POSITION PAPER OF AUTOMOTIVE WORKING GROUP

Prepared by
Automotive Working Group

I. GENERAL OVERVIEW OF THE VIETNAM'S AUTOMOTIVE INDUSTRY

Automotive industry - Introduction

The automotive industry is usually considered a symbol of the progress and development of a nation. In addition to providing and supporting the means of transportation for the citizens, the automotive sector plays a vital role in the enhancement of efficiencies of overall supply chain and growth in business and commerce.

Automotive industry's contribution to Vietnam's GDP

Automotive industry consists of a multi-tiered business model consisting of suppliers, manufacturers, and dealers. This combined multi-tiered automotive business model adds up to contribute at significant levels to the GDP of a country. Different estimates have indicated this contribution at Vietnam to range from **3-5%.** This is small when compared to the adjoining countries i.e. Thailand where the automotive industry has a strategic relevance to trade and export growth and is estimated at contributing approx. 10% of the manufacturing GDP. However, the auto industry's importance to Vietnam should not be underestimated.

Although Vietnam contributed to only 3% of ASEAN production and 4% of ASEAN sales in 2011, the potential of Vietnam is high and if adequately leveraged the industry can contribute more actively and significantly to the development and growth.

Sizeable direct employment provided by the industry

The industry is still a significant employer with more than 60,000 people working in the factories of Vietnam Automobile Manufacturers' Association (VAMA) members. If this number were to be expanded to include the other Original Equipment Manufacturers ("OEMs") and 2 wheelers and parts & component suppliers and dealers the number would be much higher. Initial guess estimates lead the numbers to be close to 125,000.

Additionally taking into account family dependants, there are more than 500,000 people whose livelihoods depend on are linked with the automotive industry. The number has been arrived by taking into account automotive dealerships where approximately 50 people are employed at one facility.

Tax collected from the automotive sector

The high taxes on automotive assembly and imports generate sizeable income for the Vietnamese Government. Local assembly kits (CKD) face an average import tax of 20%, while imported CBU vehicles bear a 68%-78% import tax, made up of 45%-60% Special Consumption Tax, 10% VAT and 10%-20% Registration tax. Finally the CIT on importers, assemblers and dealers adds to make the industry a major taxpayer in Vietnam.

From January to August, 2011 some 27,100 CBU generated US$670 million in tax and 40,229 CKD about US$653.7 million. From January to August, this year some 9,509 CBU imports generated US$183.6 million in tax revenue, while 21,030 CKD amounted to US$273.4 million, down by 55% in volume and 65% in tax revenue. As a result, there was a US$867 million variance against the corresponding to period last year.

Technology transfer to the country

Over the years Automobile industry has continuously brought into Vietnam the latest technology in assembly and manufacturing processes in the entire supply chain, trained, upgraded and transferred new skills and knowledge to the Vietnamese labor force by dispatching numerous relevant oversea experts to Vietnam as well as dispatching selected relevant Vietnamese staff to be trained in overseas which will ultimately lead to Vietnam accumulating technology, skill and knowledge.

Vietnam's motor vehicle assembly industry is tax protected and as such it has an underutilized capacity. Technical CKD investment requirements discourage new entrants. Sub-contracting assembly to existing operators is proving a challenge tax-wise, as technically the importer is not the assembler and parts are considered CBU rather CKD, tax-wise.

Creating an environment to generate local content for ASEAN exports

As Vietnam's market lacks the necessary scale to generate its own growth and volume, the only way left to compete with bigger and more experienced ASEAN automotive production bases like Thailand, Indonesia or Malaysia is to benefit from their development by supporting their industries via automotive parts-related SMEs. To incentivize foreign companies to set-up such operations in Vietnam, export processing zones already exist. Allowing such companies to sell a percentage of their products on the local market would develop local sourcing capacity for Vietnam and regionally.

II. OPPORTUNITIES FOR THE AUTOMOTIVE SECTOR

1. Growth and development opportunities in the sector

Vietnam has a population of nearly 90 million that is expected to reach 100 million within a decade. The per capita GDP is US$1,300, expected to rise to US$4,000 by 2020. These two factors will impact on car spending habits, especially when the current car density per 1,000 Vietnamese citizens is two. Similar growth across other countries has resulted in an increase in consumption of automotive products leading to automotive industry growth.

Vietnam holds a strategic position within the Asean and Asian supply chain and manufacturing footprint plans. A number of automotive companies in Vietnam have underscored the nation's potential to become a major ASEAN production hub and export base. Furthermore, Vietnam's WTO accession has laid the foundation for favorable legal conditions to entice investors. Besides, Vietnam is attractive with a dynamic and young population, which is a huge source of low labor cost and utilities.

The auto industry's growth has developed and promoted the skill sets of Vietnam's work force, while increased business opportunities with a higher volume and familiarization with international products will develop workers' skills. Meanwhile, the development of surface transportation infrastructure to link cities, ports, upcountry territories and industrial zones will further accelerate economic development.

Localization and attraction of investment in Vietnam's automotive sector should be seen from an ASEAN opportunity/exports-oriented manufacturing perspective. This is particularly important and relevant as the AFTA enters full implementation from 2018 onwards.

Recommendation of the Working Group

We request the Government take quick action to fully develop the industry to desired levels within the window of opportunity before 2018.

2. Incentives needed for investment in the automotive industry's manufacturing and supporting industry

The Government seems to under-estimate or overlooks the contribution automotive industry is making towards tax revenue and employment. Furthermore, the automotive industry is not subject to any particular investment incentives, such as those enjoyed by "high tech" industries. The Automotive Working Group is of the opinion that the automotive industry should be defined as "high tech" and should be subject to the same incentive system. Strong evidence and international studies show that the automotive industry is a key player in technological development within numerous countries. Moreover, the industry's development is strongly correlated with the development of skills, country know-how and ultimately its educational system. The numbers of engineers in a country is a key metric of innovation capability and competitiveness.

Particular supporting industry investments in certain high value added components such as engines, engine parts and electrical systems is of paramount importance to transition the country from a pure cost base advantage to a more sustainable technological advantage. Metallurgy, machining and high precision assembly are key automotive manufacturing processes that currently are slow to grow in Vietnam due to its lack of available know-how. A strong incentive system will lower the risk for new entrants and could over time help Vietnam develop a cluster advantage recognized regionally.

Recommendation of the Working Group

We request the Government consider special incentive support for the automotive sector as a "high tech" business sector.

III. PRESSING ISSUES/CONCERNS IN THE AUTOMOTIVE SECTOR

1. Immediate concerns for 2013

The automotive industry in Vietnam has fallen drastically in 2012. Just the four-wheeler category (import/CKD) is estimated to have fallen in the range of ~40%-50%. If expanded to the two-wheeler industry the overall impact will be higher. This is a very serious concern for the industry participants and has affected many businesses. The reduction in tax revenue has already been reflected above. The automotive working group has summarized the concerns of the industry and also requests the government to support the recovery of the industry at the earliest through a list of recommendations below.

1.1. Taxation and Licenses

Current context: The high level of taxation has already been described in the introduction section. The concern of the industry is the frequent changes made with respect to taxes. Currently the automotive taxes change at least once a year in Vietnam and affects the automotive sector. These changes make it difficult for planning and in fact these changes create confusion with customers and other affected parties often resulting in knee jerk reaction. Particularly in 2011: passenger cars import tax reduced from 82% to 78%, 78% to 74% and 72% to 68%; and specific import taxes reduction to 70% for CBU cars imported from ASEAN, China, Korea and Japan. Further registration taxes paid on the total value of a car increased from 12% to 15% in HCMC and 15% to 20% in Hanoi. Other taxes and proposals announced on transportation and access to inner city areas, limiting vehicle ownership have been shelved due to public reactions. Frequent and often drastic changes in taxes, in particular VAT, SCT and registration taxes, have significantly disrupted production lines, supply chain and retail operations of automotive players by creating artificial peaks and troughs in market demand. In this regard, we would like to raise some pressing issues, which need to be addressed.

Tax Walk

Issues: For the time being, identifying which tax will be applied depending of the origin of a vehicle is a challenge as various exclusion clauses can be applied to numerous bilateral treaties such as ATIGA, JVEPA with Japan, AFTA, etc. For new vehicles, the new country of origin, new technology such as hybrids, the tax applicable and the application date are opaque and each industry player cannot know these for certain until the vehicle is physically cleared relevant authorities (e.g. customs) which is usually too late. In some cases, commercial vehicles need to be re-exported as the tax classification decision can prevent the vehicles to be sold for a much higher price because of the final taxes applied.

Recommendations: A clear road map for different automotive sector taxes and policies till 2025 will benefit the industry, customers and the country overall. Further tax and policy stability will fortify investor confidence and growth in the industry. All of this will lead to increased customer choice and development of the country. Consultation with automotive working group and other industry associations will be helpful to work together with the government.

Ownership Transfer Procedure and incurred fee

Issues: The newly-issued Decree 71/2012/NĐ-CP tightening the ownership transfer procedure/regulation which was reflected in the Circular 36/2010/TT-BCA dated October 12, 2010 on vehicle registration. This regulation is extremely confusing as it tries to cover geographical, unit value, social positions and age of the vehicle. The creation of so many price levels at a marginal cost difference in the end offers little help, especially for motorbikes. Complexity benefits no one and simplification of the new regulation would be welcomed by tax payers and local authorities.

Recommendations: Enforcements by law and police checks on the streets for the automotive insurance, including that for motorbikes will reduce traffic hazards, better protect all road users and a number of vehicles on the streets. It will also provide a mechanism to ensure proper repairs are conducted in professional workshops so only well maintained vehicles will be on the road.

Number Plate Fee

Issues: The publication of reliable official registration data will help track local level automotive development and drive engagement with the city planners. That reliable data will help shape local urban development where real automotive users are located. Also, the registration tax rate discrepancy between Ho Chi Minh City (15%) and Hanoi (20%) is resulting in inflated vehicle sales in Ho Chi Minh City and depressed sales in Hanoi as companies with an office in both cities tend to register their vehicles in Ho Chi Minh City – preferably Bind Duong (10%) - rather than Hanoi. This is a perfect example of a dissuasive tax rate generating higher tax collection in a different place.

Recommendation: Have a uniform number plate and registration tax in the country. Additionally due to the fall in the industry, it will help to reduce the rates significantly to provide easier ownership and also help in recovery of the industry.

Import Duty imposed on royalties and other payments for use of intangible assets

Issues: Currently, guidelines on how royalty and other payments for intangible assets may be considered as "conditions" of imports are unclear. There are some cases where tax audit team concludes that a payment is dutiable where no other countries consider similar payments made under similar contracts as dutiable. In some cases, an audit team treats a contract stipulating a payment as indicating that the payment under such contract is a "condition" of import, where the contract never explicitly says that it is a condition. In such case, both the parties suffer unproductive and tiring arguments, and company and State budget are exposed to a potential huge loss. On the other hand, the intention to add domestic royalty into dutiable price is not reasonable because:

Royalty comprised of fees for transferred technology and royalty for IP (trademarks, design & invention patents), then:

(i) the fees for technology add value to the localization in Vietnam only and thus, by nature, they cannot be included in the imports' value, as well as they are already subject to FCT tax; and

(ii) the royalty for trademarks, design & invention patents appears only in Vietnam and thus, by nature, it cannot be included in the imports' value, as well as it is already subject to FCT tax.

An intentional application of an additional import duty in this case may risk violating ATIGA (stipulating that a member cannot increase import tax).

Recommendations: Abolish import duties on royalties and other payments related to the usage of intangible assets made under similar contracts and accepted as non-dutiable expenses in other WTO participating countries.

Lack of clarity in language used in tax-related legal documents/policies at working-level (circulars decrees)

Issues: In Vietnam, issues usually emerge after the legal documents and decisions on automotive sector published at a local implementation level. Different offices have different understandings and so do different provinces. As there is no follow-up to ensure the smooth application of decisions made at central level, the implementation stage becomes a bottleneck.

Another issue is Vietnam's preference for using its own fiscal classification self generates issues regarding wording to identify the product before classification and consequently the tax to be applied. We see more benefit in using the existing worldwide fiscal numbering system or publishing official equivalence tables with the various existing HS codes, rather than leaving it up to local Customs officers to classify this in Vietnamese language.

Recommendations: Adopt international HS codes to simplify tax classification for cars, motorcycles and its spare parts and address the lack of coherent language.

1.2. Bonded warehouse and Duty Refund process

Issues: Currently, more companies have chosen Vietnam to be their regional hub from which goods are imported and then re-exported and distributed regionally. However, the current import process does not allow for temporary transit. All import duties, SCT and VAT must be paid even though the goods are for re-export and the refund process is opaque and takes up to three months. This is too costly considering the current cost of finance.

Recommendations: Allow bonded warehouses for CKD assemblers and official importers (both Vietnamese and foreign-owned parties). It is also recommended that automotive goods such as cars, parts, tools imported into Vietnam purely for re-export are exempt from taxes. This would, however, generate revenue and foreign currencies for the Government.

1.3. Export processing zones in Vietnam attract quality manufacturers

To increase local content, Vietnam should allow quality automotive parts producers to work from export processing zones and allow them to sell a sizeable percentage of local production in Vietnam. Granting the same export rights to already existing world-class automotive OEMs in Vietnam would also benefit the local industry.

2. Medium-term concern (2014-2018) - Road Map for development and retention of competitiveness of the automotive sector

Impact on CKD businesses based on AFTA/ASEAN +2/3 alignment by 2018

Issues: Following agreement on tariff reduction commitments under AFTA, from 2018 Vietnam is expected to reduce import duties to zero for all vehicles manufactured within ASEAN and to adhere to the minimum level of AFTA's commitments. This is further extended based on ASEAN +2/3 Agreements.

There is a concern about the Government's vague plans to leverage and support current CKD operations in Vietnam after 2018. This has led to a "wait and watch approach" by global investors.

Recommendations:

- A clear plan should be revealed by the Government

Lack of clarity on Strategic Cars for Vietnam

Issues: A strategic car approach for Vietnam has been a work in progress for many years. Individual organizations and the VAMA have provided inputs to various Government departments. However, as of now, no firm guidance on a strategic car is apparent. Clear direction would have a positive impact on the industry's growth potential and earmarking strategic cars has helped other ASEAN countries' automotive industries rapidly grow. Clarity on a strategic car would allow OEMs to prepare and plan to support the Government's direction in a timely manner. Furthermore, it would help Vietnam facilitate the switch from motorbikes to cars.

Recommendations: The consultation process on the strategic vehicle for Vietnam should be opened for discussion with interested parties such as automotive associations (e.g. VBF's automotive working group, VAMA), automakers, etc. We believe the inputs of private sector will help the Government to soon publish a clear direction on a potential strategic car. Besides, we think that compact eco-friendly models could qualify as strategic cars for Vietnam. Therefore, it is recommended the Government to consider promoting the below vehicle models:

- Compact vehicles to facilitate the switch from motorbikes to cars
- Compact delivery vans to access crowded inner city streets without traffic restrictions
- Commercial vehicles (trucks and buses) which already occupied about 50% share of the car market. However, the diesel quality and reliability after storage and distribution in service stations needs upgrading.

Facilities to support vehicles on roads & overall economy

Issues: Lack of parking, while the number of office and residential buildings grows in major cities.

Recommendations: A reasonable percentage within new real estate developments be dedicated as underground multi-storey car parks. Such operators should be able to sub-rent access to such car parks to outsiders to alleviate inner city car parking shortages. The development of such facilities will support vehicle users and stimulate the automotive industry and overall economy.

Direction and special support to Hybrid/Alt Fuel/Electric vehicles and low CO2 emission vehicles

Current context: Thailand enjoys local production of the Toyota Prius, Camry Hybrid and Honda Jazz Hybrid and has recently created environmentally-friendly concept cars. Meanwhile, Malaysia is pushing green technologies. In some countries in Europe, Governments have set-up taxes based on vehicle emission levels, whilst in other countries Government incentives support alternative power trains such as hybrids or electrical.

Recommendations: It will be in the interest of the government of Vietnam to:

- Clarify tax criteria for hybrid vehicles, for CKDs and CBUs
- Different government bodies to build a co-owned and co-developed plan towards environmental protection across areas such as emissions, fuel consumption, component recycling and end-of-life vehicles
- Start engaging OEM/Associations/Technical centers and develop a road map with several steps as follows:
  (i) Establish a reliable basis and set of criteria to measure a vehicle's fuel consumption or adopt and promote higher standards in fuel consumption, fuel quality, emissions and environmental awareness. This goal will only be reached by focusing on high-technology vehicles
  (ii) Work out a plan which is in consistent with ASEAN neighbors and Europe, if Vietnam is to follow the Euro emission pattern
  (iii) Define a fuel efficiency improvement plan based on country achievements
  (iv) Define emission levels to comply with international low-carbon emission standards. Particularly with regard to new CBU cars' homologation, the Vietnam Register should simplify the homologating procedure without the need for any additional local emission test cars with EU4 and EU5 emission standards, which are more stringent than EU2.

Stability and predictability of policies to build a sustainable growth environment

Issues: 2011 and 2012 have seen multiple proposals on fees and taxes provided to the media either prior to or simultaneous sharing of information with the OEMs and automotive and consumers associations in Vietnam.

The leaking of information with different interpretations leads to speculative actions by different stakeholders, such as consumers and suppliers. Moreover, information is widely scattered with no consistency leaving automakers in a pickle for two reasons: (i) the manufacturing and supplying system is based on an average 10-month pattern and (ii) the automaker is an up-front capital intensive business model where the initial investment is three to four years before producing the first product. Furthermore, in some cases decisions have been made without consulting interested parties and stakeholders resulting in inappropriate decisions and further obstacles.

Recommendations: To sustain the industry's development, it is recommended the Government should:

- Consult automobile manufacturers' associations such as the VBF Automotive Working Group and VAMA for inputs into key proposals and policies affecting the automotive industry. Through prior consultation and discussion with the private sector, Government policies will be more practical, better understood and implemented.
- Take the method of pre-testing and piloting new proposals/policies into consideration since this is the most effective and less disruptive method.
- Share ideas and a clear industry policy roadmap to 2025 with OEMs and industry associations to offer investors a long-term horizon and better predictability for future growth.

It is worth emphasizing that a clear road map for different automotive sector taxes and policies to 2025 will benefit the industry, customers and Vietnam. Taxation scheme and policy stability drives investors' confidence to grow the industry and leverage Vietnam's development.

IV. CONCLUSION

Industry players are of the opinion that along with overall economic environment, a key factor for the automotive industry's crash in 2012 was the Government's different proposals and policies.

Statistics have revealed that the drop in automotive industry in other countries which were impacted by natural disaster/political unrest ranged around 20%. The current drop in sales/production in Vietnam ranges from 35%-50% depending on the segment and province. Coupled with the cost of rising inventory for both assemblers and dealers, business operations have become unviable and unsustainable with such drastic drops. We have seen in other countries that Governments have come to the rescue of automotive industries to help them recover and continue to provide employment. The industry, in return, will make good contribution to the State exchequer.

We plead with the Government to introduce **<u>some quick measures to accelerate the revival of the industry</u>** as soon as possible. Without Government support, the industry will not be able to recover in the immediate future. The normal industrial growth rate after such a crash will not take the industry back to its estimated potential per earlier timelines. This will impact on the investments made by companies and also future investments planned in Vietnam.

We sincerely request the Government quickly act to support the industry and help it recover during 2013.