Experience from Growth of the FDI in the Past Two Decades

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1. Lessons from the growth of the FDI

After coming into effect in 1987, the Foreign Investment Law was adjusted four times in 1990, 1992, 1996 and 2000. In 2005, the Investment Law was passed and came into effect as of July 1, 2006 as a replacement for the Foreign Investment Law and Domestic Investment Encouragement Law. These changes have helped attract some 9,500 FDI project with a registered capital of US$98 billion. The realized capital in the foreign sector reached US$40 billion equaling some 20% of the gross investment in the years 1996-2000 and this figure varied between 17% and 18% in the years 2001-2007.

The FDI in Vietnam rose steadily in recent years. In 2001-05, it amounted to US$18.5 billion and rose to US$12 billion in 2006 alone. In 2007, after Vietnam's accession to the WTO, the FDI topped the US$20-billion mark equaling the total foreign investment in 2001-05 period and 20% of total foreign investment in the past two decades. Top investors in Vietnam are South Korea, Singapore, Taiwan, Japan, British Virgin Islands, Hong Kong, Malaysia and the U.S.

The FDI in Vietnam contributed a lot to positive changes in the structure of industry and labor market. It also linked the Vietnamese economy with the world community, helped develop the service sector and allowed Vietnam to integrate more fully and actively into the world market. In recent years in particular, the foreign sector has helped turn many agricultural provinces, such as Bình Dương and Vĩnh Phú, into industrial centers. Ayumi Konishi, ADB Representative in Vietnam pointed out that the participation of the private sector, with foreign-invested companies and their strategic importance, had been encouraged in order not only to meet great financial needs but also help improve the general performance of the economy.

Besides many positive results, the FDI in the past few years hasn't reached its full potential, especially in the fact that the realized capital was very small in comparison with the registered one. Moreover, technological transfer hasn't taken place well because the number of hi-tech projects was small. The growth of the FDI in the past two decades, therefore, allow us to draw many lessons to study more carefully when Vietnam is integrating more fully into the world market and affected more seriously by fluctuations in the international trade.

The first lesson: Vietnam should make the best use of opportunities offered by the development of the international trade to attract more FDI in the coming years. After some progress in the years 1991-97, the FDI flow contracted in 1998-2004. Before the period of recession, three significant events took place in July 1995: Vietnam's accession to the ASEAN, the frame agreement on economic cooperation with the EU and normalization of relationship with the U.S.

These events brought about great opportunities for Vietnam, and its foreign sector in particular. Regrettably, Vietnam failed to create a favorable business climate on time because the red tape in most governmental agencies led to negative reactions from foreign investors.

In February 1997, the financial crisis spread over many Asian countries causing serious damage to economies considered as "East Asian miracles," but Vietnam was not so badly affected. Vietnam would have turned it into a comparative advantage to attract various flows of foreign investment but it failed to do so and when it was busy dealing with effects of the crisis, the opportunity was taken by other countries and Vietnam suffered a decreased growth rate and reduction in the FDI flow in the years after the crisis.

The second lesson: Benefits and interests of the state, investors and laborers in the foreign sector must be ensured correctly. Interests of foreign investors and local governments are not always free from contradictions. The government can introduce laws and apply administrative procedures to regulate economic activities and foreign investors can select the countries most appropriate to their investment projects. Interests of both sides must be ensured because foreign investors only put their money in places where the profit is high enough and support and direction from local governments are favorable enough.

Besides, there is a relation between foreign employers and local laborers. Strikes are still considered as unusual by authorities of various levels while it is a legitimate right assured by law. A proper view on this matter must be taken in foreign-invested companies. Authorities should help foreign investors and employers observe local customs and cultural attitude, thereby encouraging local laborers to carry out their tasks effectively and ensuring interests of both sides.

The third lesson: New comparative advantages in comparison with other developing countries are much needed for attracting the FDI. At present, the techno-scientific revolution and globalization are changing the comparative advantages of many countries. Abundant and cheap labor has stopped being one of Vietnam's comparative advantages. The more FDI projects are carried out, the greater the shortage of skilled and well-trained labor becomes. This means that Vietnam needs consistent and uniform measures to deal with this problem, from new policies to bigger investment in the education service.

At present, Vietnam is enjoying a comparative advantage. It is the political stability while regional countries are suffering social and political unrest. This advantage can turn Vietnam into an ideal destination for foreign investment if the government can adopt right policies to make the best use of it.

However, one of the biggest disadvantages that is slow to improve is technical infrastructure. Shortage of electricity and communications may discourage investors from carrying out major projects in Vietnam.

In 2007, the proportion of realized capital fell to the lowest point when it amounted to only 22.6% of the registered capital. This means that the FDI may increase only on paper if authorities fail to take measures to improve the situation effectively and timely.

The fourth lesson: The business climate must be perfected along with the legal infrastructure with a view to encouraging foreign investors to increase their investments in Vietnam.

Encouragement to the FDI and improvements in FDI projects are two organic side of the investment policy. When the FDI increases, full attention must be paid to selection of FDI projects in order to balance roles of domestic and foreign sources of finance and ensure the socioeconomic efficiency. Strong measures must be taken to reduce difference between sums of realized and registered capital because this difference tends to widen. The widening difference means that the growth of the foreign sector is not as successful as expected although the sum of registered capital may reach hundreds of billions of dollars.

After the Vietnam's accession to the WTO, the Government, when beefing up the foreign sector, must make the best use of strengths of regional and international groups. It is necessary to realize side-effects of competition for foreign investment among provinces in order to avoid bad impacts on social benefit caused by unnecessary favors given to FDI projects.

Provincial governments should make preparations for FDI projects (land clearance, water and power supply, roads, and supply of raw materials and supporting services, etc.) and issue foreign investment manuals to provide investors with necessary information.

The last lesson: The Government should develop the e-government, human resource and centers of foreign investment in provincial services of planning and investment. All provincial services must establish websites to provide FDI companies with information and deal with their complaints on time.

The Government has affirmed the procedural reform was central to the administrative reform. To achieve this aim, the PM approved the Plan to Simplify Administrative Procedures IN 2007-2010 (called Plan 30) on Jan. 10, 2007 in order to ensure consistency, simplicity and transparency of procedures, help organizations and individuals fulfill procedures easily, improve performance of the administrative machinery and reduce waste and corruption.

The approval of the Plan 30 reflects determination of the Government to accelerate the administrative reform and develop a better business climate. We hope that the bold attitude from the PM and concerted efforts from ministries will produce more favorable conditions for both foreign and local investors.

2. Measures to encourage the FDI in the coming years

a. Diversifying forms of foreign investment and encouraging intensive investment: The FDI has become an important source of finance for the economy and helped create new jobs and develop industries in recent years. Up to now, the foreign sector has made its appearance in most industries and produced positive effects on the industrial production. The Government has introduced three packs of solutions to the growth of the FDI in the coming years. They are measures to improve performance of the task of attracting foreign investment; accelerate the industrial production and promote the export. Full attention is paid to changes in the structure of industrial products, development of industries with apparent comparative advantages (such as processing of agricultural products, clothing, footwear, ship building, engineering, assembling electronic and mechanical appliances, and furniture), implementation of key projects and diversification of forms of investment, especially intensive one.

b. Diversifying cooperation with foreign partners: Deputy Minister of Information and Media Trần Đức Lai has pointed out that when integrating into the world economy, implementation of international commitments in fields of post, telecommunication and informatics by Vietnam had created new business opportunities to attract foreign investment to these fields. Companies in these fields should apply flexibly all forms of business cooperation with foreign partners with a view to ensuring both national sovereignty and business autonomy.

c. Foreign investment as the shortest way to technology transfer: Minister of Sciences and Technologies Hoàng Văn Phong said that many local companies, due to competition from foreign-invested rivals had tried their best to import new technologies and production lines with a view to make goods of better quality, designs and selling price. The foreign investment has become an important channel for technology transfer and the shortest way to replace old technologies, thereby modernizing and industrializing the whole economy.

d. Stable macroeconomic policies for a better business climate: To help the capital and finance markets develop well, the Government should stabilize its macroeconomic policies to create a more favorable business climate for all sectors and make foreign investors feel more confident in their projects in Vietnam. In addition, the privatization should be accelerated, especially in such fields as banking and insurance in order to improve their business performance and encourage the development of the finance market.

Full attention must be paid to performance and social effects from foreign-invested companies. Encouraging the foreign sector and requiring better performance from foreign-invested projects are two organic sides of the Vietnamese economic policies. Strong measures must be taken to increase number of projects and sum of capital in all industries allowed by law; and this should be considered as a strategic task. When the domestic investment is on the increase, authorities had better grant licenses only to FDI projects that can produce good effects on the socioeconomic life and development of local sectors.

According to the Ministry of Planning and Investment, Vietnam needs a gross investment of some US$140 billion for the years 2006-2010. Of this figure, some 48.8 billion will come from foreign sources and the foreign sector should account for 25 billion at least.

To achieve this aim, consistent and uniform measures should be taken to upgrade the infrastructure, develop the human resource and supporting industries, and accelerate the land clearance for the construction of industrial parks.

WB experts in Vietnam warned that Vietnam had to deal with three major shortcomings in order to compete successfully for foreign investment: poor infrastructure, red tape, and shortage of skilled labor. In addition, implementation of commitments as required by the WTO is also important to the effort to attract more FDI ■