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I. Introduction

In Vietnam Foreign Direct Investment (FDI) has had a comprehensive impact on the economy, and has been an important source of the economic performance of the country. FDI accounts for around a quarter of the total investment fund of the economy. The economic sector with foreign owned capital has contributed an increasing share in GDP, from 3.5% in 1993 to above 15% in 2004. It provides about 6-7%, or around 30% if taking into account the crude oil industry, of the total government budget revenue. This economic sector with its share of 35%, not including the export value of the crude oil, in the total export revenue of the year 2005 still plays an important role in the export (MPI and GSO).

In terms of the social impact, the economic sector with foreign owned capital has created a number of jobs. Today about one million Vietnamese people, of whom many live in poor areas, have been provided opportunities to get jobs and higher income in this sector.

An obvious significance of FDI is technology transfer, which includes the improvement of management skills. The business in enterprises with foreign owned capital in reality has become business schools in which Vietnamese managers have been trained through the process of learning by doing.

The Vietnamese government realizes the importance of FDI, and has made efforts to improve policies toward foreign direct investment as well as the investment environment. The evolution of such policies is in line with the international integration process, and has been bearing the political, cultural stamps of the country.

This paper continues to be outlined as follows:

- The evolution of the policies toward foreign direct investment.
- Current policy stance.
- Bilateral commitments relating to foreign direct investment.
- Some attention to Japanese investors.
- Conclusion

II. The evolution of the policies toward foreign direct investment

In 1986 the policy of *Doi Moi* ('renovation') was introduced. This is a landmark of the transition of the economy from a command economy to a new system of a more market-oriented economic structure. In the following year, in December 1987, the Foreign Investment Law was promulgated. This law was seen as an evidence as well as a first effort of the opening the economy to the external world. The law:

- confirms the rights of investors: setting up the business, recruiting and employing labor, transferring abroad lawful incomes, to export and to import etc.;
- guarantees interests of foreign investors. Their assets are not requisitioned or expropriated by administrative measures, and are not nationalized;
- releases the tax regime and the main incentives in incentive sectors and incentive regions;
- outlines the rules of foreign exchange control; and
- determines the functions of the agencies in the state management of foreign investment.

However the basic ideology of this law was to emphasize the dominant role of the state enterprise and the protection of the domestic market. The private enterprises were not allowed to carry out business co-operation with foreign investors.

The 1990 Law on Amendment of and Addition to a Number of Articles of the Law on Foreign Investment in Vietnam removed some limitations in the 1987 Foreign Investment Law. Especially it allowed the private enterprises to carry out business co-operation with foreign investors.

The 1992 Law on Amendment of and Addition to a Number of Articles of the Law on Foreign Investment in Vietnam provided foreign investors with more rights and incentives, including construction of infrastructure facilities, the same tax regime between joint-venture enterprise and enterprise with 100 percent foreign owned capital, expansion of the operation duration etc.

The 1996 Foreign Investment Law issued new forms of Build-Operate-Transfer (BOT) contracts, Build-Transfer-Operate (BTO) contracts, and Build-Transfer (BT) contracts. Moreover, this law gave some more rights and incentives to investors, such as the right to assign the contributed capital with some restrictions. However this law still retains a number of limitations, for instance the principle of unanimous decision in the board of management, priority to purchasing equipment, machinery, materials, and means of transport in Vietnam.

The 2000 Law on Amendment of and Addition to a Number of Articles of the Law on Foreign Investment in Vietnam accepted the right of foreign investors to merger and acquire companies and branches, and the right to transfer the form of investment.

The 2005 Law on Investment was passed on 29 December 2005 and came into force on 1 July 2006. This law was prepared to meet requirements of the accession to the WTO, especially the rule of non-discrimination. It is the uniform investment law and replaces all former laws on domestic and foreign investment, so that it outlines the current policy stance toward foreign direct investment.

III. Current Policy Stance

This section will present key points of the current policy stance toward foreign direct investment.

Vietnam's commitments:

Following the rules of the World Trade Organization (WTO) the 2005 Law on Investment issues commitments which include:

- guarantee of all lawful interests of the investors, such as the ownership of capital and assets, the long-term investment activities, the remittance of capital and assets abroad, doing business, in the case of policy change etc.
- non-discrimination. The government shall realize national treatment and most-favored nation treatment. That means it provides equal treatment between all investors and all kinds of investment. For instance, it applies uniform regulation rules, or uniform prices, uniform fees and uniform charges for all investors.
- protection of intellectual property rights. To implement this commitment in November 2005, the National Assembly passed the Law on Intellectual Property Rights. This law also was effective from the first of July 2006.
- removal of requirements relating to trade related investment measures (TRIMs) which are not in accordance with the WTO rule. Article 8 of the 2005 Law on Investment lists 7 such measures consisting of the requirement of local content which for several years ago had been a focus in the industrial policy as well as in the policy of foreign direct investment.
- opening markets for investment in accordance with the committed schedule.

Four last points of the commitments are some new terms which are included in the Law on Investment under the pressure of the international economic integration.

Rights of the Investors

The 2005 Law on Investment provides foreign investors with following rights:

- autonomy in investment and doing business, for example in selection of form, location, partner, scale or duration of investment, or in export and import.
- purchasing foreign currencies to meet demand of foreign currencies. The regulations on this term are relaxed in comparison with those in former laws.
- assignation or adjustment of capital or investment project, and merger and acquirement of companies and branches.
- access to and use of investment resources, such as land use, sources of credit capital and aid funds, natural resources, labor force.
- mortgage of land use rights and assets attached to land.
- contribution of capital to and purchase of shareholding in companies and branches operating in Vietnam. According to the new regulation foreign investors can buy up to 49% of the total shares of a domestic enterprise.
- access to information relating to investment and business, use of public services etc.

In this law more rights are given to foreign investors on the principle of non-discrimination.

Investment Incentives

The 2005 Law on Investment has provisions about incentive investment sectors and geographical areas of investment incentives. Incentive investment sectors are labor intensive sectors, high tech sectors, agriculture, forestry, aquaculture etc. Incentive areas consist of industrial zones, export processing zones, high-tech zones, economic zones and areas with difficult socio-economic conditions.

Investments in such sectors and areas can enjoy incentives, for example tax incentives with preferential tax rates, tax exemption, tax reduction; carrying forward losses; accelerated depreciation for projects with high economic efficiency and projects granted incentives. Land use incentives are also set out. The investors have the land use right in the duration of 50 years, with an exception of 70 years for special cases. They can be entitled to an exemption from payment of or reduction of land use fees for projects in incentive sectors and/or areas.

Taxes, tariffs and fees

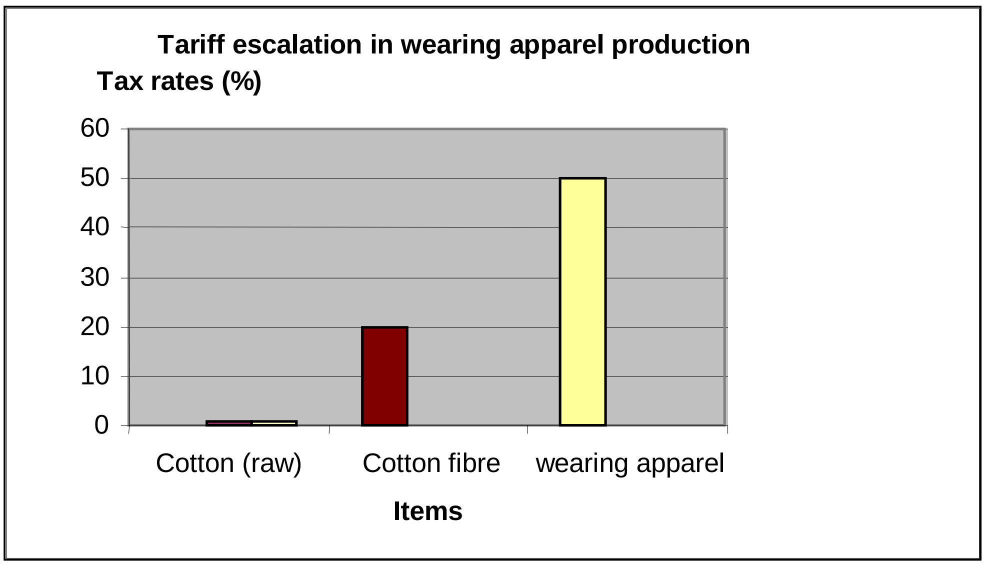
The tax system of Vietnam has been amended and prepared under pressure of the accession to the WTO. To realize the principle of non-discrimination currently the uniform tax rate of 28% of Corporate Income Tax is applied to domestic and foreign enterprises. This tax rate replaces the former tax rates of 32% and 25% applied respectively for domestic enterprises and foreign enterprises.

The latest Law on Export and Import Duties was passed on 14 June 2005, and it was in effect from 1 January 2006. Vietnam applied the Harmonized System (HS) of the Customs Cooperation Council (CCC) for its tariff schedule. The tariff rates are discriminated between the preferential duties (Most-Favored Nation – MFN), the special preferential duties (in Free Trade Area), and the normal duties (Non-MFN). The duration of the tax payment is 30 days for export commodities, and 275 days for imported inputs to produce export commodities. For the consumption goods the importers have to pay tax before receiving goods. The 2005 Law on Export and Import Duties also determines the cases of tax refunds.

Generally import tax rates of Vietnam are very high. Special high rates fall in protected commodities, such as 30% and 45% for sugar, 100% and 150% for motor vehicle, and

50% and 70% for wearing apparel, with a distinction between the preferential and non-preferential duties respectively. Moreover a structure of the tariff escalation is applied, that means a system of very low tax rates for raw materials, higher tax rates for intermediate products and quite high tax rates for final products. For example these rates vary from 0 per cent on raw material, to 20 per cent on cotton fiber and 50 per cent on wearing apparel. In the WTO accession negotiation Vietnam releases commitment and schedule to reduce tariff rates.

Figure 1. Tariff escalation in wearing apparel industry



Source of data: MOF 2004.

Note: All are favored tariff rates.

The current Value Added Tax (VAT) of Vietnam includes three tax rates of 0 %, 5 % and 10 %. Most of import goods are suffered from VAT tax rates of 5% and 10 %. Special consumption taxes also are levied on imports.

Another typical taxes and fees in Vietnam consist of personal income tax, excise taxes on domestic goods and services, land and housing taxes, licenses, gasoline fees, fees on land use rights, land rent, and registration fees.

Industrial zones and high-tech zone

Industrial zones and high-tech zones play very important role in attracting foreign direct investment, and they are listed to geographical areas of investment incentives. The Government Decision No 36/CP on 24 April 1997 and the 2005 Law on Investment provide incentives for investments in these areas.

- Enterprises in Industrial zones have the right to rent land, to use, with payment, utilities, infrastructure, to do business, and to assign or adjust capital or investment project.
- Instead of the standard rate of 28 %, tax rates of 10%, 15%, or 20% plus tax exemption depending on the kind of enterprises are applied to corporate income, (Article 19, the Government Decision No 36/CP).

Among foreign investors in Vietnam, Japanese investors are the biggest ones in industrial zones.

IV. Bilateral Commitments relating to foreign direct investment

To promote and facilitate investments of its partners, during the renovation process Vietnam has signed a number of bilateral agreements, of which the most important ones are agreements between Vietnam and the United States, and agreement between Vietnam and Japan.

Bilateral commitments between Vietnam and the United states

In the year 2000 Vietnam and the United States signed the Bilateral Trade Agreement the BTA), which came into effect in December 2001. The BTA was designed on the rules of the WTO. From seven chapters, chapter IV of the BTA is devoted to "Development of Investment Relations". National Treatment (NT), Most Favored Nation Treatment (MFN) and transparency are included in this chapter as basic principles of the development of investment relations between two sides.

The Vietnamese side has the obligation to remove all rest Trade-Related Investment Measures (TRIMs) in the time period of five years after the date the Agreement came into effect. Although Vietnam commits to open both goods and services markets, it maintains a number of the so called sensitive sectors which are excepted from National Treatment. Those are for example broadcasting, television, investment in insurance, banking, real estate business, construction and operation of inland water, sea and air ports etc. Other requirements on investment capital and restrictions still remain. For example, U.S. companies do not have the right to establish a joint stock company or to issue bonds or shares to the public in Vietnam, to acquire more than 30% of equitized State enterprises, or to mortgage land use rights.

After twelve difficult negotiation rounds, in May 2006 Vietnam concluded the bilateral market access negotiation with the United States. On 31 May 2006 the bilateral market access agreement between two countries was signed. The agreement includes the commitments of market access of agricultural goods, industrial goods, and services. In the agriculture Vietnam will reduce remarkably its tariffs on U.S. agricultural exports to Vietnam and agree to eliminate a number of non-tariff measures, and to adopt many U.S. requirements and system. From the current average applied tariff of 27%, more than three-fourths of U.S. agricultural exports to Vietnam will enjoy the rate of 15% or less once Vietnam will be WTO membership (U.S.TR 2006a).

The market access agreement on industrial goods and services is related more to the investment. Vietnam adopts to reduce tariffs on numerous U.S. manufactured goods. After full implementation of Vietnam's WTO access commitments almost exports of U.S. manufactured goods to Vietnam will be levied duties of 15% or less. Many important export goods such as aircraft, computers and semiconductors will face zero duties. Bounding all tariff lines and lowering significantly the average bound rate on industrial and consumer goods are other important commitments of the market access. In addition Vietnam will have to terminate WTO prohibited industrial subsidies, especially subsidy to its textile and garment industries (U.S.TR 2006b).

Probably the bilateral market access agreement on services is most significant to foreign investors. Vietnam commits to grant national treatment to foreign investors, and to expand a wide range of service sector markets to U.S. firms. These most important sectors consist of insurance, banking and securities, telecommunications, energy services, express delivery service, engineering and construction services, transport services, business services, distribution services, environment services, and hotels and restaurants. Obviously most of these service sectors are listed to restricted investment ones in the BTA, so that foreign investors have to face many limitations on doing business. With this agreement U.S. firms not only can operate through joint-ventures with Vietnam's partners, but also they will be allowed to be as major shareholders in joint-ventures with Vietnamese partners, and to establish their 100-percent foreign owned enterprises or subsidiaries after three to five years from the date of Vietnam' accession. Strong market access commitments of Vietnam can be found in banking and securities, insurance, telecommunications and energy services (U.S.TR 2006c).

Karin Bhatia, Deputy U.S. Trade Representive, who signed the Bilateral Market Access Agreement between Vietnam and the United States said: "This is a great agreement for the United States. It opens a vibrant and growing market for American agricultural goods, a range of services, and manufactured products. It also opens the door for Vietnam to joint the international rules-based trading system. Through this agreement, Vietnam will become more transparent in its regulatory trade practices, enhance the economic freedoms enjoyed by its people, and establish a more level playing field between Vietnamese and foreign companies" (U.S.TR 2006).

Bilateral commitments between Vietnam and Japan

In April 2003 Vietnam and Japan decided to realize "Vietnam-Japan Joint Initiative to improve Business Environment with a view to strengthen Vietnam's Competitiveness". Some months later, in November of the same year two countries signed "Agreement between Japan and the Socialist Republic of Vietnam for the liberalization, promotion and protection of Investment”. This agreement focuses on investment issues between two countries.

The MFN treatment and national treatment are included in the agreement as principle rules of the investment activities of two sides. The first commitment is to eliminate TRIMs including achieving domestic content requirement.

Two Parties confirm the obligation promptly providing confidential information relating to investment activities. Provisions to guarantee lawful interests of the investors such as non-nationalization, or in the case of revolution, insurrection, civil disturbance are involved in bilateral commitment. The right of investors to transfer freely and without delay all payments relating to investments is accorded. Rules governing the settlement of disputes are described detailed in some provisions of the agreement. In addition, the agreement still has provisions relating to protection of intellectual property rights, taxation, providing investors with other favorable conditions, and implementing provisions. The agreement also allows each Party to adopt some exceptional measures relating to special provisions.

In reality many commitments in this agreement are included in the 2005 Vietnam’s Law on Investment.

V. Some Attention to Japanese Investors

Since the beginning of the 1990s the economic relation between Vietnam and Japan has grown very fast. Nowadays Japan is the biggest investor in Vietnam in terms of FDI disbursements, and is the biggest provider of ODA to Vietnam. Vietnam and Japan trust each other, and are close in terms of culture and history. Vietnamese people are friendly. They highly appreciate the assistance of Japan, and welcome Japanese people, Japanese business and Japanese investments. Japanese people and investors can find a friendly and safe atmosphere and environment when they stay in Vietnam.

In reality, Vietnamese government supports foreign investors and favors their interests. Surely, the voice of Japanese investors has had good influence on decisions of the central and local government in Vietnam.

In Vietnam although a common legal framework is created, there is the competition between provinces to attract foreign investment. To achieve this goal provinces have made efforts to improve their investment environment. However provinces which are more attractive to foreign investors belong to few ones such as HCMCity, Binh Duong, Da Nang, Vinh Phuc, Bac Ninh.

It is necessary to mention some risks foreign investors need to take into account.

- *Effect of laws in reality*. Even if Vietnam has issued a number of laws and has made big efforts to improve its legal system, the effect of the laws in the reality remains an issue which needs to be addressed. This results from many limitations, such as opportunity to access the legal information, the transparency and the enforcement of the legal system, and dispute settlement.
- *Social problems*. In line with the boom of foreign investment, some related social problems have arisen, and sometimes it was serious. Typical were the strikes of thousands of workers from the end of last year to first months of this year in many provinces in the South, the Middle, and the North of Vietnam. The main reason was too low wages.
- *Bad protection of intellectual property rights*. This is the common situation of developing countries. However it seems to be more serious in Vietnam.
- *Policy risk*. Firstly, it is due to unpredictability of the policy change in many cases. Secondly, there are some gaps between the regulations of the central and local government. Appropriate provisions are included in bilateral market access agreements between Vietnam and its partners to address this issue.

VI. Conclusion

On the occasion of attending the fourth roundtable meeting to review 20 years of Vietnam' *doi moi* process held in June, 2006 in Hanoi, Pete Peterson, former US Ambassador to Vietnam had the comment that in the last years Vietnam missed some important development chances. Firstly if in the period of the financial crises in 1997 Vietnam had pushed up the *doi moi* process, Vietnam would have attracted enormous FDI funds which had flowed out ASEAN neighbor countries. Secondly, if Vietnam had signed the BTA sooner in 1999, Vietnam would have become a WTO member some years ago (Peterson, Pete 2006).

As in other countries, obviously, Vietnam's policies toward foreign direct investment have been impacted by different viewpoints, and have been influenced by interest groups. As a result policies have become unstable and/or difficult to predict in some cases. However, the tendency of the integration and *Doi Moi* has been growing fast and becomes a dominant tendency in the country. This promises to provide new engines for the further improvement of the investment and business environment as well as new opportunities for foreign investments.

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