion programs to attract FDI. This further detracted the attention of foreign investors from Vietnam.

Low local market demand, high business cost, complicated administrative procedures were other factors contributing to the slowdown of FDI inflows. At the initial period, many foreign investors had a very high expectation of Vietnam as a large market with approximately 80 million population.

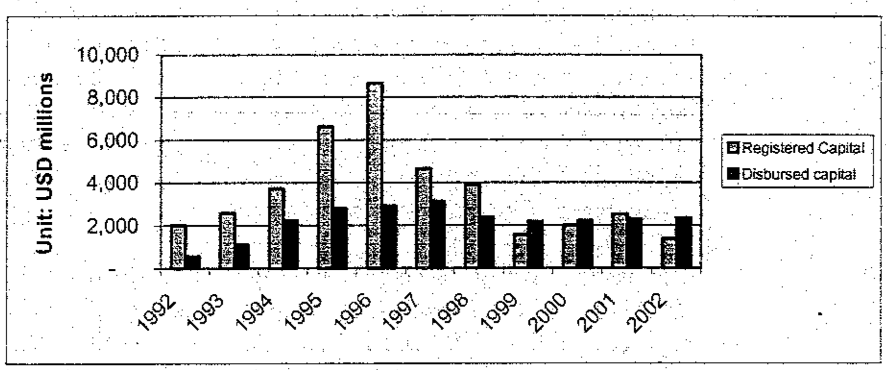
[7] Nick J. Freeman – Foreign Direct Investment in Vietnam: An Overview, a Presentation at DFID Workshop on Globalisation and Poverty in Vietnam, September 2002.

However, the low income per capita, which translates into low purchasing power, has disappointed certain investors. In addition, foreign investors are faced with various difficulties in doing business in Vietnam. This has diminished the attractiveness of Vietnam.

The reduction in registered FDI in 2002 compared with 2001 and 2000 was due to the worsening global investment environment. In 2000 and 2001, the increase in FDI was mainly due to the licensing of a few large projects, which were in preparation and negotiation for many years.

One good sign is that the value of incremental capital has increased over time. This indicates that foreign invested enterprises have started making money and have expanded their operation.

Figure 1: Overview of FDI inflows in Vietnam from 1992-2002



Source: Ministry of Planning and Investment

The realised capital remained stable during 1998-2001. By 9/02, it accounted for around 57% of the registered capital.

The amount of realised capital, however, shows a different pattern. Before 1997, the amount of implemented capital accounted for only approximately 30% of total registered capital. This was because many foreign investors wanted to reserve a place in Vietnam, but implemented a "wait and see" strategy before making any actual investment.

Although the amount of registered capital declined dramatically during 1997-1999, the reduction of implemented capital was at much lower rate. In 1999 and 2000, the amount of implemented capital actually bypassed the amount of registered capital. In 2002, the amount of realised capital was approximately US$2,345 million, 70% higher than the amount of registered capital.

By the end of 2002, the conversion rate from registered to implemented capital reached over 53%. This is an encouraging sign, indicating an increasing quality of registered FDI.

However, there is a close link between registered and implemented capital. The reduction in registered capital creates some worries since this could certainly affect the amount of implemented capital of future years.

But as the amount of registered capital was reduced, the number of licensed projects increased. The average size of the project has been steadily reduced from US$13 million in 1998 to US$1.9 million in 2002. The reduction in average size of projects seems to be closely linked with changes in the sectoral structure of FDI inflow.

Investment forms

Joint venture, 1oo% foreign owned enterprise and business cooperation contract are 3 main investment forms.

There are three basic forms of investment: joint-venture, 100% foreign owned enterprise, and business cooperation contract. The distribution of FDI among different investment forms, as of 2002, is illustrated in Figure 2 below.

Joint venture (JV)

Before 1998, JV was the most common investment form in Vietnam. During the period 1991-1998, two thirds of total registered capital was in the form of joint ventures.

However, due to various difficulties of operating a JV in Vietnam, this investment form has lost its attractiveness (mainly due to the internal disputes between the foreign and Vietnamese partners), and in many cases, the foreign partner has bought out the Vietnamese partner due to insufficient funds available to the Vietnamese partner. It is expected that more existing JVs will be convert into FOEs (see below). Up to 2002, the joint venture form accounted for 30% of licensed projects and 51% of total registered capital. However, in certain sectors such as transportation, tourist, joint venture is a compulsory form of investment.

100% foreign owned enterprise (FOE)

The form of 100% foreign investment holds 66% of projects and 36% of registered capital. In recent years, especially after the promulgation of the 1996 Foreign Investment Law in Vietnam and the relaxation of restrictions on setting up a FOE, this form of investment has increased rapidly.

BCC (Business Cooperation Contract)

A BCC is not an incorporated entity. This investment form holds 3.9% of projects and 10% of registered capital. This type of investment is more common in the telecom and oil & gas sector where JV and FOE are not permitted. The lack of legal status, which leads to the lack of control and management over the BCC by the foreign party, is the main disadvantage of this investment form. It is a common practice that the operation of the BCC is managed and monitored by the Vietnamese partner because the foreign partner does not have a legal status in Vietnam (except for liaison office).