CHAPTER 4

Experiences of Vietnam in FDI Promotion: Some Lessons for Myanmar

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Chapter 4

Experiences of Vietnam in FDI Promotion: Some Lessons for Myanmar

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Abstract

Since 1986, Vietnam has carried out various measures to attract foreign direct investment (FDI), in line with deepened integration into the regional and world economies. The legal framework for FDI entry into the country has improved since 1987, with the promulgation of and numerous amendments to the Foreign Investment Law, alongside other legal-economic reforms concerning trading rights, the tarification of non-tariff barriers, etc. These structural and procedural changes facilitated FDI inflows to Vietnam, though such inflows varied during different periods. There are, however, some concerns about the effectiveness of recent FDI inflows, particularly regarding the low ratio of implemented capital over registered capital, and the State's limited ability to manage capital inflows. Vietnam also took some practical steps, and experienced a string of success, in various aspects of FDI promotion – such as the introduction of export processing zones and industrial zones, the supply of infrastructure facilities, the delegation of FDI management authority to local governments, and the dialogue mechanism with the Government of Japan to support FDI operations. Key lessons from FDI promotion in Vietnam include: (i) the use of proper policies to support FDI promotion; (ii) greater focus on establishing a liberal neutral environment; (iii) provision of necessary conditions for the effective decentralization of FDI management; (iv) promotion of supporting industries; and (v) closer consultation with existing and potential investors. Learning from Vietnam's experience, Myanmar needs: (i) an integrative and comprehensive policy agenda towards FDI promotion; (ii) a broad framework for economic reforms that accommodate viable FDI strategies; (iii) an approach to FDI that incorporates elements of gradualism and selectivity; and (iv) a stable, transparent, and predictable policy and economic environment.

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1. Introduction

Vietnam started the Doi Moi (Renovation) reform process in 1986, with the aim of transforming the economy from a socialist model into a market-oriented one. Since then, market production of goods and private ownership (including foreign ownership) of property have been recognized and encouraged. Institutional changes aiming to improve the microeconomic foundations of Vietnam's burgeoning market economy and macroeconomic stabilization have been among the key focal points of the Government. Vietnam also adopted an "open-door policy", pursuing pro-active integration into both the regional and global economies. Such an approach is considered an important pillar for socio-economic development at the national level.

In line with pro-active economic integration, Vietnam has carried out various measures to attract foreign direct investment (FDI) flows. These infusions are essential to equip Vietnam with much-needed capital, technology and management expertise in the country's early stages of economic development. The adopted measures have a rather wide scope, ranging from the provision of a legal framework to other supporting statutes to improve the domestic investment environment. For instance, the Law on Foreign Investment was first introduced in 1987 and subsequently has been revised several times, reflecting the improvement of legal framework for FDI attraction in Vietnam. At the same time, the country gradually has relaxed restrictions on foreign trade, regulations on registration procedures, access to land, capital and foreign exchanges, and initiated tax incentives to promote greater presence of foreign-invested enterprises, whilst improving the business environment. Institutional efforts also were made to create a more level-playing field for foreign and domestic enterprises. Nevertheless, these attempts have failed to achieve uniformity and regularity, thereby leading to significant variations of FDI inflows to Vietnam.

This paper aims to summarize Vietnam's experience in FDI promotion from the late 1980s until today. As a result, a literature-survey-based methodology has been adopted, drawing on published material dealing with Vietnam's FDI policy improvement and actual outcomes of the Government's "open door" approach. The paper simultaneously focuses on some selected aspects, namely the introduction of export processing zones and industrial zones, the decentralization of FDI management, improved access to infrastructure facilities, and the Vietnam-Japan dialogue mechanism to facilitate operations of foreign-invested firms. On that basis, the paper summarizes several lessons from Vietnam's experiences in FDI promotion that can assist Myanmar in its current economic restructuring and surfacing as a newly emerging market.

2. Policies of FDI Promotion and FDI Inflows to Vietnam

2.1 Policies of FDI Promotion in Vietnam

Since the inauguration of Doi Moi in 1986, Vietnam has been pro-active in its pursuit of regional and global economic integration. In actualizing such a transformative process, attracting FDI is among the crucial measures. Along with the country's official adoption of a multi-ownership economy, FDI is critical for national development. Indeed, the promulgation of the Foreign Investment Law in 1987 clearly reflected its importance to the Government of Vietnam. The Law subsequently has undergone four revisions in 1990, 1992, 1996 and 2000. These revisions were implemented so as to increase the rights of foreign investors, to make the investment environment more favourable, and to narrow the policy gap between foreign and domestic investors. The improvements were comprehensive, ranging from registration procedures and the decentralization of investment licensing to land access, trade policy, foreign exchange control, and tax policies. These improvements were induced by such factors like the performance of the FDI sector, changes in the awareness of and views towards the FDI sector, competitive pressures in attracting FDI, and international commitments regarding foreign investment. Notably, the revisions of 1992, 1996 and 2000 were more drastic (see Table 1).

=== Table 1 ===

The Investment Law of 2005 went even further by establishing a more level investment environment for all investors, whilst simplifying the registration procedures for foreign investment. Accordingly, the Central Government has delegated increasingly more the functions and tasks related to FDI promotion and management to both provincial and municipal government authorities.[1] Those FDI projects with a capital scale of less than VND 300 billion, which are not on the List of Conditional Investment Areas, are delegated to the provinces and cities. As the Law serves to prepare Vietnam for eventual accession into the World Trade Organization (WTO), it also abolishes the requirements for FDI enterprises to procure inputs from domestic sources, to fulfill certain export ratio, and to ensure certain localization rate. More equal treatment was also incorporated in the unified Enterprise Law in 2005, which set out the legal framework for enterprises of all ownership types. Specifically, FDI enterprises were adjusted by almost the same regulations on business registration, operations, selection of unconditional investment areas, and autonomy in business decisions.

Vietnam has attempted to facilitate trade expansion and attract FDI by laying the legal foundations for such activities. Entry into overseas markets and engagement in foreign trade, previously restricted to state-owned enterprises (SOEs), has been gradually relaxed for the private sector since 1989. In 1998, all enterprises in Vietnam – public and private – were allowed to trade most goods registered in business licences without export/import licences. Since 2001, this right has become available for all legal entities (including enterprises with foreign capital). Non-tariff barriers (NTBs) were a key component of Vietnam's trade policy until the early 1990s, when the so-called tarification process was installed gradually and replaced the country's NTB regime. This has been a significant development. Vietnam progressively has phased out quantitative restrictions on imports, whilst relaxing foreign exchange controls.[2] Currently, NTBs are applicable as tariff quotas on a limited range of agricultural products only.

To further promote trade and FDI, Vietnam also employed a pro-active open-door policy and embarked on increased global economic integration. In 1995, Vietnam joined the Association of Southeast Asian Nations (ASEAN) and signed the Framework Agreement on Cooperation with the European Union (EU). The process of economic

[1] The experience related to delegation of FDI management will be discussed in greater detail in Section 2.
[2] The foreign exchange surrender rate was reduced steadily from 50% in 1999 to 0% in 2003 for all economic entities.

restructuring slowed down during the 1997-1999 period due to the East Asian monetary/financial crisis. Nonetheless, the years since 2000 have seen strong investment and trade liberalization as well as deeper integration into the global economy. Infusing market economy principles into a predominantly socialist economy took place most rapidly during this period. Vietnam signed a bilateral trade agreement (BTA) with the US in 2000 that came into effect in 2001. The country also became member of the WTO as well as a signatory to various free trade agreements (FTAs) under the ASEAN umbrella, such as those with China, South Korea, Japan, Australia, New Zealand, and India. This integration process has helped to broaden market access for enterprises operating in Vietnam (including FDI ones), whilst affirming the commitment of the Government of Vietnam to domestic economic reforms. Eventually, deeper integration heightens the attractiveness of the country's investment environment, thereby appealing more to foreign investors.

Overall, Vietnam has made significant attempts to reform its trade and FDI policies, and to enhance their role as drivers of economic growth. Such changes were not instigated separately; instead, they took place in concert with wide-ranging domestic structural and institutional reforms. These reforms improved the efficiency and capacity of enterprises, and required trade and FDI corrections to broaden the opportunities for such enterprises. Conversely, the changes in Vietnam's trade and FDI regime, together with economic integration, particularly after accession to the WTO in 2007, have revealed further weaknesses of the economy that necessitate bolder domestic reforms. Thus, FDI promotion is induced not only by FDI policy, but by the interactions of such policy with trade policy reforms and other domestic reforms as well.

2.2 Actual Inflows of FDI into Vietnam

Notwithstanding the efforts of the Government of Vietnam to improve the country's FDI policy, such efforts failed to be uniform over time. Consequently, the period from 1988 to 2011 witnessed different phases of FDI inflows to Vietnam (Figure 1). From 1988 to 1996, FDI to Vietnam went up continuously and rapidly, with newly-registered capital reaching a peak of nearly USD 8.9 billion in 1996. The number of projects also increased from 37 in 1988 to 415 in 1995, before falling to 372 in 1996.

This increase in FDI during this period resulted partly from the expectations held by foreign investor of a newly-opened economy with a large consumer market as well as from attempts of foreign enterprises to penetrate Vietnam's market in the presence of massive import controls. Also, implemented capital went up in absolute terms, but accounted for a decreasing share of registered capital. As a key reason, while this period marked the start of FDI inflows to Vietnam, foreign investor just wanted to register their capital to invest rather than actual flow capital to Vietnam.

The years from 1997 to 1999 saw a sharp fall in FDI inflows to Vietnam, mainly as a result of the East Asian financial crisis and the less attractive investment environment of Vietnam[3] relative to other regional ones. Newly-registered capital decreased on average by 34 percent per annum. Implemented capital went down more slowly, by 3.5 percent per annum on average due to the increase in implemented capital since 1997.

=== Figure 1 ===

In subsequent years from 2000 to 2003, FDI inflows to Vietnam were quite stagnant. Total registered capital fluctuated in the range of USD2.8 billion – USD 3.2 billion. Despite the decrease in registered capital, new FDI projects went up considerably in number, from 391 to 791. Therefore, the average capital scale of FDI projects became smaller. However, during this same period, implemented capital of FDI projects in Vietnam increased slightly from over USD 2.4 billion to over USD 2.6 billion.

Since 2004, FDI inflows into Vietnam began to increase. The large surge in FDI inflows can be attributed to the improved investment environment after passage of the revised Foreign Investment Law, and the granting of permission by the Government to foreign entrepreneurs to invest in some previously State-monopolized industries, e.g. electric supply, insurance, banking, telecommunications (Nguyen Thi Tue Anh, 2005). In particular, the WTO accession in 2007 enhanced the growth prospect of Vietnam, leading to a faster surge in FDI inflows to the country. The number of new projects

[3] Due to the removal of some preferential treatment statutes on foreign investment in the revised Foreign Investment Law in 1996. See Nguyen Thi Tue Anh (2005) for a more detailed discussion.

rose from 811 in 2004 to 987 in 2006, and to over 1500 in 2007 and 2008. Total registered capital went up even more quickly, from over USD 4.5 billion in 2004 to above USD 12 billion in 2006, before peaking at USD 71.7 billion in 2008. Similarly, implemented capital increased more rapidly than in previous years, to US$4.1 billion in 2006, and USD 11.5 billion in 2008, as compared to about USD 2.8 billion in 2004. More importantly, unlike previous years, FDI attraction in 2008 was characterized by presence of many large projects, each of which has billions of USD in registered capital.

Due to the negative impact of the global financial crisis and Vietnam's domestic economic downturn since late 2008, the pace of new FDI registration and the implementation of several FDI projects, particularly large ones, slowed significantly. The number of projects fell dramatically to approximately 1,200 in 2009 and 1,186 in 2011. Total registered capital went down even more sharply, reaching only over USD 23.1 billion in 2009 and USD 15.6 billion in 2011. Implemented capital decreased more slowly, to USD 10 billion in 2009 and around USD 11.0 billion in 2010-2011. Thus, the share of FDI as part of total investment in Vietnam went down to only 25.7 percent in 2009, despite a minor recovery to 25.9 percent in 2011.

Table 2 lists the major sources of FDI for Vietnam in the years from 1988 to 2011. The biggest source of FDI into Vietnam (as determined by country-of-origin) over the period was Japan, with total registered capital of almost USD 24.4 billion. South Korea followed with registered capital of nearly USD 23.7 billion, despite the largest number of FDI projects at 2,960. Other major providers of FDI to Vietnam included Taiwan, Singapore, Malaysia, and the US. Meanwhile, China acquired a rather modest position in FDI rankings in Vietnam, notwithstanding their huge cross-border trade with Vietnam as well as their attempts to enhance bilateral economic cooperation. However, registered capital only considers direct registration by foreign enterprises, without caring for the *actual* origins of their capital. If *actual origins of capital* were to be considered, the rankings would be dramatically different. For example, from 1988 to June 2006, US-related registered FDI is found to be twice as large as the US-reported figure (STAR, CIEM, and FIA 2007).[4]

[4] For further discussion, see Vo Tri Thanh and Nguyen Anh Duong (2009).

=== Table 2 ===

Figure 2 depicts the composition of FDI projects and registered capital by economic activity from 1988 to 2011.[5] The majority of FDI projects and registered capital concentrated primarily in industry and construction, whilst those in agriculture-forestry-fisheries were rather limited. The amalgamated industry-construction sector accounted for 64.6 percent of FDI projects, and 59.2 percent of FDI registered capital. Meanwhile, the amalgamated agriculture-forestry-fisheries sector only attracted 3.7 percent of FDI projects and 1.6 percent of FDI registered capital. The services sector consisted of 31.7 percent in total projects, and 39.2 percent in total registered capital. As an implication, FDI projects in services attained a larger registered capital scale on average than those in the industry-construction sectors and in agriculture-forestry-fisheries sectors.

=== Figure 2 ===

There are, however, some concerns over the benefit of recent FDI inflows to the development of Vietnam's economy. The ratio of implemented FDI over registered FDI tended to go down, from 63 percent in 2004 to 34 percent in 2006, and even 16 percent in 2008. This was partially caused by the fact that some FDI projects were just registered to "book a place" in Vietnam. In fact, the ratio between chartered capital and registered capital was only 25.6 percent in 2008 and much lower than that in the previous years (Vo Tri Thanh and Nguyen Anh Duong, 2009). The ability to manage capital inflows presents another concern. Inflationary pressures induced by the Government's massive supply of domestic currency to buy back foreign exchange in 2007-2008 (for maintaining a stable exchange rate) in the absence of adequate sterilization were a costly lesson for Vietnam.

Looking ahead, Vietnam still needs to make huge efforts to address impediments to its FDI regime. Slower FDI implementation in recent years also stemmed from "bottlenecks" in Vietnam's economy reflecting the inadequacy of State institutions

[5] This discussion focuses on the period from 1988 to 1997 and 2007 respectively due to the unavailability of data for the period from 1998 to 2006.

(despite improvement), infrastructure and human resources. Meanwhile, failure by the Government to stabilize quickly and thoroughly the macroeconomic environment also casted doubt on the effective operations of foreign-invested enterprises, at least in the short term. At the same time, institutional capacity requires improvement in order to enforce better appraisal of FDI projects, thereby deterring those with potentially unfavorable social and environmental impacts on Vietnam. For some sectors, Vietnam also failed to maintain a stable policy environment, which caused reluctance on the part of foreign companies to invest and/or significant adjustment costs for those foreign enterprises already having a presence in the country.

3. Selected Experiences of FDI Promotion in Vietnam

This section attempts to unravel some practical experiences of FDI promotion in Vietnam. In doing so, the section focuses on the introduction of export processing zones (EPZs) and industrial zones (IZs), the supply of infrastructure facilities to FDI enterprises, the delegation of FDI management to the local government authorities, and the dialogue mechanism between the Government of Vietnam and the Government of Japan to support FDI operations.

3.1 Introduction of EPZs and IZs in Vietnam

By the end of September 2012, Vietnam had 283 IZs and two EPZs. EPZ was initially the first choice but IZs were principally developed all over the country. Inappropriately planned EPZs were transformed into IZs or a mixed industrial estate between IZ and EPZ. This sub-section attempts to explain the reasons for failure of EPZ development in Vietnam and to provide some historical background concerning IZ formation. EPZs were set up in Vietnam 30 years after the first EPZ appeared in the world. The sub-section starts by discussing the establishment of EPZs. Next, EPZ development in Vietnam and its subsequent failure will be covered. The disadvantage of EPZs in Vietnam was the first stepping-stone on the path to setting up IZs.

Development of EPZs in the world

An EPZ can be defined *"as an industrial enclave that engages in export manufacturing with the assistance of foreign investment and enjoys preferential treatment that is not generally available in the rest of the country, etc."*[6] According to Warr (1989) EPZs were set up to serve the three main objectives, namely: (i) generating foreign exchange; (ii) employment creation; and (iii) technological transfer; yet only the first two objectives were achieved at a certain level in some countries and territories. Nevertheless, not all the countries achieved their objectives in EPZ development. The first EPZ in the world was Shannon Industrial Estate in Ireland, which commenced operations in 1959. This model was then followed in Asia, with the first EPZs being the Kandla EPZ in India (1965), the Kaohsiung EPZ in Taiwan (1966), and the Masan EPZ in South Korea (1970). In the 1970s, EPZs had been established in both open economies and closed economies.

An EPZ is essentially an enclave in the non free trade system of developing countries attending opening process or remaining in domestic market protection.[7] Amirahmadi and Wu (1995) explained that the attraction of EPZs for developing countries, without a sizable domestic consumer market or abundant natural resources, mainly derived from low labor costs. In non-free trade systems that are prevalent in developing countries, EPZs provide an enclave for FDI in attracting labor-intensive export-oriented production industries. Compared with other instruments of industrial policy, EPZs offer a relatively cheaper alternative for FDI attraction for developing countries in case of a shortage of adequate sources to develop large-scale infrastructure.

In East Asia, the development of EPZs in Taiwan and South Korea achieved great success due to various external and internal reasons. These pioneering economies in EPZ establishment, took full advantage of the overseas relocation of manufacturing plants from industrialized countries in the late 1960s and early 1970s. Besides sound industrial policy, strong government interference constituted a key internal reason for

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[6] Amirahmadi and Wu (1995: 828). Another type of custom-free manufacturing zone that has been introduced is the Export Processing Factory or Custom Bonded Factory which produces exports and receives preferential treatment irrespective of location.

[7] According to WTO rules, incentives applied to enterprises in EPZs to meet export targets or to use domestic inputs instead of imported substitutes to produce export goods are considered as distortion of free trade.

the success of EPZs in Asia (Amirahmadi and Wu, 1995: 836).[8] External factors like the rapid growth of global trade and the access to the open consumer markets of developed countries for manufactured goods from developing countries in the 1960s and 1970s (Bello and Rosenfeld, 1990) also explained the success of EPZs during the period.

Reasons for the decline of EPZs in the world in 1980s and 1990s

Two decades after the first EPZ was established, new economic trends appeared on the international stage. For example, throughout the second global investment wave of the 1980s, EPZs had to compete with each other for modest amounts of FDI (Amirahmadi and Wu, 1994). During this period, the economies of Singapore, Hong Kong, Malaysia, Thailand, Taiwan, South Korea and Indonesia together shared approximately 90% of total FDI inflows to Asia. Hence, insignificant volumes of FDI were directed to the remaining developing countries, thereby lessening the popularity of EPZs in other parts of the world. Furthermore, fewer multinational corporations chose EPZs as their investment destinations. Though EPZs in Asia offered preferential treatment to foreign business concerns, only small enterprises from industrialized countries and even smaller enterprises from newly-industrialized economies (NIEs) came to invest (Amirahmadi and Wu, 1995).

Besides, developed countries began to limit imported products from developing countries. In the late 1980s, Western countries applied protectionist measures against cheap imports from developing countries. Specifically, industrialized countries imposed heavy taxes on products from developing countries. For example, the NIEs failed to gain low-end market in Japan (Bello and Rosenfeld, 1990). As another example, members of the Organization for Economic Cooperation and Development (OECD) imposed a tax four-times-higher on goods imported from developing countries than those from other developed countries (Gallagher, 2003). Consequently, the opportunity for developing countries to infiltrate the consumer market of developed countries during the late 1980s was significantly narrower than before.

Another reason stemmed from the adoption of unsuitable trade policies by

[8] The governments of South Korea and Taiwan aligned activities of the private sectors and labor force through strong interventions like creation of practical standards and subsidizes, ban on activities of labor union in early stage of development.

developing countries that lessen the attractiveness of their exports in the global marketplace. For instance, the Philippines established the Bataan EPZ in an inconvenient area in order to promote that particular region of the country. The cost of infrastructure development for the Bataan EPZ was high. In order to attract FDI investment to its EPZs, the Philippine government offered special incentives (Diokno and Teresa, 1986). FDI enterprises were entitled to approach the Philippine financial market and obtain loans with 'secret' interest rates that were guaranteed by the Philippine government. According to Diokno and Teresa (1986) the Bataan EPZ was set up in 1969 but lasted only until 1986 with just 26% of the EPZ leased.

In addition, as developing countries were incapable of producing essential inputs for enterprises at the EPZs, they had to import these inputs from overseas thus driving up production costs. Moreover, the spillover impact from EPZ development on the host economies was limited. At the same time, the loose connection between EPZs and the rest of the host country's industrial sector gave rise to a dualistic structure that distorted development of the national economy. Only in economies like Taiwan and South Korea did domestic enterprises possess the resources to undertake subcontracting work from EPZ-based MNCs. Raw materials used in EPZs from domestic sources accounted for 45% and 25.5% in South Korea and Taiwan respectively in 1991 (Amirahmadi and Wu, 1995). As a direct consequence of the limited capacity of many host countries to provide needed raw materials for production, EPZ schemes became less popular in the world from the 1980s onwards.

Development of EPZs in Vietnam

The first EPZ in Vietnam was set up in 1991 in Ho Chi Minh City. Among the six nationwide planned EPZs, only two EPZs came into operation whereas the other four were undeveloped, or transformed into either IZs or a hybrid between an EPZ and an IZ (IZ with EPZ factories inside). The EPZ was a favorable model for Vietnam at the time since the country found itself engaged in export-oriented production whilst promoting further participation by foreign-invested enterprises. At the same time, preferential treatment and incentives to these foreign-invested enterprises in the EPZ were by no means illegitimate in the 1990s, since Vietnam had yet to make drastic integration-induced commitments on reducing those treatment and incentives.

=== Table 3 ===

Characteristics of Vietnamese EPZs

Vietnam's EPZs were established 30 years after the first ones had been launched in other East Asian countries. The idea of creating an EPZ in Vietnam arose after Vietnamese leaders paid a visit to the Kaohsiung EPZ in Taiwan in 1989 but only in 1991 was the first EPZ-Tan Thuan EPZ set up in the South of the country. Most EPZ infrastructure developers in Vietnam were from overseas. Unlike those in other NIEs, Malaysia, India, Thailand, and the Philippines, most EPZs in Vietnam were developed by joint ventures between Vietnamese state-owned enterprises (SOEs) and foreign partners - to which Vietnam contributed land use rights. Only one out of six EPZs was set up entirely by domestic capital from a Vietnamese SOE. Therefore, state management function and business management was separated in EPZs in Vietnam. For instance, in Tan Thuan EPZ, the management board undertook state management while the Taiwanese partner was entitled to decide all business activities in EPZ including infrastructure leasing price. This issue was hard accept and controversial at that time.[9]

Difficulties of EPZ utilization in Vietnam

There were several unfavorable factors for EPZ development in Vietnam including shortage of capital, management mechanism and experience, psychological hesitance and small benefits anticipated from EPZs. In the late 1980s, after the EPZ program was launched, some infrastructure development partners came to visit then quietly left. Others who already had signed memoranda of understanding did not promote the investment projects. Additionally, overseas investment promotion trips did not produce the desired effect.[10] Besides, disadvantages in capital for EPZ infrastructure project and the shortage of management mechanism were serious. For instance, EPZ management board did not have its own seal and decision-making right. Thus, to move a cashew nut factory out of Tan Thuan EPZ precinct, paperwork had to pass four state management levels. After a year, the Tan Thuan Management Board finally approved the move of the factory. Vietnam later applied a one-stop-policy for EPZs after studying

[9] Interview with Mr Phan Chanh Duong- project manager of Tan Thuan EPZ in "Industrial zone development in Vietnam, a sink or swim choice" *Vneconomy* 20 April 2005.
[10] Ibid.

similar experiences in other countries. Indeed, EPZ management model was a complete brand new experience for the country.[11]

Moreover, psychological hesitancy continued due to considerable concern that FDI competition would damage weak domestic industries. Therefore, to protect domestic production networks and to avoid debilitating product competition between domestic enterprises, FDI projects were only approved either for the production of goods meant for export or for the production of import substitution goods.[12] In 1988, a Taiwanese investor (now Vedan Company) asked for a license to set up a monosodium glutamate production site with a 100% of product export. Yet there was a doubt that in case of product being unable to export, consumption market was also hard to find. It took three years for the project to get approved.[13] Because of these difficulties, foreign investors were less apt to utilize Vietnam's EPZs.

Reasons for EPZ under-development in Vietnam

From the late 1980s to the early 1990s, as a consequence of a subsidized economy and the United States embargo, domestic enterprises in Vietnam were largely undeveloped. And the number of foreign trading partners was negligible. Export markets were limited to the former Soviet Union and its Eastern European satellites. Since the US lifting trade sanctions on Vietnam in 1994, the number of countries and territories having trade relations with Vietnam has increased substantially. In 1986, the total number of trading partners for Vietnam stood at 43 countries and territories. This number then went up to 90 and 210 in 1995 and in 2005, respectively.[14]

Since Vietnam was trying to engage itself more deeply in the global market, many trade barriers were abolished quickly. In 1995, Vietnam joined the ASEAN Free Trade Area (AFTA). Under the ASEAN framework, Vietnam also signed a number of FTAs with China, South Korea, Japan, Australia, New Zealand and India. In 2007, the country achieved its WTO membership. To satisfy the requirements of the organization, numerous at-the-border and behind-the-border trade barriers were eradicated. At the

[11] Interview with Mr Nguyen Chon Trung, member of Tan Thuan EPZ Management Board in "Industrial zone development in Vietnam, a sink or swim choice" *Vneconomy* 20 April 2005.
[12] Interview with Mr Phan Chanh Duong- project manager of Tan Thuan EPZ in "Industrial zone development in Vietnam, a sink or swim choice" *Vneconomy* 20 April 2005.
[13] Interview with Mr Huynh Van Binh, ex-chairman of Dong Nai Provincial People Committee from 1988 to 1995 in "Industrial zone development in Vietnam, a sink or swim choice" *Vneconomy* 20 April 2005.
[14] GSO (2006: 26).

same time, the preferential treatment and incentives (such as export credits and bonuses), made available to foreign business concerns using EPZs in Vietnam, were no longer permissible. As such, investment in EPZs became a less than viable and attractive option.

Vietnamese EPZs also encountered a less favorable international environment in the 1990s. FDI inflows to developing countries in Asia started to decrease, particularly towards the end of 1990s due to the impact of the East Asian monetary/financial crisis. Meanwhile, developed countries started to act more restrictively against the import of manufactured goods from developing countries thereby restricting Vietnam's access to its more lucrative consumer markets. At the regional level, Vietnam and other Southeast Asian countries had to compete vigorously for an ever shrinking share of FDI from multinational enterprises, yet Vietnam's economy was a new player with relatively underdeveloped production-trade infrastructure and management expertise. Accordingly, few foreign enterprises preferred to invest in Vietnam during the 1990s. Thus, it turned out that EPZ development in Vietnam was not a rational choice, particularly when considering the rapid changes taking place at both the international and regional levels.

Development of IZs instead of EPZs

Despite the decreasing popularity of EPZs globally, many provinces throughout Vietnam in the early 1990s already had plans to launch such trade/manufacturing infrastructure projects. Indeed, the Vietnamese State Committee for Cooperation and Investment (SCCI) had to refuse many applications from provincial authorities for EPZ establishment.[15] As such, governments at the provincial level switched towards the establishment of IZs to promote FDI enterprises, seeking to produce goods for both domestic and foreign consumer markets. The shift from the EPZ to the IZ model was mainly induced by investor demand, which was no longer fond of purely export-oriented production. For instance, in 1988, the Dong Nai People's Committee was approved by the Government of Vietnam to use 200 hectares in Long Binh district (the location of Bien Hoa 2 IZ nowadays) to set up an EPZ. Realizing that an IZ was more appealing to investors (production of goods for sale both overseas as well as

[15] Interview with Mr Lu Minh Chau, Vice-president of SCCI in "Industrial zone development in Vietnam, a sink or swim choice" *Vneconomy* 20 April 2005.

domestically), the Dong Nai People's Committee asked the Central Government to approve the project shift from EPZ to IZ. In fact, this change of industrial-developmental model in Dong Nai province proved to be the right decision. Since the Government promulgated new regulations on IZs in 1994, many IZs have been launched across Vietnam.[16]

The shift from EPZs to IZs was no easy process. The Sonadezi company engaged in developing the IZ in Dong Nai had no experience and capital, and merely proceeded along a trial-and-error approach. At that time, the IZ concept was itself ambiguous. The growing importance of FDI projects obligated the leadership of Dong Nai province to shift to IZ development. For example, Sonadezi introduced a German investor a piece of land next to a highway. The investor refused and asked for another location that was without a transportation system, electricity, water supply, etc. Sonadezi explained that it did not have enough capital to satisfy the customer's demands. The German investor then offered to pay the infrastructure leasing capital based on leasing area to Sonadezi and in return the company has to use the leasing capital in infrastructure development.[17] The contract between Sonadezi and the investor assisted the company to comprehend the process of launching IZs in Vietnam. With the first IZ scheme earning capital of VND 30 billion from the "leasing infrastructure" contract, Sonadezi established the Bien Hoa 2 IZ and the Go Dau IZ to attract 30 projects with a total capital of USD 230 million.

IZ projects quickly became a more attractive alternative for provincial authorities to attract FDI. Induced by the benefits of gradual delegation of tasks and functions related to FDI management as well as public investment management (discussed in sub-Section 2.c), governments at the provincial level in Vietnam enjoyed greater autonomy to develop IZ infrastructure schemes to complement national efforts of FDI promotion. Also, the competition for FDI among the provinces led to the proliferation of IZs all over the country. By the end of September 2012, Vietnam already had 283 IZs that were located in 58 out of 63 provinces/cities.[18] More importantly, the number of IZs

[16] "Industrial zone development in Vietnam: Secret of success." *Vneconomy* 21 April 2005.
[17] Ibid.
[18] http://www.khucongnghiep.com.vn/tabid/65/articletype/ArticleView/articleId/618/default.aspx.

has been rising steadily, even in recent years.[19] These IZs have attracted around 4,300 FDI projects (still in operation by September 2012), with total registered capital of USD 64.8 billion and implemented capital of USD 32.7 billion. The occupation rate of IZs was significant, reaching almost 65 percent by the end of 2011.

The introduction of IZs in Vietnam in the late 1990s avoided the restraints of EPZs, by allowing FDI enterprises to penetrate the domestic market and to mesh the national economy more closely with markets around the world. The abolishment of exporting subsidizes associated with EPZs also helped Vietnam to keep pace with both the global and regional economic integration trends. Given the massive tariff and non-tariff barriers, as well as escalating tariff structures that impose relatively smaller tariffs on inputs, investment into IZs quickly became a more viable option for FDI enterprises. With concomitant IZ development, FDI has been injected into the production of import substitution goods to meet domestic demand in Vietnam as well as to avoid the trade restrictions of exporting to developed countries like during the 1990s. As such, the IZ scheme became an increasingly appropriate model for Vietnam's economic development at both the national and provincial levels. The key risk is how to sequence IZ establishment geographically throughout Vietnam, given the limited availability of public resources and the absence of sufficient private participation in this process.

3.2 Supply of Infrastructure Facilities to FDI Enterprises

After the inauguration of the Doi Moi (Renovation) reform process in 1986, the Government of Vietnam has called for greater investment from the domestic private sector as well as foreign business concerns and individual investors. To support this shift towards a market economy, the country has committed itself to pushing forward the creation of more and better infrastructure facilities for FDI enterprises. Examples of such infrastructure facilities include electrical power grids, road networks, telecommunications, and water lines.

Together with an expanding production base that drove up economic growth, the demand for electricity also went up rapidly. Already in the 1990s, Vietnam's electrical generation capacity was insufficient to meet the huge surge in electricity consumption.

[19] The number of IZs in Vietnam was only 79 by the end of 2005, and 223 by the end of 2008.

Therefore, the lack of electricity became more severe. The issue was even more pressing in the southern part of Vietnam, where early inflows of foreign investment had been present for some time and foreign companies demanded increasing amounts of electricity to cope with rising production and plant expansion. With the installation of high-capacity transmission lines between the North and the South in 1994, this problem was eased to some extent. Due to the existence of such transmission lines, power could be delivered from the North (with excess supply) to the South (with larger demand).

To effectively attract foreign investors, Vietnam since the 1990s has had to make a serious commitment to improving the country's public utility infrastructure. For the manufacturing sector, government authorities at both the national and local levels made prior assurances to provide a stable supply of electricity to foreign enterprises. From the perspective of investors, this vital resource was a necessary obligation on the part of the Government. Foreign business concerns and individual entrepreneurs did not want to risk putting significant amounts of investment capital into Vietnam if their investment capital could not be transformed into outputs and profits.

Together with the building and operation of many power plants under a series of Master Plans, electricity supply has gone up steadily in Vietnam. The figure rose on average by nearly 14.5% per annum over the years 1997-2006, with the minimum rate during the period being 10%. By 2010, supply capacity already amounted to 100 billion KWh, rising by 3.76 times from that in 2000. In the years 2000-2010, Vietnam invested in expanding its power grid and increasing its electrical generation capacity with the installation of 86 thousand kilometers of new transmission wires which thereafter produced 13.3 thousand MWh. At the same time, transmission and distribution losses have fallen noticeably from 21.4% in 1995 to 11.8% in 2005.[20] Still, electricity shortages remain prevalent, which at times threaten the stability of the electrical supply for production. According to UNCTAD (2008) the number of outages was reported at about 10 days each year, implying more than 1 week with electricity disruption for enterprises. Many companies, including foreign-invested ones, had to endure plenty from the huge costs associated with electricity disruption. Over time, these enterprises turned to a relatively less costly alternative, i.e. to buy their own generators for back-up.

[20] See UNCTAD (2008).

In the 2005 Investment Climate Assessment survey by the World Bank, more than one third of the surveyed businesses owned a generator to protect against electricity disruption. Similarly, 7% of those enterprises that participated in the nationwide Enterprise Survey of 2010 claimed that unreliable electricity supply presented a major problem for their business.

Notwithstanding the issue of electricity outages in Vietnam, its severity has been reduced over time. There were several reasons for this accomplishment. On the one hand, the Government has recognized the importance of infrastructure investment *prior to* the promotion of FDI. Underlying this new approach was a more favorable ideological environment in Vietnam towards the introduction of a market economy with various types of ownership. Huge amounts of public finance have been dedicated to building and expanding public utilities such as water and electricity, while the Vietnamese private sector has been increasingly involved as a key stakeholder. Meanwhile, the Master Plans for these sectors also have incorporated more follow-up efforts. At this stage, the Government is on the way to implementing the 7th Master Plan for Power Generation, aiming to significantly increase electricity supply to meet growth-induced demand. Investors highly appreciate this stratagem, since it showcases the Government's commitment to improving the business environment in Vietnam. On the other hand, due to the move towards gradual decentralization, provincial and municipal governments have taken more initiative in appealing to foreign investors to set up shop within their localities. Accordingly, these local authorities have invested in infrastructure projects, including industrial zones and power grids, to attract and facilitate foreign investment.

Even in 2000, when enterprises had access to a stable electricity supply for their production and business activities, the costs they actually incurred in Vietnam were significantly higher than those in other major Asian cities. For instance, the average electricity costs for business operations in Hanoi and Ho Chi Minh cities in 2000 was 7% per KWh, which was twice as high as that in Shanghai, and nearly four times higher than that in Jakarta. Over time, however, electricity costs in USD terms fell in Vietnam due to Government controls over electricity taxes, and the gradual devaluation of the national currency against the US dollar. As such, regarding the cost of electricity, Vietnam experienced drastic price reductions up until 2011 relative to other major Asian cities. For example, while electricity costs for Japanese manufacturing enterprises fell to 5.8 US cents/KWh in 2011 in Vietnam, those in other Asian cities increased steadily and even reached as high as over 21 US cents/KWh in Singapore.

=== Table 4 ===

However, another issue of concern for FDI enterprises in Vietnam was the unstable cost of electricity. Recently, there emerged some alarm amongst foreign investors that the improvement in electricity costs would be reversed, since the Government already has permitted several upward adjustments of the electricity tariff and given signals for similar increases in the future. This adds to the negative perception of the economic prospects of Vietnam, alongside the prevailing macroeconomic uncertainty. For those FDI enterprises which already have established their presence in Vietnam, the adjustment costs may be significant.

Apart from the improved supply of electricity, Vietnam also has invested in its transportation system. In the years 2000-2010, the road transport system has been significantly. The density of road went up steadily from 0.66km per km2 in 2000 to 0.77km per km2 in 2010. The primary road systems and major bridges have been upgraded thoroughly. The connectivity between seaports, airports and roads has been enhanced considerably. Meanwhile, the railway system experienced some major improvement in terms of quality and management. Operational seaports increased in number, reaching 49 in 2010 with widespread distribution all along the coast. Airports became more active, with total number of 22 and air freight capacity rising from 6.4 million passengers and 119.6 thousand tons of goods in 2000 to 31.4 million passengers and 590 thousand tons of goods in 2010.

Other infrastructure facilities also received significant amounts of investment from the Government, albeit to a smaller extent. The telecommunications sector exhibited larger efficiency-enhancing competition, thereby improving the quality of service at drastically cheaper prices. Information technology services were gradually expanded in terms of both scale and scope to facilitate better access of both domestic and FDI enterprises. Water supply lines and treatment facilities were installed in the newer IZs prior to their launch date, though the key concern is with enforcing compliance by FDI enterprises to pay for waste water treatment.

Overall, Vietnam has acted progressively to fulfilling its commitments on infrastructure improvement to support industrial activities, particularly those of FDI enterprises. The key reason for this approach was the official recognition by the Government of the need to support FDI operations, while the scope of using traditional tax and financial incentives has been reduced significantly. At the same time, delegating FDI and public investment management to local government authorities also allowed them more autonomy in infrastructure development, thereby heightening their attractiveness to foreign investment.

3.3 Delegation of FDI Authorization from The Central Government to The Local Government Level from The Late 1990s

In order to effectively and efficiently switch from a central-planning regime to a more free market-oriented model, Vietnam decided to delegate some functions, rights and responsibilities - which were previously reserved for the Central Government - to the lower-level stakeholders, including local governments and State-owned enterprises. Such a hand over was aimed at equipping lower-level agencies and entities with more flexibility to promptly respond to market developments and trends. More importantly, this devolution stemmed from a change in ideology amongst the top leaders of the Government of Vietnam. The Resolution of the VI Party Congress only made way for *"…a clear assignment of task, authority, and responsibility of each level of government, in accordance with the principle of centralized democracy…"*[21]. Subsequently, the Resolution of the 8th meeting of Central Executive Committee (Term VII) stated that *"The authority and responsibility of each level of government must be clearly assigned. Central Government shall resolve the policies at the macro level. Simultaneously, administrative system is decentralized so as to raise the sense of initiative and responsibility of local government"*.[22] The Resolution of the Central Executive Committee (Term VIII) went even further and emphasized more specifically that *"…a task should be assigned to the level of government which can solve it more*

[21] Central Committee of the Communist Party of Vietnam (1987: 118).
[22] Central Committee of the Communist Party of Vietnam (1995: 25).

effectively…"[23].

There were several motivations for the delegation of tasks and functions. On the one hand, flowing from the Doi Moi reform process, economic activities started to increase rapidly, which made it impossible for the Central Government to manage them all. Accordingly, the Central Government needed to entrust some areas/scopes of management activities to local authorities, so that the former can focus on more important issues at the national level. On the other hand, there emerged some greater consensus that provincial/municipal governments faced different advantages and more peculiar issues, therefore, they would be in the best position to deal with local issues. Finally, delegating more power to local authorities would allow provincial/municipal governments to have more autonomy, so that they could act more promptly on local socio-economic development.

As such, the national Party Congress of Vietnam in 2001 summarized the *Doi Moi* (*Renovation*) process, after 15 years of implementation, and advocated the devolution of tasks and functions from the Central Government to local governments in a more distinct way. Specifically, the proposed areas for delegation included the administration, and management of public investment, FDI and official development assistance (ODA). In each of the delegation areas, the proposal called for a more unambiguous assignment of authority and responsibility at each government level, each agency as well as each individual; heightening individual responsibility, commendation and reward, strict and clear disciplines; avoiding of overlapping, passing responsibility which cause difficulty, delay in settling the people's complaints, etc.[24]

Accordingly, the Government of Vietnam promulgated the 2001-2010 Master Program on Administrative Reform, which emphasized the need for new regulations on decentralization between Hanoi and local governments as well as between each level of local government. These statutes enhance the authority and sense of responsibility of provincial/municipal governments. Furthermore, in June 2004 the Governments enunciated Resolution No. 08/2004/ND-CP on "Accelerating the decentralization of State management between Central and local governments" which institutionalized the process of devolution. The Resolution served specific goals in decentralizing State

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[23] Resolution of the 3rd Central Meeting, term VIII.
[24] Central Committee of the Communist Party of Vietnam (2001: 216-217).

management between the Central and provincial governments, namely "*to uphold the dynamics, creativity, autonomy, self- responsibility of local governments on the basis of clear and specific division of functions, tasks, rights, and responsibilities of local governments, etc., to promote socio-economic development in each locality*".

Thus, the delegation of FDI management was not a completely new measure. Instead, it complied with the overall framework for decentralizing power, authority, rights, functions and responsibilities from the Central Government to local authorities. There were, however, several specific problems driving the changes of the previously centralized approach to FDI management. *First,* the Central Government only could prepare and approve those socio-economic development strategies and plans that guided foreign investment activities at the national level. Notwithstanding the bottom-up approach towards formulating strategies and plans which took into consideration the development needs and advantages of local provinces, not all those needs and advantages were incorporated due to the compactness of such strategies and plans. Therefore, foreign investors interested in specific projects and specific localities would encounter lack of clarity in local socio-economic development strategies.

Second, the Central Government had a limited pool of financial and human resources, not to mention a lack of understanding of the localities that hosted the FDI projects. Following the promulgation of the Foreign Investment Law in 1987, and the country's multiple efforts at pro-active economic integration during the 1990s, Vietnam's development prospects were improved significantly. Yet, this shift appealed to foreign business concerns and entrepreneurs. However, confronted with this interest from foreign investors, the Central Government appeared to suffer from a larger workload involving foreign investment management, ranging from attraction, appraisal to monitoring and evaluation of progress, etc. As such, the Central Government tended to focus more on relatively large projects, and overlooked lesser projects that could have served better the development needs of small and poor provinces.

Third, there was doubt about the appropriate approach to selecting host localities for FDI projects. Apparently, the Central Government had the highest authority with all FDI endeavors and could assign them to those localities that were deemed to be most appropriate. Meanwhile, there emerged a larger consensus that by allowing the provinces to consult directly with foreign investors, the latter could have better opportunities to select the localities with relevant advantages (access to land, credit, labour) and benefit from other possible privileges (e.g. preferential treatment) at the provincial level.

Accordingly, delegation of FDI management has been implemented in Vietnam, in line, with delegation of investment management. Following the common Investment Law in 2005 which adjusts both domestic and investment activities, foreign investment was drastically delegated to the local provinces. Specifically, those FDI projects (that have a capital scale of less than VND 300 billion and which are not on the List of Conditional Investment Areas) are delegated to the provinces and cities. The responsible agencies at the provincial level are responsible for activities related to appraisals, granting investment licences, adjusting investment licences, and monitoring and evaluating progress of projects. For other projects, the Central Government still retains full authority. Even so, in recent years, the provinces were granted more flexibility to work with foreign investors to bring large FDI projects (worth billions of USD) to their localities, after completing formalities with the appropriate Central Government agencies.

More importantly, such consignment does not take place on its own. Instead, along with delegated authority for FDI management, the local governments were also permitted to approve their own socio-economic development strategies and plans. This could, in principle, serve as an important guideline for foreign investors in considering whether they should invest in the localities or not. At the same time, provincial/municipal governments had delegated power to develop, approve and monitor public investment projects that could help improve local infrastructure. For instance, some public investment projects directly targeted the infrastructure facilities in local industrial zones, which better improve the local business environment.

However, the devolution of FDI management has not been smooth. The motivation for Central Government agencies (particularly the Ministry of Planning and Investment - MPI) to oppose decentralization was obvious. On the one hand, Central Government agencies wanted to retain their authority with all FDI projects, rather than with only a small number of large projects. This authority equipped the small number of responsible officials with lots of power, alongside duties, in FDI management. In this sense, handing over FDI management duties to the lower-level government authorities would make Central Government agencies relatively less powerful in the process. On the other hand, there were reservations that the management of FDI projects at the national level would become more difficult, as the neighboring provinces might compete in a race-to-the-bottom for a single project.

The delegation of FDI management, together with more comprehensive institutional reforms and pro-active international economic integration, led to the boom in foreign investment in Vietnam during the 2000s, particularly between 2006 and 2008. Local governments became more active in searching for FDI projects of relevance that would satisfy their own development needs, so long as they also comply with national plans and strategies. For example, several provinces in the South now have opted against FDI projects in labour-intensive industries such as textiles and garment since they lead to increasing inflows of migrants from other provinces and associated social challenges, even though such industries remain the key drivers of national exports. The personnel of local governments also added to the pool of human resources available for attracting, appraising, approving and monitoring FDI projects, thereby simplifying the attendant administrative formalities. The rankings of provincial competitiveness, as reflected by the Provincial Competitiveness Index (PCI), also illustrate the progress and problems of different provinces in facilitating business investment activities, including those of foreign entities.

Nevertheless, the consignment of FDI management also led to some serious problems in practice. *First,* delegation of FDI management failed to be accompanied by sufficient improvement in the capacity of local officials to undertake the required tasks and functions. For instance, some local provinces were in dire need of FDI projects to polish their performance reports, and failed to improve their capacity to appraise FDI projects. Some actual projects then turned out to be problematic, due to their polluting impact upon the local environment. Various other projects were also stalled, even withdrawn in different provinces, due to the failure to mobilize sufficient capital as per registration. That is, easing the appraisal process then led to actual problems during project implementation, which imposed significant costs on the local economy and people while necessitating costly adjustment of projects.

Second, FDI management was transferred to the localities in the absence of more effective bodies to coordinate investment at the regional level. Accordingly, many provinces have displayed a tendency to compete with one another for similar projects. Eventually, the economic structures of many provinces, driven largely by investment activities, were somehow similar. For example, some neighboring provinces in the southeast of Vietnam have relied significantly on labour-intensive industries such as textiles, garment and footwear. Meanwhile, from 2007 to 2008 various well-endowed FDI projects were registered to produce construction steel throughout the country, despite claims of excess capacity. This duplication of investment then represented some costs to resource allocation, particularly as many FDI projects relied heavily on locally mobilized capital.

Accordingly, Vu Thanh Tu Anh et al (2007) portray the issue of "fence-breaking" as local authorities providing incentives to lure foreign investors to their particular locality. It must be noted, however, that the less developed provinces (in terms of GDP per capita, level of urbanization, and infrastructure) were more likely to "break fences" and, even so, tended to be outperformed by the non-fence-breaking provinces in terms of investment attraction. Various "fence-breaking" practices were also identified, including investment premia, accelerated depreciation, tax holidays, reduction of land use fees.

Third, at the national level, Central Government agencies have difficulties in monitoring foreign investment due to inadequate reporting by local agencies. By law, those agencies responsible for foreign investment management either at the provincial or municipal level had to submit *prompt* reports on attraction, implementation, and evaluation of FDI projects to the relevant Central Government agencies (particularly the Foreign Investment Agency under the MPI). Nevertheless, actual compliance on the part of these lower-level authorities was not seen to be satisfactory, in terms of detailed disaggregation of data and/or timing of report and/or adequate explanation of progress/problems with FDI management in the locality. This prevents the Central Government from having a detailed picture of foreign investment activities, which in turn thwarts relevant and proper measures for FDI management at the national level. The failure to manage capital inflows between 2007 and 2008, which triggered high inflation and macroeconomic instability in Vietnam since mid-2008, also originated partly from this circumstance.[25]

3.4 Dialogue Mechanism between The Government of Vietnam and The Government of Japan to Support Japanese Business Operations in Vietnam

Since the start of FDI inflows, Vietnam always has emphasized the need to attract investors from technologically advanced countries such as Japan. In doing so, the initiation of a formal dialogue mechanism was considered essential to facilitate understanding of investors' needs. Since late 1990s, with an aim to strengthen bilateral relations, Vietnam and Japan decided to organize the Vietnam–Japan Trade and Investment Working Group. This forum is held regularly by both countries with the involvement of pertinent government agencies and key industrial stakeholders. The first working group convened in 1999 and revolved around a discussion on investment and trade-related issues, specifically pertaining to Vietnam. The aim was to develop roadmaps for future joint activities. From Vietnamese side, the MPI played a key role in this mechanism.

As its work agenda, the Working Group followed up and facilitated the implementation process of basically all the actions to be taken by the Vietnamese Government and industries' stakeholder. However, the agenda excluded those issues directly related to the construction of economic infrastructure and other actions related to individual companies, as there were other mechanisms/fora to address these topics. The Working Group consists of different working teams, each of which followed relevant action in the overall agenda. Meanwhile, for each individual industry (such as automobiles, motorbikes, electronics, etc.), the related issues and actions were to be covered in the policy dialogues between the Government of Vietnam and each Japanese industry association.

In 2000, Japan and Vietnam then held their second working-group meeting, with the focus on expanding bilateral trade and investment. Participants at the forum included government officials of both countries, Japanese enterprises with production

[25] For further references, see Vo Tri Thanh and Nguyen Anh Duong (2009).

bases in Vietnam, and Vietnamese enterprises – state-owned and private. During the meeting, the Japanese side called for Vietnam to make further efforts to improve the business environment in general and to reduce barriers to foreign investment in particular. Specifically, Japan requested that Vietnam to resolve red-tape issues and to accept wholly foreign-owned companies into a broader range of industrial sectors, among other things. The direct impact of these changes was not restricted to Japanese FDI firms alone; instead, it was even extended to all FDI firms irrespective of capital source.

Regarding the issue of bureaucratic red tape for Japanese enterprises in particular and for foreign-invested enterprises in general, the MPI has been actively promoting administrative procedural reforms in Vietnam, especially in the areas of business registration and investment management. Since early 2000s, the MPI has followed the Government's guidelines declared in Project No. 30 on simplifying administrative procedures. To that end, the MPI has worked with relevant agencies to simplify the process related to business entry. For example, the one-stop-shop mechanism has been in effect the past 5 years to allow simultaneous applications for business registration, tax number filing and for official seals, which have reduced considerably the time and costs related to starting up a business in Vietnam. With a leading role in drafting the Enterprise Law, the Investment Law and other authoritative documents, the MPI also relaxed the entry conditions for enterprises, including foreign-invested ones. A notable policy change since 2005 has been that the enterprises can do anything that is not prohibited legally.

Drawing from the early positive outcomes of the Trade and Investment Working Group, Vietnam and Japan decided to develop this mechanism into Vietnam-Japan Joint Initiative in 2003. Over time, the scope of the original dialogue and mechanism was extended gradually well beyond those issues directly affecting the business environment. As an example, noting that macroeconomic instability since mid-2008 could affect long-term investment on the part of FDI firms (including those from Japan), the MPI, the Embassy of Japan, and the Vietnam-Japan Economic Committee (under the Japanese Business Federation, i.e. Keidanren) agreed to work on macroeconomic stabilization in July 2010.[26] This agenda would serve to facilitate more sustainable, long-term development of Vietnam, whilst consolidating the confidence of foreign investors in Vietnam's economy, thereby promoting further FDI inflows. Without a doubt, a stable macroeconomic environment will benefit all FDI firms, not just Japanese ones.

In recent years, Vietnam has extended this dialogue practice to a number of other trade partners. The US, EU, Japan and others frequently have meetings with the Government of Vietnam as well as other Vietnamese agencies to discuss issues related to trade mechanisms, investment protection, and other related policy supports for foreign investors in Vietnam. This makes way for a number of actions to improve current legal regulations and to address major restrictive impediments in the business environment, thereby supporting the operations of FDI enterprises in Vietnam. At the same time, such dialogue helps explain the policy stance of the Government of Vietnam, while seeking greater consensus of foreign investors. Finally, this communicative approach assists foreign partners to understand the Central Government's capacity building needs in order to improve FDI-related policymaking in Vietnam.

4. Lessons from Vietnam's Experience of FDI Promotion and Implications for Myanmar

Vietnam has experienced a sufficiently long process of FDI promotion, with notable successes and failures. At this stage, the country still depends on the vital role of FDI in inducing greater technological progress and productivity improvement to enhance long-term growth prospects of the country. Looking back, however, it remains essential to draw out relevant lessons in FDI promotion, not only for Vietnam's own sake but also for other latecomers in the process. Some of the key lessons are as follows:

[26] Embassy of Japan in Vietnam (2012).

First, FDI promotion can be effective only if it is accompanied by proper policies. At the broad level, the guidelines for FDI promotion, including the areas and modality for foreign investment, should be clearly and properly identified. More importantly, such course of action must comply with overall guidelines for economic development, as reflected by well-coordinated socio-economic development strategies at both the national and regional levels. This stratagem will enhance the confidence of foreign businesses and entrepreneurs that their investments are secure and protected. Implementing the wrong policy would otherwise prevent the beneficial effects of FDI promotion from being actualized.

Second, a liberal neutral environment – which involves little restrictive barriers to business and investment activities as well as insignificant discrimination between enterprises of all types - is better than heavy financial incentives for attracting efficient FDI. In that sense, improving overall competitiveness is very essential. This can be accomplished via institutional modifications, economic structural reform, improvement of investment environment and the cutting down of business costs. While public investment still has an important role in economic development, it should be re-directed to those areas creating positive externalities for business activities such as infrastructure and information provision. To that end, early commitment to the process by the Government is essential, while efforts of the Government to fulfill such a commitment are indispensable.

Third, delegation of FDI management is indispensable, but the benefits regarding FDI promotion are by no means automatic. Allowing local authorities more autonomy in attracting, appraising, approving, and evaluating FDI projects will lead to better relevance and contribution of such projects to local needs and conditions. The Central Government must take steps: (i) to build up necessary capacity and resources for local counterparts to fulfill their decentralized tasks and functions; (ii) to harmonize national interests with local benefits in FDI attraction; (iii) to ensure strict compliance with reporting requirements to facilitate a thorough understanding of FDI at the Central Government level; and (iv) to enforce effective coordination and monitoring of foreign investment at both national and regional levels.

Fourth, developing supporting industries is very much related to sustaining FDI enterprises. In addition, development of FDI projects must go hand in hand with the development of a human resource base as well as the creation of a level playing field that will create a favorable business environment for all economic entities. FDI, of course, can play an important role in developing supporting industries, for example, through the promotion of joint ventures between (private) domestic SMEs and foreign partners in supporting industries. In this regard, there is a need to support and to give some incentives from the Government. It is also very crucial to establish closer links between higher value-added services and manufacturing.

Finally, effectiveness of FDI promotion can be improved via closer consultation with both existing and potential foreign investors, as well as with domestic stakeholders. Through such a consultative process, the Government can better understand the investment needs of foreign investors, whilst being prepared to resolve any issues that foreign businesses or entrepreneurs may encounter. From an investor's perspective, investment protection is crucial. Yet even in the absence of a formal provision or agreement on investment protection, close consultation between the host country and foreign investors, and between the host country and partner countries will help strengthen mutual confidence. Ultimately, this close consultation will be transformed into better alignment of FDI projects with local development needs.

Vietnam's experience with FDI in the past decades could have important implications for Myanmar in developing its FDI policy. *First,* Myanmar needs to have a suitable politico-ideological environment that is open towards FDI promotion. FDI may constitute a good source of much needed capital for economic development in Myanmar's early stages. However, of greater importance, are the technology transfers and other positive spillover impacts embodied in such capital flows. As such, Myanmar should pay close attention to gaining such attendant benefits, rather than concentrate on the volume of foreign capital inflows alone.

Second, FDI policy must fit in with Myanmar's broad framework for economic reforms. The benefits from FDI would be more if it is based on Myanmar's comparative advantage in industrial and trade structures. Improvements would also be necessary to make the business climate more favorable to the operations of foreign enterprises. In addition, the desired FDI inflows may not materialize effectively in the absence of supporting fundamentals for business operations, specifically labour skills, and soft and hard infrastructures. Prompt efforts by the Government to provide technical training for its labour force and to develop the requisite infrastructure system, particularly in those areas related to potential industries for FDI, should therefore be consistent with the FDI policy itself.

Third, Myanmar needs an approach to FDI that incorporates substances of both gradualism and selectivity. Since FDI policy must be an integral part of an overall reform process, it should come through incremental adjustments to ensure relevance and effectiveness, whilst permitting other supporting policies to emerge. Besides, attracting FDI inflows into a large range of sectors/areas without caring about their contribution to Myanmar's development targets may leave the country with adverse consequences, including inefficiency of resources and low absorption of FDI. A possible approach for Myanmar is to start by attracting foreign investment in those sectors/areas with static comparative advantages and those with sufficiently close acquisition and supply linkages. This should then be followed by relevant incentives to induce foreign investors in building up dynamic comparative advantages for the country. Along with this process, consultation with potential investors and other stakeholders should be of immense importance.

Finally, FDI attraction is only viable if the policy and economic environment for private business operations embodies the essential elements of stability, transparency, and predictability. Foreign investors with an established presence in Myanmar would prefer a stable environment to make sound production and business decisions. Maintaining macroeconomic stability should lay the first ground of critically support such decisions. Meanwhile, a stable policy would enable investors to make long-term investment decisions. Otherwise, sudden and unexpected changes (sometimes reversals) of policies, including those related to foreign-invested industries, are detrimental since they may offset the previous efforts of firms with significant (and even unrecoverable) adjustment costs. The costly experience with the automotive industry in Vietnam – whereby policies to support the sector were then offset by the policies to restrict use of automobiles - presents a good example as to why such changes should be minimized. With this lesson in mind, further concretization of political and economic reforms, with explicit acknowledgement of foreign business entities' aspirations, should essentially be a profound start to enhance stability and predictability for business operations in Myanmar.

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Table 1: Key changes in Vietnam's Foreign Investment Law in 1992-2000

Policy areas	*Revised Law in 1992*	*Revised Law in 1996*	*Revised Law in 2000*
Registration procedures	+ FDI licence shall be granted within 45 days + After being licensed, FDI enterprises still have to register their business	+ FDI enterprises are allowed to choose forms of investment, rate of capital contribution, investment location and Vietnamese partner + Enterprises with export proportion of more than 80 percent are given priority in granting license	+ Publishing the list of FDI enterprises which are permitted to make business registration, without FDI licence. +Removing registration related fees
Decentralizing registration/licensing process Areas	+ Encouraging joint venture with domestic enterprises; restriction of enterprises with wholly foreign-owned capital	+ Encouraging FDI enterprise with export-oriented and hi-tech industries	+ Publishing the list of projects calling for foreign investment in the period 2001-2005 + Expanding areas for foreign investment, allow FDI in housing construction; + Diversifying the investment forms; +Allowing foreigners to buy stock of domestic enterprises
Land	+ Vietnam is responsible for compensation, site clearance for foreign-invested projects + FDI projects may rent land for operation, but are not permitted to re-rent land	+ Local People's Committee shall help foreign enterprise with site clearance upon project approval; The enterprises shall make payment for site clearance to the People's Committee + The FDI enterprises may rent out the land in industrial zones, export processing zones to other firms	+ May use the construction attached to land and value of land use right as collateral for borrowing loan

(Continue)

Policy areas	*Revised Law in 1992*	*Revised Law in 1996*	*Revised Law in 2000*
Capital requirement	+ Legal capital must not be smaller than 30 percent of total investment capital		
Policies on Exchange rate, foreign currency	+ the Government shall guarantee foreign exchange balance to FDI projects in infrastructure facilities and import substitution sectors. + FDI enterprises in other areas shall have to arrange foreign exchange balance themselves; the State shall not be responsible for foreign exchange balance in such projects.	+ Self guarantee of foreign exchange balance + Apply the surrender rate (80 percent) due to regional crisis, then gradually release this rate. + The enterprises may purchase foreign currency from commercial banks with the permission from the State Bank of Vietnam	+ May purchase foreign currency from commercial banks to meet transaction demand, in accordance with the law; + Not requiring approval on capital transfer; Reducing the fee on profit remittance abroad. + Reducing the surrender rate from 80 percent to 50 percent, 30 percent and 0 percent
Policies on import, export	+ Foreign firms must meet export proportion target as declared in investment licence; + The products of FDI enterprises must not be sold in Vietnam via dealers + FDI enterprises must not act as dealers for imports - exports	+ Entirely removing the regulation that the export plan of enterprise must approved by authorities; + Improving import-export procedures with regard to certification of origins	+ Reducing number of areas with requirement for export proportion target of 80 percent; + FDI enterprises may act as dealers for imports - export services
Tax policies	+ Preferential tax for FDI in areas with given priority: corporate income tax of 10 percent within 15 years of commencement of operation; + The regulation on the income	+ Exemption of import duties on machinery, equipment, specialized means of transports, raw materials, etc. for production and business of FDI enterprises; +Exemption of import duties for	+ Removing regulation that the FDI enterprise has to allocate their certain profit proportion to reserve fund;

(Continue)

Policy areas	*Revised Law in 1992*	*Revised Law in 1996*	*Revised Law in 2000*
	tax on wholly foreign-owned enterprise does not allow the deduction of profit in later years to compensate for the loss in previous years; + The FDI enterprises must exclude some items from production costs; + import duties are calculated based on the low import price applied for calculating tax;	projects in prioritized industries, regions within 5 years of commencement of operation; + FDI enterprise those have export can get tax exemption while import raw materials for their production; + The firms supplying inputs to export enterprises are exempted from import tax on raw materials, intermediate goods with corresponding proportions;	+ Further reform the tax system; gradually reduce the tax gap between domestic and foreign investment

Source: Extract from Nguyen Thi Tue Anh (2005).

Table 2: Major Providers of FDI to Vietnam, 1988 - 2011

	Number of projects	*Registered capital (Mil. USD)*		*Number of projects*	*Registered capital (Mil. USD)*
Total	**13,440**	**199,078.9**			
Of which:					
Japan	1,555	24,381.7	Cayman Island	53	7,501.8
South Korea	2,960	23,695.9	Thailand	274	5,853.3
Taiwan	2,223	23,638.5	Netherland	160	5,817.5
Singapore	1,008	22,960.2	Brunei	123	4,844.1
Virgin Island	503	15,456.0	Canada	114	4,666.2
Hong Kong SAR	658	11,311.1	China	833	4,338.4
Malaysia	398	11,074.7	France	343	3,020.5
United States	609	10,431.6	Samoa	90	2,989.8

Source: GSO.

Table 3: Planned EPZs in Vietnam

Name	*Location*	*Developer*	*Area (ha)*	*Infrastructure capital (m.USD)*	*Planned establishment year*	*Current situation*
Tan Thuan EPZ	Ho Chi Minh city	Joint-venture with Taiwan	300	89	1991	In operation
Linh Trung EPZ	Ho Chi Minh city	Joint-venture with Hong Kong	60	14	1992	Mixture EPZ-IZ
Da Nang EPZ	Da Nang	Joint-venture with Malaysia	63	13	1993	Shift to IZ
Noi Bai EPZ	Ha Noi	Joint-venture with Malaysia	100	30	1994	Shift to IZ
Can Tho EPZ	Can Tho	100% Vietnamese state owned enterprise	57	8	1995	Mixture EPZ-IZ
Hai Phong 96	Hai Phong	Joint-venture with Hong Kong	150	75	1997	Undeveloped

Source: Nguyen (2002) and Vietnam IZ Bulletin 2002, June.

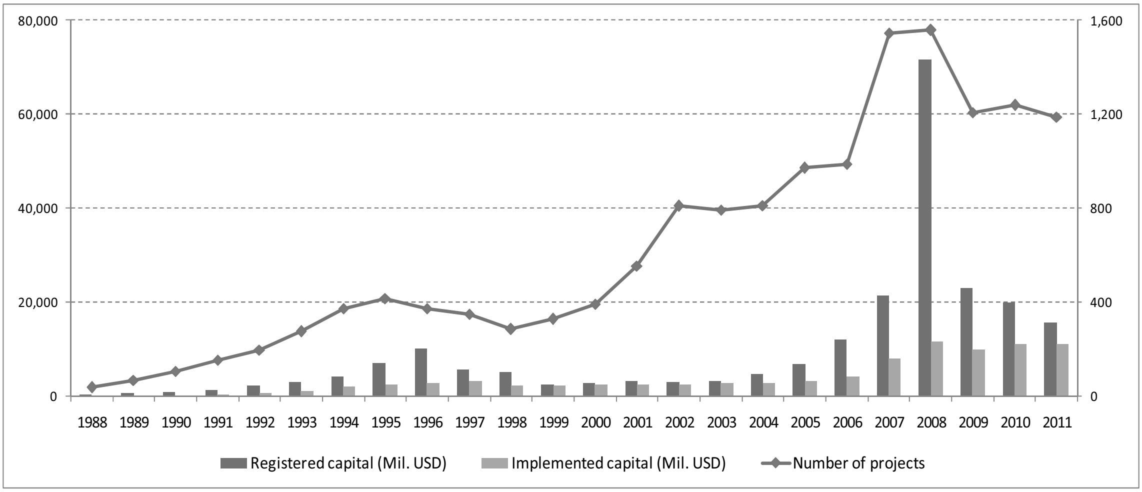
Table 4: Electricity Costs for Business in Various Asian Cities, 2000-2011

Unit: USD/KWh

	Hanoi	*Hochiminh*	*Shanghai*	*Singapore*	*Bangkok*	*Kuala Lumpur*	*Jakarta*	*Manila*
2000	0.07	0.07	0.035	0.05	0.03	0.06	0.0177	0.09
2011	0.058	0.058	0.14	0.2167	0.14	0.07	0.08	0.14

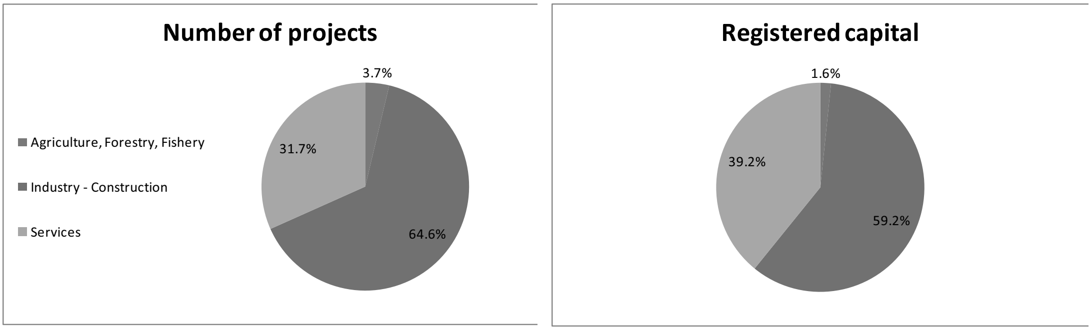
Source: JETRO (cited in Le Dang Doanh 2002); JETRO (2012).

Figure 1: FDI Inflows to Vietnam, 1988-2011



Source: General Statistics Office (GSO).

Figure 2: Composition of FDI by Sector, 1988-2011



Source: GSO.