Problems with Business Climate for Foreign-Invested Companies in Vietnam

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After 16 years of the economic reform, the foreign sector has become an organic component of the Vietnamese economy and contributed a lot to the economic growth. As a form of the globalization, however, the foreign investment in Vietnam is affected by the world economy and overseas investment trends.

Table 1: Foreign-invested companies with high increases in their capital (US$ million)

Company	Starting investment	Added investment	%
Holcim Vietnam	233.8	207.2	88.62
Pou Yuen Vietnam	167.74	120.3	139.43
Saigon-Linh Trung Export Processing Zone Development	14.0	41.5	296.43
Vĩnh Nghĩa Shoes	5.0	10.0	200
Formosa Vietnam	270.3	211.9	78.40

Source: MPI

According to the Foreign Investment Agency, the foreign investment in Vietnam in February 2004 increased by 196.6% compared with the corresponding period last year. Newly registered capital in the first two months of 2004 amounted to US$280 million. The added capital reached US$274.2 million making a year-on-year increase of 300%. These were encouraging signs in the foreign sector in Vietnam.

This improvement originated from the fact that economic powers have recovered after a period of recession. However, internal factors have their own impacts. In the past three years, Vietnam have been considered by Japanese business circle as one of the top ten countries with attractive business climate (cheap labor, high growth rate, good distribution of risk). American businesspersons considered Vietnam as a focus for American investment because of four reasons (terrorism-free society; good improvements in preparation for WTO membership; high growth rate; and potential consumer market).

Increases in the foreign investment took place mainly in the Southern Vital Economic Zone. Many foreign companies have doubled, or tripled, their capital in recent years.

Increases in investment show that foreign investors felt sure about their business in Vietnam, which helped improve the Vietnam's public image on the world market.

Besides encouraging signs from the foreign sector, there are many problems with the business climate in Vietnam.

1. Tax system

No investor wants to put money in a coutry where laws and policies are changeable, especially the tax system.

a. Company income tax: The Company Income Tax Law passed by the NA in September 2003 and the Decree 164/2003 that was effective as of Jan. 1, 2004 allowed local ones to enjoy tax reduction to a certain extent and forced the foreign-invested ones to pay more in this tax. For example, the income tax rate on foreign companies whose 50% of their output are for export increases from 10% to 20% and from 10% to 28% on developers of industrial parks and export processing zones.

Table 2: Company income taxes in some neighboring countries

Country	Tax rate (%)	Country	Tax rate (%)
Indonesia	30	Thailand	30
Malaysia	28	China	25
Philippines	32	Vietnam	28 (as from Jan.1, 2004)
Singapore	20 (as from Jan.1, 2004)		

Source: Ernest & Young Vietnam, 2004

In addition, the tax reduction that is available for companies for the whole duration of their investment projects was limited to 10 to 15 years based on the nature and location of the projects. Types of projects enjoying preferential treatment are also fewer and conditions for such treatment are also more demanding. For example, the number of provinces where preferential treatment are offered is reduced: Bình Dương and many districts in Ninh Thuận, Lâm Đồng, Đồng Tháp, Vĩnh Long and Trà Vinh were removed from the list of districts favorably treated.

The HCMC Board of Hi-Tech Parks reveals that in the past few years, investors in hi-tech parks enjoyed preferential treatment: tax exemption for eight years and a company income tax rate of 10%. The Decree 164/2003 reduces the tax exemption time to four years and allows a tax reduction of 50% for the next nine years. This makes many investors unhappy and many of them have decided to transfer their projects to neighboring countries, such as Indonesia, China or Thailand.

Let's have a look at the company income tax in Vietnam.

The current tax rates are not high in comparison with regional countries.

Thus, changes in tax rates are an appropriate step towards a common Companies Law that is applicable to all companies and provides them with a level playing field. This step is also suitable to Vietnam's effort to join the WTO.

But the problem is with the taxable income. Many experts from home and abroad are of the opinion that methods of working out the taxable income and deductible expenses contain many irrational factors and go against international practices. They make the real tax payment much higher than nominal tax rates introduced by the new regulations.

b. Value- added tax: The value-added tax is also adjusted in a manner that is unfavorable to companies, especially ones operating in export processing zones.

Before amendments to tax laws, goods and services supplied to export processing zones and industrial parks enjoyed a tax rate of 0%. New tax laws impose tax rate of 5% and 10% on such goods and services now. But local companies are allowed tax refund while companies in export processing zones are denied this tax refund. This means that companies in EPZs should pay the VAT when buying financial, banking, insurance, and telecommunications services. These expenses certainly make the production cost higher and competitiveness lower.

Facing unfavorable changes in the tax system, many investors have decide to build factories in surrounding countries and sell finished products to Vietnam because they thought the business climate in Vietnam wasn't favorable. They also complained that the government had to give proper notice of such changes in order to help investors cope with them more effectively. They remark that the Vietnamese policy on the foreign investment became stricter while neighboring countries are adopting more open ones. More importantly, they have lost interest in policies to encourage foreign investment that had been carried out in the years 1998-2003. In fact, these changes mean that Vietnam decided to stop encouraging foreign investment and made the business climate in Vietnam less attractive.

Table 3: Examples of real company income tax rates

	According to account books	According to tax agency
Total sales	100	100
Total expense	80	52
Adjustments made by tax agency	–	
– Unreasonable expenses		–8
– Expenses exceeding legal limits		–20
Taxable income	20	48
Tax payable according to investment license (20%)	4	9.6
Real tax rate	20%	48%

Moreover, such changes in the tax law make foreign investors confused when they have to suffer tax discrimination instead of enjoying tax incentives.

c. Customs duties: Unreasonable customs duties will encourage import of finished goods instead of making direct investment and producing goods in host countries. In other words, the customs duties reflect the policy on foreign investment.

After carrying out market research in Vietnam before deciding on a US$500-million plant to produce computers, a representative from a multinationals said that the current tax system would discourage all producers of electronic goods because duties on imported components and parts were from four to five times higher than those on complete computers.

Producers of cables and wires also face the same problem. Raw materials needed for making insulators pay a tax rate of 15% while the finished wires and cables pay only 5%.

2. Production cost

At present, increases in prices of many services (water and power supply, transport, fuel, etc.) have made market prices rise and companies face with more difficulties.

One of agents that cause increases in prices is the monopoly. According to a report presented by the HCMC People's Committee before the People's Council, one of reasons that made the price of water supply rise is high waste suffered by the HCMC Water Supply Company (this waste amounted to some 30% of the amount of water supplied). The price of electricity also rises frequently because, as explained by the Electricity Company, large sums of money are needed for repairing and expanding the grid.

A recent survey of rents of office buildings shows that the rent for offices in HCMC ranks fifth in the world (US$28.05 per sq.m. on average). Regarding the living standard that is based on the per capita GDP, the Vietnamese personal income is 15 times lower than the Japanese one. Thus, the rent of office in HCMC based on the living standard will be: US$28.05 x 15 = US$420.75 while the office rent in Tokyo where the office area is considered as the most expensive in the world is only US$102.38 per square meter. Such a rent has broken all records!

Transport fee in Vietnam is also high because the railroad system fails to meet the market demand in spite of recent improvements. And as a result, companies have to use other means of transportation at higher costs and see their production cost increasing.

3. Administrative machinery

You should learn to be patient when investing in Vietnam, that is what Raymond Sander from the American-Vietnamese Business Association remarked in February 2004 when duscussing difficulties facing American companies. This remark was made after the Vietnamese Government had carried out the administrative reform for two years, had four times made amendment to the Foreign Investment Law and had opened the economy to the world for 16 years. This remark is worth thinking.

Customs service is still the most worrying problem to companies. The next is land clearance and compensation payment before realizing any project. In addition, the lack of agreement among governmental bodies and public services also cause a lot of troubles for foreign-invested companies. A foreign-invested company had been licensed by the MPI to build a new factory in Long An Province, the Long An People's Committee had agreed to lease land but it couldn't carry out the project because the Long An Service of Planning and Investment didn't agree on the site it chose.

The lack of transparency relating to information about policies also leads to difficulties for companies and more bureaucratic practices.

These facts show that the Vietnamese business climate contains many shortcomings and problems that require overall and consistent solutions.

4. Solutions

a. Tax policy:

- Removing limits on expenses involved in the calculation of taxable income: this measure can help lower the real tax rate and it is suitable to international practices and economic theories. Moreover, the removal of expenses on advertising and sales promotion will provide Vietnamese advertising agencies more business opportunities.

- Making tax laws and regulations more transparent: this is also what Vietnam has to realize before joining the WTO. All changes in the tax regulations must be publicized at least three months before it comes into effect in order to avoid unnecessary complaints.

- Review of tax regulations: Tax regulations need regular reviews in order to make them more favorable to foreign investment and economic growth.

- Improvements in quality and sense of responsibility of tax officials: Training courses in new regulations must be held regularly. Tax officials must understand that their responsibility is to collect tax payment as required by laws, not causing troubles for companies. Proper incentives and punishments could be used as an effective instrument for improving the work ethics among tax officials.

- Laws in general, and tax laws in particular, must be transparent and stable. The NA should refrain from shotgun measures and should take a long view when making laws. In addition, what to keep in mind is the overall principle: Vietnamese laws must be suitable to international practices, laws and agreements Vietnam has entered.

b. Macroeconomic policies

- Privatization of state-owned companies is a good measure to remove the monopoly, especially in services and goods needed for production. The Government had better accelerate this program at any costs.

- The law system must be perfected in order to provide companies with a level playing field. All kinds of subsidies for state-owned companies must be cut.

- Encouragements must be offered to private companies that engage in infrastructure building, transportation and goods distribution.

c. Administrative reform

The administrative reform must aim at facilitating operation and business of citizens and companies instead of consolidating the power of public organization or protecting vested interests. To achieve this aim, authorities must make administrative procedures transparent and all requirements from private persons and companies must be handled with specific time limits.

As for civil servants, their responsibility and workload must be clarified. When complaints arise, both leadership and civil servants of the relevant bodies must be disciplined. To ensure good results, however, the salary scale for civil servants must be amended with a view to allowing them to obtain a decent living and therefore paying more attention to thei tasks. Moreover, good salary can attract more qualified laborers to the administrative machinery. At present when the expertise and educational level of civil servants didn't reach required standards, regular training courses are much needed.

The above-mentioned solutions, in my opinion, can not only improve the competitiveness of the business climate, but also encourage domestic investments and facilitate the economic growth. ■

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