

Special Feature

Vietnam – Tracing the origins of the newest Asian Tiger

In recent years, Vietnam's economy has benefited from its government's open-door policy. With a stable political environment and strong economic potential, Vietnam is an attractive destination for foreign investors. The Vietnamese government has been endeavouring to create a favourable investment environment by continuing to revise Vietnam's legal system and introducing important incentives for foreign investors. In this special article, we discuss the recent economic and political history of Vietnam and investment trends that we can reasonably expect will continue.

From Colonial Status To Independence

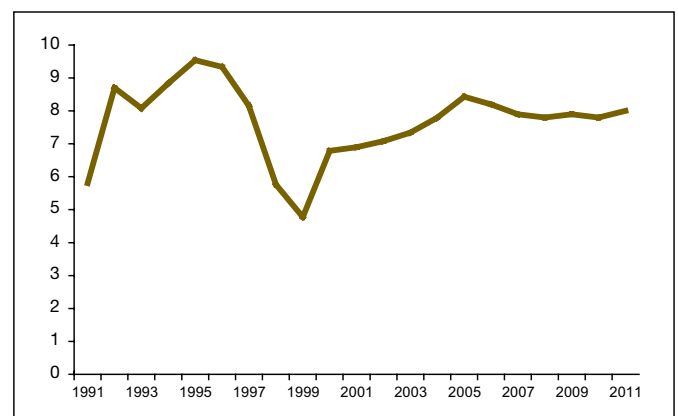
The modern day history of Vietnam is perhaps best started by reference to the Geneva Accord signed in 1954. The accord ended French colonial rule and partitioned the country along the 17th parallel into the communist North, led by Ho Chi Minh and the westward looking South, led by Ngo Dinh Diem. North Vietnam was named the Democratic Republic of Vietnam, whilst South Vietnam became the Republic of Vietnam. The capitals were Hanoi for the North and Saigon for the South. The fight led by Ho Chi Minh to unite the country started in 1959 and the well-known conflict involving the US between 1964-1973 raged on until Vietnam was formally reunited in July 1976. Hanoi became the capital of the country whilst Saigon was renamed Ho Chi Minh City (Ho Chi Minh died in 1969). Whilst largely at peace following unification, the country had fought the Khmer Rouge in Cambodia, ending their rule in 1979 and subsequently was also at war with China, for 17 days in the same year.

Economic Transition

Following reunification, the Vietnamese government's initial plan was to manage the economy via prescriptive central planning. Nationalisation, industrialisation, collectivisation of agriculture and price controls were amongst the key policies pursued. The 1976-1980 five year plan adopted for the unified country, however, delivered results below the expectations of the government. Subsequent central plans have been less rigid for agricultural collectives and State Owned Enterprises and allowed more scope for private initiatives. In particular, subsequent waves of agricultural reforms were instrumental in eliminating extreme poverty. Decree 25-CP issued in January 1981 signalled a willingness to relax some central controls: State Owned Enterprises (SOEs) were allowed a degree of economic flexibility once their centrally planned targets had been met. Growth rates during the early 80's were higher than during the 1976-1980 five year plan; however, the inefficiencies in the still predominantly centrally planned economy led to increasing budget deficits and spiralling inflation. Despite the progress made, overall, in the words of Nhan Dan, the official newspaper of the Communist Party of Vietnam, "the country's society and economy fell into serious crisis".

The evident shortcomings of central planning contributed to a comprehensive shift in economic planning. Economic reform was the key point of discussion at the Sixth National Party Congress held in December 1986. The process of moving from a centrally planned economy to an open, socialist-oriented and multi-sectoral market economy is known as Doi Moi (renovation). Landmark legislation issued the year after the Congress included Decision 217/HDBT giving significant autonomy to SOEs and The Law on Foreign Investment. In 1992, the National Assembly revised the post-unification constitution introduced in 1980 to better reflect the aspirations articulated in the Doi Moi process. Economic performance since 1986 has justified the policy of relaxation of central control beyond doubt and ever since, the challenge faced by Vietnam has been the maintenance of rapid economic growth and integration into the global economy. Real GDP growth averaged 3.9 percent during 1986 – 1990 and 7.6 percent since 1991 despite the effects of the Asian Crisis ten years ago. The forecast average annual growth for 2007 – 2011 is approximately 8 percent. In January 2007, Vietnam became a member of the World Trade Organisation.

Chart 1 - GDP growth 1991 – 2011 percent



Source: General Statistics Office of Vietnam, Economist Intelligence Unit

Foreign Direct Investment

Since the introduction of the Law on Foreign Investment in 1987, leaving aside projects which have expired or been withdrawn, there have been 6,813 active licensed projects, with a total registered capital of US\$60.4 billion. In 2006 the combined value of over 800 FDI projects licensed reached a historic record of US\$10.2 billion. Between 1998 and 2006 investors from more than 77 countries and territories have invested in Vietnam. Asia accounts for 67 percent, Europe 29 percent, and America 4 percent of the total FDI. Of the biggest investor countries and territories, the five biggest, Hong Kong, Japan, Korea, Singapore and Taiwan account for 58.3 percent of the licensed projects with a total authorised investment capital accounting for 60.6 percent of the total

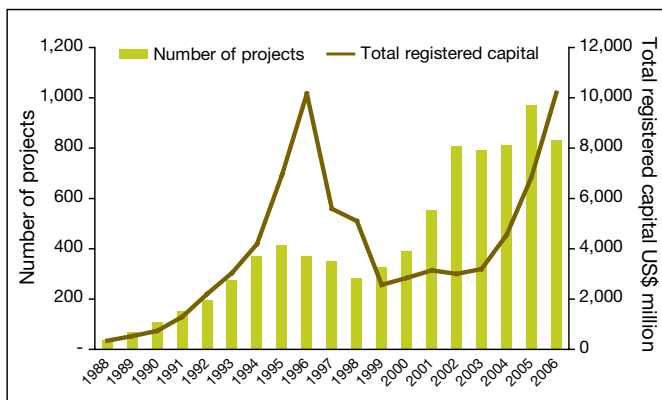


foreign investment capital of Vietnam. The next five countries and territories are the British Virgin Islands, France, Malaysia, Netherlands and the USA. These top ten countries and territories account for over three-quarters of the total licensed projects and foreign-registered capital in Vietnam. Based on preliminary statistics available for 2007, total FDI for the full year is expected to be above the record level of 2006.

As shown in chart 2, the inflow of foreign direct investment has been uneven over the years. Between 1988 -1996, prior to the Asian crisis there was rapid growth in FDI, from almost zero to slightly over US\$10 billion registered capital in 1996. FDI has been on a growth path again since 2000 and this is expected to continue for at least five more years, albeit at a more moderate pace.

The main legislation governing foreign direct investment activities is the Law on Investment and the Law on Enterprises in Vietnam. These laws came into effect in July 2006, with a view to creating a comprehensive legal framework for FDI activities and an even playing field for state and privately owned enterprises. In accordance with international standards, Vietnam has also signed and acceded to various bilateral and multilateral arrangements on investment.

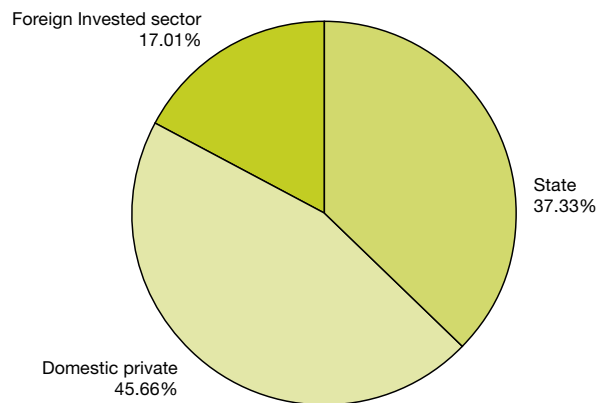
Chart 2 - Foreign Direct Investment - Projects Licensed 1988 - 2006



Source: General Statistics Office of Vietnam

By the end of 2006, there were more than 4,500 projects in the manufacturing and construction industries with a total capital of about US\$35.4 billion, accounting for 61.9 percent of the total foreign registered capital. This includes close to US\$4 billion of investment in infrastructure in designated Industrial Zones and Export Processing Zones. Investment in services has been growing in recent years, particularly in tourism, telecommunications and finance. Due to the combined effect of restructuring the local economy and inviting foreign investors, in 2006, 63 percent of GDP was generated outside the state-owned economy.

Chart 3 - Structure of Gross Domestic Product by Ownership - 2006



Source: General Statistics Office of Vietnam

The Equitisation of SOEs

The government of Vietnam is very keen to promote the SOE reform program, i.e., the reorganisation, restructuring and equitisation of SOEs and State-Owned Commercial Banks to improve their productivity and efficiency, and whenever appropriate, broaden their shareholding base too.

Since 1986, the government has pursued the reform of SOEs in three phases (restructuring, renovation and development) through the implementation of four key measures:

- (i) reform of SOE management
- (ii) reorganisation and reinforcement of state-owned general corporations
- (iii) SOE equitisation
- (iv) transferring, contracting, leasing and selling SOEs

In 1998, following the evaluation of various pilot projects run between 1992 -1997, the government formulated a detailed reform program focusing on equitisation of state companies. By the end of 2006, over 4,000 SOEs had been restructured: more than 3,000 of these were equitised and the remaining were transferred, sold or merged. In line with the expectations of the government, many indicators point to the improvements in the financial performance and productivity of equitised enterprises. At the end of 2005, small and medium-sized enterprises accounted for 77 percent of all equitised SOEs, however the government has also been prompting larger enterprises to equitise. The target for 2007 calls for the equitisation of a total of 550 SOEs, including 20 big enterprises and the government has stated that its aim is to complete the equitisation of all SOEs by 2010.



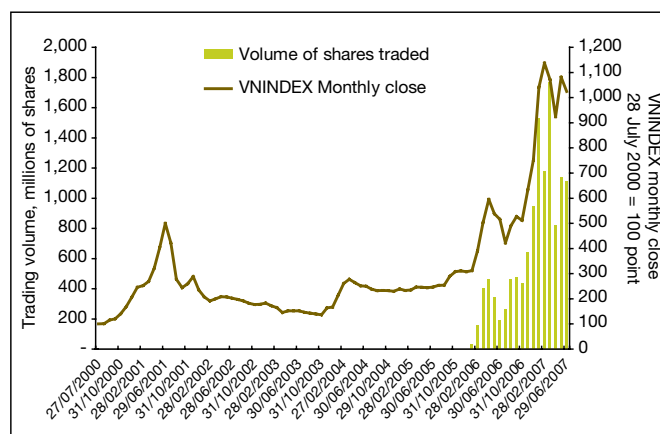
The equitisation of SOEs in the first instance creates a legal operating framework and thereafter generally leads to partial, controlled privatisation. Although the state generally remains the dominant shareholder, in most cases managers, employees and trading partners also become shareholders. As such, equitisation paves the way for better performance due to the direct economic incentives of managers and other stakeholders. It also increases the opportunities for M&A activity by strategic or financial investors via over the counter deals as well as the stock exchange.

The Emergence of Stock Exchanges

As part of the economic reforms and the equitisation process, Vietnam has been developing its capital markets too. The State Treasury was set up in April 1990 and issued its first securities the following year. In 1996, the State Securities Commission was set up as a governmental agency charged with organising and regulating the securities markets. The first ever stock exchange on Vietnamese soil, the Ho Chi Minh City Securities Trading Centre opened for business in July 2000. The market opened with only two listed companies at a combined market capitalisation of US\$28 million. Initial trading was extremely thin and in fact until March 2002, the market only traded on alternate days. By the end of 2005 the number of companies listed had grown to 32 and the total market capitalisation had increased over ten times. During 2006, largely due to the year-end expiry of favourable tax legislation, companies rushed to the market and the STC closed the year with 106 listed companies and a total market capitalisation of US\$9.3 billion. By the end of June 2007, market capitalisation surpassed US\$14 billion. Whilst the possibility of the bubble bursting became a daily conversation topic and of definite concern to the government, the fortunes made by some investors has prompted company managers and others to invest time in learning more about the role of the stock exchange in a market economy. No matter how share prices move in the short term, we believe that this increased attention ultimately paves the way for further development of the Vietnamese economy and will create a steady stream of investment opportunities to foreigners. Chart 4 shows the trading history of the Ho Chi Minh City Securities Trading Centre. (Trading volumes of shares are not available before 2005)

A second market, the Securities Trading Centre in Hanoi opened in March 2005. Whilst the importance of this market is well below the Trading Centre in Ho Chi Minh City, interest in Hanoi has also been growing impressively recently and it is reasonable to expect this trend to continue.

Chart 4 – VNINDEX Monthly Trading Volume and Closing Values



Currently, foreign investors may acquire up to 49 percent of a listed company and 30 percent of a non-listed company. Bonds may be freely held. The government is drafting a new regulation to revise the limits of shares held by foreign investors in listed and non-listed companies based on Vietnam's commitments under bilateral and multilateral international treaties. Under Vietnam's WTO commitments, after one year from the date of accession to the WTO, the 30 percent foreign equity limit for acquisition of Vietnamese enterprises shall be eliminated (except for the acquisition of shares of joint stock banks and a number of certain sectors designated as strategically important).

Summary and Outlook

Whilst geopolitical circumstances prevented Vietnam to join the original group of Asian Tigers, the economic renovation initiatives collectively referred to as Doi Moi have put the country on a very rapid growth track, which economic commentators generally agree is maintainable for the foreseeable future. As in all emerging markets, formal and informal practices of doing business and conducting mergers and acquisitions are changing at a breathtaking pace and are not always in line with more mature economies. The rush to capture market share in a country of 85 million people and to participate in the development of Vietnam's economy across all sectors is undeniable. Vietnam has clearly become a very credible investment destination alongside other emerging markets in Asia such as China and India. We expect continued interest in Vietnam both from the key Asian investors, many of whom already have a foothold in the country, and increasing interest from multinationals from Europe and North America.

