

FROM AGENDA TO ACTION: PREPARING FOR NEW TRADE AGREEMENTS

*Presented by
Mr. Fred Burke
Co-head of Investment & Trade Working Group*

Your Excellency, Mr. Prime Minister, Minister Vinh, Vice Ministers and honored guests,

I am very pleased to have the chance to present today on behalf of the Investment and Trade Working Group. A more detailed version of our contribution with some supporting documents is included in the book, but please let me briefly summarize the key points of our suggestions on the question of how to prepare most effectively for accession to new free-trade agreements. Such agreements include the EU Vietnam FTA ("**EU FTA**"), the Trans-Pacific Partnership ("**TPP**"), the Regional Comprehensive Economic Partnership ("**RCEP**") and ASEAN Economic Community 2015 ("**AEC 2015**"), among others.

Vietnam stands to gain uniquely and even disproportionately in some respects if it can make some adjustments to its investment and trade environment. To this end, we have been asked to respond specifically to three questions:

1. First, what are the recommendations from working group has to fix the current problems in the investment and trade environment?
2. Second, what are the challenges Vietnam's faces when entering into new trade agreements?
3. Third, what does Vietnam need to do to prepare for the new opportunities presented by these trade agreements?

We respectfully set out our group's various comments and suggestions below.

I. INNOVATIONS REQUIRED IN THE INVESTMENT ENVIRONMENT TO "FIX PROBLEMS"

We would like to raise five basic points in this area.

1. Response to the Disturbances of the Week of May 12th

a. Immediate Follow up and Support Measures

First, we must address the aftermath of the disturbances in certain industrial zones during the week of May 12. The full impact of the disturbances of the week of May 12 on the Vietnam supply chain have yet to become apparent. We are hearing reports of serious disruptions in certain important industries, especially certain export related industries which had up until now been the backbone of Vietnam's economic growth story.

The immediate needs of enterprises to restore stable production and minimize the impact on the labor force were raised in a constructive meeting on May 20th in Hanoi. The Prime Minister released new set of measures that are intended to mitigate the impact for affected enterprises. While these measures are welcome, they do not go far enough to account for the damage, much less restore the sector to its previous competitiveness. Moreover, longer-term questions about the supply-chain and international sources of raw materials need to be addressed.

For the short-term, the most immediate issue was alleviating the impact on the workers themselves. In respect to social insurance, unemployment insurance, etc. help is badly needed. Records have been destroyed by vandalism and the affected employers need government departments to help replace them or manage without them. Government supplements in terms of pay outs of social insurance and unemployment insurance for the affected workers should be expedited to ensure that all workers receive what they are entitled to a timely manner. Work permits should be issued on an extraordinary basis to enable manufacturers whose staff have fled the country to return immediately. The measures suggested in the May 20th Notice from the Government Office go some way to addressing these issues, but relevant authorities still have to implement them.

More on measures to mitigate the impact of the disturbances in the near term will follow in the sections below, but these immediate financial measures for the workers' well being are the most critical, if they have not already been addressed at the end of May in the normal payroll cycle.

b. Scope of Support Program

In terms of compensation for the disturbances, there is also the issue of how broadly this compensation will be extended. Many enterprises are pointing out the fact that even though their factories were not burned down, they are being severely impacted for one reason or another. Sometimes it is their key Taiwanese or mainland Chinese staff who have left, sometimes it is the investment project that has been suspended or cancelled by the worried investor, or the tourist groups that will not be arriving to stay in Vietnam's beautiful new resorts. There should be some measures to facilitate the recovery of these enterprises too, until the market gets back to normal, so may we respectfully suggest that some of the measures set out in the May 20th Notice be applied broadly to all enterprises however affected, directly or indirectly?

c. Improving Workers' Lives

Third, in order to reduce the chances that such disturbances happen again in the future, some members have made constructive suggestions for consideration. While we appreciate that the initial trigger for the demonstrations that lead to the disturbances was an external factor, it must be recognized that there were some internal grievances that fuelled the violence and destruction that occurred overnight between Tuesday and Wednesday of May 13 May 14. According to many of the manufacturers in the affected areas, it seems to have been a small minority of workers, instigated by still unidentified outside influences, behind the disturbances. We would like to know what the Government has learned about the events that lead up to the disturbances. In the meantime, we note here that while peaceful demonstrations held in accordance with law are a normal part of the democratic process in all modern countries, illegal vandalism, rioting and theft should be dealt with swiftly in accordance with law. It was the delays on the night of May 13th that lead to the biggest property damage in certain key industrial zones, so measures for more rapid deployment of control measures to stop illegal violence should be developed for the future.

For the longer term, some of our members have suggested certain measures that industrial zones could use to help improve the lives of their workers with recreational and community facilities. These facilities might include not just job placement offices, but health and recreation facilities such as a swimming pool, parks and athletic facilities so that workers can relax and have a better standard of living. Such facilities need not be expensive, if the proper incentives are given to the industrial zones, and they would not seem to violate any rules on subsidies for export manufacturers. To supplement the industrial zone and government support for this idea, perhaps some of the 2% of payroll

that is allocated for union dues could be mobilized for this purpose? This may seem like a small move to many people, but done properly, it could reinforce the strong worker support already enjoyed by the majority of employers in these zones.

2. Too timid market opening and global competition requirements

Turning to the problem areas that need "fixing" for Vietnam to take fuller advantage of international trade agreements, we believe that in many cases, Vietnam has opened its market to foreign goods and services that support the export economy, but in many ways its remaining market access and national treatment limitations handicap exporters from competing in international markets by limiting the international standard services and inputs they require to compete.

There are many examples of this problem, and each one may seem but a small detail to high-level policy makers. But to businesses any single measure may mean life or death in a competitive global marketplace.

Example 1: H.S. Code Requirement for Foreign-Invested Trading Companies

To take just one example: foreign invested enterprises license to engage in trading must list the specific H.S. Codes for each product they trade in their Investment Certificate. Unless the product's H.S. Code is in the Investment Certificate, the company cannot trade in that product. This applies to foreign invested trading companies only.

It often takes 6 months or more to amend an Investment Certificate to add a new good, even if that good is not on any legal restricted list. This obviously handicaps traders in terms of the response time for local projects and exporters when they need specific new inputs for their exported products, or to meet local market requirements. This is also a form of *de facto* discrimination against foreign invested enterprises as compared with local enterprises, who do not need to list these H.S. Codes in their Business Registration Certificates (local companies do not need Investment Certificates to engage in trading, but more on that later).

Moreover, even for the local enterprises, as noted below, there is still the issue of what happens when these local enterprises mobilize some foreign capital to meet their funding needs? Do they become "foreign invested enterprises", subject to the same H.S. Code requirement, as some local investment officials insist?

There are reports that the Investment Law may be amended to do away with this requirement and that would be very welcome.

Example 2: Education and Vocational Training

While educational and vocational training services were committed areas under Vietnam's 2007 WTO commitments, these areas have still not seen the flourishing of activity that they could have with bolder support from the Ministry of Education and Training, and other relevant authorities. There is clearly a huge thirst for knowledge and job-ready graduates in Vietnam, and many foreign educational institutions are ready to step in. A few universities and vocational schools have, very slowly and after much wasted time, got limited programs off the ground, and there have been a few company-driven programs like the one Intel has invested in to produce the skilled workers it needs. But so much more could be done to mobilize international capital and know how to help train up Vietnam's workforce. This goes not just to the curriculum, the investment appraisal process but even to issues such as work permits teachers and visas for international students. This is indeed an area where

more robust follow through on the WTO commitments is needed to develop the workforce Vietnam needs to climb the value chain.

3. Recognition and Enforcement of Foreign Arbitral Awards

Some members have complained that the record of recognition and enforcement of foreign arbitral awards in Vietnam remains very poor, notwithstanding that it has been a member of the 1959 Convention on the Recognition and Enforcement of Foreign Arbitral Awards for nearly two decades. The Vietnam International Arbitration Center ("VIAC") is developing well as a viable alternative to arbitration in the more established regional and international centers, but it only undermines Vietnam's reputation as an investment destination when foreign investors learned that applications for recognition and enforcement are routinely turn down based on the most spurious of technicalities. This is another thing that needs to be "fixed" to reassure foreign investors.

II. CHALLENGES FOR VIETNAM

Clearly, Vietnam has more to gain than it has to lose from participation in the pending set of new trade agreements. If the last 20 years have showed anything, it is that the net benefit to the country has been greater as a result of its joining the several important trade agreements Vietnam has already exceeded to, including most importantly the WTO Agreements. Although the benefit of WTO accession was muted by the Global Financial Crisis that followed Vietnam's accession in 2007, nevertheless, its benefits in terms of GDP growth, boosting exports and producing jobs and taxes has been obvious. Some of the shortcomings that became apparent during the WTO implementation process remain. So what are the shortcomings and how can they be addressed?

Here, much discussion takes place regarding the need for better infrastructure, and that is clearly important. But there is a counterpart that is never discussed that is the what for want of a better word I would describe as "superstructure". By this I mean the way of thinking of many officials and business people as they implement their tasks and try to survive in the new economy. If this way of thinking does not shift in the direction of how to provide international standard services in areas such as customs, business registration, product registration etc., then Vietnam will be frustrated in achieving its intentions under these agreements. The superstructure will be too weak, even if the infrastructure is available.

1. The "Superstructure" Issues : More Administrative Reform Needed, Better Mentality

The important Administrative Reform program that we know as Project 30 resulted in certain tangible benefits, but much work remains to be done this is an ongoing struggle. Sometimes, limits on the supply of international standard services in the domestic market hinder domestic enterprises' ability to compete in the global marketplace. As noted above, this is a topic that requires an overall change to the way of thinking away from "control" to "support" of legitimate business activity.

Example 1: Freight Tax Exemption under Double Taxation Agreements

For example, Project 30 resulted in an attempt to simplify the process for freight transport companies to claim their legal exemption from the 2% freight tax on international goods where a Double Taxation Agreement applies. However, this potential reduction of 2% in the cost of export products has been stymied by the fact that the exemption is still too difficult to claim in practice. We have submitted a lengthy paper regarding the best practices in the international marketplace and our suggestion for Vietnam to further streamline the domestic procedure. We hope that this will help Vietnam achieve its own objectives as stated under Project 30 and its Double Taxation Agreements.

Example 2: Trading Companies - Trans-shipment Limitations

Second, there is the example of trading companies that are foreign invested who would like to engage in trans-shipment of goods from other countries into regional target markets such as Cambodia, Laos and Thailand. Allowing foreign invested trading companies to sell their products not just in Vietnam but into these other markets under the rules governing trans-shipment would be advantageous for Vietnam in terms of creating jobs, taxes and know-how. This should be allowed under Decree No. 187 of 2003, but we do not understand why the Ministry of Industry and Trade still does not favour this kind of business activity. We hope that its concerns can be articulated and addressed so that Vietnam can capture this potential business and not let it go to another competing jurisdiction in the region.

Example 3: Lack of Facilitating Environment for e-Government

Third, while the rest of the world is rapidly and developing e-Government solutions to facilitate the emerging "e-economy", Vietnam remains locked in a paper bound system that is an antiquated holdover from the colonial era. Take a couple of random examples. One, a Danish citizen who applies for a work permit cannot meet the requirement for a "No Criminal Record Certificate" from Denmark because such certificates are only available online and their print outs are not signed by a human being, therefore they cannot be legalized and therefore are not accepted in Vietnam. Similarly, companies from some US states cannot meet the requirement to produce a legalized copy of their audited financials because they are submitted online and the Secretary of State of certain states does not sign them or certified copies of them. Vietnam has taken steps to proceed to the Apostille Convention and this is a move in the right direction, but noting that the concept of apostille itself is becoming an anachronism in the modern world and better, more "e-friendly" solutions need to be researched and adopted.

Example 4. Lack of Duly Licensed International Ship/Rig Classification Service Providers

A fourth example is the lack of fully licensed classification societies for international ship repair and ship manufacturing, including offshore oil rigs. Although a few of the several international companies that provide this vital service are operating in Vietnam on an *ad hoc*, informal basis under the umbrella of the Vietnam Registry, their operations have not been normalized in the form of duly licensed commercial presences with the relevant business lines in their Investment Certificates. They would like to set up normal business operations here to support Vietnam's ship building and repair industry. The case of VINASHIN illustrates the importance of these invisible services in supporting Vietnamese enterprises as they try to compete in the international marketplace. In VINASHIN's case, due to the lack of these international classification service providers, the shipbuilder could never have sold its ship building or repair services to foreign buyers because Vietnam lacks mutual recognition agreements between Vietnam Registry and the target markets.

Example 5: Dissolving Enterprises

Fifth, and last for the time being, the procedures on dissolving an enterprise remain overly cumbersome, prompting the comment remark that there are thousands of enterprises that want to "die" but cannot obtain a death certificate. Delays in completing tax audits are the main reason cited as the tax offices say that they often do not have enough officers to do tax audits. To find a solution to this problem, the tax office and the Department of Planning and Investment of Ho Chi Minh City have recently proposed to the People's Committee there that the enterprises should be allowed to be dissolved based on the audit result from an auditing company, but the auditing company will have to be responsible for its audit reports. To further streamline the process, the enterprise would be allowed to return the Business Registration Certificate and chop to the tax office instead of going back to the Department of Planning and Investment. It remains to be seen if the People's Committee will agree to this

proposal, and whether the auditing companies will be willing to assume this legal liability, but it would certainly provide a better procedure than the current one.

Example 6: Licensed Production of Medical Equipment for Export and Clinical Trials

Government should apply common sense in applying domestic regulation to exported products. For example, there should be no need for Vietnamese clinical trials of drugs and medical equipment that are being produced under license exclusively for a foreign export market. Clinical trials, required for medical products sold into the domestic market, are expensive and time consuming and they should only be required for goods sold into the domestic market, and only where reliable international clinical trials are not available. Yet the draft of the Decree on the Management of Medical Devices that was released on 11 March 2014 would have required clinical trials even for pure export sales.

This requirement was thankfully dropped from the most recent draft of the Decree thanks to the good effort of the drafters to seek comments and the timely feedback from the business community. However, there remain some issues regarding the requirements for the registration dossiers and the procedure for registering for the acknowledgement of satisfaction of conditions for the manufacturing conditions for medical devices that may inhibit the development of the manufacturing industry in Vietnam. These remaining issues were presented in the paper sent to the Ministry of Health on March 28th.

2. Infrastructure and the PPP Program

The next major challenge for Vietnam is infrastructure. This is an area where in the last couple of years Vietnam has made remarkable gains, especially in terms of ports and roads, so that supply is meeting demand more often. However, there are concerns regarding the proposed new PPP program and specifically that notion that it might replace the BOT program and even private infrastructure investments. No doubt, you will hear more from the Infrastructure Working Group on this point but in terms of investors and manufactures this is a key issue because of the concern that the PPP regulations would only slow down infrastructure development, which is already challenged in light of the important role that Chinese construction companies and key suppliers have been playing in the recent period.

III. CAPTURING NEW OPPORTUNITIES

There are many measures and indeed industrial policies that Vietnam can adopt to take better advantage of the opportunities presented under the trade agreements it is negotiating. In addition to the points noted above, the following are worth mentioning.

1. Attracting Investors into a new Textile Industry to Supply the Garment Sector

The most important of these, perhaps, is the industrial policy to attract textile manufacturing investment, preferably in concentrated industrial zones with relevant environmental services and energy supplies. In order for Vietnam to enjoy the TPP duty rates for the garments it exports, the raw materials must originate in a TPP country, or at least they must have been spun, woven or dyed in one. This means that it is not necessarily required to grow the cotton or raise the sheep in a TPP country in order to get TPP duty rates for cotton and wool clothes. It is however necessary for the cotton or wool to have been spun, woven or dyed in Vietnam. As we went out in our detailed paper, this industry requires serious capital investment and this will be an even bigger challenge in the current post-disruption environment. Policies supporting infrastructure for wastewater from dyeing operations will be critical, as is reliable access to electricity. More details and specific issues are raised in our paper.

2. Customs

There are a number of issues that come up in the customs area that Vietnam should address in order to improve its competitiveness.

a. Advance Ruling System too Narrowly Applied

First, the implementing procedures for the advanced rulings system that the new customs law introduced last year, have not gone far enough to make that procedure available to most traders. Obviously, the burdensome paperwork requirements, including the signed contract for the good in question even before you have a custom's ruling, we intended to focus the mechanism on existing large-scale manufacturers and general traders. However, if there is going to be an advanced ruling system, it should be open to all commercial traders. We hope that this mechanism can be streamlined and perfected going forward to eliminate the unnecessary documentation and make it more reliable.

b. Advance Pricing Agreement ("APA")

Similarly, the Advanced Pricing Agreements used to manage transfer pricing need to be more legally authoritative. There is no point in negotiating an APA with the customs authority if it is not legally binding.

c. The New Customs Software System

As noted already in the presentation by Am Cham, and as discussed at the Ho Chi Minh City forum in March, the introduction of the new software for managing customs clearances is facing serious problems. We are glad that the General Department of Customs agreed to slow down the introduction of the new system to a few pilot provinces and we hope that the lessons learned in those provinces will enable the eventual roll out of an improved system nationally. We look forward to continued cooperation and communication with the General Department of Customs to make this transition as smooth as possible.

d. Tracking and Transparency

Certain government departments have recently introduced excellent new procedures to enhance transparency and improve service levels. For example, the Ho Chi Minh City Department of Planning and Investment now sends e-mail updates to applicants for Investment Certificates updating them regularly on the status of their applications.

This is an encouraging innovation and it should be applauded. Customs could adopt similar measures to track and report on the time required to clear customs, providing an objective measure of its service record as compared to other customs administrations in the region (who already report this data).

3. Investment Licensing

Much work has been done to come up with new proposals to streamline the Investment Certificate issuing process. It is even proposed to eliminate the investment certificate altogether, except for "conditional" areas. This is a very constructive orientation, but it may not go far enough.

a. Doing away with "Investment Certificates"

If all businesses, both foreign and domestic, can rely on a single uniform document, being the Business Registration Certificate, to evidence their legal establishment and identity as a legal entity, then the Investment Certificate is probably altogether unnecessary. The proposal to retain the Investment Certificate for "conditional" areas may not be relevant because all of those areas are already governed by branch-specific regulatory requirements in each of the regulated sectors they fall into. Whether it is property

development, infrastructure, multilevel marketing, insurance, legal services, securities, banking and finance, construction, health services, telecommunications, etc. - all of these areas for investment are already subject to specific licensing procedures that obviate the need for an Investment Certificate. Moreover, it we are concerned that it will create confusion in the marketplace especially in terms of capital raisings and other regulators, if the system is changed so that it is not exactly clear when Investment Certificate is needed. Further study in this regard is required to mitigate such confusion.

b. Mobilizing Capital from Abroad

Private Vietnamese companies, not to mention state owned enterprises, need foreign investment to take advantage of the opportunities that will arise in the international marketplace. Getting that capital, and expertise that goes with it, remains a serious impediment to their taking full advantage of international trade agreements. This issue is still a serious disincentive for Vietnamese companies to mobilize capital. For example, if a Vietnamese company wants to raise new capital by issuing new shares to a foreign investor, some local authorities would require both the local and foreign investors to apply for an Investment Certificate. This could be done away with if the proposal to eliminate the Investment Certificates adopted in the pending round of amendments to the Law on Investment.

4. Work permits

Turning to the subject of work permits, this remains one of the most common concerns of foreign investors, not to mention more and more Vietnamese enterprises.

First, it should be clarified when work permits are necessary. For example, workers present in Vietnam for a limited period of time under cross-border service contracts should not be required to get a permit if they are not being paid by a local enterprises and they are not on the local payroll. The measures announced by the Prime Minister on May 19, which involve returning to the old system of five years of experience or four years university level education, rather than *both* of those, would be welcome if applied across the board to all enterprises because, as noted above, all enterprises are in fact being impacted by the current supply chain disruptions.

A radical revisit of the current rules should be initiated, especially in light of the special circumstances we are facing.

5. Avoid Impractical New Rules - Regulatory Impact Assessments

The point is to avoid passing impractical new rules and to follow more strictly the requirements for regulatory impact assessments of new legal measures.

a. 90 Day Deadline for Chartered Capital Contribution

For example, in the draft amendments for the Enterprise Law, it is proposed that investors must contribute all of their charter capital contributions within 90 days of the issuance of the investment certificate friends or perhaps business registration certificate. This an impossible requirement if it applies across the board to all kinds of enterprises, such as real estate companies as well as smaller service businesses. It would only increase the cost of capital for Vietnam to require that cash funds come in and sit in a bank account awaiting a construction contract progress payment that may not be due until years into the future. Moreover, the requirement is somewhat discriminatory, if applied in the current legal framework that distinguishes foreign and domestic enterprises, because it is easy for a domestic enterprise to raise its charter capital anytime in most sectors, while foreign invested companies must seek discretionary (i.e., unpredictable) approvals.

We only request that this proposal be reconsidered. It is reasonable to set the liability of the foreign investor at the amount stipulated as charter capital so that it is liable for the debts of the enterprise up into the full amount of charter capital stipulated. But the liability of the foreign investor to pay in the charter capital in the event that the company requires the funds, is different from requiring it to pay and those funds within a 90 day period.

6. Approaching New Trade Agreements

The new round of trade agreements that Vietnam is currently negotiating are broader in scope and deeper in reach and not like anything it has negotiated previously. It will require a globally competitive domestic platform for services, infrastructure, intermediate goods, etc.

To fulfill Vietnam's potential, the domestic market should be inclusive, sustainable, equitable and "green" in order to meet the demands of the 21st century marketplace. FTA's are no longer just an issue of duty rates; they reach into "behind the border" issues that impact trade. It is also necessary to develop the superstructure or mindset to take fullest advantage of these opportunities.

The recently agreed "Bali Package" of WTO-related trade facilitation measures is a good step for all the WTO members in terms of trade facilitation issues, food security and LDCs, but it is not enough to leverage a country like Vietnam up into the next level in the value chain.

Vietnam must be careful not to miss the train as it leaves the station, for once it is gone it may be hard to catch up. Vietnam experienced challenges when it wanted to join the WTO, a "club" that had been established by members years prior and became harder to join as a new member.

To maintain competitiveness in the global economy, it is important not to unnecessarily interfere with the marketplace and distort market pricing. Vietnam's hard work to marketize fuel and energy prices in recent years is one example. On the other hand, the issue of powdered milk and infant formula has been a controversial one in Vietnam. I personally know of two milk formula production projects that were put aside simply because of the unpredictability introduced by the price control system. This means that far from keeping the price of milk low, the promoters of the price control system are unintentionally restricting demand and thereby increasing milk prices. If it is really price that you're concerned about, it is better to address that with supply-side measures, in our view. This helps keep the entire economy on a sounder footing, functioning more efficiently. Avoiding price controls also helps defend against "Non-Market Economy" charges from trading partners that Vietnamese exports are subsidized or sold below fair market value.

The Investment and Trade Working Group has done a lot of direct work on the proposed amendments to the Enterprise Law and the Investment Law. Some of these materials should be in the book. Some protectionist tendencies that would limit competition and handicap the Vietnamese enterprises in international markets have arisen, but generally speaking, much good thought, expertise and experience has gone into these discussions.

But it is clear that the law itself cannot create the kind of environment where the Vietnamese enterprises are supported to compete. They need access to world class services such as Dun & Bradstreet reports on their counterparties, standards and classification services for their goods and services, including technical training on how to

meet those standards, risk mitigation mechanisms such as insurance, derivative tools and futures markets.

Finally, the elephant in the room is today is China. There has been much talk recently by some of the smartest people in Vietnam about weaning the country away from Chinese raw materials and services reasons of national security. While self-sufficiency is a nice dream, it is an impossible fantasy in the real global economy we live in today and Vietnam's pragmatic "integration" strategy has been successful by recognizing that reality to date.

Vietnam is already integrated to some extent with the Chinese economy, just as we are with the rest of the global economy, and Vietnam has enjoyed some of the success of the successful China supply chain. Looking at this issue objectively and rationally, we have to ask ourselves how realistic it is to avoid sourcing from our northern neighbour. Whether it is steel for infrastructure projects, construction services or many other inputs and raw materials, Vietnam competes more efficiently in the international market to the extent that it can rely on cheap inputs from China. The question then is how to co-exist peacefully, and here we can only hope that the leaders of both countries can find a way to co-exist and cooperate in the future.