VIETNAM'S LEGAL ENVIRONMENT OF FOREIGN INVESTMENT IN COMPARISON WITH OTHER REGIONAL COUNTRIES

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I. CRITERIA TO ENCOURAGE INVESTMENT IN THE LEGAL ENVIRONMENT

Due to changes in the world political situation and economic development viewpoint on capital intensification shifting to export orientation, countries' enhancement of competitiveness in foreign investment attraction is globalized. The participation of China, a very big country, both in production and consumption, has increased competition in alluring foreign investment. Other countries also rushing into the race of attracting foreign investment are of Latin America, Eastern Europe, and those near our country are India, Myanmar. Meanwhile, Asean countries has continually adjusted their foreign investment laws in order to make them become more flexible and attract investment stronger.

Thus criteria attracting investment due to competition become popular and are raised to standards and amended incessantly for foreign investment attraction. Commonly countries protect domestic investment or give the same preferential treatment to domestic and foreign investment (the common investment law). Our country's privileges have many points similar to this standard, even much more flexible, even offering foreign investment more advantages than domestic one with the aim to win in attraction of foreign investment for rapid industrialization.

Our country has advantages of abundant labor and lowest wages in the region. In addition, our country pays insufficient attention to environmental protection and lacks technological knowledge, so it easily becomes a dumping ground for foreign outdated machinery and technology. In spite of such privileges, but due to imperfect legal environment, investment in capital construction is not updated...the VN's competitiveness in foreign investment attraction in the world market is still very weak.

The standards of investment encouragement are commonly as follows:

1. The legal system of economy, investment is relatively sufficient. Regulations are made into laws. Evaluation for approval should be done quickly and one door policy should be carried out if possible.

2. Property and capital ownership is secured, recognized by law and free from nationalization.

3. Enterprises' operational duration is increased. The accounting system and ratio of asset amortization are opional.

4. The foreign stake in joint venture can be raised, even 100% foreign invested capital can be accepted, a prohibition before.

5. Profits tax with low tax rate and tax exemption or reduction are applied to investment in some areas preferentially developed and challenging areas. Profits tax is reduced in the first years when the enterprise has no profit. Capital allowance is approved.

6. The profits remittance to home country is guaranteed. The loss is transferred to the following year for calculation of taxed profits. The agreement avoiding double taxation is available.

7. Import duty imposed on equipment, raw material and material is reduced or exempted.

8. Land rent and severance taxes are reduced. Limits of ratio of using domestic material are reduced. Limits on technological transfer are reduced. Environmental protection is not paid strict attention.

9. Procedures of entry-exit, residing and travelling are easily performed.

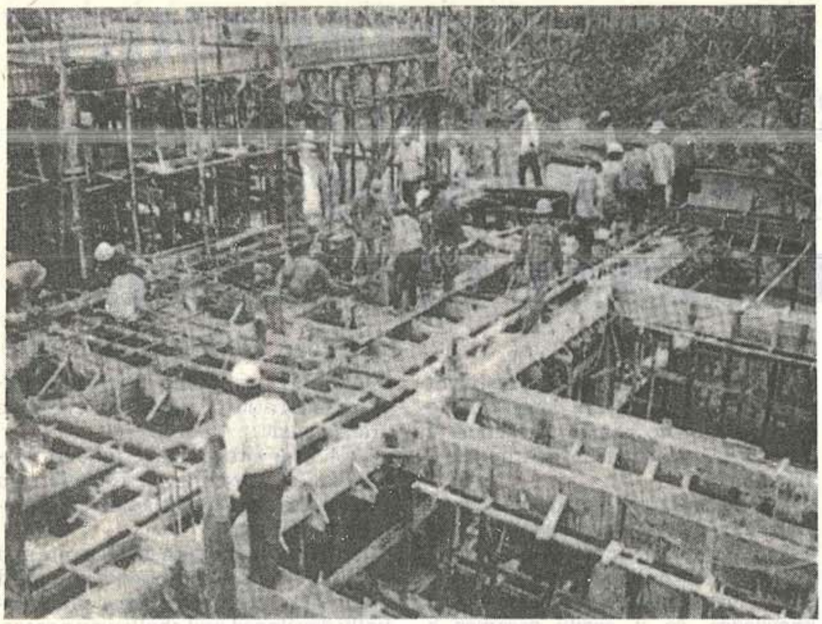
11. The Labor Code should not impose limits on minimum wages, employment of local managers and laborers, domestic workers.

12. The practice of dispute settlement is done by international arbitrator.

13. Domestic and foreign investment are treated alike.

In addition, there are other incentives such as preparing infrastructure works such as electricity, water, telephone, port, airport, warehouse...and other facilities such as hotel, school, entertainment site...other intangible privileges such as trade protection, participation in trade blocs, most favoured nation status, quota. Most important is the institution of laws on investment, including using financial levers to stimulate foreign investment.

Countries see the importance of agreements avoiding double taxation, if there are not these agreements, then



foreign investors only enjoy temporarily tax privileges, later they have to pay tax imposed on their overseas profits to their governments, unintentionally, the poor countries contrarily finance the rich ones.

Among factors of attracting foreign investment, tax privilege is not the decisive one. Many other factors are very important to decision of investment such as domestic consumption market, cheap and skilled labor, stable finance, open and complete legal system, tariff barrier. However, the common trend is more and more priviledges, but concurently more attention to high technology and environment protection with the aim to prevent the host country from becoming a dustbin for toxic substances and discharged equipment and technology of developed countries.

Our country's investment privileges as compared with other countries in the table below show the same, many points of our country are more flexible. Developing countries has continually adjusted their investment laws and relevant regulations with a view to enhancing competitiveness in investment attraction. Asean countries alone has adjusted their investment policies in the direction of insreasing openess and more competitive factors.

Most countries increasingly expand sectors to apply the form of 100% foreign invested capital, however, many sectors are permitted to involve only in domestic investment projects or in JVs with regulated foreign stake. Countries target at making foreign investment change from outside factor into inside one, that means to promote domestic investment, not to regard foreign investment as decisive factor, therefore foreign and domestic investments are given the same preferential treatment and ruled by similar regulations.

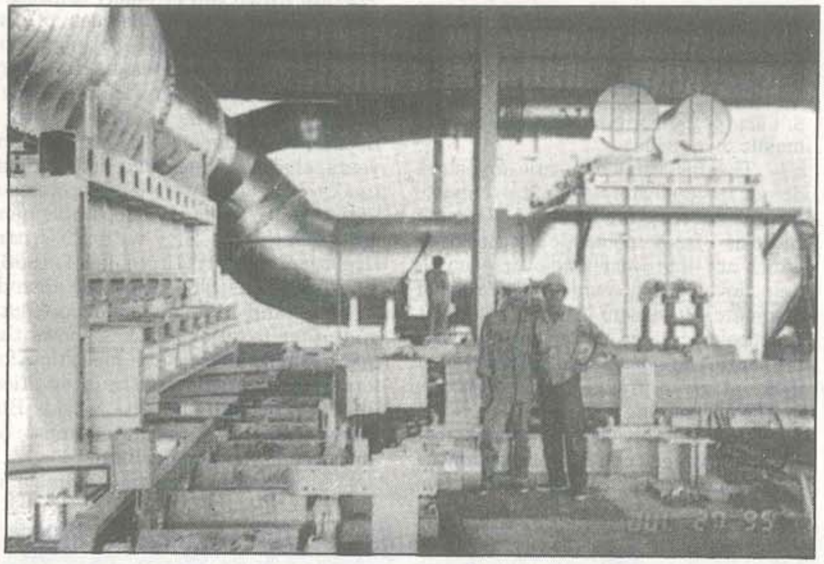
COMPARISON OF INCENTIVES FOR FOREIGN DIRECT INVESTMENT IN ASEAN COUNTRIES

Nation	Tax preference	Tariff	Export processing zone (EPZ) and transaction establishments	Incentives or other conditions
Indonesia	Not available	Returning import duty on materials	Storing areas	Inviting to form joint venture with foreign direct investment
Malaysia	Tax exemption in 5 years	Tax exemption for machinery, material of approved projects	Some EPZs	Getting permission to borrow capital from banks funded by the State, tax can be deducted from expenditures on research and development (R&D)
Philippines	Tax exemption in 5-8 years	Tax exemption for machinery. Tariff protection after operation	Some EPZs	Preferential tax for projects in underdeveloped areas, tax can be deducted from expenditures on R&D
Singapore	Tax exemption in 5-10 years	Duty exemption for most imports including FRI	Some free trade areas	Being able to receive soft loans in specific industrial projects tax can be deducted from expenditures on R&D.
Thailand	Tax exemption in 3-5 years	Tax exemption for selected machinery and materials	Two EPZs	Granting credits to operations including tax payment for projects outside Bangkok Helping with infrastructure for big projects
Vietnam	Tax exemption in 2 years and tax reduction by 50% in 2 years	Tax exemption for machinery, materials of approved projects	5 EPZs and concentrated industrial zones under construction.	Lower tax rate for foreign invested enterprises engaging in preferential industrial areas Giving green light to 100% foreign invested projects.

Source: *Vietnam shifts to the market economy*, the World Bank-the Vietnamese edition-Chính Trị Quốc Gia (National Politics) Publishing House, 1994 and other sources.

The Ministry of Finance does not determine amortization ratio, it allows concerns to choose amortization method on their own. It only inspects when the calculation of duration is unreasonable, and also permits the amortization of intangible assets and expiry machinery. Equipment and spare parts are free from import duty based on specific condition. Value added tax (VAT) is applied replacing turnover tax, many countries do not impose VAT on exports. The profits tax - free duration is longer and longer, it can be six years for preferential sectors.

Most countries have stock markets, allow shares transfer and sales via and outside stock markets but they will be imposed different tax rates.



Regarding land, due to features of viewpoints on ownership, land leasing and sales are easily done in the above countries. Land rent is also very cheap including land with infrastructure in industrial zones, especially in Philippine industrial estates, the rent of building ranges from US$1.8 to 2.2 per square meter monthly, land from US$0.18 to 0.4 monthly. The profits tax rate is only 5% for operations in the Phillipines' Subic, Clark transformed from formerly American military base into industrial zones. Some countries limit strictly investment in agriculture, for example, Malaysia does not accept investment in agriculture and land speculation, the Philippines does not allow investment in planting and processing cereals (not to mention Singapore since this island country almost has no agriculture).

These above countries applied BOT (build-operate-transfer) investment very long ago, Indonesia, Thailand, the Philippines for example. Reality shows BOT form has met a lot of obstacles in investment in roads construction where foreigners have to collect fees directly from customers, thus hurting the national feeling, BOT investment in electricity was very effective.

Vietnam's basical difference in foreign investment from other countries is local pooled capital in joint ventures which is mainly the value of land use right and the exchange of land for structure. The real capability of local partners in joint ventures is poor in capital, experience and management. In addition, most local partners are State enterprises or State bodies.

Vietnam agrees the form of 100% foreign invested capital more widely than other countries, but its procedures are cumbersome and the evaluation for approval progresses slowly. The minimum wages specified by Vietnam authorities is low, the labor quality is generally good, but the skill is lower than other countries.

The favorable investment environment is properly understood as the total of issues concerning geography, socio-economic situation creating conditions for foreign investment to produce highest efficiency, and generally speaking, the political stability, high grow rate and complete, open legal environment are what foreign investors pay full attention to.

II. SHORTCOMINGS OF LEGAL ENVIRONMENT NEEDED TO BE IMPROVED

1. Cumbersome evaluation procedures

Apart from economic environment, especially macro-economic management measures, of which the best important ones are financial , monetary policies having great impact on the whole investment including foreign investment; the improvement of legal environment is decisive. The policies are effective only if administrative procedures such as project evaluation, tax declaration procedures, reports submitted to local and relevant ruling agencies are reformed, especially negative, partial activities of branches and localities. There are still many complaints about administrative procedures, corruption, bureaucracy affecting the impartiality, legality in the stage of investigating, designing, evaluating, approving, granting licence, watching project realization, managing business operations of foreign investment projects.

2. Unreasonable tax and fee

The principle of taxation authorities is to collect tax completely but they have to maintain tax payers, do not force them to evade tax or stop producing due to high tax rates. Binding or encouraging regulations target at raising productivity, increasing foreign currency proceeds and revenues of the State budget, but they have to ensure logical profits in order to encourage reinvestment and allure more new investments.

Privileges without restrain do not have good effect on the investment orientation (many provinces did not have foreign investment yet although they enjoy preferences according to law), do not make economic structure alteration in the direction of modernization, do not increase comparative advantages and competitiveness of Vietnamese products in domestic and international markets.

High privileges should not be deemed as good policy to attract investment, but as for particular cases having great effect on development or special technological benefits, special privilege, big enough, should be offered and regulated in order to make investments flow into economic sectors and areas directed by the State.

The increase of privileges impacts investment attraction only when interests generated by those privileges are bigger than losses made by shortcomings of infrastructure, increased transport fee and lack of skilled labor force. If we do not give preferential treatment, we will made loss to the State budget or damage to the society or domestic investment. Reality of investment in the past time shows incorrect concentration on orientation for branches and territories should be readjusted reasonably and equally.

3. Slow pace of investment in infrastructure construction

The decision to attract big investment projects of infrastructure under the BOT form has attained some achievements but it still has progressed slowly, especially for power sector, a leading infrastructure factor necessary for all other sectors.

Investment in infrastructure construction in industrial estates and export processing zones (EPZs) by domestic capital sources or loans will not be able to catch up with investment pace and secure high standards enough to attract investors. However, the encouragement of foreign investment in infrastructure construction of industrial estates and EPZs, urban infrastructure and housing has not been stated clearly and completely. The Government should make careful study and institution for this practice since these projects have long operational duration and their advantages of occupying urban land areas are rather large.

Thermo-or hydro-electric plants built with foreign investment capital are not remarkable yet. Today, modern power sector, including hydro-and thermo-electricity, needs gigantic investment capital hard to mobilize from domestic sources, so projects involving in this area should be carefully selected and their feasibility need be ensured in project planning and investment appealing.

There are foreign investment projects involving in electricity and water business, which are public services subsidized by the State since they directly have great effect on the people's living but the Government did not have statute on electricity, water business and did not perform surveys on the people's feeling about it yet.

4. Lack of attention to protection of environment

Regulations on environmental protection have not been strictly executed. Many projects produced bad effects on environment, especially untreated effluent and caused losses and the public complaints. Before 1994, only one project installed effluent treatment system as stipulated. The situation is now improved but still not good. The pollution not only causes losses to the proximally located people, workers but also produces bad effects on the other much larger area for a long time.

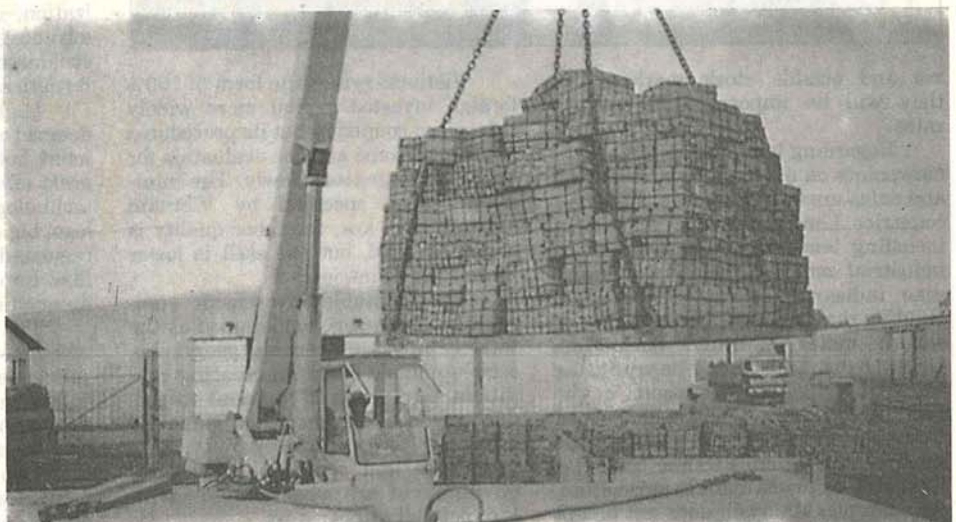
There are enough legal documents concerning environmental protection, even permitted levels of toxic substances. Some regulations are even so high that they go beyond the reality and can be considered as norminal issues. Here, the important issue is not to make law but to strictly abide by law.

The cost of treating waste, effluent and smoke as very strictly ruled by developed countries' governments makes investment cost skyrocket. Regional nations also saw environmental damages and made strict regulations on environmental protection. As a result, our country's flexible evaluation and implementation of Environmental Protection Law partly enhance attraction of foreign investment, but the damage is hard to repair in the long run. Drawing from countries' experiences, Thailand and China for example, our country should urge the strict execution of the Environmental Protection Law and regulations on the usage of eco-friendly technology.

5. Lack of concern and equality for domestic investment

The fact that domestic investors do not have advantages and privileges (profits tax rates are higher) is unequal. Returns from domestic investment which are not transferred overseas will help develop the country. The role of domestic investment is more important because it creates more jobs. It faces difficulties in quality competition, so if it is not given preferential treatment, it will not be able to develop.

Preferential forms to attract foreign investment is not so important as the economic environment with few



risks. The World Bank stressed: "...drawing from other countries' experiences, Vietnam need put foreign investment policy in the whole industrial policies. The best is the two policies for domestic and foreign investment are alike. Some Asian countries tended to favor foreign investment in their first development stages and later they gradually gave equal preferential treatment to both foreign and domestic investors.

6. Inappropriate taxes and compensation for clearance.

Laws on domestic investment, especially taxation, produce great effects on competitive capacity and reinvestment. High taxes, multiple taxes are popular and thus together with complicated regulations, negative activities in tax assessment, collection, and evasion will take place.

The State should not protect trade without restrain, it should reduce the definition of so many tax rates. A low tax rate which can be easily controlled will increase more revenues of the State budget than high rate that can be hard to collect and results in smuggling. The World Bank said tax rate structure should be simplified with a list of more uniform tax rates. In recent years, changes in tax rate list of tariff tend to reduce levels and protection with the aim to step by step implement agreements on CEPT with VN's participation in AFTA (from Jan 1, 1996).

In the past few years, the amendment of land rent, import-export duty and other taxation policies shows the quick adaption to the competition for foreign investment and the integration into the region and the world. But many taxes and tax rates must be amended and supplemented.

Measures to compensate for clearance are slowly performed, they are sometimes inappropriate to real values, thus retard the development of most projects■

Next issue: To perfect legal environment in order to enhance Vietnam's attractiveness to foreign investment.