IMPROVING LEGAL FRAMEWORK ON INFRASTRUCTURE SECTOR TO ENCOURAGE FOREIGN DIRECT INVESTMENT INTO VIETNAM

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1. Background

Over the years Vietnam has made substantial investments in infrastructure. Investment on electricity, water supply, waste treatment, transport and communications in Vietnam amounted to about 12 percent of GDP from 2006 to 2010, which is a high percentage by comparison with other regional countries, including China. Successful countries build the infrastructure needed to maintain growth. However, despite this high level of investment, Vietnam's infrastructure is still regularly rated by businesses and chambers of commerce in Vietnam as a constraint on growth. Vietnam is still far behind other Asian emerging economies in terms of infrastructure development, possibly because Vietnam started with much poorer infrastructure and therefore has to invest heavily to catch up. But the mismatch between spending and performance indicates that there has often been inefficient implementation.

The past few years of macroeconomic instability has shown that the expansionary monetary and fiscal policies that supported this investment cannot be sustained by the underlying fundamentals of Vietnam's economy. The government has already decided to reduce total investment from more than 40 percent of GDP in the past to 34 percent in 2012 and 30 percent in 2013. Infrastructure investment should be reduced to 8 or 9 percent of GDP, which is more in line with regional standards. If the public investment process is to be more limited, the question is whether private investment can take its place to any meaningful extent.

The Government of Vietnam is in the process to review, consider and revise the PPP legal framework, which is reflected in both (i) the draft amendment of the Law on Procurement ("**Draft Law**") and (2) the draft amendment of Decision 71. It is expect to create a unique opportunity for Vietnam to fundamentally enhance its legal framework governing PPP. In light of Vietnam's infrastructure funding gap and persistent difficulties in implementing a PPP pilot program, VBF shares the view from the international donors and investors that without significant changes, Decree 108, Decision 71 and the proposed PPP provisions in the Draft Law will be unable to create the necessary legal foundations for a successful PPP program. Summarized below are major gaps in Decree 108, Decision 71 and PPP provisions of the Draft Law and some recommendations to rectify such deficiencies so as to maximize investor interest while advancing the government's development agenda.

2. Gaps in BOT regime and PPP regime

The following shortcomings have diminished investor confidence in Decree 108 and Decision 71:

- Investors complain that potential PPP projects are not tendered through a transparent and competitive process.
- It is unclear whether Decree 108 or Decision 71 would apply to a particular PPP transaction.
- Decree 108 and Decision 71 do not adequately define the scope of state contribution and fail to provide a transparent mechanism for determining the same. This leads to an ad

hoc and inconsistent treatment of government guarantees in the BOT regime and difficulties determining the scope of viability gap funding under Decision 71.
- Decree 108 and Decision 71 do not provide for a single PPP unit that is empowered to act on behalf of the government and address investor concerns.
- Principles guiding risk allocation among parties are not set forth in Decree 108 and Decision 71, thereby leading to significant variations from one deal to another.
- The BOT regime under Decree 108 and its earlier regulations have been tested and proving success for the development and financing of infrastructure projects (mainly for power projects). However, the BOT regime have not been assessed and used as legal foundations and market practice for the boarder infrastructure sector.

In summary, Vietnam's legal framework has not been created for PPP projects based on the market practice in Vietnam, while introducing some uncertain development for BOT projects. The harmonized combination of Decree 108 and Decision 71 has not been taken into full consideration as a workable framework for infrastructure projects.

3. Gaps in PPP provisions of Draft Law

Outlined below are weaknesses in the proposed PPP-related provisions of the Draft Law that will hinder use of competitive tendering in PPP transactions:

- Definitions of key terms are not clearly drafted making the law difficult to interpret and apply.
- Certain unfair provisions such as domestic preference will discourage robust competition.
- Certain provisions are overly prescriptive about the government's obligations with respect to the investors and fail to empower relevant government negotiators to take decisions.
- Linkage between PPP provisions under Draft Law, Decree 108 and Decision 71 is unclear.

4. Risky aspects of BOT regime

To boost investor confidence in Vietnam's legal framework on infrastructure projects, it is critical that deficiencies identified above be addressed simultaneously and comprehensively by revising the PPP regime under Decision 71 and the Draft Law into a boarder and harmonized framework with the BOT regime as well as strengthening and encouraging foreign investment under the BOT regime.

- Strengthening government guarantee of foreign exchange: A solid government guarantee is fundamental to obtaining foreign lending on infrastructure projects. There is a concern for foreign lenders as the Government considers reducing foreign exchange guarantee less than the current 100% basis under the BOT regime. The concern also comes from lack of uniform applicability of guarantee principles with regard to those projects which have been licensed and those projects under negotiation or future projects. Foreign lenders are selective in the current narrow commercial lending markets for funding the best projects in Asia. As a result, guarantee of foreign exchange would become a decisive factor if everything else is equal.

- Assuming the cost of land: The Government should have a stronger commitment to work out budget allocation and prepare for land clearance/compensation in advance. Otherwise, the risk of longer delay of land transfer and higher project costs on a passing-through basis will be shifted to the private sector.

- Allowing mortgage of land use rights: There is an indirect financing cost of not being able to mortgage land for which no payment has been made, in opinion of some ministries. It is believed the issue should have arisen at all as land rent exemptions for BOT projects are an investment incentive, and should not prejudice investors' entitlement to grant security interests over the land they need for their project. This is an easily soluble issue. All that is needed is a regulation that states that land that is exempted from rent as investment incentive is (i) deemed to have been paid for in full when it is leased or (ii) not barred from mortgage. A compromise by the Government in giving an undertaking to guarantee the transfer of the land use right to any assignee of the attached assets may eventually give banks the comfort that they need. But it does not assist in Vietnam's goal of obtaining the best terms for its borrowings.

- Providing supporting infrastructure: Some infrastructure projects (particular power projects) require certain supporting infrastructure for operation and maintenance. As the issue of infrastructure sharing is currently not specifically regulated, it would be suggested that it would be more efficient if the authorized state body procured the completion of any supporting infrastructure for the project. This would have cost benefits as well as avoid any delays to the estimated project schedules.

- Reducing administrative complexity: The government has made an effort to centralize, coordinate and accelerate negotiations for BOT projects. But ministries and other bodies do not necessarily act with a unity of national purpose. Every stakeholder seems to have a veto or at least substantial delaying power. It is time for some radical action to provide greater support for investors and a serious examination of the cost/benefits of so called inter-ministerial working groups where participants have veto rights on projects but little incentive to promote the speedy development of the project. The successful BOT projects should be assessed to create the best practice and documentation on the BOT regulations so as to remove administrative discretion and hence reduce delays. Many investors who are willing to commit hundreds of millions of dollars find it unnecessarily tiresome that the regulations contain so few clear answers and that everything depends on administrative discretion. The cost of these delays to the Vietnamese State and people can be substantial.