

## **Presentation to Melbourne APEC Finance Centre Training Program “Capacity Building to Enhance Investment Flows in APEC Economies”, 8 April 2008, Roy Nixon\***

In my presentation I would like to focus on more practical matters – in the earlier sessions of this training program, you will have been given more theory and this morning’s sessions were basically to draw out from you the major characteristics of a good policy environments in the areas of investment generally but also more specifically in the case of competition and governance policies.

What I will try and bring to our discussion are my personal observations about how the PFI assessment of Vietnam – an exercise I was involved in the past year or so – was undertaken.

The Vietnam case study was based on a structured self-assessment. I’m sure our OECD representative will have covered the many potential uses of the PFI earlier in the program – so I will only add here that this was the first such use of the PFI of its kind in the Asia Pacific region. So it is a good one for us to study.

I would like to bring a focus on the actual processes – how the PFI was conducted. Some practical issues will be discussed here.

We would like to take a look at the outcomes and how this might play out in the domestic reform environment.

Finally, it might be useful to consider the practical benefits to Vietnam from undertaking this process and possible future work.

### **APEC and the PFI**

In 2006 APEC commenced an expanded investment work program. One of the central elements was to increase economies’ understanding of the barriers to investment, including their impact and why they seemed to be higher in lower income economies. The studies found that restrictions to investment are both external and internal<sup>†</sup>. The internal or behind-the-border barriers to investment are far more important because typically around 90 per cent of investment for a low-income economy is sourced domestically. But the analysis is even more revealing. Behind-the-border barriers to investment are not just formal restrictions on investing – they comprise a raft of domestic policies, rules, procedures and laws (or lack thereof) that unnecessarily impede investment in the domestic economy. The barriers come in many forms from excessive regulation, unclear property rights and poor legal systems to a lack of appropriate laws that foster competition.

The appeal to many APEC economies about the PFI type approach was multi-faceted: first it fitted in well with APEC’s renewed focus on structural reform. Second it is a diagnostic tool with at its core the goal of improving transparency and predictability. Third, it was flexible enough to allow different uses - structured economy-wide self-assessment being one that dovetailed well with APEC methodology. Fourth the PFI aims to encourage and maximise the contribution the private sector can play in economic growth and development.

Finally, which chapters of the PFI to use is basically a process of self-selection based on priorities established by the economy being studied and to some extent the donor community. The outcome

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<sup>†</sup> See APEC “Enhancing Investment Liberalisation and facilitation in the Asia-Pacific region (Stage 2): Reducing behind-the-Border Barriers to Investment”, Investment Experts Group, 2007 (download from [www.apec.org](http://www.apec.org))

has to be mutually acceptable and of course it is non-binding – again an APEC operating trait. Notwithstanding its non-binding nature, it offers a good opportunity for the host economy to re-affirm its commitment to all stakeholders that it understands the priority policy challenges and its resolve to work on solutions in the short to medium term.

That said, I would like to make clear that APEC has not “endorsed” or “adopted” the PFI – but then it has not adopted other diagnostic tools of other relevant international organisations like the World Bank or UNCTAD either.

### **Diagnostic approaches to investment climate reform**

A key requirement in many developing countries to attract and benefit from foreign direct investment (FDI) is building a conducive institutional environment that provides for stability, predictability and transparency, and that creates the necessary support structures that allow FDI to benefit the local economy.

Countries all over the world have pursued many different policy approaches in this quest, some more successful and some less. Although realizing that no one size fits all, there are however lessons to be learned from this vast array of experiences. Building international consensus and disseminating best practices in this respect promises to be a key building bloc in investment for development, and helping countries harness its potential.

The PFI does not have a monopoly on how to undertake investment climate reform. Many approaches can identify best practices. These include those based on general research and policy advice (e.g. UNCTAD's World Investment Report), those based on country-specific research and policy advice (e.g. UNCTAD's Investment Policy Review) or those based on general policy diagnostic tools (e.g. the PFI, World Bank Doing Business Surveys, Competitiveness Indexes etc).

### **Background to the Vietnam assessment**

Australia and Japan have been strong supporters of the PFI in OECD so it was not too difficult for the two to become joint funding partners for this project<sup>‡</sup>. The project was done in two phases – the first was a low-impact overview assessment undertaken by OECD and a local Vietnamese collaborator against **all ten** PFI chapters. This assessment was presented by Vietnam at the APEC High level Public Private Dialogue on the PFI held in Melbourne in April 2007. It was here that Vietnam announced its decision to go to a more detailed phase II project.

The basic methodology chosen in Phase II was an in-depth self-assessment but of only 5 full PFI chapters (investment, investment promotion and facilitation, trade policy, tax policy and competition policy) and the financial sector reform section of the infrastructure chapter.

Why structured self-assessment? Well Vietnam is not an OECD member and therefore not a party to the traditional peer review methodology of OECD. In that case, the assessment report is peer review by other government experts with support provided by the OECD Secretariat. The process is internal up to the point of publication of outcomes where the country being reviewed will be required to follow through with the recommendations. Under the Vietnam case study approach the situation is not strictly government to government scrutiny. A report is prepared by OECD Secretariat experts based on the Government of Vietnam providing written responses to the PFI questions for the chapters chosen. The report is basically an agreed outcome and publication subject

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to agreement. Its value depends primarily on the attitude of the country being reviewed as there is no requirement for structured follow-up as would occur under traditional OECD peer review.

There were three missions to Vietnam in Phase II – the first discussed the preparation of a questionnaire to assist Vietnamese government officials interpret the various PFI questions. We also discussed the scope and most importantly discussed the coordination process on the Vietnamese side to ensure everyone understood their roles and responsibilities. Intersessionally the questionnaire was answered in detail. By the time of the second mission, we had an early draft report which formed the basis of our discussions and consultations with other stakeholders (ie business community). The report was revised and a findings chapters and reform roadmap prepared by OECD. This was further discussed at the third mission where we also held a stakeholders workshop and donor meetings to discuss the key findings.

Throughout this process the attitude and energy of the Vietnamese government was remarkable.

### **Vietnam's Investment Climate – important background**

Before looking at two or three specific issues including competition and governance – the main subject matter of this training course, it is important to look at the broader investment policy context and to understand why the investment policy chapter is so important in the Vietnam case study.

First there is Vietnam's accession to the WTO in 2007. This gave momentum to many important changes in the legal framework dealing with investment. There is no doubt that there have been many improvements to the investment climate as a result both in terms of market access and the conditions for operating businesses in Vietnam. But the demands of getting ready for WTO accession may have brought with it particular stresses and strains.

We also need to consider the particular characteristics of the Vietnamese business climate which resulted in an enhanced need for greater transparency and predictability. I have in mind here:

- increasing decentralisation of government;
- the role of the state in land management;
- the small scale of enterprises in the Vietnamese economy and its concentration on manufacturing;
- State owned enterprises (SOEs) owned a significant proportion of the economic wealth (competition issue);
- relatively poor infrastructure especially in communications technology;
- the large informal sector (governance issue).

Y now have a much fuller picture of the degree of complexity in the Vietnam investment climate at this time.

### **Investment policy issues**

I would like to move on to a couple of issues that were highlighted by the PFI assessment. First I am not saying that these issues were in any way “new” and that previous work by existing players in Vietnam had not drawn attention to the problems. What did happen as part of the PFI process was the realisation by the Vietnamese authorities of the urgency of the need to deal with this problem because of the important linkages to other policies.

In our discussions with the Vietnamese authorities, they pointed out that an issue of concern for them was the big gap between the \$ value of total indicated investment in new applications and the actual amount implemented. Historically about 40% had been implemented but in recent years including 2007 when investment levels rose sharply, this gap widened such that only 30% or \$6.8 billion of total investment capital of nearly \$20 billion was actually implemented.

The facts underpinning this problem are probably the regulatory issues which were uncovered by the PFI questions. These appear to be the need to simplify implementing regulations, target duplication, provide better guidance at the provincial level to officials thereby raising administrative capacities, tackle highly variable performance at the provincial level (private sector initiative had measured this variation which has provided a stimulus to improve performance in many cases). There was some evidence that previous attempts to reduce the number of regulations while successful had not addressed the root cause of the problem – the officials who had created the problem were still able to continue to create more regulation so more regulations sprang up in its place later requiring a further process to attack the new regulation. This tended to suggest a solution would only come through a high level regulatory review unit to consider the impact of new laws, regulations and policies on competitiveness.

A second important issue raised in the Vietnam case study is land registration and ownership. There is no private ownership of land in Vietnam – land is managed by the state. Land use rights can be granted to investors. However, the process is universally regarded (including by government) as complex, lengthy and non-transparent. Improvements are hampered significantly by poor IT infrastructure particularly at provincial level to the registration systems and databases. In addition to registration issues, even after land use rights are obtained, the planning processes are equally complex and protracted and can lead to major delays in for example tourism/hotel/ commercial office developments. Another issue is that the complexity and time-consuming nature of the process is relatively more disadvantageous to foreign investors and SMEs. (I acknowledge the Vietnamese government may not share this view.)

The key difference about this issue and the previous one is the political importance of land ownership and management in Vietnam. While suggestions to improve things are plentiful, there are entrenched political reasons for making change slowly and perhaps a more fruitful way to help on an issue like this is to focus on the winners and losers and how best to handle adjustment costs.

It amplifies a key message: where the politics of undertaking reform are favourable – action is possible. Where the politics are too sensitive, it is difficult to effect meaningful change.

### **Competition policy**

Vietnam's new Competition Law, enacted in 2004 was the subject of much technical assistance from the experiences and statutes of a number of countries and international model laws. Not unreasonably there was a strong focus on getting the technical and legal aspects right. Implementation issues are to some extent still being addressed. The competition agency, the Vietnam Competition Administration Department, is under the Ministry of Industry and Commerce. This has raised concerns about maintaining the authority's independence from political interference in its enforcement activities.

There are many good features of the law – it is applicable to every business without discrimination towards ownership or size. It is also clear that Vietnam appreciates the key role competition policy can play in realising its investment potential. Implementation will have to be careful to conform to the non-discrimination principle else provisions in the law risk being used against efficient foreign firms. Another issue may be enforcing the law with respect to the predominant State-owned sectors evenly.

The PFI review suggested that the priorities for competition policy reform should include continuing to implement the Competition Law in an even-handed manner to every business in Vietnam without regard to its ownership. It should also seek to eliminate instances of discriminatory treatment between SOEs and private enterprises. In efforts to fight predation it should avoid targeting efficient foreign firms. It should also accelerate the move of ownership of SOEs from line Ministries to the State Capital Investment Corporation. Every effort should be made to assure the independence in practice of the Vietnam Competition Council, including appointing some competition experts who are not public officials to the VCC. Finally, and it is almost certainly the case that Vietnam is not quite ready for this now, it should consider adopt strengthened and focused procedures for reviewing the effect on competition of new laws, regulations and sectoral development strategies.

### **Financial sector reform**

The role of financial sector is also worthy of mention because of its many links to development, growth and therefore competition. Only a small portion of the Vietnamese population use banking services regularly. The financial sector of Vietnam has been transformed in recent years, moving from a State owned mono-banking system to a diversified banking system, including a growing number of joint stock banks, joint venture banks and branches of foreign banks. This development has contributed to channelling funds more effectively to finance promising investment opportunities. But the five State-owned commercial banks (SOCBs) still have dominant market share. There is a plan in place to move forward – the May 2006 roadmap for reform. It includes continuing the equitisation of SOCBs. However, the ability of foreign banks to participate in the equitisation process will be limited.

Commercial lending is severely limited by a lack of credit information. The situation should improve with the establishment of private credit bureaus, the first of which is expected to be launched in 2008. Vietnam's capital market is still underdeveloped, with the bond market being rather inactive. A new Law on Securities and Securities Markets is well designed, drawing on OECD best practices. Market surveillance and enforcement still need to be strengthened.

The PFI review suggests some priorities for Vietnam's financial sector development based on accelerated implementation of the May 2006 roadmap for reform of the financial sector, including strengthening and modernizing the State Bank of Vietnam, improving the performance of the SOCBs, accelerating the equitisation of the SOCBs and increasing opportunities for foreign banks to participate fully in the equitisation process, with the objective of reducing the involvement of the state in the financial system, where it currently acts as both regulator and commercial operator. It was suggested that Vietnam ensure timely implementation of WTO market access commitments with respect to financial services and otherwise reduce the many regulatory limitations on the ability of foreign financial firms to participate in Vietnam's financial sector. The availability of credit information should be improved by encouraging the establishment of private credit bureaus and providing the necessary legal framework.

### **Governance issues**

While the PFI review of Vietnam did not include either Chapter 6 – Corporate Governance or Chapter 10 on Public governance, the Vietnam case study clearly amplifies the fact that old “command and control” mechanisms are increasingly being replaced with more flexible and indirect forms of rule-making, guidance, evaluation and persuasion across all levels of government. The overarching tests in Ch 10 are regulatory quality and public sector integrity.

In the chapters examined in the Vietnam case, most had important governance aspects. For example, in Chapter 1, I discussed earlier the whole issue of Vietnam's land ownership and usage

rights. Here unclear property rights, complexity in the rules facing investors and lack of clear guidance provided from the central to local government officials can create an environment where low level corruption can thrive. For Chapter 2 on investment promotion, better coordination of regulatory effort was a key finding suggesting variable regulatory quality. For chapter 3 on trade policy, it was clear that despite recent improvements, Vietnam's customs procedures were still complex, slow and unpredictable (at least according to the business community). Some of the unpredictability may have resulted from unclear implementation of WTO commitments. On tax policy, it was clear that Vietnam is doing more work on evaluating the level of the tax burden and how this links with its overall investment attraction strategy. Finally as mentioned in the findings on competition policy there is still a sense that in the implementation of its laws, the principles of transparency, non-discrimination and independence were vital in dealing with the role of SOEs to improve governance.

## **Conclusions**

In conclusion, I hope that my presentation on the Vietnam experience has helped you to envisage how the PFI might assist you in formulating better strategies to reform your investment climate. The real value of the PFI approach to developing economies may not necessarily lie in its being able to come up with new issues – let's face it, in a place like Vietnam, many development agencies have been working hard for a long time so to find anything new would be rather difficult.

The value is perhaps more in the process itself. The process of coordinating a whole of government response to the searching PFI questions can help to better appreciate policy impacts and the barriers to investment they can represent. It clearly can assist in the setting of reform priorities. Another possible useful contribution can be its use by existing donors to coordinate donor responses/follow up activities more effectively with the government.

Finally, the PFI review may be the first step in further engagement between Vietnam and OECD which recently added SE Asia to its list of regions where more active engagement should occur. Possible direct capacity assistance on tax issues by OECD may also result. There is also the potential use of this case study regionally, ie within APEC or even ASEAN to promote the sharing of experience about investment climate reform approaches.