

INVESTMENT AND TRADE POSITION PAPER DEVELOPING THE PRIVATE SECTOR - BUILDING THE BACKBONE OF THE ECONOMY

Presented by
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Your Excellency, Mr. Prime Minister, ministers, vice ministers and honoured guests,

I am very pleased to have the chance to present today on behalf of the Investment and Trade Working Group. The theme underlying my remarks to day goes back to the very roots of the Vietnam Business Forum's initial *raison d'être*, which was namely how to strengthen the private sector and its role in contributing to national economic development.

I. ACCOMPLISHMENTS IN 2014

The year 2014 saw some significant accomplishments in terms of the economy in general and the role of the private sector in particular. While the macro economic situation continued to remain stable, Vietnam looks set to become the largest ASEAN supplier to the United States by the end of 2014 – with a net export value of about US\$30 billion. This is a historical achievement for a nation surrounded by supply chain giants. The prospects for the coming years are even better, though some of the bilateral and multilateral trade agreements that are necessary for this continued growth are facing obstacles that require us to find every possible means to enhance efficiencies and strengthen competitiveness. To that end, 2014 has seen some noteworthy progress.

Example 1. After many rounds of stakeholder consultation, the amended Enterprise Law and Investment Law will have been adopted by the National Assembly by the time of this Forum. These are the two most important laws enabling the healthy development of the private sector in Vietnam. The Enterprise Law, in particular, has been the foundation for nearly every business in Vietnam and updating it to reflect the experience of the past eight years since it was last amended is timely and welcome. The Investment Law, for its part, should lay the groundwork for accession to the Trans-Pacific Partnership, the EU FTA and the implementation of AEC 2015 by moving to a more open investment licensing system and introducing new tax reforms to support strategic industrial policies.

Example 2. Recognition and Enforcement of Foreign Arbitral Awards

Since the last Forum, the Ministry of Justice held a productive workshop on the issue of recognition and enforcement of foreign arbitral awards. The fact is that the success rate in enforcing international arbitration awards in Vietnam is dismal. Very few foreign arbitral awards that would pass muster under strict international scrutiny seem to meet the strict criteria imposed by the Vietnam courts when it comes to recognizing enforcing them. All too often, these failures to respect international arbitration awards seem to be for the wrong reasons, and this hurts Vietnam's credibility as a reliable place to do business.

Vietnam's obligations under the 1958 International Convention on Recognition and Enforcement of Foreign Arbitration Awards require it to enforce international arbitration awards through its court system except in cases where the Vietnamese respondent lacked the opportunity to be heard or there was some other fundamental procedural failure in the arbitration process. This is not happening yet, with some reports indicating that as little as one in thirty foreign arbitral awards have been successfully enforced in Vietnam.

The effort of the Ministry of Justice is laudable insofar as it has addressed this important issue head on and we look forward to seeing progress in this area. Meanwhile, we are also encouraged by the steady development of the Vietnam International Arbitration Center. VIAC

provides a viable domestic alternative in appropriate cases and it is becoming a realistic alternative in cross-border trade and investment agreements.

Example 3. Freight Tax Exemption under Double Taxation Agreements

There has been some tangible progress in respect to the issue of freight tax and the requirements for seeking exemption under the relevant double taxation agreements.

As reported in the last Vietnam business forum, 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, according to industry experts, this potential reduction of 2% in the cost of export products had been stymied by the fact that the exemption is still too difficult to claim in practice because of the record keeping requirements.

We have exchanged several papers and we have had several constructive working meetings with the relevant authorities to discuss more streamlined solutions, drawing especially from the best practices of other countries in the region. Based on these exchanges, we believe that a workable reform is possible in the very near future. We remain optimistic and engaged in this issue, which directly impacts the competitiveness of Vietnamese exports.

Example 4. Elimination of Cap on Marketing and Advertising Expenses

It has been reported in the press recently that the Ministry of Finance will eliminate the deductibility cap on marketing and advertising expenses. This would address one of the only remaining issues that was raised at the very first Vietnam Business Forum in Hue about 15 years ago. It would help local companies who need to invest in advertising their products to familiarize them with consumers and avoid the situation where enterprises are forced to pay "profits tax" on profits they have not actually enjoyed.

Enterprises are happy to learn of the proposed change, but naturally concerned to know what new system will replace it. If there is a discretionary right of tax officers to disallow expense because they are not deemed related to the production of income, or they are deemed unreasonable, then the opportunities for bad practices may only get worse. If there are still going to be bases for disallowing unreasonable expense in cases of fraud, tax evasion and the like, these need to be spelled out clearly in the detailed implementing rules to that they are transparent and predictable.

There are many other detailed accomplishments, many of which are reflected in the Progress Matrix published for this Forum. But while it is important to recognize achievements, businesses are always looking forward, for new opportunities and new challenges, so let me please move on to some of the newly emerging challenges for the private sector.

II. NEW AND EMERGING CHALLENGES

Generally speaking, the private sector in Vietnam has made amazing accomplishments and numerous entrepreneurs have flourished, notwithstanding all of the challenges. But reduction of market entry barriers and improvement of supporting services are essential elements in a healthy economic development strategy. Today, private businesses in Vietnam still suffer from lack of access to credit, land, energy, and an enabling State administrative apparatus. Tax, customs, transportation, land, trade regulation and other authorities are still too often seen as hostile threats, not as supporting services. While it is impossible to cover all of these challenges in a single paper, a few current examples may provide a starting point for some next steps.

Example 1. Land Use Rights in Industrial Zones

Challenges for the private sector arise unexpectedly with the implementation of new laws and regulations. One recent example is the impact of the rule in the 2013 Land Law that requires industrial zones to pre-pay their entire multi-year rent in advance to the State before they are allowed to enter into leases with industrial zone tenants which, in turn, enables those tenants to obtain land use rights certificates. These land use right certificates are critical for obtaining vital financial support in the form of debt from banks for which the security is the prepaid land rent from the tenant.

The issue at hand rose recently in the Department of Natural Resources and the Environment ("DONRE") in Long An province, but it may spread to other provinces where may interpret the new Land Law 2013 the same way. The issue arises out of Article 210.2 of the new Land Law 2013, which took effect on 1 July 2014. This article provides:

"If an investor leasing land from the State with annual rental payment for construction and commercial operation of infrastructure of industrial parks, industrial clusters or export processing zones has subleased out the land together with infrastructure in the form of full one-off rental payment for the entire lease period prior to the effective date of this Law, the investor shall pay the land rental to the State in accordance with the Government's regulations. Those who sublease the land have the same rights and obligations as leasing land with full one-off rental payment for the entire lease period from the State after the investor has paid the entire land rental payment to the State budget."

In the past, lessees in industrial zones could mortgage their land use right certificates to Vietnamese banks to raise finance for their working capital needs so long as they had prepaid the entire rent in advance for the term of the lease, typically up to 50 years or the remainder of the industrial zones prime land lease, whichever is less. As a result from the above article, however, after 1 July 2014, it seems that lessees in industrial zone/export processing zones **will not be able** to transfer the Land and its rights and obligations in the land to a third party ***if the industrial zone Landlord has not yet paid the entire land rental payment to the State, even if the lessee fully paid up entire rental in advance.***

Based on this article and from our experience, DONRE in some provinces take the view that the signing of a new sublease agreement after 1 July 2014 and the issuance of LURC for the one off land rental payment for the lessee will be subject to the landlord's fulfilment of its payment obligations of the one off land rental to the Tax Authority.

This article may very well impact the legal rights and financial status of thousands of the existing lessees who have previously fulfilled their one off pre-paid land rental payment obligation to the landlord. What happens if the landlord does not make its payment obligations as required by the new Land Law 2013, as many have not? If all of the leases it has entered into an land use right certificates that have been issued on the basis thereof are suddenly void, this could have a negative impact on the banking system as a whole due to the large amount of collateral involved. If the tenants' land leases become un-transferable under the mortgage agreements they have signed with local banks, their loans may go into technical default.

We suggest Article 210.2 be abolished since it should not link the obligations of the lessee with the obligations of the landlord which the lessee may not control. Short of abolition, the implementing decree should clarify that it will not apply retroactively to void or render un-transferable any existing leases or security arrangements based on them. This issue is an example of the kind of unintended consequence new laws may have, however well-intentioned they may be.

Example 2. Energy infrastructure and the PPP Program

The electricity issue needs to be addressed squarely because it may become a serious potential medium term constraint and even a social issue. We appreciate that there is no easy solution but the issue needs to be more openly debated for solutions to emerge.

Energy infrastructure and the supply of electricity as a competitive price is a looming issue for Vietnam. Some investors forecast electricity shortages the 5 - 10 year future due to the delays in implementation of the large planned coal-fired power plants. Pricing flexibility is a key element in the delays. Even assuming the plants will come on line in several years' time, provisional solutions must be worked out to bridge this gap and maintain investor confidence.

In this area we urge the government to take into account all available options including alternative energy sources such as wind and solar is supplemental sources, energy efficiency programs, more liberal licensing criteria for private and captive power plants, and so on. Non-strategic projects based solely on cheap electricity (e.g., steel mills) should be considered carefully in terms of the demand they place on the power supply.

Vietnam has made remarkable gains and other aspects of its infrastructure, including roads, bridges, and ports. These successes have shown that the private sector has a role to play, but there are concerns regarding the new PPP program and specifically that notion that it might replace the BOT program and even private infrastructure investments. A more flexible PPP regime would be desirable in some early gains in terms of licensing appropriate projects would be helpful, and allowing for more private and captive alternative energy power producers would be welcome.

Example 3. Labor Costs and Supporting Industries

One of Vietnam's key challenges is to remain competitive in global markets while meeting the aspirations of its workforce for ever better working conditions. For the last 20 years, this has been made possible by virtue of the low cost of living and related salary structure in Vietnam. However, as industrial wages continue to rise steadily, we need to look to other competitive advantages to maintain our attractiveness as an investment destination for global buyers. Controlling the increases in wage structure and all of the related benefits crucial given the challenges we face in finding other comparative advantages. This is also one of the crucial preconditions to developing supporting industries for Vietnam's basic manufacturers, whether it be footwear or computer chips, garments or smart phones.

There is a natural attraction to moving supporting industries so that they are close by their major customers. However, up until now, some regulatory distortions of discouraged the location of supporting industries in Vietnam. For example, customs duty exemptions don't always apply for supporting industries happen to be located outside industrial zones export processing zones. In some cases, ironically, this can make it cheaper to source the components from another country than from within Vietnam. The paper work to claim the exemptions is intimidating and the consequences of making a mistake may be disastrous, further discouraging supporting industries. While great progress has been made in the pure export manufacturing sector, the reforms there need to be extended to streamline the environment for local enterprises as well, including foreign invested and local companies outside the zones.

In fact, all of the deficiencies or inefficiencies of the economy work their way into the production cost of the supporting industries. Whether it is transportation, electricity, water, labor, technical experts or the administrative environment in general, all of these factors of production must be addressed to create an environment where the supporting industries can follow their natural tendency to gravitate towards their major customers. If these areas can be addressed, a virtuous cycle can be created where more and more supporting industries will spring up to compete to offer better goods and services.

One of the key supporting industries that we discussed at the last Forum is the textile industry, a necessary precondition to taking advantage of the preferential duty rates of the Trans Pacific Partnership Agreement (“TPP”) and its “yarn forward” rule. Simply put, this rule means that if the raw materials for the garments Vietnam makes are not sourced Vietnam or another TPP country, the end product government will not be eligible for the TPP duty rate.

Some progress has already been made in attracting new textile investment. Whether or not the TPP is concluded in the near future, attracting investment in the production of textiles fabrics is a challenge for Vietnam due to the high capital costs and needs for international experts to install and operate these facilities. But the government can help by adopting a favorable investment industrial policy that supports this trend through tax credits, tax incentives, simple customs procedures, allowing importation of used equipment, cleared land nearby the main garment manufacturing zones, stable energy supplies, access to water treatment facilities and other basic preconditions. I know that sounds like a lot, but this is a strategic historical opportunity and it may not happen without the rights conditions being put in place.

III. ISSUES THAT REMAIN PENDING

There are some issues that we have discussed previously that remain unresolved. Some of these need repeating.

Example 1: Trading Companies - Trans-shipment Limitations

An obvious example of an issue that seems counterintuitive in light of Vietnam's overall strategy to integrate and compete in the global economy is the conservative licensing approach to trading companies engaged in commissioned agent services based in Vietnam but servicing the region.

Specifically, 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 favor 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 2. VAT on Export Services

For many years now we have discussed the issue of Value Added Tax on exported services. Most countries grant exported services a 0% VAT rate in order to avoid disadvantaging them in international marketplaces and imposing unfair noncritical VAT burdens on form customers. The law in Vietnam has changed twice, moving from an eligibility test that focused on whether the service was “related to Vietnam” to test of whether the customer had an establishment in Vietnam, and then back to the quote related to Vietnam” test. Many foreign customers complained to their Vietnamese-based service providers about being charged VAT on exported services that are paid for from abroad. Others cave into the pressure of therefore customers and either absorb the VAT themselves or fail to pay it, sowing the seeds of future tax disputes.

In countries where 0% rate is granted as part of a overall policy to support exported services, stimulate hard currency earnings and compete in international marketplaces. Vietnam would do well to follow this model because it can compete in many service sectors. Vietnam could do this by adopting the simple rules that were the service is paid for in hard currency from abroad to a bank account in Vietnam it is eligible for the 0% rate. Vietnam is not risk losing any tax because if the service paid for was later charged back on form customers to its affiliates in Vietnam, the affiliate would be paying foreign contractor withholding tax on the amount charged

back. Under the current system, taxpayers can be taxed twice on the same income exacerbating the negative impact on the competitiveness of the service suppliers.

Example 3. Work permits

At last Forum, the issue of work permits was one of the key concerns expressed by the private sector. Some progress has been made in terms of correcting the rules so that they are more reasonable, but serious practical problems remain. The strict criteria in the new rules continue to create problems for businesses, indeed, the survey of the employment working group demonstrates clearly that this is one of the top concerns for foreign investors Vietnam today. Vietnamese enterprises also suffer when they can't compete in international markets because they can't hire international talent.

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.

- **Requirement for 4-year bachelor degree and 5-year's experience**

Second, in respect to the requirements of 4-year bachelor degree *and* 5-year experience for specialists in work permit application: For application for newly issue work permits, according to Resolution 47¹ of the Government, MOLISA issued Official Letter No. 2779² dated 4 August 2014, confirming the rules set out by Resolution 47. i.e. only **either** condition applies to specialists. This applies in practice now.

However, Resolution 47 mentions both specialists and technicians. Though, the wording of Resolution 47 and Official Letter No. 2779 is very confusing as to whether technicians can obtain work permits when they just satisfy only one of the two conditions – i.e. one -year training or three-year experience. Therefore, it seems that in practice DOLISAs still apply the old rule to technicians requiring the satisfactory of both two conditions.

- **Extension of work permit granted under the old regulation**

Third, regarding the renewal of work permits granted under the old regulation but which have since expired, DOLISA HCMC issued an official letter specifically requiring companies to apply for a newly issued work permit in accordance with the new criterion, rather than a re-issued work permit (i.e. a renewed one).

Though the DOLISAs may require either condition only, the problem is that under the regime of new issuance of work permit, foreigners need to apply for a Vietnam juridical record if they have been here for a long time, and police check report in their countries which may require them to go back to the countries to obtain.

¹ Resolution 47/NQ-CP of the Government dated July 8, 2014 - Relaxing the conditions for Work Permits issuance for foreign employees

² Official Letter 2779 / VL LDTBXH notified the application conditions were adjusted for foreign workers in Vietnam in Resolution No. 47 / NQ-CP dated 07/08/2014

The wording under Resolution No. 47 is below:

| English | Vietnamese |
|--|---|
| <p>Item 4.a</p> <p>4. Regarding the conditions for foreign labourers entering into Vietnam to work: The Government decides to adjust the conditions for foreign labourers entering into Vietnam to work in the following circumstances:</p> <p>a) Foreigners who are specialists, technicians if satisfying the condition on educational qualification or the condition of at least 5-year experience relevant to the position/ job that the foreigner will take in Vietnam</p> | <p>Điểm 4.a</p> <p>4. Về điều kiện đối với lao động là người nước ngoài vào làm việc tại Việt Nam: Chính phủ thống nhất điều chỉnh điều kiện đối với lao động là người nước ngoài vào làm việc tại Việt Nam thuộc một trong các trường hợp sau:</p> <p>a) Người nước ngoài là chuyên gia, lao động kỹ thuật nếu đáp ứng yêu cầu về trình độ chuyên môn đào tạo hoặc có ít nhất 05 năm kinh nghiệm làm việc phù hợp với vị trí công việc mà người nước ngoài dự kiến sẽ làm việc tại Việt Nam;</p> |

The confusion arises out of the requirement for in 5-year's experience. There is no problem with specialists because they are subject to 5-year experience. However, technicians are only subject to 1-year training certificate and 3-year experience under Decree 102³ and Circular 03⁴. The wording under this Item can be interpreted to mean that technicians must satisfy either condition of educational qualification (i.e. 1-year training certificate) or **5-year experience, which is unreasonable.**

Therefore, the revised wording should be:

“Foreigners who are specialists, technicians if satisfying the condition on educational qualification **or** the condition of at least 5-year experience **(for specialists) or 3-year experience (for technicians)** relevant to the position/ job that the foreigner will take in Vietnam”

This small change in the language of the rules could significantly ease the uncertainty and burdens on the private sector when hiring foreign talent. Other issues remain, however, such as the inconsistency of the standard Japan health certificate when comparing the requirement of the health certificate under the work permit rules, which makes it hard for Japanese applicants particular. Eventually, a comprehensive overhaul of the work permit requirements would be advisable.

Example 4. Facilitating Environment for e-Government, Notarization Requirements

There has been some progress, but some backward movement in the area of e-Commerce: 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 just one example:

Requirements for foreign legal documents to be notarized, consularized, legalized, translated and notarised again impose undue burdens on new businesses as well as existing businesses.

³ Decree 102/2013/ND-CP, issued by Ministry of Labour, Invalids and Social Affairs (MOLISA) on September 6, 2013, provides guidelines on the implementation of provisions of the new Labor Code on the management of foreign nationals working in Vietnam

⁴ Circular 03/2014/TT-BLDTBXH on guiding implementation of a number of Articles of Decree No. 102/2013/NĐ-CP dated September 05, 2013 by the Government on detailing implementation of a number of Articles of Labour Code on foreign workers in Vietnam

This is required in many circumstances ranging from setting up a new representative offices or companies to getting work permits, etc. 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 5. Lack of Duly Licensed International Ship/Rig Classification Service Providers

No apparent change has been reported in the area of opening the market to licensing the international 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. The service suppliers who care about legal compliance would like to set up normal business operations here to support Vietnam's ship building and repair industry. This is a vital supporting service in supporting Vietnamese ship repair enterprises as they try to compete in the international marketplace.

Example 6. Dissolving Enterprises

Not much progress has been made in the area of the procedures for dissolving an enterprise. These 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 had 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. 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 to streamline the process. We do not know what became of this proposal. Perhaps it was not taken up enthusiastically by the auditing companies?

Example 7. Licensed Production of Medical Equipment for Export and Clinical Trials

In this area there has been some progress with entity licensing but, not in the area of clinical trials.

Healthcare industry experts suggest that 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.

IV. CONCLUDING REMARKS - HOW TO CREATE A BROAD BASED PUBLIC - PRIVATE PARTNERSHIP?

The Necessity of a Strong Public Sector

At the end of the day, a healthy private sector depends on a supportive public sector. The private sector cannot thrive if it is not supported by basic public utilities (such as electricity and water), an appropriate education system, professional government regulators, a well functioning legal system to protect legal and contractual rights, physical security.

In this context, the question is still being debated - should State enterprises be absorbing scarce capital resources in non-productive assets? Should the State raise capital for its urgent core functions by selling off its own non-core assets such as hotels and beer companies, just to name two?

There are plenty of examples around the world where countries have taken advantage of the value of their non-core assets to modernize their functions. Here I am not talking about halfway equalization programs, but a full-scale privatization of non-core assets. At the end of the day, if we want to make the private sector the backbone of business in Vietnam, it will be necessary to create a level playing field by removing the preferences inevitably enjoyed when the State owns the competitors.

Some of these preferences may be very subtle and hard to detect. For example, a private Vietnamese bank competing with the state owned bank suffers a disadvantage because state owned enterprises naturally deposit their funds with state owned banks, reducing the cost of capital for those two don't banks and allowing them to lend on more preferential terms. These are the kinds of subtle forms of discrimination that really can't be eradicated with a simple obligation in an international trade agreement but which must be discussed openly to create consensus domestically about the way forward.

There is much left to be done in creating a stronger private sector in Vietnam, but given the tremendous progress over the past 20 years, there is every reason to be optimistic that working through channels like the Vietnam Business Forum, among others, obstacles can be identified and solutions can be found.

Thank you for your attention to my remarks today and I look forward to our ongoing work to resolve these issues.