

Chapter 5. FDI Policy of the Host Country

■ **Goal**

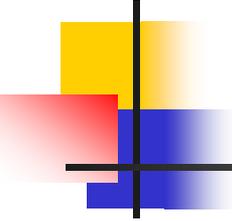
- To analyze host countries' instruments regulating and directing inward FDI

■ **Objectives**

- To understand contents of FDI policies and measures
- To analyze and assess FDI policies and measures
- To assess Vietnam's FDI policies and measures

■ **Content**

- FDI policies
- FDI policy measures



Textbook and references

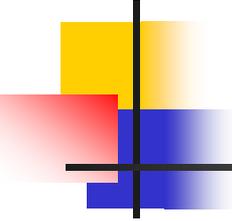
- , NxB
ĐHQGHN, 2001, Chương 5.
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Nam, NxB ĐHQGHN, 2010, Chương 1, tr. 11-23.
- UNCTAD, WIR 2006, pp.219-228 Host country's FDI policy.
- UNCTAD, WIR 2007, pp.157-182
- UNCTAD, WIR 2008, 10-20
- UNCTAD, 2008, Investment Policy Review – Vietnam, New York and Geneva.
- UNCTAD, WIR 2010
- <http://www.unctad.org/templates/WebFlyer.asp?intItemID=4695&lang=1>

Opening case: Chinese Telecom: Who Wins, Who Loses?

- http://www.businessweek.com/globalbiz/content/jul2008/gb2008079_485740.htm

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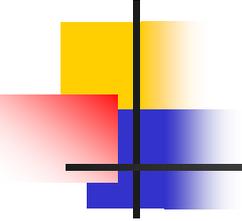
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Definition

- FDI policy is an integral part of a nation's economic development policy made out to regulate FDI activities in order to achieve goals of economic-social development of the nation in a certain period.

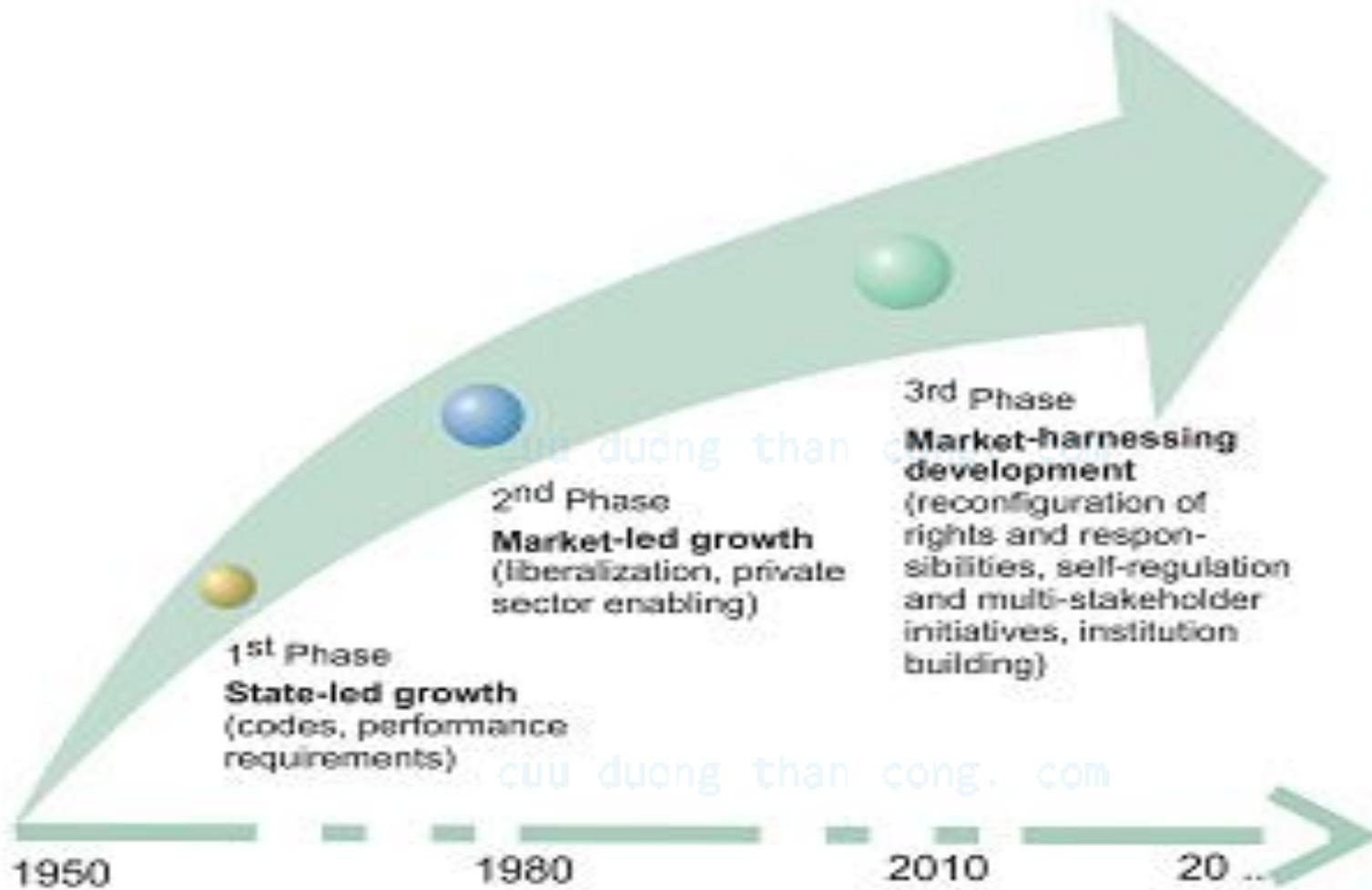
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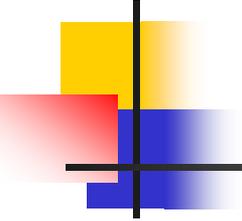
FDI policies

- What do host countries want from FDI and foreign MNCs?
- What policy measures are available to host country governments?
- How effective are FDI policies?

Figure V.1. The evolution of policy approaches towards foreign investment



Source: UNCTAD.



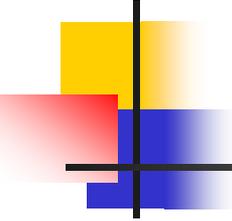
FDI policies and measures

FDI policy

1. Ownership and investment guarantee
2. Investment sectors and orientation
3. Fiscal and Financial incentives
4. Foreign exchange control
5. Project screening and management
6. Others

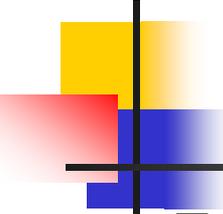
FDI measures

1. Investment promotion
2. Infrastructure upgrade
3. Human resource development
4. Construction of EPZs, IZs



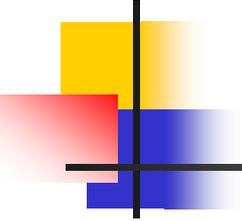
Objectives of FDI Policy

- Attract and maintain foreign investment
- To acquire
 - capital and jobs
 - technology, production, and R&D skills
 - organizational and managerial skills
 - marketing and exporting skills
- Facilitate technology transfer, and spillover/diffusion
- Encourage human resource development
- Access international market
- Strengthen national competitiveness in luring FDI
- Retain national control over strategic industries and strategic decisions



Characteristics of FDI policy

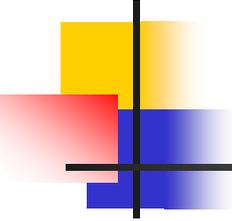
- To be highly systematic and comprising rules, tools and measures imposed by the host government to adjust FDI activities
- Objects of FDI policy are foreign-factored investments. The policy aims at protecting foreign investors' property rights on physical and knowledge capital including capital, equipment, managerial and business skills, brand name
- Scope of regulated objects is wide including investment carried out by foreign investors from various countries and territories. On the other hand, FDI closely links with international production network, therefore, any change in investment environment of the host country or the relevant region will directly affect investment decisions of foreign investors.
- To impact strongly on different benefit groups in the host country, possibly induce contradictions and conflicts among local and foreign investors.



Role of FDI policy

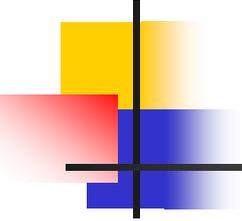
- For the host government
 - Create stable legal framework for effective performance of FDI; express the government's transparent attitude and standpoint towards attracting FDI.
 - Regulate foreign productive factors in accordance to the host country' economic development orientation.
 - Improve FDI attraction and utilization efficiency.

NxB ĐHQGHN, 2010, ch.1



Roles of FDI Policy (cont.)

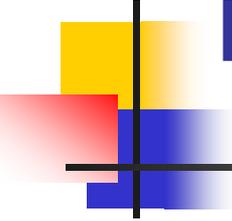
- For foreign investors:
 - Provide the norms so that domestic and foreign investors can select suitable partners (in terms of technology, industry, managerial ability, business strategy, culture...)
 - Legal documents based on which domestic and foreign investors settle disputes (including instruction of process, measures, relevant authorities, and applicable rules...)
 - Protect and encourage ownership-specific advantages of foreign investors.



Objectives of Policy measures

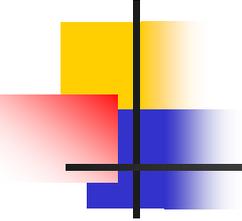
- Investment promotion - to attract foreign MNCs
- Market access restrictions - to retain national control
- Regulation of MNC operations - to make the foreign MNCs behave in the right way

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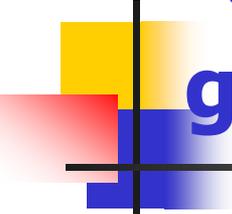
Market access restrictions

- License requirements (where applications are individually screened)
- Outright prohibitions
 - military industries
 - mass media
 - air and land transports
 - banking and finance
 - telecommunications



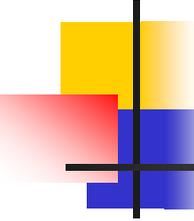
Regulation of MNC operations

- Performance requirements
 - technology transfer
 - exports
 - employment
 - local content
- Requirements for joint ventures
 - to secure transfer of technology to local industry



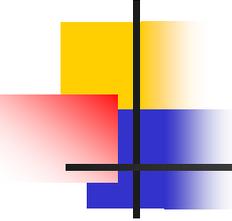
Ownership and investment guarantee

- **Ownership ratio:**
 - Depends on form and field to which the project relates.
 - Other conditions: export ratio, project size, technology transfer ...
- **Protect the ownership of invested capital and legal rights of foreign investors**
 - Guarantee not to requisite, confiscate lawful assets of foreign investors, and not nationalize enterprises with foreign capital investment.
 - Facilitate foreign investors to remit abroad their profit and assets.
- **Legal framework for the guarantee:**
 - Host country's legislation
 - International agreements: bilateral or multilateral arrangements (BTAs and MAIs)



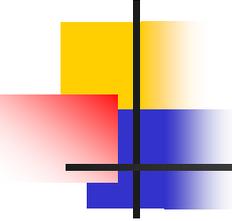
Vietnam's FDI Policy

- FDI Law (1992): apply “non-retroactive principle”
- Law on Investment (2005): “Chapt.2. Investment guarantees, Art.6. Guarantees regulating to capital and assets:
 1. Lawful assets and invested capital of investors shall not be nationalized or confiscated by administrative measures
 2. In case of real necessity for purpose of national defence and security and in the national interest, if the State acquires compulsorily or requisitions an assets of an investor, such investor shall be compensated or paid damages at the market prices at the time of announcement of such compulsory acquisition or requisition”.



Orientation and Sectors of Investment

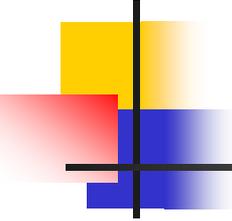
- **Orientation of investment**
 - Host country's economic-social development plan
 - Investment fields with priority
- **Encouraged or restricted investment sectors**
 - Provide information on permitted areas so that investors can select
 - Increase or decrease protection of domestic production: Strengthen or degradation competitiveness, gap between domestic and foreign investors (inequity treatment).



Vietnam's Investment Law 2005: *Three investment groups*

- Prohibited sectors: Investment is prohibited for both domestic and foreign investors;
- Conditional sectors: Investment is conditional for both domestic and foreign investors;
- Conditional sectors for foreign investors: Investment is conditional only for foreign investors

Sectors that are not listed in the prohibited or conditional lists are considered by default as being "non-conditional". It is crucial to note that the Law on Investment assimilates joint ventures where Vietnamese nationals own more than 51 per cent of the capital of an enterprise to "domestic investors". It stipulates clearly that "the same investment conditions which are applicable to domestic investors shall be applied to foreign investors where Vietnamese investors hold more than 51 per cent of the charter capital of an enterprise."



Fiscal and financial incentives

- **Fiscal incentives**

- List and tax levels for foreign investors
- International rules of tax ranges and categories: easily or difficulty applicable for foreign investors

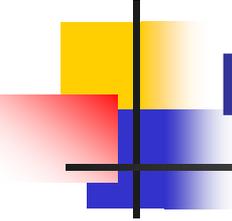
- **Financial incentives: preference credit or other investment service**

- Subsidiary, loan
- Use the same service and at the same rates of charge as domestic investors

Private income tax (%)

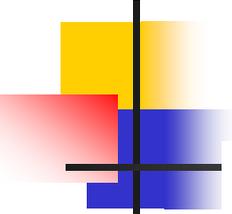
Country	Level 1	Level 2	Level 3	Level 4	Level 5	Highest Level
Vietnam	0	10	20	30	40	
China	0	5	10	15	45
Malaysia	0	19	24	27	28	
Philippines	5	10	15	20	32
Singapore	0	3,5	5,5	8,5	---	20
Korea	8	17	26	35
Thailand	0	10	20	30

Source: UNCTAD, Investment Policy of Vietnam, Nov. 2007, tr. 56



FDI incentives

- Used by almost all countries
- Financial incentives in OECD; fiscal incentives in developing countries
- Probably becoming more important for corporate decision making...
 - WTO membership makes other policies more similar across countries
- ...but also risk for excessive subsidization
 - politically attractive
 - competition between host countries
 - uncertainty about spillover benefits
- Case study:
Vietnam's FDI incentives: Law on Investment (2005). Section 2



In-class discussion

Box I.1. FDI in tax haven economies

Since the beginning of 2008, reducing international tax evasion, implementing high standards of transparency and promoting information exchange have been high on the international policy agenda (OECD, 2010).^a The conclusion of a higher number of double taxation treaties in 2009, for instance, reflected a desire to reduce FDI flows to tax haven economies (chapter III). As a result of such efforts, investment to these economies contracted to \$30 billion in 2009, a 42 per cent decline.^b At the same time, investment from tax havens to major host countries, the bulk of which consists of FDI round-tripping to its original source countries and FDI in transit that is redirected to other countries, has declined too.^c FDI flows into the United States from the British Virgin Islands, for example, sank from \$16.5 billion in 2008 to a negative value of \$0.5 billion in 2009. The 81 per cent decline in cross-border M&A sales in these economies was more pronounced than the global decline of 65 per cent (see <http://www.unctad.org/wir> for detailed data on FDI and cross-border M&As).

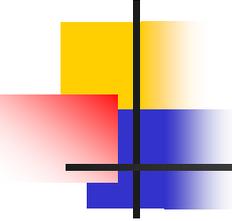
Source: UNCTAD.

^a For example, tax transparency was a key feature of the deliberations at the G20 summits in Washington, London and Pittsburgh in 2008 and 2009.

^b However, FDI flows are underestimated, as some of those countries do not report FDI data. For example, data on FDI inflows to the British Virgin Islands are collected from home countries that report investments there.

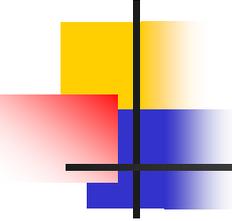
^c Round-tripping refers to investments to foreign destinations that are channelled back to their original economy countries. The purpose is usually to obtain more favourable tax treatment.

Source: WIR 2010, p.5



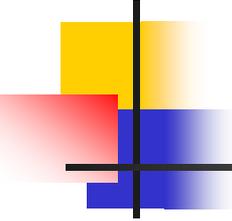
Foreign exchange control

- **Opening a bank account**
 - Procedures
 - Conditions [cuu duong than cong. com](http://cuuduongthancong.com)
- **Policy of Exchange rate, and foreign exchange flow in and out the host country**
 - Exchange rate
 - Liberalization on transferring in/out foreign exchange



Investment project license and management

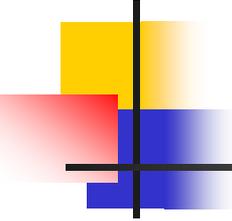
- **Investment project screening and license**
 - Licensing procedure
 - Time for permission grant
- **Project management**
 - Troublesome and impediments caused by multiple level check and control
 - Treatment of arising issues/problems/disputes



Other policies

- Technology transfer
- Environment protection
- Import of Machine and equipment
- Land use and site clearance
- Labor relationship, customs, immigration, resident...

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Investment promotion measures

■ **Necessity**

- Introduce investment environment...
- Actively encourage FDI inflow
- Base for TNCs to set up long-term investment strategy

■ **Forms of promotion**

- on-the-spot survey aboard
- PRs of investment environment through mass media, workshop.....
- PRs through representative agencies abroad

In-class discussion

Box IV.10. Promotion of low-carbon foreign investment in the Republic of Korea: a selective approach

Green growth is a top policy priority of the Republic of Korea. In August 2008, the Government set “low-carbon, green growth” as the new national vision, in response to the growing threats of climate change and the depletion of natural resources. In 2009, it announced a comprehensive five-year plan to spend 107 trillion won (approximately 2 per cent of its GDP) to support green growth between 2009 and 2013 – double the proportion recommended by the United Nations. In the same year, it announced its GHG emissions reduction goal of 30 per cent from the business-as-usual level by 2020. The *Framework Act on Low-Carbon, Green Growth* attained bipartisan support in the National Assembly, passed in December 2009 and took effect in April 2010.

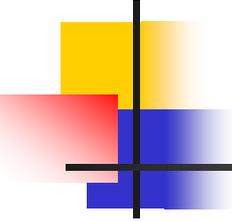
At present, the Republic of Korea relies on foreign countries for low-carbon technologies, as its green industries are still at the fledgling stage. For example, imports account for approximately 70 per cent of all products and components used in solar energy facilities and approximately 96 per cent of those used to generate wind power.

Against this background, the Government is actively promoting foreign investments into “green industries.” The Government believes that foreign investments in green industries are essential to develop them as new national growth engines. To this end, the Government has designated key sectors, including smart grids and LED panels, as targets of investment in green technology-related R&D projects

Moreover, the Government has introduced numerous incentives such as cash grants and corporate tax breaks for companies that develop cutting-edge green technologies. Examples of TNCs that are taking advantage of the incentives include the photovoltaic module manufacturer Solarworld (Germany), the wind power company Acciona Energia (Spain), and Robert Bosch (Germany), manufacturer of Li-Ion batteries. According to the Industrial Bank of Korea, investment in green technology by the top 350 companies in the Republic of Korea rose by 34 per cent in 2009 compared to 2008.

Considering the Government’s strong commitment to green growth and the public funding for related R&D, its green industries appear to have a great potential to grow up rapidly. For example, the Republic of Korea is proud that some domestic companies already excel in the fields of LED display panels and rechargeable batteries.

Source: UNCTAD, partly based on information supplied by the Ministry of Knowledge Economy, Republic of Korea.



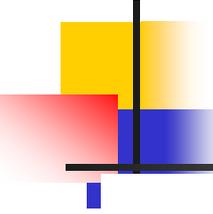
Upgrading infrastructure

- **Hard infrastructure**

- Transportations, electricity, water supply, communication system ...
- Fee levels equally treated between domestic and foreign investors.

- **Soft infrastructure**

- Finance and banking system
- Quantity and quality of service
- Labor quality

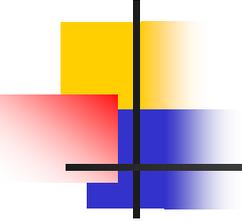


Telecommunication costs

(Dollar per minute)

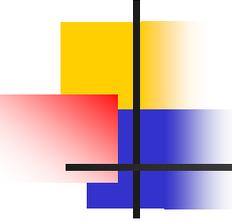
	Mobile-mobile	Fixed-United States	Fixed-Japan	Fixed-United Kingdom
Viet Nam (VNPT)	0.11	0.78	0.78	0.78
China (China Telecom)	0.07	2.0	1.7	2.0
Malaysia (Digi)	0.14	0.26	0.53	0.26
Singapore (Singtel)	0.1	0.026	0.6	0.04
Thailand (True)	0.05	0.3	0.6	0.6

Source: UNCTAD, 2008, *Investment Policy Review – Vietnam*, New York and Geneva, p. 82



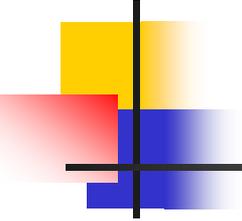
Construction of EZs, IZ, High-tech Zones

- **EZs, IZ :**
 - Clear out / reduce barriers on cheap labor supply
 - Facilitate foreign investors to access domestic market
 - Supply favorable conditions for foreign investors ...
- **High-tech Zones and “Zone-in-Zone”**
 - Meet requirement of high-tech industries
 - Create favorable conditions for foreign investors to select strategy, reduce costs..



Are FDI policies efficient?

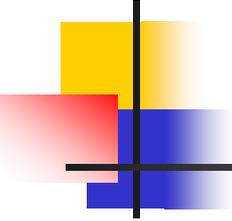
- Prohibitions work
- Performance requirements not very efficient - easy to get around
 - and increasingly in conflict with WTO rules
- Investment incentives increasingly important, but mainly because everyone else is offering them
 - fundamentals like political stability, market size, and growth rate more important
 - risk for "bidding wars" between host countries
 - better to focus on industrial policy?



Example:

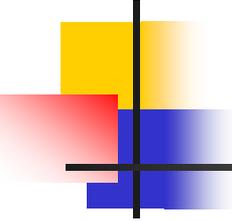
Objectives of FDI policy in India

- technology transfer
- technology diffusion
- limitations on foreign ownership
- save foreign exchange
- national independence
- priority sectors
- employment creation
- avoid concentration
- diversification
- local content
- export promotion
- advancement of Indians
- local R&D
- regional development
- capacity utilization



Consequences of Indian FDI policies

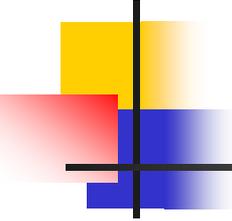
- Very little FDI until early 1990s
- Major MNCs left because of regulations
- Reform recommendations in late 1980s
 - liberalize and simplify bureaucracy
 - focus on employment creation and labor-intensive industry
 - allow foreign majority ownership
- Reforms and somewhat increased inflows of FDI from early 1990s
 - but still only a fraction of that directed to China



In-class discussion

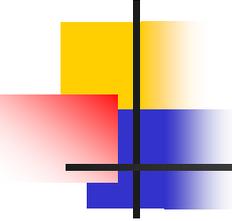
- **Antonios Kalyvas** , October 03, 2007, **A tale of two countries** (Locational advantage between Mexico and Costa Rica), <http://www.fdimagazine.com>

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Case study: FDI policy in extraction industry. WIR 2007 pp.157-182

- Regulating the entry and operations of TNCs in extraction industry (PP.157-163)
- Arrangement for rent-sharing (pp.163-168)
- Policies for broader economic benefits (pp. 168-171)
- Coping with environmental challenges (pp.171-173)
- Addressing social-political concerns (pp.173-182)



Issues for further study

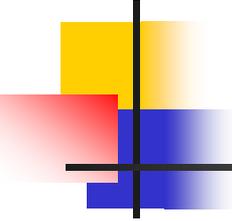
1. Analyze efficiency of Vietnam's FDI policy admenment in 1988-2009.

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, Nxb ĐHGQHN, 2010. pp.200-254.

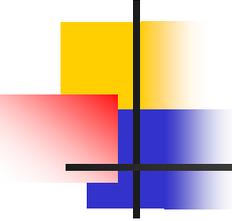
2. Political risks on offshore investment
3. Impacts of policy untransparency on FDI attraction
4. Impacts of protection policy on FDI attraction.

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Additional references

- Joong Wan Cho, Foreign direct investment: Determinants, Trend in Flow and Promotion Policies, Investment Promotion and Enterprise development, tr.99-112
- Bruce Blonigen, April 2005, A review of Empirical literature on FDI Determinants, University of Oregon and NBER
- UNCTAD, World Investment Report 1995, tr. 272-350



Guidance for Chapter 6

- **Materials:**

- **Required:**

- Textbook : Phung Xuan Nha, International Investment (pp.146-177);
- Other references mentioned in syllabus
- World Investment Report, 2006, tr.3-23
2007, tr. 23-28; 33-73
2008, tr. 10-20