Vietnam Private Sector Development Policy Note

Availability, affordability, and administration

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Private Sector and Land
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A Private Sector Development Policy Note

Hanoi, May 2004
Abstract: Access to affordable land continues to be one of the most important obstacles affecting domestic private sector development in Vietnam. The October 2003 Amendment of the Land Law brought some improvements, but in practice private sector access to land will remain difficult due to problems of scarcity and affordability and cumbersome administrative procedures. This Note aims to disentangle the complex subject of the domestic private sectors access and use of land; separating legislative, administrative and physical availability issues, and thus help clarify the policy debate around the land issue.
Acknowledgments

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Executive Summary

Domestic private firms demand for land, outstrips the land available by multiple times. With the introduction of the Enterprise Law in 2000 the number of private enterprises in Vietnam has increased more than three-fold. Parallel with the rapid growth of business activity there has been a strong growth in demand by private firms for suitable industrial and commercial land upon which to locate their factories, warehouses, offices and retail outlets. However, finding access to land has become one of the most difficult tasks for Vietnam’s private enterprises, new and existing alike. In Hanoi, in the 8-year period from 1994 to September 2002, only 147 private enterprises succeeded in leasing land from the City, which is less than the number of applicants for land in the first 10 months of 2002 alone. Perhaps the highest impact opportunity for the government to stimulate private investment and employment through firm growth at this stage in Vietnam’s development is precisely with policies and actions that would facilitate private sector access to affordable land.

Private sector access to land suitable for manufacturing is constrained more as a result of practical considerations than legal constraints. There is a physical shortage of available land because (a) existing industrial land is already occupied, mainly by State owned enterprises (SOEs) who have no incentive, nor legal means to sell or legally sub-lease to the private sector (b) the “creation of new” industrial land through the rezoning of agricultural land to industrial land by provincial governments has proven to be very controversial and slow over the issue of land compensation. Thus the “flow” of available land (mostly newly zoned industrial land) that comes on to the market is well below demand. Firms applying for industrial land are required to go through complex and long-winded procedures, which typically take 2-3 years and more often than not, reportedly involve corruption.

1 Report from Architect Pham Cao Nguyen, Director of Hanoi Land & Housing Management Dept, Nov 2002 Conference “Land for Production & Business”.
Even for office and retail space, private firms in major urban centers are reporting considerable difficulties in finding suitable premises. The lack of a real estate market means that there is no easy way for firms to find premises for rent, and the space that is available tends to be rented only on a short-term basis at high rental costs, reflecting years of extensive price escalation in urban centers and the expectation of further increases. Many service sector firms are forced to move frequently and many private firms wanting to invest or expand their manufacturing capacities are subjected to years of delays or simply cannot access land to do so.

For the lucky few able to find or be “allocated” land the next issue is price. Land in industrial zones with good management and infrastructure is beyond the financial capacity of most domestic private firms as they require the payment for the full term of the lease period upfront (up to 50 years). Whereas the industrial zones with lease fees/rents in the affordable price range for domestic firms, usually have very limited infrastructure and are not “cleared”. Hence in addition to the cost of the lease fees, firms have to pay for the land clearance (compensation plus ground preparation), the installation of the necessary infrastructure, on top of the factory construction costs. The combined upfront investment costs create an effective price barrier to entry for many private firms.

Land clearance in newly created industrial zones is a highly uncertain process that typically takes years, further delaying firms access to land that they have already been “allocated”. Prices to compensate the agricultural households moving off the land can increase after they have been “agreed” and in some cases the land allocation has been revoked. The residual options for domestic private firms who can’t get land allocated or afford the cost of industrial zones, are to lease land informally from communes, households, or un-officially from SOEs, all of which carry uncertainty of tenure and higher costs of doing business as rental expenses are not tax deductible.

SOEs are crowding out the private sectors access to land. SOEs are on land they have been allocated for a specific use, and do not have the right to sell/transfer the land nor, without special permission, to sub-let the land. Moreover, even if they were legally able to sell the land-use rights (LURs) they have no incentive to do so, as they could not keep the proceeds from the sale. At present the land of SOEs is not accounted as an asset, so the SOEs are not concerned with optimizing the return on this asset. Thus a lot of invaluable land is lying idle in hand of SOEs, who have no incentive to return land to the State, and the State lacks the
capacity to enforce its return. Many private enterprises are informally subleasing land from SOEs, but in such cases, the State cannot claim any revenue tax from the SOEs, and the private firm cannot claim the rental as business expenses. Government should further consider the advantages and disadvantages of enabling SOEs to sell/sub-lease land, within clear limitations, as part of the overall package to reinvigorate effective SOE reform, and level the playing field.

The result of these access and affordability constraints to land is that only a select few private firms hold LURs in the name of the firm. Beyond delaying firms’ ability to expand production or capture new market opportunities, the land constraint has crippling implications for the firms’ access to other key resources. LURs are at the center of firms ability to access commercial finance as commercial banks in Vietnam typically insist on LUR as collateral from private firms to underwrite their loans. Similarly foreign firms promising new technology and looking to form joint ventures with Vietnamese firms typically only want domestic partners who can provide land. Major constraints on domestic private sector access to land, limits their access to finance and new technology through joint venture partners, and is detrimental for the development of Vietnam as investment levels and job creation is held-down below its potential.

The recent Amendment of the Land Law ushers in many important changes in the legal regime for land and its’ administration, some of which are relevant for private domestic firms. The enactment of the Amended Land Law (July 2004) should (i) speed up the registration of land legally occupied by generally switching to a “registration” system through a network of district Land Registration Agencies (LRAs), and setting time-limits on several of the administrative procedures involved (ii) strengthen State’s management by putting more enforcement for the recall and reallocation of underutilized land that was granted by the state; (iii) introduce a land allocation system for businesses, where-by the business pays a lump-sum land use fee in exchange for full land use rights, including the right to transfer, to guarantee, and to contribute land as capital; (iv) provide a green-light for the real-estate market by defining the potential products and recognizing the rights of participants in this market, and (v) introduce a more market-oriented mechanism to “price” land.

But the Land Law amendment does not really address the fundamental issues constraining formal private sector access to affordable land. It is unlikely that the amendment will increase the incentives or ability of SOEs to
give-up land or increase the availability of affordable newly zoned industrial land; nor will it reduce the high up-front costs and uncertainty faced by the private sector. Thus it is unlikely that the amendment will have a significant impact in making land more accessible and cheaper for private businesses.

With severe constraints on its access to land; the ability of the private sector to contribute to Vietnam's growth and employment generation is compromised. The current disadvantage that the private sector faces in respect to this critical resource means that Vietnam's resources are not allocated to the most efficient use, and perpetuates unfair competition between the private and SOE sector.
Private Sector and Land

Availability, Affordability, and Administration

Introduction. Land is and will remain a highly charged reform issue in Vietnam. It is a subject of great confusion and contradiction. The purpose of this Note is to (i) disentangle the complex subject of the private sectors access and use of land, and thus help clarify the policy debate surrounding the land issue, and (ii) heighten awareness of the difficulties private sector faces in accessing and using land and how this situation compromises and distorts the development of the private sector. This Note tries to predict the impact of the recently amended Land Law on the private sector. It determines that while the revised legislation makes some improvements especially in terms of administration, as it does not tackle the fundamental issue of the lack of available land for businesses, it will fail to resolve the problem.

This Note is not designed to, nor does it attempt to provide recommendations of reforms to alleviate the problem of private sector access to land. Any land reforms will carry with them significant ramifications for many groups in society and involve sensitive issues such as resettlement. Accordingly, a multi-sectoral approach should be adopted to elaborate and prioritize reforms in the land allocation system, taking into account the affect on rural population, the SOE reform program as well as private sector. This Note, more narrowly presents the private sector perspective, as an input to this larger policy issue.

Over the past decade the legislative framework for land has evolved considerably. The first law on land, considered a landmark improvement when it was introduced in 1993, was drafted at a time when there was virtually no private business in Vietnam. This Law did not address several key issues such as the pricing of LURs; it failed to provide clear responsibilities of related authorities in processing LUR
requests, and; to develop an effective mechanism for re-zoning /change of land use purpose. As a result, the availability of land continued to be very scarce and subject to the discretionary power of officials, thus providing fertile ground for corruption and the development of an informal real estate market. The market has witnessed two periods of intense “land fever” speculation in the Hanoi and Hochiminh City areas, in 1995 and in 2000. As a result the per-meter price of land in Vietnam’s main urban centers is now among the highest in the world relative the GDP per capita.

After a revamp in 1998, the Land Law was revised again in December 2003, to come into effect from July 2004. While much will depend on the Implementing Guidelines yet to be issued, the amended law is expected to give the LUR more characteristics of a real commodity (while retaining the principle of public ownership of land); to speed up LUR granting; to reduce the gap between administrative and market price of land (LUR) by officializing the real estate market, and; to strengthen the State’s administration of land. However, as discussed in this Note, it appears overly optimistic to expect the amended law to significantly improve private sector access to affordable land.

1. Availability: Access to Land

By Constitution and Land Law, land is of all people’s possession. However 100% of urban and agriculture land has now been given to either individuals or organizations for effectively permanent use, so there is effectively no “vacant” land available. In practice the only source for businesses that need “new” land is to

(I) get provincial authorities approval to lease land, mainly in areas zoned for industry (IZ), or

(II) buy/sub-lease it directly from current occupants,

Allocation/lease from provincial authorities (Option One). For private businesses to access land through obtaining authorization from the Peoples Provincial Committee to lease land entails many difficulties and may take several years. The choice of land-location for private businesses is effectively restricted to designated industrial zones2. Typically provincial or city authorities create IZ by identifying a large area of agricultural land for conversion into an industrial zone and the sub-

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2 It is virtually impossible for private businesses to get approval to convert agricultural land to industrial land if the concerned land hasn’t already been identified for re-zoning as part of the provincial master plan.
sequent leasing of “plots’ within this zone to companies with 50-year contracts. However, the process of converting land from agricultural to industrial use has proven to be very problematic and slow. The major complication has been the disagreement by the occupying households about the proposed levels of compensation, as the example of An Khanh illustrates.

Such difficulties have limited the efficient mobilization of land and led to a significant shortage of industrial land, while there is still plenty of under-utilized land zoned for other purposes. Even in the “richer” business friendly provinces such as HCMC, industrial zoned land is limited. At present, HCMC has 17 industrial zones/parks with 1,397 hectares of leasable land, but ¾ of this combined land was already occupied/committed as of April 2004. Only 140 ha, or 10 % of the total combined area of all HCMC industrial parks and zones is available for leasing in 2004 (the balance of about 15% will be developed in the future), and as most firms would occupy at least a hectare this means that there is sufficient space for only about 140 firms this year.

Moreover, the conversion of land by provincial authorities from agricultural land is just the first step. Once a zone has been successfully re-designated for industrial use, in order for the individual firm to receive authorization to “lease” a piece of this rezoned land, the firm must go through very complex and lengthy procedures, which vary from province to province. Hung Yen for example requires businesses to negotiate directly with households to take over the land. In Ha Noi the provincial government requires businesses to commit to hiring at least 10 local persons per hectare of agriculture-converted land (similar practice in Ha Tay and many other provinces).

In a typical case, companies have to go from door to door to various State agencies including the Provincial Department for Planning and Investment (DPI) (under the Ministry of Planning and Investment - MPI), Department of Finance (under the Ministry of Finance - MoF),

**Box 1. Trouble in An Khanh Industrial Zone**

An Khanh IZ (30 hectares) was established alongside the Lang - Hoa Lac highway in Ha Tay Province (Decision 672/TTg dated 31 May 2001). Households have actively resisted this development, claiming that the land compensation was lower than the compensation paid for nearby land in Hanoi. Ha Tay PC has organized many meetings to resolve the problem but no agreement has yet been reached with all households.

About 600 (out of 854) households have now (as of Dec 2003) accepted compensation but, after more than 2 years, only 4 enterprises have completed workshops and started production. Some 21 enterprises that have been allocated and leveled their land cannot implement their projects. Long delays in resolving this issue have reportedly frightened away potential investors.

Source: Comparative Provincial Performance in Private Business Development - Dec 2003 - CIEM/UNDP

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3 HCMC Peoples Committee website.
Cadastral Office (under People's Committee - PC), Department of Natural Resources and Environment (under the Ministry of Natural Resources and Environment - MONRE), local (commune) authorities, and provide extensive unofficial payments. Under a typical scenario the whole procedure would take between two and three years to complete and incur considerable hidden costs along the way.

One of the key improvements in this time's Amendment to the Land Law for the private sector is expected to be the establishment of the LRA system. The LRA is intended to create a one-stop shop for all requests relating to land, except for the initial application stage. While it is not clear that the new land law will increase the private firms chance of getting "authorization' to lease land (the "hard" part), but for those businesses that succeed the subsequent paper processing should be smoother and faster as a result of the amended Land Law (see section on administration). Whether the Government will be able to demonstrate an effective enforcement of these deadlines when the Law comes into effect this July remains to be seen. To affect these changes significant capacity building and institutional strengthening support will be necessary.

The current draft Implementing Guidelines to the Amended Land Law provide a glimmer of hope that the "supply" of new land will be increased. In an effort to increase the availability of land for industrial use, the draft Guidelines states that each province would set up a "Land supply development" agency (belonging to the provincial PC). The task of this new agency would be to gather possible land through a range of measures including conversion from agricultural land, recalling from SOEs, and providing a buy-back option to LURs sellers who fail to find a buyer on the market. The Agency would also organize land auctions and introduce land to potential investors. However, as these Guidelines are only in draft form, it is too early to be confident that these provisions will be in the final version of the Guidelines, let-alone speculate on whether they would make a difference in practice, or prove to be yet another good proposal that didn't eventuate in practice.

Buying /sub-letting from current occupants (Option Two) It is also difficult for private businesses to access land by buying/sub-leasing it directly from the current occupants, because the vast majority of current occupants of suitable industrial land (i.e., larger than a household
sized plot) are SOEs, who have no incentive, nor the legal means to “sell/sub-lease” the land to private businesses.

The Hanoi province provides a stark example of the magnitude of the land access disadvantage between private and SOEs. Reflecting the fact that most available land in Hanoi is already allocated, only 428 new rental contracts covering about 3 million m$^2$ were issued between 1994 (after release of 1993 land law) and Sept 2002, of which more than half of this new rental contract were for SOEs.$^4$ As the following diagram illustrates, SOEs occupy an overwhelming 95 percent of land under lease to organizations in Hanoi, leaving less than 5% to private firms and other non-agricultural cooperatives/production groups.

To add “salt-to-the-wound” a huge amount of land is either under-used or unused by SOEs. By law, SOEs are required to return any unused land to the State and cannot sublease the land they have been granted to any third party. But procedures to take back such land that could be leased out to the private sector have been insufficient and ineffective. And in practice many SOEs are informally renting their land to private enterprises at a negotiated rate, usually several times higher than the official leasing rate from the State. The current draft of Implementing Regulations for the Amended Land Law is attempting to address this problem of idle or misused SOE land. According to the current draft the Government will require all SOEs to apply for the LUR certificate and during this process, land that is unused or not used for the purpose it was originally allocated for, would be recalled. The practical limitation of this new regulation will be the States ability to make SOEs apply for LURS. The draft Implementing Regulations also indicate that in the future land will not be allocated without land use fee to SOEs or any commercial organizations, which should help level the playing field.

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$^4$ Report from Architect Pham Cao Nguyen, Director of Hanoi Land & Housing Management Dept, Nov 2002 Conference "Land for Production & Business".
Government should further consider the advantages and disadvantages of enabling SOEs to sell/sub-lease land, within clear limitations, as part of the overall package to reinvigorate effective SOE reform and level the playing field. Requiring SOEs to treat land as the extremely valuable asset it is, would help optimize use of this asset. Selling/sub-leasing the land could also provide an important source of investment finance to support SOEs efforts to restructure and become more competitive.

For firms that cannot access land in IZ, and are not able to buy large pieces of land from households, one of the only remaining options for many private enterprises is to informally sublease land from SOEs, which carries great uncertainty and dilemmas for the private firm. SOEs are not legally permitted to sublease their unused land so they do so informally on the condition that they can recall the land whenever they need to (e.g. due to checking from their superiors). With such uncertainty on the term of the lease private firms avoid making any investment, or even a long business plan on the property. Another consequence of this "unofficial" arrangement is that private firms cannot formally declare business expenses (for taxation purposes) relating to land under sublease from SOEs such as rental and electricity. These expenses can be quite significant for private firms, and thus constitute a competitive disadvantage.

Another informal practice private firms currently use to circumvent the lack of access and complicated procedures, is to lease land directly from households and to build their factories with approval from local commune only, but this practice entails a huge risk of the land being confiscated in the future if the higher authorities (district, provincial, or State) have plans to use the land for other purposes.

Because of the fundamental importance of land, the private sectors land-access disadvantage permeates through to all other aspects of the firms business, compared to state owned firms. For example, it detrimentally affects private firms ability to attract new technology and form joint ventures with foreign partners (where LUR is usually the contribution of the domestic partner), or to raise investment and working capital (where LUR as collateral is typically required).

The amended Land Law is unlikely to substantially affect the fundamental issue of the amount of land available, as it does not provide a persuasive mechanism to flexibly convert agricultural or other purposes land use purpose, partially as a result of the very limited availability of land through official sources, and partially as result of the limited enforcement capacity of the government to deal with land use violations.
categories into commercially available land. In this sense the “supply” of land will still depend on provincial governments willingness and capacity to convert land for industrial use. (If the proposed guidelines to introduce provincial “Land Supply Development Agencies” come into practice, this could help). Nor will the amended law alter the reluctance of provincial governments to move farmers off their land, nor their ability to finance the land clearance /farmer compensation to prepare the industrial zones. The extent, to which the amended law will provide a mechanism to effectively transfer un-used land currently used by SOEs to private enterprises with plans for a better use, also remains unclear. Most likely, the officially available land will continue to be insufficient to meet demand, and private domestic firms will have little option but to continue their informal and high risk practices to “acquire” land.

1.1 Access to premises for the Firms in the Service Sector.

In economic centers such as Hanoi and HCMC, finding a spot in a decent office building is too expensive for most local private enterprises. Their only option is to rent from households or SOEs with a rate from 2-10USD/sqm/month, but with significant risks:

- Businesses renting premises from households can only claim rent as a tax deductible expense if the landlord has declared the rent as part of his/her income. Landlords are reluctant to declare this rental income as it would increase their personal tax liability, and require them to go through the hassle of cumbersome tax procedures (e.g., monthly visits to the local tax office to buy an invoice to issue to the tenant). In the current “renters” market (shortage of office space) landlords often tell the firms to “take it or leave it”. As a result, many businesses cannot officially report rent as a business expense.

- As SOEs cannot sublease their property officially, they cannot issue formal invoices, and therefore the private business cannot claim it as a business expense.

Box 2. Struggling for a Spot In Big Cities

Hanoi at present (as of March 2004) has 185,000spm office for rent, of which only 1,400spm is still available (occupancy rate of 99 2%). In the next 2 years the total rental area in Hanoi is expected to grow to 250,000spm only (two new office building may soon be in use are the Ocean Park and Ever Fortune Plaza, totaling about 56,000spm).

In HCMC, according to recent study by CBRE Vietnam, current average office rental in the city (including service charge and tax) is about USD 28.05/sqm/month, increasing 5-10% from 2003. This level is 5th in 15 big Asian cities, chasing after Tokyo (102.38USD/sqm); Hong Kong (32.19USD/sqm), Mumbai (34.77/sqm) and Seoul (29.28USD/sqm). Occupancy rate for C-type offices (10-15USD/sqm/month) is also 95%.

Regardless of whether the landlord is SOE or private homeowner, rental of this nature is usually short-term and instable. The typical lease term is one year without guarantee on the next year's continuation. Landlords understand the lessees' difficulties in moving their businesses around (losing contact with customers, losing a proven location for good business, losing investment in furnishing and office fixtures, etc) and in many cases take advantage of that to increase the rent unreasonably.

Facilitating or encouraging private investment in the construction of office space for private firms, with a reasonably good location and affordable rental would be a practical way the Government could help local businesses, and should be considered in the urban planning process.

2. Affordability: The Price of Land

In Vietnam, there are effectively two prices for land— the official price and the unofficial “market” price. The official price of LUR (which is actually the compensation rate for land when recalled by the State, regulated by Decree 22 (1998)) is set by the Government, and varies according to a number of criteria, including the intended “use” of the land (i.e. business line), and who are the leasing parties. This “official” or “administrative price” has no relation to the market price; i.e., the price individuals or enterprises are willing to pay for the land, which is typically several times higher than the official price in urban centers. As a result of the huge price discrepancy between the “very cheap” official price, and the very “expensive” unofficial market price, the ability to buy LUR (lease land) directly from the Government is considered a privilege that few very favored private enterprises can enjoy. Obviously with such a potential financial gain to access land officially this is fertile ground for corruption.

Speculation on LUR prices in urban areas has been common. The experience of the last 10 years has created the popular belief that the value of LUR always goes up, sometimes bringing in great windfalls for speculators. The dearth of other investment options in Vietnam,

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6 It is popularly estimated that about 80 percent of all land transactions take place on the unofficial market. Many households and small businesses tend to informally transfer LUR among themselves, resulting in extensive miss-match between the actual current user of the land and the paper records. Many land transactions are not registered with provincial Department of Land Administration (DLA). Obviously, without the certificates the landholders cannot use this land as collateral. Moreover, as this trading has been unofficial, no legitimate real estate industry has been able to develop, which could provide market information and thus bring much needed transparency to the land market.
and fear that the local currency will depreciated have created a tendency for many people to quickly convert any large enough sum of money they have into LUR. The land market in Vietnam is therefore very volatile, and a land fever can occur anywhere shortly after a new development plan is released (which sometimes turn out to be just rumors).

The new amendment to the Land Law attempts to significantly reduce the difference between the market and administrative prices. It stipulates that land prices shall be determined either by (i) Provincial PC’s (ii) auction of LURs (iii) agreement among land users and concerned parties (with some limitations), and (iv) the price registered by the owner, provided that it is within the price-frame of the State. From the private sector perspective, open public bidding is particularly welcomed and has been successfully piloted in the case of LUR for urban estate development projects in Hanoi and HCMC. Extending this pilot to land for commercial use, such as manufacturing, services, and office-space, would be a welcomed move.

Importantly, the intention of the amendment is not to let the “market” determine the price of LUR; this will continue to be under the control of the State. But in the future the State is expected to calculate the price of LUR “close to market value” (“based on market in normal circumstances”; the question is how to eliminate the abnormal or to know what price the market would determine). The Implementing Guidelines are expected to provide guidance on how this determination would be made; one possibility that MONRE is considering is to take the average market price over a number of years, but as there has been no records kept of the “market” (unofficial) price over the last few years, such a formula would be difficult to implement in the first years and subject to much official discretion. Pricing of LUR is one of the most awaited issues in the implementation guidelines.

A notable characteristic of the Amended Land Law is that the land prices stipulated by the Provincial PCs shall be published January 1st of each year. Owners of LURs will be required to register their land
prices with the PCs and to re-register them when the land price has appreciated as a result of investment or a state decision to adjust land prices (which it is likely to do on an annual basis). This registered price will be the basis used to calculate all financial obligations (i.e., fees, taxes).

The government is attempting to discourage speculative investments and multiple land transactions, in order to stabilize land prices, through legislation and specifically high taxes. Under the Law on Income Tax and the new Ordinance on Personal Income Tax of High-income Individuals, planned to be effect from 1 July 2004, individuals or businesses who make a gain on LUR transfer will be taxed on the added value with a rate as high as 28% (i.e. cum capital gains tax) in addition to the LUR transfer tax of 3 percent of the LUR value. While this approach is consistent with international practice and should help level the playing field, in practice this policy could backfire. It is possible, that in an effort to avoid this tax even more land transactions will be carried out unofficially. For this reason, it may be useful to consider other taxation approaches, such as the New Zealand practice, where income tax is only applied to gains made from the sale of land that was brought with the intention of resale (i.e., not for investment/use).

Arguably, it is unrealistic for the State even to attempt “control” the land price, which would only be possible if State could control the supply and demand in the market, (i.e. has sufficient reserve of land to sell to the market when the price gets too “hot”, and available capital to buy back land when market needs a push). In practice the Government does not have a reserve of “marketable” land, as all such land is occupied either by individuals or organizations, who will demand market based compensation prices for any land recall.

The importance of the land affordability issue for the private sector depends on the type of land the private sector needs and its location. The price factor is critical for service sector businesses, such as retail outlets and offices servicing the public as these business need to be located in high-pedestrian-count locations such as inter-cities. It is these urban areas that have witnessed exponential increases in the price of land over the last decade. The m<sup>2</sup> cost of land in Vietnam main urban centers is now among the highest in the world, and certainly compared to the per capital income (see Box 2). These arguably inflated land prices have resulted from more than a decade of severe limitations in access to land in the face of a rapid increase in demand,
artificial administrative prices providing the opportunity for a lucky few to buy land well below market price, speculative trading of land, the dearth of alternative investment opportunities (e.g., effective stock-market) and probably a degree of corruption/money laundering.

For manufacturing firms (beyond the small scale workshop located in household property), access to land in the urban centers is effectively out of the question as there is virtually no “good-scale” vacant plots available, so trying to obtain land in industrial zones is their best option. In general, IZs have not been the target of the multiple land transactions/speculation as seen in the urban centers, and therefore the m² price tends to be relatively less of an issue, than getting “access” to the land, (which involves significant unofficial costs). The formal price nevertheless remains an important consideration for many firms, especially in well-located IZs with good infrastructure. At one end of the continuum, full-infrastructure IZs targeting FDI firms are beyond the price range of the vast majority of domestic firms. At the other end of the continuum, the leasing cost of industrial zones in remoter areas is not an issue; here the eligibility conditions (e.g., minimum employment requirements and local material input levels) and the increased cost of doing business due to the remoteness become the main concerns.

Table 1: Land Leasing Costs in Industrial Zones In Selected Provinces.

<table>
<thead>
<tr>
<th>Province/name of IZ</th>
<th>Distance to major city and/or port</th>
<th>Average price per m² of LUR with infrastructure</th>
<th>Conditions to lease land in the IZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hanoi</td>
<td>On the city’s outskirt</td>
<td>$1.2/m²/yr ($12,000 per hectare) plus $0.5-1/m²/yr for infrastructure</td>
<td>None</td>
</tr>
<tr>
<td>Dong Nai - Song Mai IZ</td>
<td>45km to HCMC</td>
<td>USD 1.54/m² or $15.400 per hectare</td>
<td>None</td>
</tr>
<tr>
<td>Phu Yen - Hoa Hiep IZ</td>
<td>About 600-700Km from HCMC</td>
<td>$0.2/m²/yr plus $0.1/m²/yr for infrastructure - so USD 3,000 for 1 hectare plus up to 10% for broker fees</td>
<td>Employment of average of 300 workers, Export turnover of ever USD$ 5million/yr, 40% of local raw materials to be used for production investing in encouraged sectors</td>
</tr>
</tbody>
</table>

Source: Staff research, various Peoples Committee’s Websites.
Affordability also depends on how much the private firm has to pay up-front. Different IZs have different policies regarding payment. Most high-end IZs request the land users to pay a lump sump for the whole term, while some IZs catering for small- and medium-enterprises (SMEs) may allow annual rental payment.

*In addition to the land leasing costs, private domestic firms are often required to pay the ground clearance costs* (mostly the compensation for existing residents), except in the industrial parks and zones with a management company. Provincial Departments of Finance and Pricing (DFP) have the responsibility of setting fair prices for the transfer of different categories of land, a basis for compensation payments. The authorized prices rarely reflect the market realities, and provide opportunity for corruption and speculation. Moreover, the compensation price set by the province and sometimes is not accepted by current residents (mostly farmers), who react by preventing the investors to proceed with the construction (see An Khanh case). According to a recent study by the CIEM, in some cases such as Trung Trac, Hung Yen, local authorities have even introduced retrospective policies requiring investors to pay additional compensation some years after acquiring LUR. In contrast, to the treatment of domestic firms, the local provincial or city PC assumes responsibility for the site compensation and clearance, and completing other procedures required for foreign invested projects.

For other provinces that are trying to lure investors, the PC usually uses the provincial budget to finance the compensation payment and build some infrastructure for investors, in exchange for which business need to commit to use local labor. Other incentives such as delayed rental payment are also common.

3. Land Use/ Ownership Rights.

If a private firm is lucky enough to be able to access and afford to lease land the issue then becomes what rights the entrepreneur enjoys in respect to that land. While the Law stipulates that land is under the possession of the public and is not allowed to be traded; it also states

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**Notes:**

7 Investors have to pay current residents for the crop-compensation fee (if conversion from agricultural to industrial). In theory this compensation would at least equal to the accumulated value the land would deliver in the leased period (20-50 years) had it been used for agriculture. Even though the province has regulated the rate, many residents do not comply, arguing the rate is too low. Interference from local authorities in this case is both weak and delayed, leaving investors with no choice than to pay some extra to the residents.

8 Comparative Provincial Performance in Private Business Development - Dec 2003 - CIEM/UNDP
that the users of land have the rights to transform, transfer, inherit, mortgage, pool, lease, and sublease the LUR at freely negotiated prices. The term of the lease/allocation, “ownership” rights and the payment requirements differ significantly according to the type of owner. In the case of private firms this depends also on their payment terms (whether they pay annually or in a lump sum) and whether they are foreign or domestic. Many small businesses in Vietnam use the land of their owner(s); i.e., the “Household” land in the individuals name rather than the company name. The advantage is that the term of the land use is effectively indefinite, and they can enjoy full ownership rights (see Table 3), if they have the certificate. In practice many household do not currently hold certificates for the land they occupy, but the amended law is expected to greatly accelerate the granting of LUR to households.

The amended law also introduces a welcome feature for householders-cum businesses as it will address the relatively frequent occurrence when a family-turn-into-company wants to capitalize their residential houses or bring it in as capital contribution in joint-stock (JS) relationship (households cannot enter a joint-venture with foreign partners). The amended law provides a solution of temporarily converting the residential land into commercial land with the term indicated in the JS Company’s charter (up to the limit of commercial land used set by the law). The value of that converted land will be decided among the company founders. All rights of the company regarding that piece of land (use, sublease, transfer, mortgage, guarantee) would be limited to that term only, after the term matures, the piece of land would be converted back to residential status and returned to the original owner. This flexible approach seems to provide a way out for a dilemma that many SMEs are facing, which is that entrepreneurs cannot use their most valuable asset (their houses) as capital or collateral to obtain funding for their SMEs, or to report business expenses (for tax purposes) when they use their house for business.

In respect to private businesses, the ownership rights they can exercise is relatively more complex and depends on a number of factors, (as illustrated in the following table). The first consideration is whether the private firm is domestic or foreign as this limits the options available. Next it depends on whether land was leased or allocated and whether the LURs are paid for on an annual basis or lump sum.
Table 2: Ownership Rights Enjoyed by Private Businesses (Based on the amended Law)

<table>
<thead>
<tr>
<th>Allocated Land</th>
<th>Leased Land</th>
</tr>
</thead>
<tbody>
<tr>
<td>(usually cheaper than lease)</td>
<td></td>
</tr>
<tr>
<td>without land use fee</td>
<td>with land use fee (pay full-term in advance)</td>
</tr>
<tr>
<td></td>
<td>with annual payment</td>
</tr>
<tr>
<td></td>
<td>with one lump-sum payment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Domestic private firms</th>
<th>Option not available</th>
<th>Option not available</th>
<th>Option not available</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>full rights on LUR: transfer, lease, JV, collaterize, participate in real estate market</td>
<td>no right on land</td>
<td>full ownership rights on property on land</td>
</tr>
<tr>
<td></td>
<td>full ownership rights on property on land</td>
<td></td>
<td>(term depends on lease)</td>
</tr>
<tr>
<td></td>
<td>almost automatic renewal upon expiry of term (50-70 years)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign private firms</td>
<td>Option not available</td>
<td>Option not available</td>
<td>Option not available</td>
</tr>
<tr>
<td></td>
<td></td>
<td>full ownership rights on LUR: transfer, sublease, collaterize *, participate in real estate market</td>
<td>full ownership rights on property on land</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Term depends on lease, renewal will be considered on application.</td>
<td>Term 20-50 years, (70 years in exceptional cases), renewal will be considered on application.</td>
</tr>
</tbody>
</table>

In simplified terms, the private enterprises (whether they be domestic firms on allocated land, or foreign firms on leased land) that have paid the lump sum in advance can enjoy full ownerships rights for that term. But obviously the financial implications vary significantly with these options. For private firms that have:

9 Due to the "public ownership nature of land in Vietnam, it is impossible for businesses to mortgage their LUR with international credit institutions."
Leased land on annual payment: The length of the term depends on the lease, and the rental cost depends on both the location and infrastructure, but are usually relatively high. The land use tax is typically included in the rental, and if land is already pre-cleared there are no compensation costs.

For the private domestic firms (this option is not available for foreign firms) that have:

- **Land allocated with “Land Use Fees”** is an expensive option. In these cases, private firms (i) pay a lump sum for the land use fee for the full term usually 50 years plus, and (ii) an annual land use tax: based on type of land and ranges from several hundred to several thousand VND per sqm. (The draft Land Use Tax Law suggests a common land use tax for all kinds of land at 0.2% of the official price of the land). Other costs may also be involved, such as compensation and land clearance (depends on province, some provinces deduct the compensation into the land use fee, others do not).10

For the foreign firm (option not available to domestic firms) that has:

- **Leased land paid in lump sum (foreign firms only).** In theory this option is very similar to allocated land with land use fees in the case of domestic firms, in respect to the ownership rights, but tends to be considerably more expensive (Rentals ranges from USD12,000 to USD20,000/ha per year; paid in a lump sum payment = USD600,000 to USD1,000,000 for the 50-year period). FDI firms are “introduced” to industrial parks only, therefore compensation, infrastructure cost and land use tax are already built-in the rental.

In the case of domestic firms it seems that the amended Law will provide them with the flexibility to select between paying for the whole term in advance, so that they can enjoy the LURs for this

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10 As an indication of the costs involved, the estimate land use fee (for IZs in and surrounding Hanoi): is about USD2,400-2,700/ha per year for industrial land. For office and residential housing development projects the current price for Tay Ho District in Hanoi is as high as USD1,700/sqm. The estimated cost for compensation (for conversion from agriculture land): even though the bases to calculate this cost is the future incomes from the crops (had the land continued to be farmed) for the whole allocation period (50 years), in practice the cost varies from location to location, ranging from around USD24,700/ha (Chuong My, Ha Tay) to USD35,000 (An Khanh, Ha Tay) and can be as much as USD70,000 (later compensation request in An Khanh).
Box 3. Using Land as Collateral: Mechanisms for Banks to Take over LURs from Defaulting Firms.

When a bank grants a loan to a client with LUR as collateral, it keep the original LUR certificate. In case the client cannot playback the loan the bank can process in two way:

1 Negotiate with the debtor on the tranfer of the LUR to the bank, for subsequent liquidation. In practice this direct negotiation approach is rarely used, as it tends to involve prologed negotiation that is only settled if the bank accepts an overvalued evaluation of the asset.

2 The more typical mechannism used is for the bank to take the case to court and seek the permission to liquidate the asset. for LUR the law requires the bank to openly auction the property ( cannot privately sells the LUR as with other kinds of collateral). If the collateral’s liquidated value still less than the loan, the bank would seek the court’s approval to confiscate the debtor’s other assets.

Another good feature for private firms under the amended Law is that it states that LUR can be used as capital contribution or mortgage in economic relationships within the effective period of the LUR. However, the Law limits the lease term for industrial land to no more than 50 years in common cases and 70 years in exceptional cases (which will be amortized during the use period), which will make it difficult to use it as mortgage during the latter part of the term.

The new amendment also provides additional flexibility to address special situations such as early return of land or bankruptcy (withdrawn before term ends etc). In other aspects, it is still unclear how the amended Law will be applied; for example, if a land user contributes LURs as equity to a joint venture (domestic or foreign) must they convert the LUR to a land lease. It is hoped that the Implementing Regulations will provide clarity on these issues.

11 The draft decree proposes that domestics organizations that have “purchased” non-agriculture LURs from other land users and have paid in full do not have to convert their LURs to a land lease.
Box 4: Land Use Rights: Terms and Conditions for Households, SOEs and State Agencies.

Households. Residential household with the Certificate of LUR (Red Book), the owners have right to (1) exchange (2) transfer, (3) lease, (4) bequeath, (5) gift, (6) mortgage, (7) guarantee and (8) contribute capital by LURs and (9) for compensation in the case of land recovery by State. Households enjoy an indefinite term – and pay annual fees. In practice many households do not have Red Book (for the land they are living on) but one of the main aims of the new law is to speed up the Red Book granting process).

State Owned Enterprises. SOEs do not have LURs or a “Red Book”. Land nor LURs are not regarded as an asset. SOEs are allocated land by the State by Decision on a case-by-case basis, and usually on an indefinite basis. As the Decision often refers to the land to be used by at the General Corporation (GC) level, subsidiaries under that GC often have no specific document allocating them land to use. SOEs may only use the land for the purpose for which it was allocated. They may not sell/transfer/exchange the land. SOEs need the specific permission of the concerned state agency/ministry to sub-lease the land (in practice many SOEs do this informally). A nominal annual use fee is paid for the land SOEs occupy, either by the SOE itself out of its cash flow, or by its line ministry (so, from state budget). In theory if SOE are not using their allocated land, they must return it to the State; however, in practice this rarely happens (the amended Land Law tries to deal with the idle land issue by saying the State will force SOEs to return unused land, but provides no details on how to define a piece of land as unused, or how the enforcement would be conducted).

The new Law allows for the possibility, upon permission by the competent state authority for change specialized land allocated without collection of land use fees, into the specialized land allocated by the state with collection of land use fees, so it seems that SOEs will be able to apply to convert their land from granted land to leased or rented land and enjoy the increase ownership rights associated, if they are prepared to pay.

In respect to equitized SOEs there has never been clear guidelines on the treatment of the land previously granted to them. In practice, SOEs were equitized without any value assigned to the land they occupied, so tended to be extremely under-valued (as in the case of Phu Gia Hotel) making it a much “better-deal” for the employees and management buying shares in the company. After equitization process, these companies will typically apply to convert the land they occupy to have official LURs.

Public, or state agencies are considered as “borrowers” of the land from the State and therefore do not have any right with the land, except using it under the pre-agreed purpose. The land can be recalled and reallocated (except land for religious use such as temples, pagodas etc). The term is indefinite, and they do not pay use fees.
4. Land Administration

The current administrative procedures for land are extremely cumbersome and opaque. Private firms trying to access land can expect this process to take years and involve numerous procedures with numerous different state agencies. Fortunately the amended Land Law is expected to significantly improve the administration of land in Vietnam to the benefit of all including the private sector. The Law introduces clearer and some-what simplified procedures, in most cases with specified time limits for the concerned agency to process, such as in the case of the land allocation procedure, illustrated below.

The introduction of the system of LRA from province to district level, provided for in the amendment should reduce the need of the entrepreneur to go door-to-door around the state agencies. The LRA would be responsible for the following services: all needs relating to the implementation of rights of land users, such as registration and providing LUR certificates, making and modifying cadastral maps, building and updating land information system. The LRA will report to provincial DNRE. In parallel with the establishment of LRA system, the Government would build a national land registration database and information system. Given the fact that the task starts nearly from scratch it will be a huge challenge for the Government to set it up in time, and require both capacity building and institutional reform.

For the allocation or lease of land, this will be handled by DNRE, not LRA. This application process, if implemented according to the laws design should significantly streamline the application process, and the time involved. The amendment stipulates that DNRE must respond within 3 days of receiving the application file, to inform the applicant if the application will be further processed (a good sign) or provide an explanation in case it will not be. The amendment also provides time limits of 5 days for relevant agencies (LRA, PC) to complete their part and return the application to DNRE.
Figure 3: Procedure for Land Allocation & Lease under Amended Land Law.

<table>
<thead>
<tr>
<th>Firm</th>
<th>DNRE</th>
<th>Peoples Committee</th>
<th>DNRE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepares file which includes Application Investment project</td>
<td>Check and within 3 days submit file to LRA or return to applicant with reasons explained.</td>
<td>Within 3 working days PC will sign the lease/allocation decision</td>
<td>Within 1 working day DNRE will inform the applicant to complete financial obligations (if approved) or return the file to applicants with explanations</td>
</tr>
<tr>
<td></td>
<td>LRA within 3 working days will create the cadastral map and return to DNRE</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>DNRE within 5 working days will verify the map, determine the land use fee/rental and submit to district/provincial PC</td>
<td>Send back to DNRE the decision or refusal (with reasons explained)</td>
<td>Within 5 working days, firm has completed all financial obligations (paid at LRA), the LRA shall hand over the land and provide the LUR Certificate</td>
</tr>
</tbody>
</table>

Despite streamlining the process, the opportunity for official discretion will remain (and hence the possibility of corruption). For example, private entrepreneurs are required to submit their Investment Plan with their land application. Thus it will up to the subjective judgment of the official to determine whether the proposed plan is suitable, and whether the entrepreneur should be allocated land or not.

Finally, in an effort to strengthen the enforcement of law and improve accountability the amended Law makes the PC Chairman at all levels responsible to detect, prevent, and punish violations relating to land in his/her territory. In theory at least, officials in land management agencies and commune cadastral offices will be held responsible for violations of procedures, which is a positive step towards increasing accountability of public officials. Time alone will be the judge of the success of the new Law in bringing in a new chapter in land administration to Vietnam, but the drafters of the amendment should be congratulated for their ambitious vision.
Summary

This Policy Note has dissected the issue of private sectors access to land into issues of availability, affordability and administration. It has emphasized the magnitude of the difficulties that Vietnam’s private firms face in accessing affordable land and how this constraint is hampering firm-level growth and the potential of the private sector to generate new employment opportunities. The key findings are outlined in the Executive Summary.

In particular, this Note discusses the potential impact of the amended Land Law, which is expected to introduce several improvements notably by streamlining the cumbersome administration procedures. It argues however, that because the amended Land Law will not address the fundamental issue of the shortage of land available for the private sector, it will not resolve the land issue for the private sector. This is a critical concern, because in the wake of the amended Land Law there is risk that many will assume that implementation of the amended law will resolve the issue and take no further action to address the problem. The Note argues that exactly the opposite should be the case. Indeed, perhaps the highest impact opportunity for the government to stimulate private investment and employment through firm growth at this stage in Vietnam’s development is precisely with policies and actions that would facilitate private sector access to affordable land. To do so the Government needs to

- design effective measures that provide both the incentive and mechanism for SOEs to free-up the under-utilized land they occupy, as part of a package of SOE reform actions, and

- rethink the adequacy of the land zoned for industrial use in terms of the country’s industrialization plans and develop an objective methodology to revise the zoning plan when appropriate. Special
care needs to be taken in developing an efficient method (faster and more transparent) to convert agricultural land to industrial zone land in an equitable way for all concerned, including the rural occupants.

The land constraint is so fundamental to business that it permeates all other aspects of a firms operation. Without LURs that can be pledged as collateral, it is extremely difficult for private firms in Vietnam to secure commercial finance, which is often referred to as the life-blood of business. Without finance private firms cannot grow; commit to large contracts; or penetrate new markets. Land is also the most sought-after contribution by potential foreign investors looking to partner or joint venture with domestic firms. Such linkages with foreign investors often bring with them new technology, new management methodologies and exposure to international markets and standards—all vital elements to strengthen the competitiveness of the domestic firms. But without land to contribute to the venture the domestic partner has little to offer potential foreign partner(s).

Some of the reforms that the Government is currently undertaking will help ease these related constraints, for example, the current SBV-WBG sponsored ROSC on Insolvency and Creditor Rights Systems\(^\text{12}\), will make specific recommendations on how to facilitate firm access to commercial finance through strengthening the creditor rights system. But without policy makers directly tackling the land issue, Vietnams domestic private sector will continue to be disadvantaged, especially vis-à-vis the SOEs, and its growth will be sub-optimal. It is therefore hoped, that the Government will actively explore new measures to resolve private sector access to affordable land, in parallel with efforts to monitor the impact of the amended Land Law. The WBG would welcome the opportunity to support such an endeavor if requested to do so.

\(^{12}\) The ROSC (Review of Observation of Standards) assessment is based on the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems.
<table>
<thead>
<tr>
<th>Term</th>
<th>Vietnamese</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land use right (LUR)</td>
<td>Quyền sử dụng đất</td>
<td>The rights on a piece of land the State grants to individuals/organizations. LUR will be presented in a LUR Certificate, which consists of name of the user, cadastral map of the land, term allowed, and property on land (at the time of granting the Certificate). New law requires all types of land users to register for LUR Certificate as the only legal evidence of their rights on that piece of land.</td>
</tr>
<tr>
<td>Allocation</td>
<td>Giao (đạt)</td>
<td>The State provides LUR to the object by administrative decision. Allocation can be with or without fee. Allocation without fee will be applicable in non-commercial cases only (to build offices for State agencies and non-profit organization, for religious purposes...). All land granted to commercial organizations will in the future be fee-based.</td>
</tr>
<tr>
<td>Leasing</td>
<td>Cho thuê (đạt)</td>
<td>The State provides LUR to the object by leasing contract. Leasing can be under annual or whole period basis (whole period lease is currently applied to FDI businesses only).</td>
</tr>
<tr>
<td>Land for production and non-agricultural commerce</td>
<td>Đất cho sản xuất và kinh doanh phi nông nghiệp</td>
<td>This is a sub category of Non-agricultural land group, including: land to build IZs; land to build production or commercial facilities; land for mining activities; land to produce building materials; and land to produce pottery</td>
</tr>
<tr>
<td>Land use fee</td>
<td>Phi sử dụng đất</td>
<td>The amount a land user has to pay the State in case of Allocation with Fee. Land use fee is paid in lump sum for the whole period.</td>
</tr>
<tr>
<td>Rental</td>
<td>Tiền thuê đất</td>
<td>Payment for the land leased from the State. Rental can be paid annually or in a lump sum (applicable for FDI only). Rental in IZs ranges from 0.2 to 2USD per sqm per year.</td>
</tr>
<tr>
<td>Land use tax</td>
<td>Thuế sử dụng đất</td>
<td>Annual tax payment for the LUR; land use tax is calculated based on a reference table with various level of tax rate attaching to each type of land (residential, agriculture, industrial...). Land use tax will be governed under the Law of Land Use Tax (in drafting now). One important article in the Law is to apply a 0.2% tax rate on all types of land. In case of land lease, land use tax is usually combined with the rental.</td>
</tr>
<tr>
<td>Land use tax</td>
<td>Thuế chuyển nhượng QSDD</td>
<td>Annual tax payment for the LUR; land use tax is calculated based on a reference table with various level of tax rate attaching to each type of land (residential, agriculture, industrial...). Land use tax will be governed under the Law of Land Use Tax (in drafting now). One important article in the Law is to apply a 0.2% tax rate on all types of land. In case of land lease, land use tax is usually combined with the rental. Currently the land use tax is from some hundred (residential) to some thousand (agricultural) VND per sqm per year.</td>
</tr>
<tr>
<td>LUR Transfer Tax</td>
<td>Thuế chuyển nhượng QSDD</td>
<td>Tax imposed on the party who transfers (sell) LUR to another party. The new law has increased this tax from 2% to 3%</td>
</tr>
<tr>
<td>Income Tax on land transfer transaction</td>
<td>Thuế thu nhập từ chuyển nhượng đất</td>
<td>Income from the appreciation of LUR when a party transfers LUR will be considered as high-come (for individuals) and business revenue (for businesses). In business case the tax rate is 28%. In individual case the new Ordinance on PIT with High-income Individuals (effective from July 2004) also stipulates a tax rate of 28% in this case.</td>
</tr>
</tbody>
</table>