IV. Main conclusions and recommendations

During the 20 years since Doi Moi, Viet Nam has undergone an extraordinary transformation from an isolated, poor and collectivized agriculture-based economy into a booming nation on the verge of becoming a new Asian Tiger. It has achieved an extraordinary reduction in poverty and is becoming a significant player in world trade.

Even though Viet Nam has only gradually opened to FDI, foreign investors have represented a major force in the process of economic transformation. They have underpinned the rapid development of the manufacturing sector and the strong increase in output, created more than one million jobs, offered higher-than-average wages, generated high levels of exports, transferred knowledge and skills, accounted for a significant portion of tax revenue and created employment for women.

The majority of FDI inflows to date has been concentrated in manufacturing for exports, partly as a result of legal restrictions on FDI entry. To a significant extent, foreign enterprises in Viet Nam still operate as enclaves, with relatively few linkages with national firms through supplier or buyer contracts. This is partly due to the predominance of export-oriented manufacturing FDI, the small number of large Vietnamese private firms, and limited structured efforts to promote linkages.

Viet Nam has the potential to attract much higher levels of beneficial FDI and to create more significant linkages with the local economy, as illustrated in UNCTAD's World Investment Prospects Survey 2007–2009, where it ranks sixth among the most attractive economies for the location of FDI. There are already clear indications that foreign investment is diversifying into new and technologically more complex segments of manufacturing for exports, including consumer electronics and information technologies. The negotiation process for WTO membership has encouraged the Government to press ahead with structural reforms over the past 12 years, and formal accession in early 2007 means that a number of sectors that were previously closed to FDI will open in the near future, even though the Government has decided to maintain a significant number of restrictions to FDI entry. The potential for FDI in services is extremely large, including in banking, telecommunications, insurance, retail, distribution, higher education and infrastructure.

Doi Moi represented a systemic and structural breakthrough in economic policy, allowing private property ownership and encouraging private investment, both national and foreign. It marked the beginning of the transition towards a regulated market economy. Although the transition is extremely well advanced, it is still "work in progress", and important structural and regulatory issues remain that affect policy towards FDI. These issues include:

- **The regulatory attitude towards private investment**: The current regulatory approach is biased towards "steer and control", rather than "regulate, monitor and enforce", as in long-established market economies. An approach that gives more freedom to investors in managing their businesses and a less intrusive regulatory attitude would promote more innovation and dynamism in the private sector.

- **The place of commercially-oriented SOEs in the economy and the nature of their interaction with private investors**: The policy and attitude that the Government will adopt as SOEs come under increasing competitive pressure from FIEs and emerging Vietnamese private enterprises will be key determinants of the investment climate in the near future.

- **The extent to which the Government will wish to protect the emerging Vietnamese private sector from competition from FIEs**: FDI inflows to date have focused on manufacturing for exports and have not significantly competed with Vietnamese private firms in supplying the domestic market. This will change as Viet Nam is committed to lifting some FDI entry restrictions. The policy on the extent to which FDI – including by small-scale foreign investors – will be allowed to compete with Vietnamese private firms for the domestic market will be another important determinant of the investment climate.

- **The solutions to capacity constraints arising from Viet Nam's rapid growth**: These constraints are easily discernible in electricity and transport infrastructure and less visible, but none the less important, in areas such as human capital development and strengthening local business competitiveness needed to support upgrading and productivity growth.

The recommendations in this review address these key issues. The main recommendations are summarized below. Additional recommendations on the regulatory framework for investment are provided that are not summarized here but can be found in chapter II.

A. Doi Moi 2: unleashing the forces of innovation

The impact of Doi Moi in terms of economic development and poverty reduction has been remarkable, but much remains to be done to alleviate poverty and raise the standards of living to a level comparable to that of Viet Nam's more developed neighbours, including Malaysia and Thailand. The issue that Viet Nam currently faces is how the legal and regulatory framework for investment should further evolve in the future so as to best bring about sustainable development, wealth creation and poverty reduction.

The Government should now consider a "Doi Moi 2" in investment policy in order to allow companies to become more competitive, innovative, flexible and in tune with the needs of the people and the market. It is timely to consider whether Viet Nam wishes to push all the way the logic and fundamental principle of a market-economy system, which is that agents have the freedom to identify and pursue business opportunities and to innovate – under a set of well defined and enforced rules aimed at protecting consumers and the national interest. The potential for innovation, creativity and ultimately prosperity in Viet Nam could be increased by adopting a less intrusive approach to investment regulation than is the case at the moment.

Concretely, Doi Moi 2 would imply to shift from a "steer and control" attitude to a "regulate, monitor and enforce" attitude in investment policy. This should be based on the presumption that investors – the market – are best informed of valuable business opportunities and that the role of the Government is to: (a) set rules (regulations) in order to protect the people and the national interest; (b) monitor whether market participants obey these rules; and (c) enforce the rules. Concretely, this would mean to:

- Restrict FDI registration/certification procedures for foreign investors to an FDI entry compliance check.
- Draw up a full list of FDI entry restriction: the nature and extent of FDI entry prohibitions, limitations and restrictions should be clearly defined, transparent and non-arbitrary.
- Remove investment registration and certification requirements for domestic investors.
- Apply regulatory rules to govern the market economy separately from the initial FDI registration/certification process: securing sectoral licences and company registration would

be separate processes from FDI registration/certification, and regulatory rules would apply equally and in a non-discriminatory manner (post-establishment) on both foreign and national investors.

- Cut down the number of Master Plans and redefine their function to policy documents that set out broad policy measures, rather than specifying specific targets and projects that need to be implemented. Remaining Master Plans would focus on the long-term planning of public infrastructure rather than private sector development.

Doi Moi 2 would also mean that investment regulation/promotion institutions take on stronger promotion, facilitation and aftercare role and reduce their regulatory and oversight functions. The latter would be exercised almost exclusively by sectoral oversight institutions, such at the central bank, the competition authorities or the electricity regulatory agency.

In addition, this review recommends that the corporate tax system be simplified and incentives be rationalized in order to promote investment further. A comprehensive assessment of the cost of benefits of fiscal incentives should be conducted and reforms undertaken in order to:

- Make the general corporate tax system attractive and competitive;
- Streamline and simplify the number of incentives and restrict them to a small number of specific objectives;
- Simplify the tax system and reduced the administrative burden on investors and the tax authorities.

B. Allow the FDI potential to be realized in key sectors

Viet Nam has gained tremendously from allowing the entry of foreign investors over the past two decades, even though the opening to FDI has been fairly gradual and partial. Under the WTO accession agreement, a number of services sectors will become open to foreign investors in the near future, including in particular financial services. In the next stage of opening to FDI, the Government should consider key backbone sectors where providing globally competitive services are vital to sustain economic progress, and which risk becoming bottlenecks. Well-orchestrated policies for attracting FDI in such sectors could generate large inflows of beneficial FDI and further promote the development of the economy. These backbone services are:

- Telecommunications;
- Electricity;
- Transport;
- Higher education and vocational training.

Attracting beneficial FDI in these sectors will require a coherent and properly planned strategy of market liberalization. Similarly to the policy of gradually opening to FDI applied in the past two decade, a gradual approach could be adopted to ensure that the benefits of opening to FDI are maximized, while the potential costs or disruptions are avoided or minimized. The Government is putting in place such a strategy in the electricity sector, and this review proposes a number of measures to attract FDI in power generation. It is recommended that similar strategic reviews and policy packages be prepared for telecommunications, transport and higher education.

C. Promote FDI in new and dynamic sectors

Keeping up with the rising demand for core infrastructure services is a necessity to sustain the rapid pace of economic development of the past two decades. Increasing the quality of services in telecommunications, electricity and transport and further raising the skills level of the labour force would also better position Viet Nam to attract FDI in new and dynamic sectors. Although it is not the mandate of this review to propose an overall FDI strategy, it is suggested that Viet Nam should start elaborating and putting in place a broadened strategy of FDI promotion and attraction. Such a strategy would no longer focus mostly on FDI in export-oriented manufacturing activities, but would be broadened to FDI in new and dynamic sectors, including in services. It would also seek to enhance the role of Viet Nam as a logistics centre in the Greater Mekong subregion and as a business hub for TNCs operations in the ASEAN area.

D. Provide necessary skills to the rapidly evolving economy

One of Viet Nam's key assets in attracting foreign investors is its relatively low labour costs, combined with a productive, industrious and trainable workforce. This has allowed the country to attract a large number of foreign investors in labour-intensive sectors that require either relatively low skills (textile and garments) or intermediate skills (consumer electronics and basic manufactured goods). More recently, Viet Nam has also started to attract foreign investors in need of more highly skilled workers.

As it continues to develop, Viet Nam will require more and more skilled workers in a wide variety of fields. While education policy will underpin the development of such skills, Viet Nam would greatly benefit from setting up a proactive immigration policy to facilitate the entry of foreign skills that are in short supply but needed by its economy. Such a policy would seek to achieve the twin purpose of selectively attracting skills in short supply locally and to promote skills transfer, thereby complementing the education-based skills development policy. It would replace the current restrictive regime of entry of foreign workers and would be articulated along the following principles:

- Conduct a comprehensive skills and labour market audit and update it on a regular basis.
- Establish a migration occupations in demand list on the basis of the skills and labour market audit. The list would identify a detailed set of specific occupations where there are insufficient workers in Viet Nam at the level of qualification required by employers. The list should be forward-looking in assessing the needs of the labour market and updated regularly.
- Facilitate and promote the entry of foreign workers who possess qualification on the migration occupations in demand list.
- Promote the transfer of skills to Vietnamese workers through targeted programmes.

E. State ownership and regulatory functions

State-owned enterprises represent a sizeable share of output and most are involved in essentially commercial activities where they are likely to face increasing competitive pressure in the future from private investors, Vietnamese and foreign. The extent to which the Government may seek to protect fledgling SOEs engaged in commercial activities from competition and possible bankruptcy will be an important determinant of the investment climate. Excessive protection, subsidies or an un-level playing field could have wide repercussions and sour the overall investment climate, thereby discouraging Vietnamese and foreign private investment.

The current approach is to use the SCIC to improve management performance in SOEs and prepare them to face fair competition under a market economy framework. The purpose of the SCIC is also to start putting in place a clearer separation between the State's ownership and regulatory functions. This approach will be very time consuming, however, and may not prove fast enough in the face of a rapidly evolving economy and investment climate.

In the end, regardless of the extent to which the authorities wish SOEs to remain involved in economic activity, the crucial element in terms of the regulatory framework for investment is that the ownership and regulatory functions of the State be properly ring-fenced in order to provide a level playing field between public and private investors. This will be all the more important as competitive pressures on SOEs increase and as the threat of bankruptcy of some SOEs rises.

While some steps have been taken to separate ownership and regulatory functions, this Review recommends additional steps to ensure a level playing field between private and public companies in commercial activities, including to:

- Transfer the ownership of all SOEs to SCIC and mandate it to enforce hard-budget constraints on all of them.
- Equitize SOEs in purely commercial and non-strategic activities, with the State selling all or the majority of its shares.
- Narrow the list of SOEs in which the State will maintain 100 and 50 per cent ownership to companies operating in genuinely strategic or socially sensitive sectors.
- Establish and publish a comprehensive census of all SOEs, together with a full audit of their assets and liabilities and ownership structure.

Viet Nam has greatly improved the legal framework for heavily regulated sectors (e.g. telecommunications, electricity, banking, transport, higher education) and for competition in recent years. It has also started to put in place an institutional framework for the enforcement of regulations. In most cases, the enforcement institutions are a Department within the parent Ministry. While this kind of arrangement may be suitable for the moment, Viet Nam should aim to create independent regulatory institutions with their own enforcement powers. Such an arrangement is likely to be the only one susceptible to guarantee the impartial enforcement of the rules of the game to public and private investors alike. The aim should be for the Government to turn the key regulatory Departments within various Ministries into independent institutions soon after they have built up and demonstrated their capacity to enforce the laws and regulations.

F. Attracting FDI in electricity

Viet Nam aims to establish a competitive power market at the retail level by around 2025. Concurrently, the Government wishes to attract significant levels of private investment in the sector, in order to ensure that the power market be genuinely competitive and that the large expected increase in electricity demand be met with high-quality and reliable supply. It also wishes that its exposure to commercial risk in the electricity sector be minimized, if not eliminated altogether.

The establishment of such a competitive power market is a very complex undertaking, and the Government has done well to adopt a gradual and stepped approach. This Review suggests market framework and operational recommendations in order to promote a smooth transition to the competitive power market and create the conditions needed to attract foreign investors in power generation on a significant, sustainable and mutually beneficial basis.

1. Market framework recommendations

Genuinely disaggregate generation, transmission and distribution: The three operations should be operated by legally separate companies, without cross-ownership.

- **Disaggregate the EVN group:** EVN should cease to be a vertically integrated power company. This would lead to the creation of a strategic power generation company on the basis of EVN's key generation assets, the Viet Nam Power Company. A handful of other power companies would be created from the other generation assets. In turn, independent state-owned companies would be created for transmission (nation-wide monopoly), distribution and electricity services.

- **Separate the single buyer from EVN.** The single buyer in the transition to a wholesale electricity market should be part of the proposed transmission monopoly, which would also include the National Load Dispatch Centre.

- **Transfer the ownership of EVN and other SOEs in the sector from the Ministry of Industry to the SCIC:** Ownership of SOEs and regulatory functions should be separated. This would require that all State-owned assets be transferred as soon as possible to the SCIC.

- **Transfer the Institute of Energy to the independent transmission company.** The credibility and objectivity of the Master Plan must be as high as possible. This requires that the Institute of Energy be separated from EVN (VPC) in order to avoid conflicts of interest between a generation company and the main drafter of the Master Plan.

- **Strengthen ERAV and gradually increase its powers and independence.**

2. Operational recommendations

- **Seek to attract first-tier investors:** Attracting first-tier investors who possess and master the best and most efficient technologies available is important for a number of reasons, including to protect the local and global environment and public health, and to ensure that long-run electricity costs are minimized with the use of fuel-efficient technologies.

- **Gradually phase out sovereign guarantees:** Viet Nam will need to provide sovereign guarantees to foreign IPPs as it has done in the past if it wishes to attract first-tier investors in generation, at least in the near term. It should put in place a gradual phase-out strategy, underpinned by the establishment of a competitive market at the wholesale level and could provide sunset clauses in the sovereign guarantees provided until the phase-out is complete.

- **Create standard PPAs:** Standard PPAs should be prepared and made readily available to investors. This would not only accelerate the implementation of projects, but also reduce the cost of reaching an agreement for the Government and investors.

- **Establish competitive bidding for all power plants on the Master Plan:** All power plants listed on the Master Plan should be subject to competitive bidding open to private and public sector companies.

- **Make EVN–VPC the developer of last resort:** In order to ensure that overall plant requirements are met, create a datum against which other costs can be judged and minimize delays if other bids are unresponsive, EVN-VPC should be required to bid for all generation projects. In order to cover the cost of being required to bid for all projects, EVN-VPC could be granted a subsidy earmarked for that purpose.

- **Allow zone-specific IPPs:** Zone-specific IPPs should be allowed as long as they are part of the least-cost development programme.

- **Seek strategic investors in equitized power companies:** Equitizing one or two of the smaller power companies created from EVN's generation assets to strategic foreign investors could be a useful tool to promote FDI, accelerate new greenfield projects and promote a competitive market for generation.