Changing Foreign Direct Investment Climate in Vietnam

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This paper examines the current situation of Vietnam's Foreign Direct Investment (FDI) and some of its advantages and disadvantages in attracting FDI since1998 when the Law on Foreign Investment was approved to until 2004.

1 – Overview of FDI development

Since the late 1980s when the Law on Foreign Investment was approved, attracting FDI has become an integral and important part of the Vietnamese reform process. According to the Ministry of Planning and Investment, during the period 1998-2004, there were 6,086 projects licensed with a total registered investment capital of about US$55.95 billion, of which the implemented capital reached U$$27.15 billions, accounting for 48% of the registered capital. Up to now, foreign enterprises have been operating in most of the economic sectors and all over Vietnam. The development of FDI can be summarized as follows:

From 1988 to 1990: FDI started to flow into Vietnam during this period, however, the amount of the FDI flow was far from the government's expectation. With this "new climate", the foreign investors' prudence in seeking investment opportunities in Vietnam is easy to understand. Total registered capital in this period was about US$1.709 billion, of which a small share (25 percent) was implemented. However, from *1991 to 1997,* the flow of FDI into Vietnam was higher than that in previous years both in terms of the number of projects and invested capital, contributing an important part to meet the socio - economic targets.

From 1991 to 1995, the total registered capital gained was US$16 billion, in 1995 alone investment capital amounted to US$ 6.6 billion and was 5 times more than the investment capital of 1991, US$1.257 billion. The total implemented capital in 5 years was about US$ 7 billion which was equivalent to 32% of the total social investment (US$18.6 billion).

From 1996 to1997, FDI flow kept increasing, recording more than US$ 13.3 billion of registered capital and US$ 5.3 billion of implemented capital. It can be said that this period was the highest growth period of FDI. The reasons for this success were the stability of socio-economic environment, cheap labor and the Law on Foreign Investment which was improved due to the

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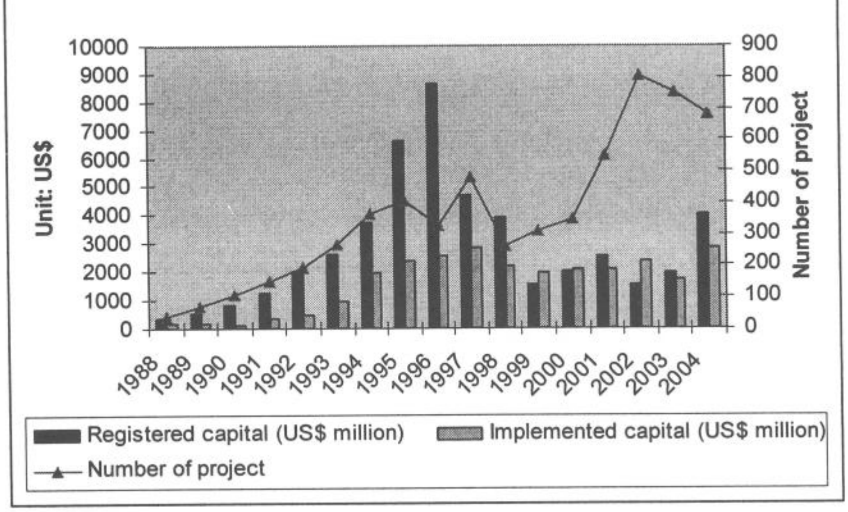
amendments of 1990, 1992 and 1996. In addition, Vietnam is a new area of investment which has many promising investment opportunities.

From 1998 to 1999, as is shown in figure 1, the FDI flow into Vietnam had a down trend, the registered capital in 1998 was US$ 3.897 billion which declined 55% and 6.2% compared with that of 1996 and 1997 respectively. In 1999, the FDI continued to decrease compared with 1998 which had a registered capital of US$1856 and an implemented capital of US$1971 though the number of projects were higher than 1998. This decrease was mainly due to the financial crisis in Asia. According to the IMF (2002), between 1988 and 1998, about two thirds of the disbursed and committed FDI in Vietnam was from Hong Kong, China; Japan; Korea; Malaysia; Singapore; Taipei, China; and Thailand. This crisis drastically reduced and changed the investment outflows from these countries causing the decline of FDI inflows to Vietnam. The investment climate of Vietnam, which is less favourable compared with competitors, also contributed to this investment decrease.

From 2000 to 2003, FDI recovered but at a slow pace. The number of FDI projects in 2001 increased by 59% compared with that of 2000 while registered capital increased by 25.6%. In 2002, the implemented capital and the number of projects were higher than those in 2001 which reached US$ 2345 million and 802 projects (against US$2100 million and 550 projects respectively in 2001). In 2003, the number of projects reduced compared with 2002 but the registered capital was higher, reaching US$1942 million (it should be noted that the law on foreign investment was amended in 2000).

2004 was the first time that the implemented capital achieved its highest level since 1988 with US$ 2850 million and the registered capital exceeded S$4.000 billion. The sharp increase in FDI in 2004 was due to the increase of supplemented capital of the projects which has dramatically increased. As a result, the plan of attracting FDI in the period of 2001-2005 achieved the target at the end of 2004, a year earlier than originally planed. This also proved that the investment climate of Vietnam has much improved and the production and business activities of the investors have been active.

Figure 1: FDI in Vietnam from 1998-2004



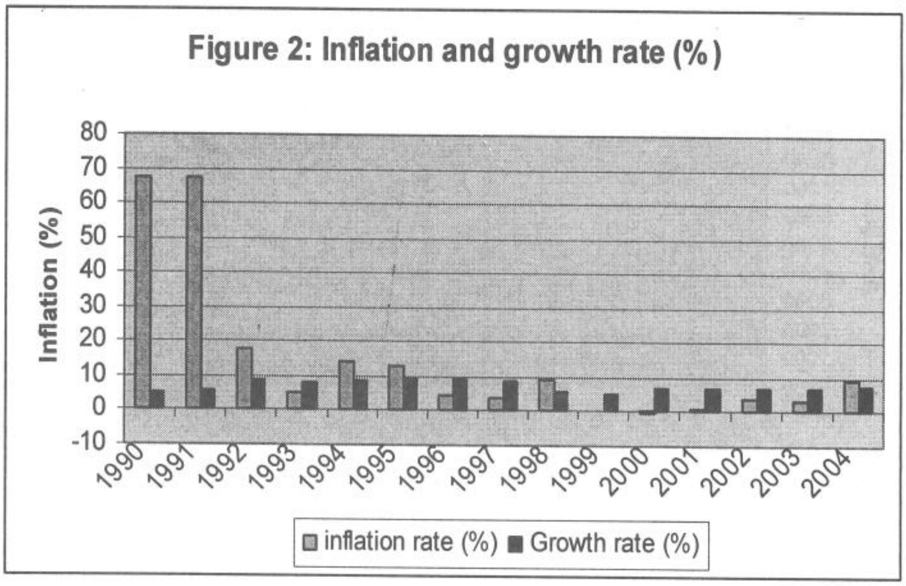
Source: Ministry of Planning and Investment

2. Comparative advantages of Vietnam

2.1Politica land socio-economic stability

According to the investment climate survey after the September 11 event by Political and Economic Risk Consultancy (PERC) of Hong Kong, PERC has ranked Vietnam in the first position among regional countries regarding political and socio-economic stability. In Vietnam, there have not been serious problems related to religions, languages or ethnic disputes. Thus the safety of foreign direct investment is guaranteed. Since 1986 to the present, thanks to renovation policy, Vietnam's economy has grown at a high speed and the inflation rate has been controlled successfully at the level of one digit (see in figure 2). Poverty has been reduced quickly, from 19.9% of the total population in 1993 to 11% in 2000 and 8% in 2004. Vietnamese Human Development Index (HDI) has improved steadily and ranked at 109th position among 173 nations (UNDP, 2003)

These figures are persuasive to make foreign investors confident of both political and economic stability in Vietnam. In other words, it could be expected that the creditworthiness of Vietnam in attracting FDI will be enhanced

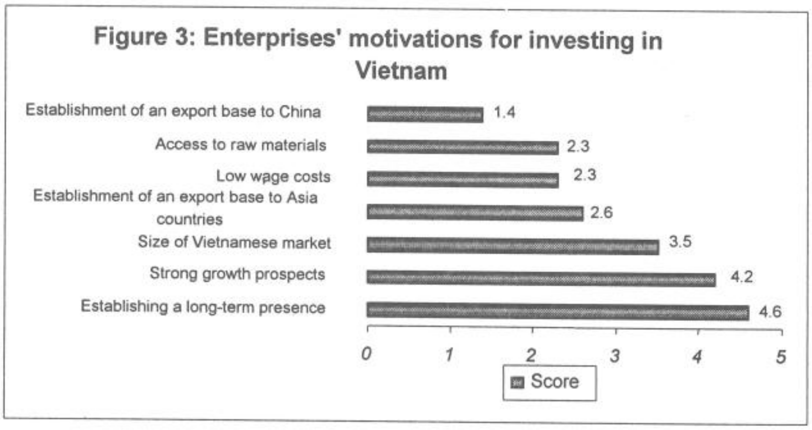


Source: General Statistic Office

2.2 The growth of market and its size

A large market size and rapid growth of the market are very attractive factors to foreign investors. Vietnam has a large domestic market with above an 80 million populations. Although, Vietnam's per capita GDP is still low, it is expected that the high economic growth rate will be maintained in coming years and Vietnam's domestic market with also expand. Remarkable economic achievements in the past years and ambitious targets to increase the per capita GDP eight to tenfold by the year 2020 compared to that in 1990 are a really good indicators for foreign investors.

A survey of 35 Australian firms which are operating in Vietnam confirms that high growth prospects and large market size are two important determinants of Australian FDI (figure 3). The result of this survey also suggests that low labour cost a rich natural resources endowment are favour able factors that attract FDI in to Vietnam.



Source: DoMinhHoai, 1998, p91

Note: Scores are ordered from 1 to 5, of which 1 represents less importance and 5 represents most importance

2.3 Plentiful labour force and low labour cost

At present, Vietnam has a population of about 82,000,000 people, 48% of which are in the labour force, most of whom are relatively young. (GSO, 2001). However, labour supply is higher than labour demand, so labour surplus translates into low labour cost.

According to the data in table 1, it is shown that the labour cost in Vietnam is rather low compared with other countries in Asian region. The worker's salary per month in Hanoi is US$94 compared with US$329 of Kuala Lumpur and US$468 of Singapore. The foreign invested projects in Vietnam mainly rely on cheap labour, natural resources and the domestic market, rather than invest in technology-based areas. Meanwhile, companies operating in high –tech areas only concentrate on assembling and simple processes rather than invest in Research and Development (R&D) in Vietnam.

The abundant labour and low labour costs are comparative advantages of Viet Nam for investors who have suffered from rises in wages. Thus it motivates them to transfer labour –intensive industries to countries in a lower stage of development, like Vietnam. In coming years, low labour cost may still be an important factor of Vietnam in attracting FDI, especially in the manufacturing sector.

2.4. Improving investment climate for foreign investors

Since its promulgation in 1987, the Law on Foreign Direct Investment has been improved through four revisions. The latest revision in 2000 aimed at streamlining it with commitments and requirements of international integration and creating more favorable conditions to attract foreign investment to Vietnam

In 2003, foreign investors were given new, more liberal business rights, especially the rights to choose the relevant type of projects, to choose investment partners, forms and location for projects that do not belong to restricted investment fields. Procedures for granting licences were simplified, which helped to shorten the time to obtain a licence to 15 days for project registering, and 45 days for project appraisal. Dual-price policy between domestic enterprises and foreign enterprises has been abolished.

Apart from that, the Vietnamese government adopted a number of incentives for foreign investors through preferential policies in tax, land, export and import, creating flexibility in transferring capital contributions among parties. Moreover, many obstacles for foreign enterprises have also been removed or become more favourable in government procedures in FDI management, worker recruitment and so on.

Industrial zones and export processing zones have been encouraged and given support for their establishment. The enterprises that have been operating in industrial parks and export-processing zones will be exempt from tax for five years. The government has also abolished the list of commodities that required the export of 85% of their products. The foreign invested firms were also allowed to mortgage their land use rights to borrow from credit organizations (Quynh, 2003).

2.5 Rich natural resource

Natural resources are considered as a determinant of FDI in developing countries, especially in their early stages of development. Vietnam is a country that is endowed with natural resources including forest resources, sea resources and minerals. It was estimated that more than two thirds of population of Vietnam earn their living on natural resources exploitation and more than three fourth of foreign exchange earnings of Vietnam comes from these activities

Among sea resources, considerable oil and natural gas reserves were found and exploited in recent decades. The natural gas reserves in Vietnam are somewhere between 1,652 and 2,212 billion cubic meters (Do Minh Hoai, 1998), particularly on the Southern continental shelf, oil and gas deposits are spread over a surface of 200.000 square kilometres. This implies that it is an attractive investment area for foreign investors. The facts showed that during the early period of attracting FDI, many large TNCs (Trans National Companies) such as Mobil, BP, Shell, etc. have invested in the oil and the gas industries. As a result, FDI disbursements in the oil and gas industry accounted for 22.1 percent of total FDI disbursements during 1988-1996 (Do Minh Hoai, 1998). Besides sea resources, Vietnam has a variety of mineral resources such as coal, iron ore, manganese, bauxite, copper, and tin. The Coal-mining region of Quang Ninh province, which has 3.3 billion tons of proved reserve, has already been exploited. Uranium has been discovered in many places, mainly in the Central Highland and Northern mountainous regions and their reserve is estimated at 200-300 thousands tons; Manganese ore was found in the Cao Bang province with a reserve of 3.2 million tons. Also, iron, bauxite, copper, tin and so on were found in many places in Vietnam. These resources are a lure to foreign investors because raw materials can be directly exported thus easing a shortage of raw materials for production in investing countries, like Japan and Singapore. To summarize, natural resources are considered as one of the factors that attract FDI to Viet Nam when the demand for these resources is increasing both on the domestic and foreign markets.

3. Disadvantages of Vietnam

3.1 High service costs

The ultimate goal of FDI is to make a profit, so high service costs are the first disadvantage for the foreign investors. This conclusion discovered out on the basis of data collected by the Japan External Trade Organisation (JETRO) in 2000. JETRO has published comparison of business costs among regional countries (table 1), in which the cost on international telephone calls, internet fees, seaport costs and electricity costs of Vietnam are exorbitant. For example, international telephone costs from Vietnam to Japan (block of 3 minutes) is three times higher than that in Jakarta, and two times higher than that in Shanghai. It is caused by the dual price system in Vietnam. In addition, personal income taxes (50% of the gross income) are well above regional average.

There was no remarkable improvement in business cost in Vietnam over the past three years. Vietnam's relative cost for housing rent slightly declined, but another important factor such as international telephone and electricity costs showed a rising trend compared with other countries in the region (JETRO, 2003).

Table 1: Comparison of business cost among countries

(12/2000, unit: US$)

	Hanoi	HoChi Minh	Shang-hai	Singapore	Bangkok	Kuala Lumpur	Jakarta	Manila
Worker's salary/month	94	113	248	468	176	329	64	228
Engineer's Salary/month	251	221	447	1313	378	668	190	344
Middle-level manager's Salary/month	511	488	453	2163	727	1407	723	620
Expenses for office lease/ month/ m^2	23	16	24	42	13	17	19	28
International telephone cost (3 minute call to Japan)	8.52	8.52	4.3	2.23	3.11	2.61	2.59	3.78
Personal income tax (highest tax rate %)	50	50	45	29	37	29	30	33

Source: Japan External Trade Organisation (JETRO)

3 .2 Cumbersome legal and administrative system

Despite many improvements, the legal system in Vietnam is still inadequate and the administrative system is very cumbersome. For example foreign investors are entitled to buy only a maximum of 30% of shares of equalized SOEs (State Owned Enterprises), even in the same industries Where foreign investor could fully own an enterprise. This restriction seems to overlook the recent wave of merger and acquisition in FDI in the region. Joint venture (JV) with a domestic private company requires a special licensing procedure, which is more time consuming and more difficult. Several industries and markets are not yet opened to foreign investors. In particular, some new banking services have not yes been introduced to Vietnam , or have not been covered in the legal framework, although they are already committed to allow foreign banks to perform these services in the US-Vietnam bilateral trade agreement.

In addition, legal regulations in Vietnam are fast changing, predictable difficulties and less consistent, especially in tax, foreign exchange, labour regulation, land and jurisdiction. Moreover, red tape, bureaucracy and less transparency are the main weaknesses of the business environment in Viet nam.

To improve the attraction of FDI in the coming years Vietnam should (i) further reform its legal system, making it consistent, comprehensive and effective at the same time; (ii) regard administrative reform as a key measure in improving the investment environment; and, (iii) further develop infrastructure and business supporting services

3.3 Insufficient and weak infrastructure

The development of infrastructure is seen as an initial requirement for attracting FDI. However, physical infrastructure in Vietnam is still weak and underdeveloped. In the existing 200,000 km of roads, only 8.5 percent is in good condition, 65 percent is macadamised. The bridges which cannot support more than a 10 ton container, account for 90 percent while 70 percent cannot carry over 5 tons. There are a total of 12 percent of comnunities which cannot be reached by vehicle. This figure climbs up to 32 percent in the Mekong delta (Nguyen Sinh, 2002). OECF in its annual report for 2002 showed that the paved roads of Vietnam were is 35.9 percent in 2002 which far lagged behind its neighbour's figure: China: 95.7 percent in 2000, Indonesia: 61.2 percent in 2000; Malaysia: 85.3 percent in 2001 and Thailand 99.1 percent in 2001.

The railway system is very old, being built many decades ago. The average speed is around 30-40 km per hour (Nguyen Sinh, 2002). In big cities the only means of public transportation is buses that meet only 20 percent of the transportation demand in Ho Chi Minh City and even less in Ha Noi (Hoang Van Huan, 2002).

The airport system and civil aviation services remain underdeveloped despite the market being opened for foreign entry. Only two airports (Noi Bai and Tan Son Nhat) of the total 21 airfields reach international standards.

Vietnam has a great system of seaports scattered along the coastline. However, the present system of seaports is undereveloped with only a modest capacity. Currently, only four seaports are accessible to containers weighing 10,000 tons. These are in Ho Chi Minh port, Da Nang port, Hai Phong port, Quy Nhon port. Some other large ports such as Sao Mai, Cai Lan, Thi Vai are under construction. If the seaport system is developed, it will release the transport bottleneck and further realise the potential of the country's position in regional transportation network.

In the past, a huge amount of capital has been invested in electric power development, notably the completion of Hoa Binh hydro-power in early 1980s and Phu My I and II thermal-power plants in late years of the twentieth century. Nevertheless, they could not meet the electric demand for industry and household.

There exists a total of about 25 percent of communities without electric power. The price of electricity in Vietnam is higher than in some countries of the region. In Vietnam, Electricity costs for business per KW is about US$ 0.07. Electricity costs for business in Shanghai, Singapore, Thailand, and Indonesia are US$ 0.035, US$ 0.05, US$0.03, US$ 0.0177 respectively (Le Dang Doanh, 2002).

Post and telecommunication is a pioneer in technology updating. However the present achievement is considerably modest compared with its neighbours. On average, in 2002, every 100 people in Vietnam had 10.2 telephone circuits, whereas the figure is 30.4 in China, 17.6 for Indonesia and 59.8 for Thailand in 2002 (Hoang Van Huan, 2002)

In general, the present state of hard infrastructure is insufficient to support the increasing sophisticated business requirements. Therefore, it is an obstacle for attracting FDI in Vietnam.

3.4 Weaknesses of banking and accounting system

For a market economy, banking and accounting operations have a close relationship with investment activities. However, in Vietnam, there remain many weaknesses in the banking and accounting systems. The modern banking services such as business intermediary, service payment settlement via banking system and project consultancy are not well developed. In many aspects, the banking monitoring and inspection system is not in line with international standards and is not very efficient and effective in ensuring strict enforcement of rules and regulations on banking and banking system safety.

Vietnam's banking sector could not cope with the requirements of economic development and investment so it has become an obstacle to investment operation.

Also, there are many discrepancies in accounting systems, in financial information and information disclosure; reliability and legitimacy is not high (for example, accounting standards are not subject to international standards, there is no punishment regime in case of failure to comply with rules and regulations, financial information system has not been paid due attention). The shortage of regulations on information disclosure has been causing many obstacles for enterprise management as well as failing to create confidence for investors.

3.5 Shortage of skilled worker

Although the segment of the labour force with professional qualification continues to increase, it still does not supply enough for foreign investors. In 2003, the number of people with professional qualifications[2] was 8,844,000, representing 21% of total labour force, increasing from 9.7% in 2002. Skilled workers and those with higher qualifications (including skilled workers without certificates) made up 11.8% of the total labour force. However the number of skilled workers remains very low. According to the assessment of Vietnam Business Environment Risk Research Organization, the labor quality of Vietnam gets 32/100 marks and ranks in the weak labor quality group among countries in the world, particularly technical skill. This organization also considers that any country that having under 35 marks run the risk of losing its competitiveness (National Economics University, 2002). As these figures show the quality of skilled workers in Vietnam was much lower than most of the countries in the region. The shortage of skilled workers in Vietnam has been emerging as serious constraints to the effective operation of foreign firms, especially in relatively high- tech projects. The unavailability of high- skilled workers, and middle and senior managers in the long run will make Vietnam's market less attractive if Vietnam does not take measure to solve the issue.

4. Conclusion

In recent years, Vietnam has been known to the world as a country where the reform process has been carried out successfully and its economic growth rate is fairly high in many consecutive years. Reaching these achievements, should be credited to FDI's great contributions.

In the past years, the Vietnamese Government has made a great deal of effort in creating a favourable investment climate to aim at attracting more and more FDI. However, many foreign investors complained that the investment climate in Vietnam remains unfavourable. Thus, in order to better understand Vietnam's investment climate, in this paper, the author tried to provide some

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[2] Persons with professional qualifications mentioned here include those who have been trained or self-trained from the primary level or with professional certifications and higher, regardless of forms and the duration of training

important information about FDI's development from 1988-2004 and examined its advantages and disadvantages. They are concluded as follows:

- For the development of FDI: in general, from 1988-2004, the FDI flow coming into Vietnam has been unstable. In the first three years (1988-1990), the FDI in Vietnam was very low because Vietnam was a new market so the foreign investors were hesitant in making decision to invest in Vietnam. From 1991 to 1997, the FDI flow into Vietnam increased because the Law on Foreign Investment had been supplemented and amended in a positive direction. In addition, the stability of socio-economic environment and cheap labour also actively contributed to this growth. From 1998 to 1999, the FDI into Vietnam had a down trend in both registered capital and implemented capital. This was partly because of the effects of financial crises and partly because of a worldwide decrease of FDI flow. From 2000 - 2003, the FDI had recovered but with a slow pace. In 2004, the FDI flow into Vietnam increased rapidly in both of registered capital and implemented capital, especially in the supplemented capital of the projects that are under operation. This also proved that the investment climate in Vietnam has much improved and the production and business activities of the investors have become more active.

- Vietnam has many advantages to attract foreign investors such as the political and socio-economic stability; larger market size; available labour force and low labour cost, rich natural resources and a consecutively improved investment climate.

- Although theVietnamese Government has made many attempts to improve the investment climate, there remain some disadvantages that discourage foreign investors such as: high service costs, a cumbersome legal and administrative system; insufficient infrastructure; the weaknesses in the banking and accounting system; the shortage of skilled workers.

Although there remain some disadvantages in luring FDI as mentioned above, the author believes that in the coming time, these restrictions will be gradually eliminated because the Vietnamese government is committed to improve its investment environment. Furthermore, in terms of attracting FDI, Vietnam has many more advantages which are more than disadvantages so the author comes to the conclusion that in the near future, FDI flow into Vietnam will continue to increase.

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