INVESTMENT IN VIETNAM AND THE COMMITMENTS MADE IN THE ASEAN INVESTMENT AREA

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INVESTMENT IN VIETNAM AND THE COMMITMENTS MADE IN THE ASEAN INVESTMENT AREA

Andras LAKATOS[1]

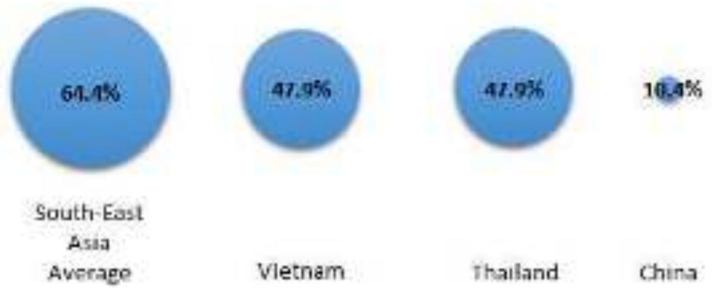
ABSTRACT

Vietnam is fast approaching its next milestone of regional economic integration: as a Member of ASEAN, it is committed to implement the ASEAN Comprehensive Investment Agreement (ACIA) whose objective is to create a free and open investment regime by 2015. ACIA provides ASEAN investors with a host of benefits and advantages over what they currently enjoy when investing in Vietnam, in terms of transparency of rules, non-discriminatory market access and operating conditions, protection of investments according to international best practice, and access to an investor-state dispute settlement mechanism. This article provides a review of achievements made by Vietnam in attracting FDI and improving the market access conditions for foreign investors, but also highlights some of the challenges faced by foreign investors wishing to establish a commercial presence in Vietnam and makes a strong case for the need for continued reforms by the Vietnamese Government in the area of transparency and, *inter alia*, elimination of Trade Related Investment Measures.

VIETNAM'S DRIVE FOR BILATERAL INVESTMENT TREATIES

Vietnam received 8% of the total FDI to ASEAN in 2013, and ranked 5th after Singapore (52% share), Thailand (13%), Indonesia (11%), and Malaysia (10%)[2]. The importance of foreign investment in Vietnam's economy is highlighted by the level of its FDI stock in the economy. The share is close to 50%, on par with Thailand and significantly higher than China (see Figure 1).

Figure 1. FDI inward stock as a % of GDP in 2013



Source: UNCTAD (2014) World Investment Report, Geneva

Vietnam is party to a large number of investment agreements. As of June 2013, it had signed 60 Bilateral Investment Treaties (BITs), and undertook legally binding obligations on cross-border investment under a series of trade agreements, such as the Vietnam-US Bilateral Trade Agreement (BTA) and the General Agreement on Trade in Services under the WTO (GATS). Some of these agreements have overlapping scopes with diverging provisions, and some of them call for the

[1] **Andras Lakatos is Senior Economic Advisor at International Economics Ltd**. He recently supported the Ministry of Planning and Investment of the Government of Vietnam to implement the ACIA. This article summarises his main findings.

[2] World Bank East Asia Pacific Economic Update April 2014.

extension of other treaty benefits to third parties by virtue of the Most-Favoured Nation Treatment obligation (MFN)[3].

Over one generation, Vietnam has been gradually opening up its market to foreign investors, although the overlapping arrangements is adding complexity to the implementation of multiple investment treaty obligations and is posing a challenge of doing so in a coherent manner. Vietnam is now fast approaching its next milestone of regional economic integration: as a Member of ASEAN, it is bound to implement the ASEAN Comprehensive Investment Agreement (ACIA) whose objective is to create a free and open investment regime by 2015.

Box 1. Vietnam's Market Opening

Vietnam's market-oriented reforms were launched by the Doi Moi (renovation) policy in 1986, which promoted a multi-ownership structure of the economy giving domestic private investment and foreign direct investment (FDI) room for growth whilst maintaining the hegemony of the State-owned sector. Progressive trade and investment openings were central elements of Doi Moi and proved to be keys to the economic success of the country over the last three decades. Central element of this policy was also the progressive integration of Vietnam into the global and regional economies through trade and investment agreements, such as membership in ASEAN, "ASEAN+" Free Trade Agreements with China, Korea and Australia-New Zealand, accession to the WTO, and recently its participation in the Trans-Pacific Partnership (TPP) trade negotiations.

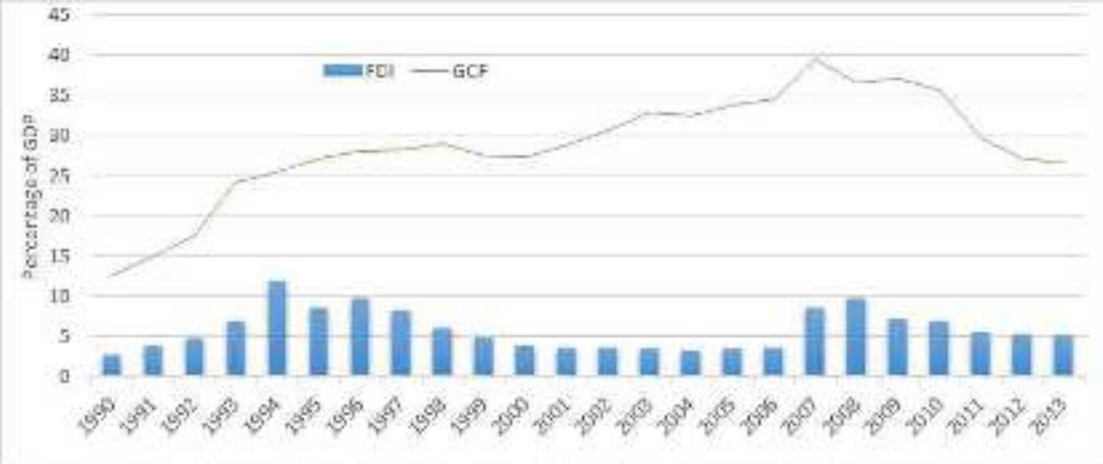
VIETNAM'S INVESTMENT POLICY REFORMS

Foreign direct investment has become a significant driver of economic growth in Vietnam over the last three decades. As noted by a report produced by UNCTAD 20 years after the process of economic reforms and transformation took place[4], foreign investors have played a major role in transforming Vietnam from an isolated, poor and collectivized agriculture-based economy into a booming economy with a dynamic private sector. As a first step, foreign ownership was allowed in various industries for Greenfield projects with guaranteed free repatriation of profits, capital and assets. The Government made successive revisions to the FDI regime to facilitate more FDI inflows (especially in export sectors) and to comply with its international commitments. FDI policy reforms had a wide scope, ranging from registration and investment licensing procedures, land access, trading rights, foreign exchange control, and tax policies. FDI reforms lost momentum during the East Asian financial crisis of 1997, but were put back on track in the late 1990s through a series of measures (Figure 2).

A unified investment law applicable to both foreign and local investors establishing a more level-playing field has been introduced, the investment approval and monitoring processes were simplified, local-content and export-performance requirements removed, and (limited) participation rights were given to Foreign Invested Enterprises (FIEs) in selected "equitized" state-owned enterprises (SOEs). As a result, Vietnam experienced rapid growth in FDI since the 1990s. It was Vietnam's accession to the WTO in 2006 that dramatically pushed FDI to close to 10% of GDP.

[3] The MFN treatment requires that you treat other members of the WTO equally.
[4] UNCTAD (2007) Investment Policy Review: Vietnam, UNCTAD: Geneva.

Figure 2. FDI and Gross Capital Formation 1990-2013



Source: World Bank

VIETNAM'S REMAINING RESTRICTIONS ON FDI

Despite the success of these reforms, Vietnam still does not have a liberal FDI policy regime. Statutory ownership restrictions exist in designated sectors, classified as "prohibited" (those considered strategic), "restricted", and "conditional" sectors (where restrictions are applicable only to foreign investors). Foreign investment is prohibited in some key sectors, e.g. in fixed line and mobile telecommunications, media industries, and select transportation services; and is conditional in sectors such as, *inter alia*, mining, post and telecommunications, property trading, banking, securities, and insurance, culture, information, finance and banking; public health; entertainment services; real estate; survey, prospecting, exploration and exploitation of natural resources; ecology and the environment; and education and training. Under the Law on Press, private investment (domestic or foreign) in media and newspaper publishing is prohibited. Vietnam imposes a limit of 49 percent on foreign capital participation in a series of sectors, e.g. in the international passenger air transportation and the provision of telecommunication infrastructures. Legal restrictions to FDI are also imposed on mergers and acquisitions of domestic companies.

Market access for FDI is further reduced by the opaqueness of the investment regime. In sectors that are not explicitly opened by a trade or investment agreement, foreign investors have to negotiate their access with the government on a case-by-case basis, which de facto creates different entry and operational conditions among like foreign investors and investments. Though the Government is to exercise uniform State administration of investment throughout the whole country, the complex decentralized institutional structure of "State management" of FDI leaves significant discretionary power to the 58 provincial Governments (People's Committees and Departments of Planning and Investments) over FDI conditions. This creates discriminatory entry conditions, uneven implementation of laws and regulations across the country and incoherencies of decisions on FDI applications.

The openness of Vietnam's investment regime is greatly impacted by the weight and role of the State sector. Although the share of SOEs has declined to 24% of GDP after WTO accession in 2006, SOEs still control 70% of fixed assets and 45% of new investments. The SOE sector is not only explicitly given the dominant role, but the privileges SOEs receive (e.g. privileged access to land and capital, cross-subsidized interest rates granted by State-owned banks to SOEs, etc.) distorts the competitive environment of both the domestic private and the FDI sectors.

BENEFITS FROM ACIA'S IMPLEMENTATION

Pursuant to the ASEAN Economic Community Blueprint, Member States undertook to progressively reduce and eliminate restrictions and impediments to regional investments and to create an open investment regime by the end of 2015. This commitment is to be implemented through the ASEAN Comprehensive Investment Agreement, which consolidated and superseded two existing agreements: the ASEAN Investment Area (AIA) of 1998 and the ASEAN Agreement on the Promotion and Protection of Investments of 1987, also known as ASEAN Investment Guarantee Agreement (IGA). ACIA, which entered into force in 2012, was conceived to provide a single framework for the *four pillars of the ASEAN investment regime*: protection of investors and investment, liberalization of investment restricting measures, investment facilitation and promotion of investments.

"Investment" is defined comprehensively: ACIA not only covers, and therefore protects, FDI and portfolio investments, but also *any kind of asset* that has the characteristics of an investment, e.g. business concessions such as Build-Operate-Transfer contracts, and Intellectual Property Rights. This all-inclusive definition of investment reflects ASEAN's policy to provide full protection of investors with respect to all possible forms of investments, including future, new forms of investments.

In terms of investment protection, Vietnam commits under ACIA to provide the following Minimum Standards of Treatment of ASEAN investors and their investments:

i. Fair and Equitable treatment, which means guaranteed access to justice in accordance with the principle of due process to seek protection against any harmful legal or administrative measure or practice adopted by its central, provincial or local governments or authorities;
ii. Protection against arbitrary direct or indirect expropriation. Accordingly, Vietnam may expropriate an investment only if the expropriation or nationalization is taken for a public purpose and in a non-discriminatory manner. Non-discriminatory measures designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations. This provision ensures that Vietnam's sovereign right to regulate is preserved. On the other hand, any expropriation or nationalization must be compensated without delay and the compensation must be equivalent to the fair market value of the expropriated asset;
iii. Full protection and security, which means the protection against various types of physical violence;
iv. Compensation in Cases of Strife on a non-discriminatory basis; and
v. Freedom of Transfers ensures that every ASEAN Investor may freely and without delay conduct payments and transfers relating to its investments into and out of Vietnam.

Vietnam, like the other ASEAN Member States, undertook progressive liberalisation of its investment regime in five goods sectors, namely manufacturing; agriculture; fishery; forestry; and mining and quarrying, and the services sectors incidental to these goods sectors. Liberalisation is to be achieved by the end of 2015 subject to its reservations list. Vietnam's core obligations are to provide non-discrimination (i.e. both Most-Favoured Nation treatment (MFN) and National Treatment (NT)) with respect to admission and establishment in both "pre-entry" and "post-entry" phases, the latter extending to the full investment cycle. Other obligations include the removal of nationality requirements imposed on investors in the composition of their Senior Managements and Boards of Directors, and the elimination of Performance Requirements imposed on ASEAN investors, which are also prohibited by the WTO Agreement on Trade-Related Investment Measures (TRIMS). Interestingly, ACIA does not prohibit non-trade related performance requirements such as those relating to employment, training, R&D (or technology transfer) etc., and more generally, those applied in service sectors. While MFN and the prohibition of TRIMs are unconditional obligations, Vietnam's liberalization commitments with respects to the elimination of NT and nationality requirements for Senior Management and Board of Directors is subject to its reservations list.

CHALLENGES IN IMPLEMENTING THE ACIA

According to the latest ASEAN Integration Monitoring Report[5], Vietnam's investment regime in terms of foreign equity caps is among the most restrictive ones in ASEAN (together with Thailand and the Philippines) although Vietnamese experts say that many of the reservations made under ACIA for more than 70 sub-sectors are obsolete and actually not necessary for the development of the Vietnamese economy and therefore could have been removed. A high level of investment restrictiveness in Vietnam appears to stem from a variety of discriminatory restrictions. Whilst Trade Related Investment Measures (TRIMs) are already explicitly abolished, performance requirements remain and have a strong dampening effect on investment in Vietnam. Indeed, according to Vietnamese sources, whilst TRIMs have been removed by law, in practice performance requirements are used when evaluating and deciding on the issuance of investment certificates. Furthermore, the experts say that although ACIA does not permit grandfathering, investors face huge difficulties to have TRIMs removed from their pre-existing investment certificates.

In the light of the present complex regulatory system prevailing in Vietnam, implementing ACIA is a challenging task for all stakeholders. However, the benefits of a full implementation would overweigh by far the administrative and economic adjustment costs. ACIA obviously provides ASEAN investors with a host of benefits and advantages over what they currently enjoy in the Vietnamese market in terms of transparency of rules, non-discriminatory market access and operating conditions, protection of investments according to international best practices, and access to an investor-state dispute settlement mechanism. However, it is important to realize that not only foreign investors would gain from a fully implemented ACIA, but maybe more importantly, huge benefits would accrue to the Vietnamese economy in terms of efficiency gains that result from better resource allocations and a more competitive investment market. Additionally, Vietnam would legitimately expect reciprocal investment liberalization of other ASEAN markets, which would provide free market access for Vietnamese investors.

[5] ASEAN Secretariat (2014), ASEAN Integration Monitoring Report, ASEAN and World Bank, February.

ABBREVIATIONS

ACIA	ASEAN Comprehensive Investment Agreement
AIA	ASEAN Investment Area
ASEAN	Association of South-East Asian Nations
BIT	Bilateral Investment Treaty
BTA	Bilateral Trade Agreement
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprises
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
MFN	Most-Favoured Nation
NTM	Non-Tariff Measure
NT	National Treatment
SOE	State Owned Enterprise
TPP	Trans-Pacific Partnership
TRIM	Trade-Related Investment Measure
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

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.

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Contact Us:

Kerry O´Donoghue (Brussels)
Senior Manager
o.donoghue@tradeeconomics.com

Natalie Donikian (Mauritius)
Public Affairs Manager
donikian@tradeeconomics.com

@TradeEconomics
InternationalEconomicsLtd
trade-economics