

REPORT FROM INVESTMENT AND TRADE WORKING GROUP

*Presented by Mr. Fred Burke
Head of Investment and Trade Working Group*

1. Introduction

This report addresses two large issues that face Vietnam today: (1) how to respond to the unexpected withdrawal of the United States from one of the biggest and most important multilateral trade agreements since the WTO was founded; and (2) the changes looming in the face of the 4th Industrial Revolution. Both require nimble decision making to adjust quickly to the rapidly evolving external international economic environment. For the first, we are confident that Vietnam has not just one but several fall-back plans to help it recover the momentum of its global integrationist development strategy. On the second issue, Vietnam has the opportunity to accelerate its development, if only it can give full play to its considerable human resources.

In addition to these newly emerging issues, we would like also to assess where we stand on some lingering issues arising in the areas of market access and supply chain management.

2. Trans-Pacific Partnership: What Next?

The Trans-Pacific Partnership Agreement ("TPP") was hailed as a 21st century multilateral trade agreement that would produce significant income gains for each of its 12 signatory member states. As the only developing country in the 12 nation group, Vietnam had a lot to gain – the biggest proportional boost to its GDP of all of the TPP countries, according to the best analysts. TPP was seen as the next logical step in Vietnam's amazingly successful 20 year long global economic integration strategy, following on its 2007 accession to the WTO and many other bilateral and multilateral trade agreements before that. So it came as a disappointment to all of us that the new administration in Washington kept its promise and formally withdrew from the Agreement almost immediately on taking office.

But Vietnam has wisely not put all of its eggs in the TPP basket. In fact, we can say that Vietnam has not just a "Plan B", but also a plan C, D, E and F. Vietnam is a shining example of the potential benefits of global trade. It has developed quickly from a state of having virtually no trade in 1990, to become one of the world most significant top exporters of garments and footwear, sea products, key agricultural products such as rice, coffee and spices, furniture, and more recently even electronic products and software. So how to continue this amazing story?

2.1 Plan B – The Trade Facilitation Agreement

Plan B - is the Trade Facilitation Agreement. This is the only multilateral agreement in the Doha Round of negotiations under the WTO that has been successfully signed, ratified and entered into force, which it did as of February 22, 2017. Vietnam has a lot to do to implement this agreement including the activation of its National Trade Facilitation Committee, and the signing of a Customs Mutual Assistance Agreement with its major trading partners. The WTO estimates that this agreement alone can reduce global supply chain costs by as much as 20%, making countries who implement it more competitive in global markets.

2.2 Plan C – Implementing WTO and Other Existing Agreements

Next, "Plan C" for Vietnam will include, first and foremost, continuing to implement its commitments and the 2007 WTO accession agreements. This would include finishing some

unfinished business like getting rid of some unnecessary and burdensome administrative procedures for trade and distribution of foreign products. Implementation of other WTO commitments has brought great changes to the Vietnamese economy and society, improving lives for consumers in particular but also for businesses who depend on access to global supply chain of goods and services to stay competitive in the global economy.

Even something like finally opening up import trading for foreign pharmaceutical companies (which was promised in the WTO agreements) can have a knock on effect by lowering the cost while raising the quality of imported pharmaceutical products. Vietnam's integration into the global supply chain has been supported by the implementation of its commitments to open its markets to international logistics services and many other trade-supportive sectors. It has allowed first class international supply chains to start to relocate here, and the benefits are reaching ever more people as the enabling reforms take root and grow.

Implementing other active Free Trade Agreements such as the Vietnam South Korea Free Trade Agreement are having noticeable, positive effects on the bilateral trade and investment relationship.

2.3 Plan D – Pursue ASEAN Economic Community Roadmap for Regional Integration

“Plan D” is continuing to implement the objectives reflected in the ASEAN Economic Community agreements with the nine other ASEAN nations. Vietnam has already become the leading ASEAN exporter to the United States and has set the pace for reform and development. ASEAN itself is expected to be the third largest exporter in the world by 2018. This provides real opportunities for Vietnamese enterprises to test their metal close to home in friendly and accessible markets. Further harmonization of regulatory procedures, visa-free movement of natural persons, and further moves to enable the freer movement of capital, goods and services within ASEAN all contribute to its unusual cohesion as an economic association. Meanwhile, the ASEAN-China FTA continues to enable Vietnam to import raw materials, components and equipment from China to assemble products in Vietnam for international markets at a competitive price.

2.4 Plan E – EV FTA, “TPP-11”, RCEP and other pending agreements

“Plan E” involves pursuing other pending bilateral and multilateral trade deals. First on the list right now is this so called TPP 11 (i.e., TPP without the US). Meetings among the TPP 11 countries have been hopeful and the most authoritative study coming out of Canada indicates that there would be material gains coming out of such an agreement.

Other pending international trade agreements that could materialize soon include the EU Vietnam Free Trade Agreement (“**EV FTA**”) which has already been signed and is pending ratification in 27 European Parliaments, and the Regional Comprehensive Economic Partnership (“**RCEP**”), a massive trade block which would include China and India as well as most of Southeast Asia and Australia, but not the United States. None of these treaties are mutually exclusive; in fact they complement each other to “make the whole greater than the sum of its parts”. More trade opportunities makes for more competitive pooling of resources, and Vietnam should continue its multilateralist strategy of capturing as many of these opportunities as possible.

2.5 Plan F – Continue Domestic Reform

“Plan F” involves continuing the domestic economic and administrative reforms that Vietnam needs to maintain competitiveness and build to reduce poverty and rise up to the next level of

economic development, these include administrative procedure reforms to make the role of the state more supportive in nurturing industries to compete in the global stage, investing more efficiently in infrastructure, and equitizing state owned enterprises to reduce the amount of capital that they drain out of the economy. Resolution 35 has been helpful in this respect and the spirit of this important document should be carried forward even more resolutely. The Investment and Trade Working Group members are involved in many different areas of the economy and therefore they have contributed many different specific suggestions along these lines, which I will lay out in due course, below.

2.6 Plan G – US Bilateral FTA

“Plan G”, even as the US withdrew from the TPP, it announced that it is interested in pursuing a free trade agreement with Vietnam on a bilateral basis. Apparently the thinking in the new administration is that it will have more negotiating leverage and be able to secure a better deal for itself with bilateral agreement. Considering the substantial trade deficit that the US suffers in its trade with Vietnam, at least in terms of trade in goods, it is understandable that American business interests will ask for increased market access as part of the FTA deal and the Trump administration will want to show immediate export gains for the US. Vietnam can turn this into an opportunity to accelerate the phase ins for its reciprocal market access in the US market. While a bilateral deal may not be the most effective and efficient approach, so long as the human resources (knowledgeable negotiators) are available on both sides then it may fit into and complement the other trade initiatives outlined above.

All in all, Vietnam is well-positioned to reap rewards by carrying-on with its global integration strategy notwithstanding the withdrawal of the US from the TPP, given how many other bilateral, multilateral and domestic initiatives it is pursuing. Especially at a time when some countries are lapsing into backward protectionism, Vietnam is setting a laudable example of engagement with the world. We urge the government to be resolute in continuing to pursue its global economic integration strategy notwithstanding the setbacks encountered from time to time.

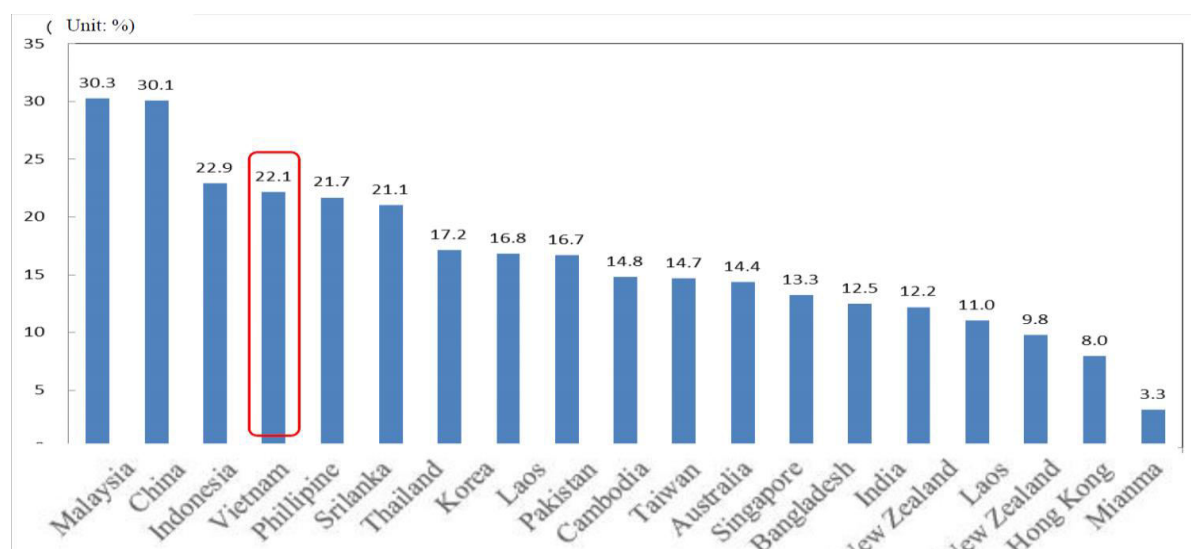
3. The Fourth Industrial Revolution: Impact on Vietnam

3.1 Automation and the Emerging Digital Economy

There is much talk recently about the 4th industrial revolution and how it will force realignments in global supply chains. The digitalization of manufacturing and the delivery of services is sure to have broad reaching consequences for the way we work right around the globe and Vietnam will not escape its consequences. Among other things, low cost labor will increasingly lose ground as a source of comparative advantage to automated production processes, starting from design right through to testing, commercial production, delivery and after sales service and warranty. Every step in the supply chain will be affected. Jobs that employ millions today may be gone in a decade or two, replaced by new jobs that require new and more advanced skills.

Vietnam is already feeling the effects, with some sport shoe manufacturing moving to countries like the US that were formerly considered too expensive to produce light industrial products. This trend, if real, could reshape decades of supply chain realignment. The JETRO survey below shows that 22.1% of Japanese enterprises operating in Vietnam are already dealing with increased wage costs by adopting more plant automation. This is a trend that will continue and must be addressed.

- *Proportion of enterprises applying the solution for wage increase problem through plant automation (According to JETRO investigation in 2016):*



3.2 Importance of Training and Education

Highly educated staff are key to being able to quickly and deeply adopt new technologies. Vietnam's excellent educational foundations give it a partial advantage, if only it can build on these to keep up with the fast-changing demands of the new digitalized industries. There is plenty of reason for hope; Vietnam became a major software-exporting powerhouse in a few short years after regulatory and policy steps were taken to eliminate surtaxes on "high-income earners" in the engineering field and open up data communication channels to allow real time servicing access to software users abroad.

3.3 Energy & Electricity

Electricity is the lifeblood of the digital economy and one of the urgent tasks for Vietnam is to ensure reliable supplies of power at competitive prices. In addition, in an era where the impacts of climate change are increasingly obvious, consumers around the world are taking environmental considerations into account when choosing what goods and services to buy. They want products that can be proven to be made with green energy. In the Vietnam Business Forum, we will hear from the Energy Sub-Working Group regarding the critical importance of moving past coal-fired power plants as the main source of energy into the rest of the century.

Natural gas (cleaner than coal), and renewable energies such as wind, solar and geothermal are all plentiful in Vietnam and could help maintain energy security by avoiding reliance on foreign coal imports. Many members of the Investment & Trade Working Group consider this to be one of the most important issues of our generation, a generation in which human beings have the power to protect our planet, or imperil it.

4. Other Supply Chain Obstacles and the Implementation of Resolution 35

4.1 Supply Chain Obstacles

4.1.1. Decree 23 - "Trading License"

The MOIT's implementing Circular for Decree 23 requires a "trading license" for foreign invested enterprises engaged in import and distribution of any kind of product. This is in addition

to the existing approvals included in their Investment Registration Certificates (“IRC”) and Enterprise Registration Certificates (“ERC”), as well as any product specific special condition relicensing or imposed for purposes of safety, human health or the environment. This requirement for a trading license is not timely response for government, the criteria for issuance are opaque and it should be done away with as a nontariff barrier.

This requirement applies to the following areas of business activity, among others:

- Commercial promotion services;
- Commercial brokerage services;
- Leasing goods service;
- E-commerce service;
- Logistic service;
- Inspection service;
- Market research service;
- Management consulting service;
- Service related to production;
- Auction service;
- Tendering service;
- Commodity exchange, or member of a Commodity exchange; and
- ***Other commercial activities related to the purchase and sale of goods.*** (Emphasis added).

The last item means that literally any service that touches on the sale and purchase of goods may be deemed subject to the "trading license" requirement.

We have raised this issue before and the only response has been a citation to the offending measure. We respectfully request that the measure itself be scrutinized more carefully with a view to a more transparent and efficient approach.

4.1.2. HS Code Requirement for FIE IRC/ERCs

The requirement that foreign invested trading enterprises include the HS Codes of the products they import and distribute in their Investment Registration Certificate and/or their Enterprise Registration Certificate seems not only unnecessarily onerous and burdensome, it also seems to raise an issue of National Treatment in so far as domestic trading companies are not subject to the same handicap. This handicap prevents foreign invested trading companies from supplying in a timely manner all kinds of imported components, raw materials and finished products needed for the supply chain to function efficiently because it requires them to amend their IRC/ERC each time they want to offer a new product. This requirement applies even where the product in question is not subject to any condition or special licensing requirement. In any case, issues of safety, human health, and the environment are already addressed in other regulations applicable to the importation of goods. Therefore, measure is redundant and unnecessary, constituting a nontariff barrier, and we respectfully suggest that it should be eliminated.

4.1.3. "Economic Needs Test"

We have questioned the need for the so-called "Economic Needs Test" ("ENT") many times and have never received a satisfactory answer as to why it is necessary. There are no objective criteria for its application and all it does is present in another handicap to foreign retailers seeking to develop the market. The ENT would have been eliminated in five years under the TPP, recognizing its uselessness. Why not accelerated this reasonable measure and help the many retail construction projects looking for good tenants around the country by giving full play to the spirit of the WTO commitments to open the market to foreign important distribution services?

4.1.4. Logistics Services

Foreign investment cap on postal service

On 17 June 2010, the Vietnamese National Assembly adopted the Law on Posts (No. 49/2010/QH12) (the "Law"), which becomes effective on 1 January 2011. As stipulated in the Law, enterprises engaging in postal services must obtain a postal service licence. Foreign ownership in postal services enterprises is limited to 51% of the charter capital and must be in a form of a joint venture with a Vietnamese partner.

4.1.5. Customs Clearance

Although Vietnam's customs procedures are currently being modernized with a new electronic customs clearance system ('e Customs'), launched in 2014, delays are still common. These have largely been attributed to a number of inefficient and manual customs processes, including cargo inspections that lack transparency and consistency. For example, it takes, 21 days to export a cargo shipment from Vietnam, compared to 14 days from Thailand and 11 days from Malaysia. To be fair, most of the commonly cited delays are "behind the border" issues, including non-tariff barriers imposed by authorities other than customs, especially in the name of health and safety.

4.2 Banking Issues - From the Enterprises' Perspective

4.2.1. Circular 39 on Interest Calculation

Circular 39 on lending introduced a new way of calculating interest that is both rigid and inconsistent with international best practice. It has been blamed on the Civil Code. As borrowers, enterprises are finding it difficult to negotiate credit agreements that involve both foreign and domestic credit institutions because of the inconsistency in the method of calculating interest. Circular 39 should be supplemented or amended to eliminate this anomaly and facilitate normal credit activities necessary for efficient supply chain functioning.

4.2.2. Circular 32 on Account Opening

Circular 32 seems to limit the types of entities having the legal capacity to open bank accounts to just two: (1) natural persons, and (2) enterprises established under the enterprise law. As it is being implemented, this circular is being interpreted conservatively by the banks to mean that representative offices, NGOs, business associations, and other non-incorporated entities no longer have the legal capacity to open a simple bank account. We urge the early review of this measure to ensure normal financial operations of all forms of legal business activity.

4.2.3. Direct Investment Capital Accounts

The concept of the Direct Investment Capital Account was introduced in order to help regulators track the flow of capital coming in to and out of the country. While this is a reasonable intension, the implementation of the DICA account has been far from smooth, with different banks interpreting the rules differently across the country. It would be helpful for enterprises and foreign investors alike if the state bank could please clarify these rules uniformly and reasonably.

4.2.4. Financial Regulation - Payment Services

In recent years, Vietnam's two domestic payment processing networks were merged to form a new monopoly SOE, the National Payments Corporation of Vietnam ("NAPAS"), which is majority-owned and controlled by the State Bank of Vietnam ("SBV") and domestic SOE banks. In June 2016, the SBV issued Circular 19/2016/TT-NHNN ("Circular 19") which essentially codifies SBV's plan, starting in 2018, of requiring all transactions - domestic and cross border - to use NAPAS switching for all transactions.

Requiring all transactions to be routed through NAPAS will significantly impede the security, speed and reliability of the transactions, as well as substantially hinder the competitiveness of foreign payment companies. It is critical that Vietnam maintains a conducive environment that fosters competition among local and foreign players to promote innovation, better cybersecurity and more cost-effective solutions and products.

A key provision in Article 24 of Circular 19, is the insertion of NAPAS between all banks and the ICNs, at both the issuer (i.e., banks of individual cardholders) and acquirer (i.e., banks of merchants) ends. Implicit in that is the removal of all the direct connections between the ICNs (i.e., American payment companies) and their client banks in Vietnam. As a payment network itself, NAPAS competes with international payment companies. Article 24 of Circular 19 has the effect of unlevelling the playing field to the detriment of competitors.

In addition to the issue of competition, the removal of the direct connections between international payment companies and their client banks will also weaken the ability of the former to optimally provide services to secure transactions for their clients and to introduce innovation in payment services and products. As the sole point through which all transactions pass, NAPAS will also be vulnerable to cyber-attacks – it will be a single point of failure impacting the entire electronic payment system. If highly dependent on NAPAS, then international payment companies risk business disruption and reputational damage should NAPAS fail.

Article 24 of Circular 19 should be revised so that foreign companies will be able to do business in Vietnam on a level playing field and continue to contribute to the greater supply chain in terms of delivery of high quality, secure payment services.

4.3 Investment Environment

Housing

Everyone here is aware that Vietnam has made great progress in creating a hospitable investment environment, in which local and foreign businesspeople and their families can work in an atmosphere that is secure and comfortable. Schools and hospital services have improved dramatically, there are more entertainment, cultural and recreational options. One element that has proven elusive is in the area of home ownership. Although rules have already been issued that allow limited sales of certain types of condominiums and villas to foreign buyers,

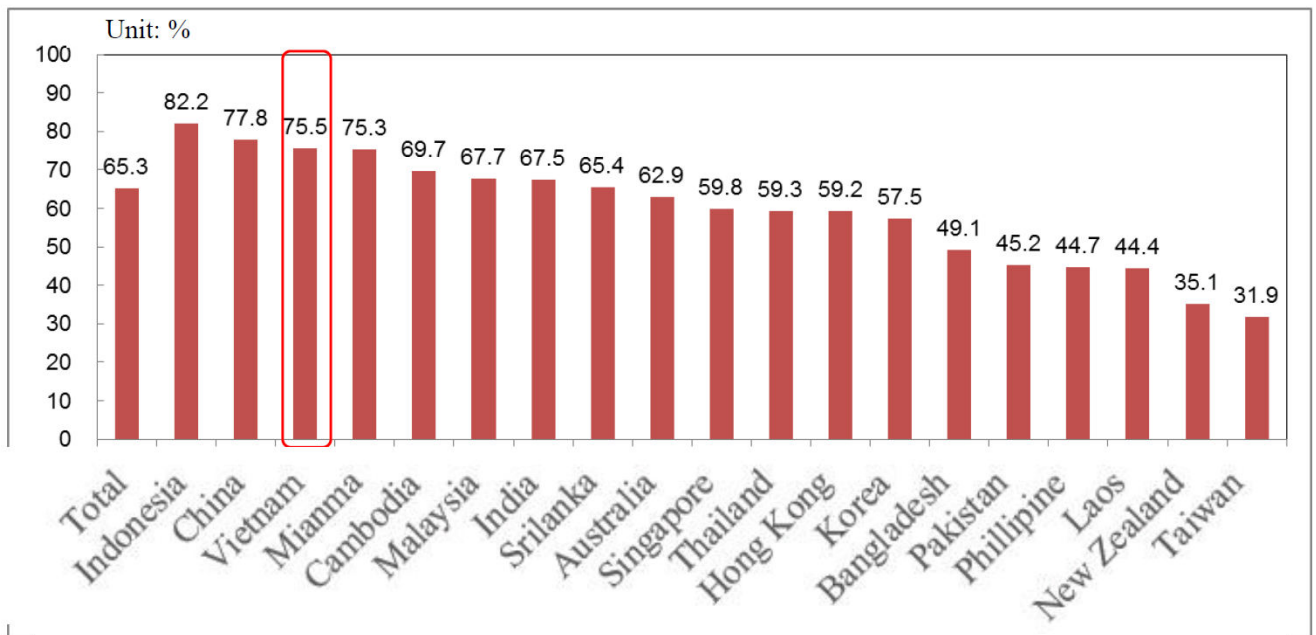
implementing rules have not been followed in a timely manner and as a result there is much confusion and risk in the market.

For example, foreign ownership of condominiums in a residential tower is limited to 30%, but the Ministry of Construction and its local departments have not yet implemented the necessary system for registering and tracking the number of foreign owned apartments in a given project, so the secondary market has frozen up completely. In most provinces, there seems to be no system for changing the ownership category from local to foreign once a property has been sold to a local buyer. This kind of risk only increases the cost of capital that is needed for building up Vietnam’s housing stock. We hope that these issues can be sorted out soon so the market can start to operate normally.

4.4 Labour: Draft Decree on Compulsory Social Insurance for Foreign Employees Working in Vietnam – Concerns over Rising Employment Costs

Investors - both foreign and domestic - are concerned that the rapidly rising cost of labour may undermine Vietnam's attractiveness as an investment destination and the Government's ability to continue generating jobs for the young people coming into the labor market will be affected. The chart below shows that Japanese investors are more concerned about this trend in Vietnam than almost anywhere else.

- Proportion of Japanese enterprises responses that wages increase causes business concern (According to JETRO investigation in 2016):



According to this Draft Decree foreign employees and their employers will be subject to compulsory social insurance contribution. This includes foreign employees who:

- are working in Vietnam under indefinite-term labor contracts, definite-term labor contracts, or seasonal or specific job contracts with durations of more than one (1) full month with employers based in Vietnam, and
- have been granted either (i) a work permit ("giấy phép lao động" in Vietnamese), (ii) practicing certificate ("chứng chỉ hành nghề" in Vietnamese) or (iii) practicing licence ("giấy phép hành nghề" in Vietnamese).

The Draft Decree proposes that foreign employees working in Vietnam will be required to pay into all five regimes of the Vietnamese compulsory social insurance, which are currently applicable only to Vietnamese employees, namely: (i) sickness, (ii) maternity, (iii) labor accident and occupational disease, (iv) retirement and (v) survivorship allowance. The contribution rates imposed on both employers and foreign employees will be the same as applicable for Vietnamese employees; specifically 8% from the employees and 18% from the employers, respectively, based on their actual monthly salaries and benefits, and capped at 20 times of the applicable General Minimum Wage.

According to the Draft Decree, the processes and procedures for foreign employees' participation in the Vietnamese compulsory social insurance regimes would not be different from the current procedures applicable to Vietnamese employees, which are provided for under the 2014 Law on Social Insurance. The Draft Decree provides some details on the contents of dossiers for the foreign employees' participation in the scheme, but there are concerns about how accessible the regime will be when those who pay in need to claim their benefits.

The Draft Decree and the Proposal Statement introducing it, address some of the concerns that will arise. For example, the Proposal Statement provides that the accumulation of periods of social insurance premium contribution is not regulated in this Draft Decree, and this principle will be applicable only to the nationals whose countries have signed bilateral agreements with Vietnam on this matter. This seems to be because of the difficulties of calculating contribution periods when the foreign employees work in many different countries. In addition, foreign employees subject to this Draft Decree would be entitled to a lump-sum social insurance allowance upon their request in case their labor contracts or work permits expire and they do not continue working under the contracts or extend their work permits. The foreign employees are supposed to make their requests within 30 days prior to the expiry date of their contracts or work permits (the earlier date would be applicable), and the insurance authority is supposed to be responsible for settling and paying the allowance to the employees within 10 days upon the date of the receipt of proper requests. The calculation of the lump-sum social insurance allowance applicable to foreign employees would be the same as what is currently applicable to Vietnamese employees according to the Law on Social Insurance. However, any foreign employee who has ever tried to claim benefits under the health insurance scheme will already know that it may well be practically impossible to realize the benefits he/she has paid for until many unexpected administrative procedures are resolved.

To assess the financial impact of the Draft Decree, below is a table that calculates how much the change would cost a business, using the current applicable General Minimum Wage and Regional Minimum Wage:

Year	2018		2018	
	Employer	Vietnamese employee	Employer	Foreign employee
Social insurance	18%	8%	18%	8%
Unemployment insurance	1%	1%	[N/A]	[N/A]
Health insurance	3%	1.5%	3%	1.5%

This scenario assumes:

- Social insurance and health insurance are calculated based on actual monthly salary capped at VND24.2 million (approximately US\$1,100), being 20 times of the current General Minimum Wage, which is VND1.21 million at present;
- Unemployment insurance is calculated based on actual monthly salary capped at VND52 million to 75 million (approximately US\$2,400 to 3,400), meaning 20 times of the Regional Minimum Wage, which ranges from VND2.58 million to VND3.75 million, depending on the regions, at present.

To illustrate, the chart below shows the actual costs of employment in regards to the total contribution to the three social insurance funds at four levels of wages for an employer based in Ho Chi Minh City, which belongs to Region I, using the current applicable General Minimum Wage and Regional Minimum Wage:

Exchange rate: 1 USD = 22,800 VND

Salary range	Salary used to calculate the contribution (VND)		Total Contribution (VND/USD)			
	For Social Insurance and Health Insurance	For Unemployment Insurance	Employer	Vietnamese employee	Employer	Foreign Employee
The current applicable minimum wage (for Region I: VND 3,750,000)	3,750,000	3,750,000	VND 825,000/ USD 36.2	VND 393,750/ USD 17.3	VND 787,500/ USD 34.5	VND 356,250/ USD 15.6
USD 400	9,120,000	9,120,000	VND 2,006,400/ USD 88	VND 957,600/ USD 42	VND 1,915,200/ USD 84	VND 866,400/ USD 38
USD 4,000	24,200,000	75,000,000	VND 5,832,000/ USD 255.8	VND 3,049,000/ USD 133.7	VND 5,082,000/ USD 222.9	VND 2,299,000/ USD 100.8
USD 10,000	24,200,000	75,000,000	VND 5,832,000/ USD 255.8	VND 3,049,000/ USD 133.7	VND 5,082,000/ USD 222.9	VND 2,299,000/ USD 100.8

Applying these calculations, a combined contribution of USD\$ 323.70 for an employee with wages of USD\$4,000 per month will be considered burdensome by many, especially if there are any issues with redemption, pay-out and remittance at the end of the contract period.

Moreover, the Draft Decree seems to make mandatory what the Law on Social Insurance had initially held out as an optional benefit. The 2014 Law on Social Insurance provided that from January 1, 2018, to require that foreign employees working in Vietnam under a work permit, practicing certificate, or practicing licence issued by a competent body of Vietnam “will be

allowed to” participate in the compulsory social insurance program. However, the Draft Decree makes it sound more like an obligation than a right to pay into the social insurance program.

Adding in this new tax, Vietnam's taxes on workers will be among the highest in the region, taking into account the number of taxes, high rates, and broad bases (which include not only salary but all forms of benefits). Stakeholder comments were only welcome until June 12th, so it may be too late to reconsider, but to ensure the smooth implementation of this change we would encourage the drafters to consider taking more time to introduce this important change in the employment environment. Otherwise, this Draft Decree will come into force on January 1, 2018.