

Institutional Environment and Foreign Investment for Sustainable Development

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Abstract: *In order to attract FDI for sustainable development, it is necessary to ensure a favorable institutional environment. This paper examines the theoretical basis of different points of view on sustainable development and institutional economics to apply the analysis of the institutional environment improvement process in Vietnam over the past time. There have been many positive changes in formal institutions, informal institutions and their implementation; and there are still limitations in the components of the institutional environment. That is the basis for proposing a number of policy implications to further improve the institutional environment in the future.*

Keywords: *foreign investment, sustainable development, attraction, institutional improvement.*

1. The theoretical background

1.1 The definition of sustainable development

“Sustainable development is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (United Nation, 1987). The 2005 Global summit mentioned three pillars of sustainable development including economic growth, social development and environmental protection, which are interdependent and support to each other mutually. The diversity of cultures was considered the fourth element to invest in by sustainable development according to the general announcement of Cultural diversity (UNESCO, 2001).

1.2 The definition of institution and its roles to the economic development

The great difference of living standard among countries is resulted from the difference of performance. The factors such as capital, workforce, technology,

skills, natural resources and the change of structure are the key elements that affect the performance of each country. The development of human societies has observed the significant technology advances and organizational structures. These developments rely on the evolution in institutions which have brought the advantages for capital accumulation and implement market-oriented activities. Being free in doing business, politics, and institutional frames that have built the mutual beliefs among countries, as a result, it leads to the economic prosperity in each country.

2. What is the definition of institution?

Institutions are the humanly devised constraints that structure political, economic and social interaction (North 1991, p 97). Institutions consist of informal constraints, formal rules and the specialties implementing the rules and the combination of these rules, constraints and specialties.

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The better an institution is, the higher the level of living in a country is, because a government has an effective institution that will bring benefits such as reducing the cost, improving the effectiveness, boosting the growth.

3. Completing the institutional environment for attracting the foreign direct investments in Vietnam

3.1 Some official improvements in the institution

The Law on Investment in Vietnam was first introduced in 1996. The Law on Enterprise 1999 replaced both the Law on Enterprise and the Law on Private Enterprise 1990; the Law on State-Owned Companies 2003 also replaced the one 1995. The Law on Enterprise 2005 unified the regulations of establishing and managing any enterprises that belong to any possessions, and the Law on Investment 2005 created an equally competitive environment for investors and enterprises. The two laws were replaced by the Law on Enterprise 2014 and Law on Investment 2014 respectively, which created a suitable legislative framework compared to the global legislation and met the requirements of the signed commercial agreements. The Ministry of Justice reviewed these two Laws 2014 to remove business conditions which were no longer appropriate. But recently, the Central Institute for Economic Management (CIEM) recommended further removal of 3,000 business conditions.

In order to reduce investment barriers and expand the potential access to real estate market in Vietnam, the Law on Real Estate Business 2014 and Law on Housing 2014 supported the real estate sectors to gain more investments. It also created a friendly investing environment for both domestic and foreign business that helps them live and work in safe, comfortable

atmosphere with the necessary facilities such as schools, hospitals, entertainments to choose. The renewed Labor Code permits to increase anti-social working time. It also supports the establishment of the Institute of Human Resources, which has brought the advantages for foreign businesses in increasing productivities and efficiency in doing business in Vietnam.

Investors are particularly interested in regulations of the socialization in the field of aviation, power, energy and the Private-Public Partnership (PPP). Therefore, foreign enterprises have more opportunities to participate in building the infrastructure in Vietnam, which would create positive changes (According to the Ministry of Planning and Investments, Vietnam would need 68 billion USA from FDI capital source in order to build infrastructure structure.

3.2 Some changes in non-government institutions

In the period of economic reform, the strong development in private business sector has contributed significant achievements in improving the standard of living in Vietnam. On the other hand, there have been unexpected results, especially in food and beverage manufacturing and business and problems related to copyright infringement. In recent years, however, non-official institutions have had strongly positive changes, and vietnamese value systems have changed toward the intension of integrating into region and in the world where vietnamese entrepreneurs and companies are highly appreciated and respected. The illegal business activities have tended to decrease, while acts of kindness and compliance of official regulations, standards of social ethnics are encouraged, published on the media.

3.3 Features of institutional implementation

Enterprises are increasingly paying attention to set up behavior rules based on optimal practices, especially the responsibilities in supervising and implementing the regulations. Resolution No.35/NQ-CP which supported the enterprise development from 2016 to 2020, identified the duties of administrative reform to bring benefits to businesses. It helps to create a supporting environment for start-up companies, and innovative ones in order to ensure business rights and enterprises' approach to the business sources and create business opportunities equally. It helps the enterprises to reduce the cost, protect their rights and legal benefits.

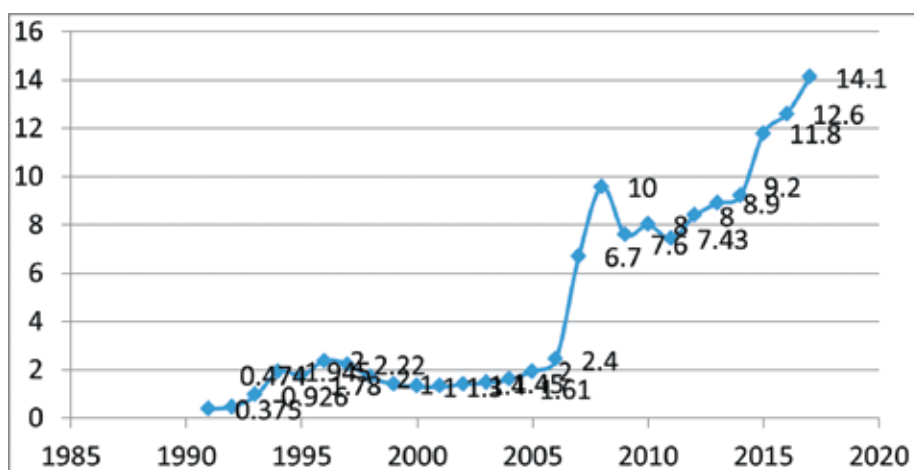
The State Bank has always cooperated closely with Banking work team of, Vietnam

Business Forum, to check and deal with technical problems. Moreover, they have made a lot of efforts in terms of industry restructure, issued resolutions to deal with bad debts and amended the Laws on credit institutions. This has brought positive results, and removed a lot of obstacles.

The Prime Minister decided to focus on cutting cost of business activities, particularly compliance costs. The Directive No 20/CT-TTg regulated the adjustment on inspecting, testing business activities to enterprises. There have been strong reforms in the sector of custom and tax payment.

The improvement in the institutional environment has directly affected FDI flows in Vietnam (H.1 source World Bank)

PI. FDI flows in Vietnam (BoP), billion USD (current price)



3.4 Shortcomings in the improvement of institutions

a) Official institutions

In spite of being significantly improved, there have been still limitations in legal regulations, having bad effect on attracting FDI flows.

Firstly, there has been discrimination in the law, inconsistency between laws, and the gaps.

The Law on Investment and Law on Enterprises still discriminate against FDI

enterprises and domestic enterprises (Decree 102/2010/NĐ-CP). The FDI enterprises have got difficulties in importing activities against those of domestic enterprises (Decree 23/2007/NĐ-CP) because the regulation in Law on Commerce requires that FDI enterprises which participate in importing and delivering goods, need to have a Trading license (except the Investment Registration Certificate and Enterprise Establishment Certificate available). In other words, foreign companies need to have a “baby

license”, yet there have been unclear criteria regarding as non-tariff barriers. Applying the code on imported products has shown the embarrassment and inconsistency of Customs, causing nuisance and violating national treatment principle. Because of unclear tax regulations, the identification of the enterprise’s responsibilities on tax is difficult. In order to join in the game, foreign retailers have to compliant Economic Need Test (ENT). However, there is not an objective criterion for ENT application. Foreign investors taking part in Logistics service are forced to apply the price cap for the investment capital in postal service: the capital contribution ratio of foreign investors must not exceed 51% (Law on Post No49/2010/QH12). There is a unification of investment Approval Decision between Law on Landing and Law on Housing. The draft of Decree on compulsory social insurance for foreign employees working in Vietnam raises concerns about increasing costs, as they have joined one in an original company abroad.

The State Bank regulates that payments for FDI enterprises are paid to the company’s direct capital account, and payments, for foreign indirect investment (FII), are paid to the account in VND. This regulation is easy to mislead and is interpreted by the banks in different ways. The Law on Enterprise does not provide any regulation for the share exchange. There are some unrealistic requirements, such as asking for capital contribution within 90 days. The company is required to reduce its charter capital when purchasing back its shares. According to Law on Housing 2005, investors on housing projects are able to mobilize capitals from all legal sources following the law. The new Law on Housing, however, is limited by removing the content of “other resources following

the law” in the list of capital sources for housing development. This means that housing investors are restricted when borrowing capital from oversea credit institutions and non-credit ones.

Issuing the certificate of land use to foreigners has been delayed. Decree No99/2015 stipulates that the Ministry of Defense and the Ministry of Public Security send The Provincial People’s Committees a written notification about areas where need ensuring national defense and security in their localities. Subsequently, the People’s committees of the provinces and cities directed the Department of Construction to issue a list of commercial housing projects where foreigners are not allowed to own houses. However, the list hasn’t been still issued yet, so the Department of Natural Resource and Environment hasn’t yet issued the Certificate of Land use right for foreigners who have signed housing purchase agreements, making it difficult for them and the real estate investors in Vietnam. There are also unnecessary requirements such as if they want to change land users in case of purchase and sale of stake transfer in enterprises, they must carry out procedures for land use right transfer, registering changes in land and assets attached to land. (Decree No01/2017).

Secondly, there have been ambiguous contents in the law that make officials and administrative organizations understand in different ways. The definition “Foreign invested enterprise” in the Law on Land, the Law on Investment, and the Law on Real Estate Business is not unified and unclear, leading to apply inconsistently. There have been overlaps in Laws: Law on Housing, Law on Investment, Law on Land, Law on Construction, Law on Real Estate and Law on Stock, etc. In Circular 32 on account opening, it seems to have limited corporate

legal entities, there are only two entities: individuals and businesses established under the Law on Enterprise. However, in practice of implementing the circular, banks interpret it conservatively, and assume that representative offices, non-government organizations, business associations and unincorporated organizations have no longer the legal capacity to open bank accounts.

Thirdly, the laws are slowly enacted. Although the Law on Housing has issued regulations which allow for sale of certain types of apartments and villas to foreigners limitedly, the regulations have been issued slowly and led to many confusions and risks to foreign investors. The concepts, definitions in the laws are unclear and overlapping, inconsistent that leads to confusion and lack of confidence in real estate sector.

Fourth, the regulations are not compatible with international practices. In particular, Circular 39 on the calculation of interest is not only rigid but also inconsistent with the best international practices due to inadequacies in the Civil Code.

In order to help the authorities monitor capital flows in and out of Vietnam, a direct investment account was created.

However, it is difficult to implement it because of inconsistent interpretation from banks. According to the regulations on finance and payment service, all transactions are required to be routed through National Payment Corporation of Vietnam (NAPAS), which significantly obstructs on the term of security, speed and reliability of transactions and reduces the competitiveness of foreign payment corporations. The regulation has removed all direct connections between international card manufactures and their clients, banks in Vietnam, creating inequality in the market.

b) The implementation of official institutions

The implementation of formal and informal rules plays an important role. There are some exceptions in implementing official rules including:

Firstly, too many steps must be taken to ask for approval, license, and request lots of documents that waste time and money. A foreign company operating in Vietnam needs up to three different types of licenses: an investment registration certificate, an enterprise registration certificate and a business license (Figure 2)

Figure 2. Admitting process

1. The application for Investment registration certificate	2. Admitting investment registration certificate	3. The Application for an enterprise registration certificate	4. Admitting the enterprise registration certificate	5. The application for business	6. Admitting the business license
15 days		3 working days	As soon as possible	(...) working days	
As soon as possible					

This process requires a lot of preparation and all documents issued by foreign agencies outside of Vietnam must be lawfully used in Vietnam and certificated by Vietnam embassy in the host country and have expire within 3 months. There are

no constraints on the executors, so it often makes foreign investors annoyed and costly. For example, Decree 118/2015 requires that foreign investors need to get approval from the Department of Planning and Investment, in following cases: (i) buying shares in

conditional business lines, (ii) owning more than 51% shares in domestic companies in Vietnam. However, in fact, all cases are always required to have the approval of the Department of Planning and Investment.

Secondly, the tax and customs authorities intentionally interpret words in legal documents in a way that is detrimental to enterprises in order to increase their revenues. Many licensing agencies do not allow the company to consolidate the capital of the branch into its headquarters' Investment Registration Certificate.

Thirdly, due to unclear regulations, enterprises find it difficult to determine

their tax liability. Therefore, if there have any problems, or errors, tax authorities often blame the taxpayers. Tax authorities make administrative mistakes to impose tax unreasonably, it makes enterprises lose their legitimate rights.

E-customs was launched in 2014, yet the delay is often caused by some manual and inefficient customs processes, checking goods lack transparency and inconsistency.

Restrictions on the implementation of formal institutions lead to tiny improvement in the corruption index in Vietnam, even from 2012 to 2015 with no change (Table 1)

Table 1. The Vietnam corruption index- score 1-10, after 2011 0-100 score (the smaller score is, the higher corruption is)

Year	2010	2011	2012	2013	2014	2015	2016	2017
Index	2.7	2.9	31	31	31	31	33	35
Rank	116/178	112/182	123/176	116/176	119/175	112/168	113/176	107/175

(Source: Transparency International)

4. Conclusion and policy suggestions

4.1 Conclusion

Over the last few years, Vietnam government has carried out improvement effortstocompleteinstitutionalenvironment for business and investment activities in general, and attract FDI source in particular. Business institutional environment has been more and more improved, creating the advantages for any legal business institutions: (i) Official institutions- the laws are renewed to be suitable for practical demands; documents under laws are revised to remove unnecessary requirements that obstructs domestic and foreign investors; (ii) Non official institutions have also changed positively: the concept of business and entrepreneurship has changed toward the direction of high appreciation on honest business activities, positively contributing to the sustainable development

of society; (iii) The implementation of formal institutions has also significantly changed: simplifying the process, reducing and shortening the implementation time of administrative procedures, etc. The institutional environment improved has contributed positively, therefore, FDI in 2017 was 8.8 times higher than that in 2005.

However, there have been still numerous issues in the institutional environment to domestic and foreign investment: (i) administrative procedures related to licensing are complicated; (ii) Legal documents still have vague definitions which make it difficult for investors and enforcement agencies to interpret differently; (iii) law enforcement agencies are usually not responsible for the mistakes made when applying the laws, yet they blame business entities.

4.2 Some policy suggestions

In order to further improve the institutional environment to attract FDI with the aim of economic development that satisfy current and future demands, the institutional system needs to be completed toward the direction of: (i) Improving the quality of legal documents in laws to remove contents that are incompatible with international law, and to avoid overlaps and inconsistencies between laws; concepts, definitions must be clear to avoid different interpretations, interfering investment activities; (ii)

further simplify licensing process; they can put existing licensing processes into one or two steps, meanwhile, the details need to be strengthened, simplified, and enterprises can be allowed to submit electronic records; (iii) Improving the efficiency of law enforcement: tax and customs authorities must update tax and customs policies, as well as regularly train to disseminate to the collection officers. Tax authorities are responsible for their conclusions and decisions and they should not be blame others like enterprises for getting responsibilities./.

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MÔI TRƯỜNG THỂ CHẾ VÀ ĐẦU TƯ NƯỚC NGOÀI CHO PHÁT TRIỂN BỀN VỮNG

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Tóm tắt: Nhằm thu hút FDI phục vụ mục tiêu phát triển bền vững cần đảm bảo môi trường thể chế thuận lợi. Bài viết này nghiên cứu cơ sở lý thuyết là các quan điểm khác nhau về phát triển bền vững và kinh tế học thể chế để vận dụng phân tích quá trình hoàn thiện môi trường thể chế ở Việt nam thời gian qua. Đã có nhiều thay đổi tích cực trong các thể chế chính thức, thể chế phi chức thức và việc thực thi các thể chế đó, đồng thời vẫn tồn tại những hạn chế trong các bộ phận cấu thành môi trường thể chế. Đó là cơ sở cho việc đề xuất một số hàm ý chính sách nhằm tiếp tục hoàn thiện môi trường thể chế trong tương lai.

Từ khóa: đầu tư nước ngoài, phát triển bền vững, thu hút, hoàn thiện thể chế.

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