A REVIEW OF FOREIGN DIRECT INVESTMENT IN VIETNAM: IMPLICATIONS FOR IMPROVEMENTS

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A REVIEW OF FOREIGN DIRECT INVESTMENT IN VIETNAM AND IMPLICATIONS FOR IMPROVEMENTS

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ABSTRACT

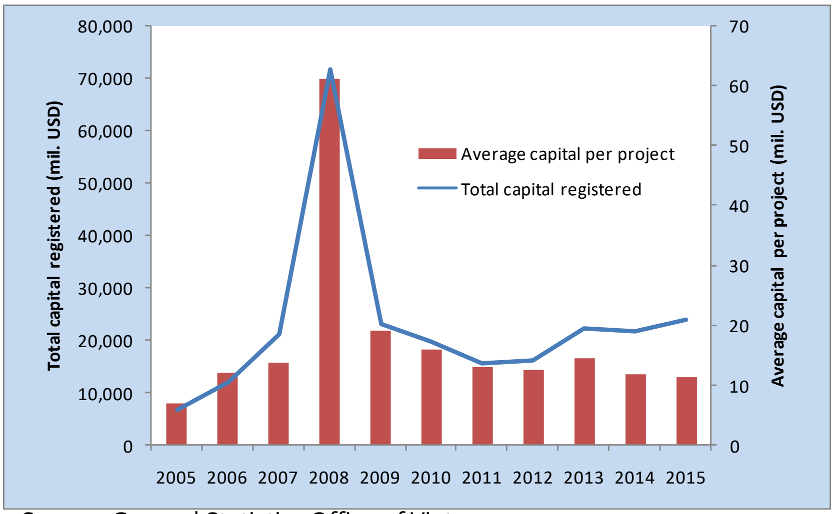
Many countries believe that their efforts in attracting FDI will accelerate economic growth, generate more jobs, contribute to government budget, and transfer technology to local enterprises. With those expectations, Vietnam has provided attractive investment incentives to absorb FDI from all over the world. As a result, Vietnam has received more than 21 million FDI projects from more than 100 countries, representing approximately 315 billion USD of registered capital. Foreign invested companies have proved to be more competitive internationally and have become an important source of export earnings for Vietnam. However, while FDI inflows are meeting some the expected development ambitions of Vietnam, there is room for improvement. In the new global context, it seems that Vietnam should reformulate its FDI policy for further FDI attraction in both quality and quantity.

VIETNAM'S FDI PERFORMANCE

Since its integration in the global economy in the early 1990s, Vietnam has become an increasingly attractive destination of Foreign Direct Investment (FDI): in 2015, it was ranked the world's fifth major attractor of FDI by number of projects, after China, India, Singapore, and Australia, and ranked in the fourth position when considering the total investment capital, after India, China and Indonesia, according to The FDI Report 2016 published by fDi Intelligence.[2] Additionally, this report ranked Vietnam the highest FDI performance index amongst emerging economies for the period 2014-2015.

Vietnam's FDI inflow has followed a long-term upward trend, with specific short-term fluctuations.

Figure 1 Vietnam's FDI total capital registered and average captial per project



Source: General Statistics Office of Vietnam

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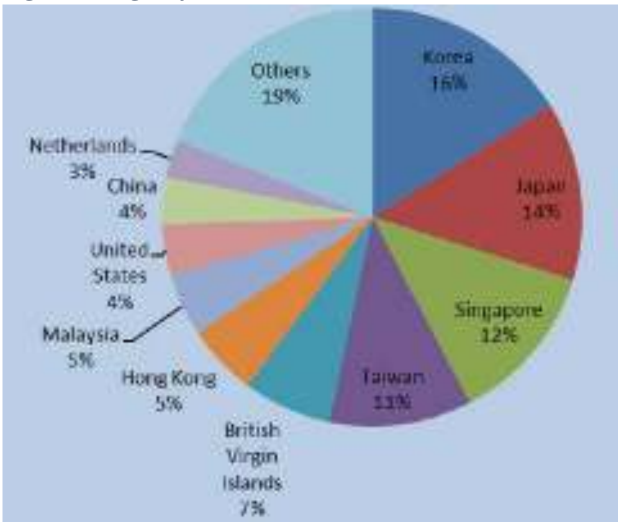
[2] See Barklie, G. 2016, *Vietnam leads emerging market greenfield FDI performance index,* fDi Intelligence, Available from: http://www.fdiintelligence.com/Locations/Asia-Pacific/Vietnam/Vietnam-leads-emerging-market-greenfield-FDI-performance-index

During the period of 2005-2015 (Figure 1), FDI, in both number of projects and registered capital, increased steadily, with average growth rate of 8.1 percent and 13.4 percent, respectively. The sharp increase in FDI in 2008 reflected the strong world economy up to the global financial crisis, as well as the rising interest of foreigners in Vietnam following the country's accession to the WTO in 2007. Registered FDI in 2008 included some large projects, such as a petro-chemical complex, steel mills, a software park and a tourism complex. However, as the world economy was hit by a severe financial crisis, many of these projects were delayed or cancelled.

Figure 2 Origin of FDI in Vietnam – 2015



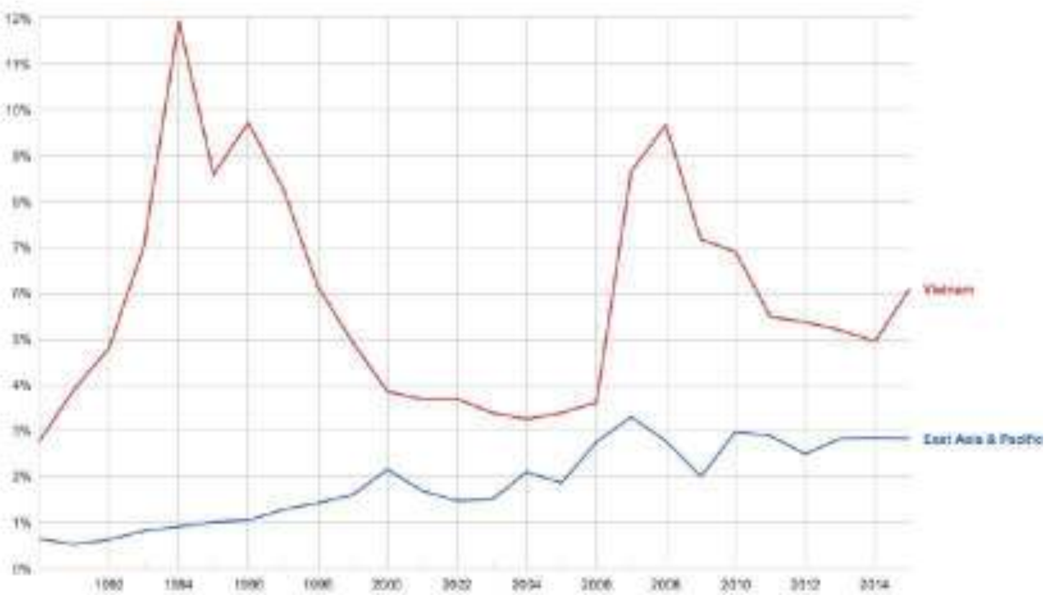
Source: General Statistics Office of Vietnam

Notably, FDI in Vietnam is concentrated in the manufacturing sector, with flows from accounting for the majority of investments. At the end of 2015, seven of the top ten investors in Vietnam were Asian countries. Registered capital by these countries accounted for 67.2 percent of Vietnam's cumulative FDI over the last decade.

Vietnam's success in attracting FDI has had a positive impact on the country's economic development: during the period of 2005-2015, FDI's contribution to GDP followed an increasing trend, moving from 15.1 percent in 2005 to 18 percent in 2015.

The contribution of FDI to job creation is more modest. In 2015, FDI contributed to approximately 4.2 percent of Vietnam's labour force, a contribution that is likely to be even greater if indirect effects are taken into account. Additionally, the share of FDI in total investment increased from 14.9 percent in 2005 to 23.3 percent in 2015, and the contribution of foreign invested companies to the state's budget fiscal revenues increased from 8.3 percent in 2005 to 14.1 percent in 2014.

Figure 3 FDI performance in Vietnam (FDI as percent of GDP) -1990 to 2015



Source: World Bank World Development Indicators

FDI also makes a particularly important contribution to Vietnam's export revenue and general national competitiveness. In 2015, Foreign invested companies exported more than US$114 billion, equivalent to 70.5 percent of the country's total export. This supports the view that FDI activity is a crucial determinant of trade flows and structure in the Vietnam's economy.

INVESTMENT INCENTIVES IN VIETNAM

Under the current Vietnamese laws, there are various incentives to investing in preferential sectors and/or geographical areas. These incentives are scattered in many laws and by-law documents, but, overall, are comprised of (i) tax incentives, (ii) incentives on land use, and (iii) accounting incentives.

Tax Incentives

The standard corporate income tax (CIT) rate in Vietnam has been 20 percent since January 1, 2016, decreased from 22 percent previously. [3] A reduced rate of 10 percent is foreseen for those firms investing in sectors of special interest and/or certain geographical areas, for a maximum period of 15 years. In addition, these firms can also enjoy further CIT incentives, such as four years of CIT exemption, and nine years of 50 percent reduction on the CIT.

Firms investing in sectors of special interest also benefit from the importation of raw materials and components needed in their production process at duty-free rates. Additionally, any product imported and used as input for export activities is not subject to an import tax or duty if the enterprises are located within an economic zone. Furthermore, goods imported for direct use in scientific research and development of new technology previously unavailable in Vietnam are also given an exemption of import duties. Additionally, an enterprise can set up a "bonded warehouse" where it can stock imported goods destined for export processing.

Incentives on land use

The general rule is that the duration of land use for an investment project shall not exceed fifty years. With respect to those projects with a large amount of invested capital and a slow rate of capital recovery, and projects investing in geographical areas with difficult socio-economic conditions, which require a longer term for land use, the duration of allocation or lease of land is extended to a maximum of seventy years. If at the expiry of a term of land use, investors have had good compliance with the law and there is the need to continue using the land, the competent state body will consider an application for extension of the term of land use, in conformity with the approved land use zoning. Investors who invest in designated sectors and geographical areas with investment incentive might be entitled to an exemption or a reduction of land rent and land use fees in accordance with the relevant laws.

Accounting incentives

If an investor suffers after-tax losses, he will be allowed to carry the losses forward to the following year, and the amount of such losses will be set off against taxable income for the purposes of CIT in accordance with the law on corporate income tax, with a maximum of five years. Regarding depreciation of fixed assets, investment projects in sectors and geographical areas designated for

[3] Law on Corporate Income Tax (2008) and Law on the Amendments to the Law on Corporate Income Tax (2013).

investment incentive, as well as projects with high economic efficiency, are granted accelerated depreciation of fixed assets. The maximum rate of depreciation cannot exceed twice the rate of depreciation as stipulated by regulations on depreciation of fixed assets.

NEED FOR FDI-RELATED REFORMS

Vietnam has achieved a phenomenal success in absorbing large levels of FDI, which have helped it cushion occasional spells of foreign exchange droughts over the last decade. However, Vietnam's FDI policy framework and incentive system may need further reform to improve quality and quantum of FDI, especially in the face of the fierce competition among ASEAN economies.

In particular, a number of objectives were not achieved, such as:

- Expectation of attracting high-tech foreign enterprises, which would create high domestic value and bring advanced technology to the manufacturing and agro-forestry-fishery sectors, was not realized, with most MNCs investing in simpler assembly operations, with low value-added using low or mid-level technology. Foreign investment in medium-low and low technology sectors, which are mostly labour and land intensive, export-oriented projects, account for nearly 80 percent of total FDI project number and registered capital.
- The number of joint ventures, an investment form that can potentially secure cooperation and technological spill-over effects from foreign invested firms for a long time, has declined drastically after 100% foreign-ownership was permitted as a compulsory commitment to join the WTO.
- The propensity for creating jobs has been relatively low in comparison to domestic investments.

Moreover, investment incentives have multiple categories that are spread over different laws, geographies and regulations. This makes it hard for authorities to administer and apply them fairly and consistently, and difficult for enterprises to understand. The lack of transparency in the incentive regime as well as in the law also raises the opportunities for corruption and rent seeking.

Investment incentives in Vietnam mainly comprise of tax incentives, based on both positive and negative lists of sectors and geographic areas, while many other performance-based tools have not been utilized, such as incentives for labour training, supplier development, industrial linkage, productivity practices, and so on. Overall, and despite being an important element, foreign investors do not make investment decision solely on tax incentives, as they are more interested in the future potential and overall business effectiveness of the country, as well as stability and transparency of investment environment and tax regulations and practices.

Post-investment monitoring is crucial in raising the ratio of implemented projects and maximizing FDI's positive impact on the national economy. Nevertheless, such monitoring is not systematically implemented in Vietnam. Helping foreign investors during the entire life of their projects will improve their profitability, expand their businesses, invite even more investors to Vietnam, and generate a win-win situation to both the investor and the host country. On the negative side, problems caused by irresponsible investors, such as violation of labour, environmental and national security laws, energy inefficiency, inappropriate resource use, and importation of backward machinery can also be managed with a good post-investment monitoring system.

In order to achieve the missed objectives, it is crucial for Vietnam to have a clear long-term vision to guide state organizations and local governments in FDI marketing, as well as to provide hands-on guidance to foreign investors. Vietnam should reformulate the FDI policy framework with proper post-investment monitoring system and performance-based incentives to encourage investors to increase their local procurements, create linkages with local suppliers, and provide training to their labour forces. The new regime must also be consistent with commitments in new FTAs that Vietnam has signed recently, namely TPP, EVFTA, which require transparency, non-discrimination, and a more competitive business and investment environment. FDI marketing programs and missions should be redesigned to be more strategic and selective, targeting specific potential partners that could create positive spill-over effects on local firms in improving productivity, standards and quality; respect for the environment and labour standards, as well as build capacity in quality, production management, and business efficiency.

ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CIT	Corporate income tax
EVFTA	EU-Vietnam Free Trade Agreement
FDI	Foreign direct investment
FTA	Free Trade Agreement
GDP	Gross Domestic Products
MNC	Multinational Corporation
TPP	Trans-Pacific Partnership
WTO	World Trade Organization

HOW CAN WE HELP?

Support C-level executives and boards to prepare for different challenges

International Economics can help facilitate internal discussions on strategy by providing technical insights, developing dashboards of key performance measurements, and giving advice to executive boards on building resilience to possible disruptions related to exogenous trade shocks, such as Brexit or Donald Trump's Presidency. We work closely with our clients to brainstorm and identify challenges and opportunities based on our professional experience.

Map market access

In order to quantify the potential costs to your business in engaging in trade, including tariffs, standards, and customs procedures, among many others, we (i) undertake a mapping of which terms are most at risk of changing and by how much, depending on the type of agreements; and (ii) quantify and forecast the potential effect on your business using predictive analytics to generate insights into future outcomes.

Navigate through trade and investment agreements

With more than 400 trade agreements and 2,400 investment agreements already in place, *International Economics'* team is able to navigate through them, guiding and identifying which specific agreement will better suit the interests of our client. Additionally, we have developed optimization techniques, through the use of sophisticated rules and algorithms, to analyse the Free Trade Agreements (FTAs), which are growing in space, depth and complexity, in order to offer insights into investment and trade decisions. With increasing fragmentation of global production networks and the need for careful evaluation of supply chain risks, the tools developed by *International Economics* offer a solid foundation for the adoption of critical decisions by businesses.

Prepare briefings and strategic papers

Our clients need to prepare strategic position papers to assess the issues and prepare responses, whether it be internal restructuring, supply chain re-engineering or addressing policy risks. We assist our clients with short, impactful, and relevant position papers, including setting out the possible impacts of risks at different business levels (policy, financial, structural, etc.) and provide the latest thinking on the issues to date, based on a holistic economic framework.

Undertake a full economic and legal review of the trade and investment exposures to worldwide events

We conduct independent and objective reviews of the impact of different worldwide events on your business and industry. We use deep learning tools, large multi-country macro models and the latest unstructured data to offer insights into the risks, exposure assessments and likelihood of disruptions to supply chain. These provide our clients with a competitive advantage as they prepare mitigation strategies and leverage identified opportunities. We work with our clients to develop the right strategies and make breakthrough decisions.

Brexit: Help the private sector position itself during the UK's trade negotiations

Brexit will affect our clients' business strategies, supply chains, funding, tax positions, regulations, growth and opportunities. *International Economics* works with public affairs companies and specialized firms to offer the full range of trade-related technical support and advice to help companies position themselves and ensure that their interests are addressed in the negotiations.

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