

**Viet Nam in ASEAN:**

**Regional Integration  
Process and Challenges**

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"Promoting Viet Nam's Integration into ASEAN" (VIE/95/015).  
Edited by UNDP consultants Neal Forster and Adam McCarty.

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# FOREWORD

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The report reflects the personal points of view of the contributors and editors and does not necessarily represent those of the Bureau of the National Committee for ASEAN, Office of the Government of Viet Nam or the United Nations Development Programme.

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# ACRONYMS AND ABBREVIATIONS

|         |  |
|---------|--|
| ACCSQ   | ASEAN Consultative Committee for Standards and Quality       |
| AEM     | ASEAN Economic Ministers meeting                             |
| AFTA    | ASEAN Free Trade Area  |
| AHTN    | ASEAN Harmonized Tariff Nomenclature                         |
| AIA     | ASEAN Investment Area  |
| AIC     | ASEAN Industrial Complementation scheme                      |
| AICO    | ASEAN Industrial Cooperation scheme                          |
| AIJV    | ASEAN Industrial Joint Venture scheme                        |
| AIP     | ASEAN Industrial Projects scheme                             |
| AMM     | ASEAN Ministerial Meeting                                    |
| APEC    | Asia-Pacific Economic Cooperation                            |
| ARF     | ASEAN Regional Forum   |
| ASC     | ASEAN Standing Committee                                     |
| ASEAN   | Association of South East Asian Nations                      |
| ASYCUDA | Automated System for Customs Data and Management             |
|         |  |
| BBC     | Business Cooperation Contract                                |
| BBC     | Brand-to-Brand Complementation scheme                        |
| BDV     | Brussels Definition of Value                                 |
|         |  |
| CCCA    | Coordinating Committee for implementing the AFTA CEPT scheme |
| CEPT    | Common Effective Preferential Tariff                         |
| CIEM    | Central Institute of Economic Management                     |
| CIS     | Community of Independent States                              |
| CMEA    | Council for Mutual Economic Assistance                       |
| C/O     | Certificate of Origin  |
| COCI    | Committee on Culture and Information                         |
| COSD    | Committee on Social Development                              |
| COST    | Committee on Science and Technology                          |
|         |  |
| ESCAP   | Economic and Social Commission for Asia and the Pacific      |
| EU      | European Union   |
| FDI     | Foreign Direct Investment                                    |
| FPI     | Foreign Portfolio Investment                                 |
|         |  |
| GATS    | General Agreement on Trade in Services                       |
| GATT    | General Agreement on Tariffs and Trade                       |
| GDC     | General Department of Customs                                |
| GDS     | General Department of Statistics                             |
| GEL     | General Exception List                                       |
| GTV     | GATT Transactions Value                                      |
| GVA     | GATT Valuation Agreement                                     |
|         |  |
| HCV     | Home Consumption Value                                       |
| HS      | Harmonized Commodity Description and Coding System           |
| ICC     | International Chamber of Commerce                            |
|         |  |
| IMF     | International Monetary Fund                                  |
| ISO     | International Standards Organisation                         |
| IWE     | Institute of World Economy                                   |

|        |  |
|--------|--|
| MFA    | Multifibre Agreement                                 |
| MFN    | Most Favoured Nation                                 |
| MOF    | Ministry of Finance                                  |
| MOFA   | Ministry of Foreign Affairs and Trade                |
| MOI    | Ministry of Industry                                 |
| MOSTE  | Ministry of Science, Technology and the Environment  |
| MOT    | Ministry of Trade                                    |
| MOU    | Memorandum of Understanding                          |
| MPI    | Ministry of Planning and Investment                  |
| MRA    | Mutual Recognition Arrangements                      |
| NAC    | National ASEAN Committee for Viet Nam                |
| NAFTA  | North American Free Trade Area                       |
| NGO    | Non-Government Organisation                          |
| NT     | National Treatment                                   |
| NTB    | Non-Tariff Barrier                                   |
| OOG    | Office of the Government of Viet Nam                 |
| OECD   | Organisation of Economic Cooperation and Development |
| PIECT  | Post Import-Export Control Team                      |
| PSI    | Pre-Shipment Inspection                              |
| PTA    | Preferential Trading Agreement                       |
| QR     | Quantitative Restrictions                            |
| RILO   | Regional Intelligence Liaison Office                 |
| SAD    | Single Administrative Document                       |
| SBV    | State Bank of Viet Nam                               |
| SEOM   | Senior Economic Officials Meeting                    |
| SGS    | Societe Generale de Surveillance                     |
| SITC   | Standard International Trade Classification          |
| SL     | Sensitive List                                       |
| SOE    | State-Owned Enterprise                               |
| SOM    | Senior Officials Meeting                             |
| SPS    | Sanitary and PhytoSanitary measures                  |
| STE    | State Trading Enterprises                            |
| TBT    | Technical Barriers to Trade                          |
| TEL    | Temporary Exclusion List                             |
| UAP    | Unprocessed Agriculture Products                     |
| UNCTAD | United Nations Conference for Trade and Development  |
| UNDP   | United Nations Development Programme                 |
| UNIDO  | United Nations Industrial Development Organisation   |
| VAT    | Value Added Tax                                      |
| VCCI   | Viet Nam Chamber of Commerce and Industry            |
| VER    | Voluntary Export Restraints                          |
| VIR    | Viet Nam Investment Review                           |
| VIT    | Viet Nam Institute of Trade                          |
| WCO    | World Customs Organisation                           |
| WTO    | World Trade Organisation                             |

# INTRODUCTION

Viet Nam's membership to ASEAN occurred at a time when the size and scope of ASEAN cooperation activities has been increasingly rapidly. The complex requirements of ASEAN integration have posed significant challenges to Viet Nam's policy makers and institutions. However, the practical experience of dealing with ASEAN institutions and cooperation activities has strengthened Viet Nam's capacity to effectively participate in the international arena. As a mechanism for promoting Viet Nam's integration into the regional and world economy, ASEAN membership has served Viet Nam well. It is time, however, to look beyond the initial integration successes of ASEAN membership and develop a strategy for Viet Nam's future involvement in ASEAN cooperation activities which best meets the needs and aspirations of the country.

Viet Nam's highest priority within any newly formulated ASEAN engagement strategy will continue to be the implementation of those ASEAN cooperation commitments already undertaken, with special attention given to the ASEAN Free Trade Area (AFTA). AFTA is ASEAN's most important economic cooperation agreement on which rests much of ASEAN's credibility. A meaningful and substantial participation in AFTA by Viet Nam will build ASEAN confidence in Viet Nam's ability to participate fully in ASEAN cooperation agreements.<sup>1</sup> Most importantly, however, the successful implementation of Viet Nam's AFTA commitments will result in considerable economic gains for the country itself as well as attracting a positive international image and greater confidence among investors. Apart from meeting previous ASEAN commitments, Viet Nam's ASEAN future engagement strategy will depend significantly on Viet Nam's ability to work effectively within the ASEAN institutional arrangements to identify and promote its own agenda for future ASEAN cooperation activities and commitments.

Therefore, Viet Nam must have a clear understanding of both the likely areas of future ASEAN cooperation and the institutional processes that formulate these agreements. To do this effectively Viet Nam needs to consider the historical process of ASEAN cooperation and institutions as well as an analysis of the current state of play.

Chapter one provides an introduction highlighting and explaining the international trade aspects of Viet Nam's remarkable transition to a market economy. The legacy of central planning remains, however, and understanding Viet Nam's present trade regime requires considering that policy and institutional legacy. Chapter two is a detailed overview of Viet Nam's trade regime. It is a comprehensive survey of the complex network of tariff and non-tariff measures applied in Viet Nam. A daunting read of 55 pages, one may feel inclined to race ahead to the chapters specifically about ASEAN and AFTA. Yet this would be a mistake. The chapter lays out the detail of the trade reform challenge. It gives an appreciation of the utter complexity of the present regime, and of the limited scope for measuring the welfare impact of so many non-transparent policies. Clearly tariffs are just one of many instruments, and maybe not the most important. The chapter presents a good argument for greater attention within ASEAN, and within other regional and international trade arrangements, to the removal of non-tariff barriers to trade.

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<sup>1</sup> It will also spur the newly admitted ASEAN members of Laos and Myanmar to implement those measures required for their own ASEAN integration processes.

In chapter three, Frank Flatters presents the arguments against protectionist policies and illustrates the gains from the trade that accrued from trade liberalization. Dr. Flatters makes his case with a minimum of theory and maximum of common sense, using Viet Nam industry case studies and policy stories from other countries.

The next two chapters by Jose Tongzon explain ASEAN, AFTA, and Viet Nam's commitments to these organizations. The commitments are impressive, particularly to reduce all tariffs to five per cent or less by 2006. Of course these commitments raise questions about institutional and political capacities to achieve the reform targets, which Jose also discusses.

Trade liberalization within AFTA, or unilaterally, we argue, is a welfare-maximizing policy choice. But it is not a win-win choice. There are losers, but the winners gain much more, particularly over the long-term. Chapter six looks at one of the losers: government revenue. Peter Donovan and Adam McCarty work their way towards measuring tariff revenue losses under AFTA, which they conclude are much less than many people have presumed. The impact of AFTA on foreign direct investment and service sector development are discussed in chapters seven and eight. Chapter nine looks at the specific institutional challenge of Customs reform and ASEAN.

This book presents a comprehensive survey of Viet Nam's trade regime, the commitments to change that regime as a member of ASEAN, and the progress made to date. That progress has been less than might have been hoped for, but it has nevertheless been positive. In forthcoming years, important commitments must become reality. This will be a testing time for Viet Nam, not only with respect to its ASEAN membership, but also in relation to pending membership of the WTO. The ability to liberalize, and to therefore put national interest before those of powerful internal interest groups, will be closely watched by observers both inside and outside Viet Nam.

# Chapter 1 : Understanding Viet Nam's trade regime

## 1.1 Introduction

Viet Nam's reform process, some argue, has slowed in recent years (World Bank, 1998, 1999; UNDP 1998). Others point out that transition is a long process and that progress over the past decade nevertheless has been impressive (Mallon and Irwin, 1997). It is partly an explanation of relative performance. Structural reform in Viet Nam from 1988 to about 1992 was impressive: macroeconomic stabilization, state enterprise reform (which shed 22 per cent of its workforce during 1989-91), a re-orientation of international trade, and a boom in private rural and urban household economic activity, make reforms of the past five years pale in comparison.

A more controversial view would be that reform has not merely slowed, but stalled (Womack, 1997; Thayer, 2000; Riedel and Turley, 1999). This view is based on the argument that the vision for development of Viet Nam's leaders constrains them. Their vision for development is not really the one that donors strive to define for them (McCarty 2001; World Bank 1999; IMF 1996). At heart is the commitment to a "leading role" for the state commercial sector, which requires policies to control and micro-manage state enterprises, and other policies to limit competition. Without real and meaningful commitment to a private corporate sector, the official reform process may have come as far as it can.

The forces for change, however, are mounting. These come from internal processes, such as the gradually increasing influence of the "technocratic elite" – a generational process of changing world-views - and from external pressures, such as the requirements to achieve international integration. The Asian Crisis added spice to the brew: undermining relative competitiveness and cutting back foreign investment. It stimulated a re-think of the strategic development model, and it has helped to build a consensus for moving forward again. The Vietnamese approach to the Asian Crisis has been defensive, which is to say that control mechanisms have been used to maintain relative prices. This also, however, only sustains economic contradictions that must be faced at some stage. In the meantime, the cost seems to be sustained slower growth rates of GDP and international trade<sup>2</sup>.

The next two chapters examine in detail one important policy area where internal and external processes have driven reform in recent years: international trade. They give substance to the above generalizations by tracing trade policy reforms since about 1996. They also provide an analysis of the existing policy regime, including the sometime peculiar policies required to control state enterprises.

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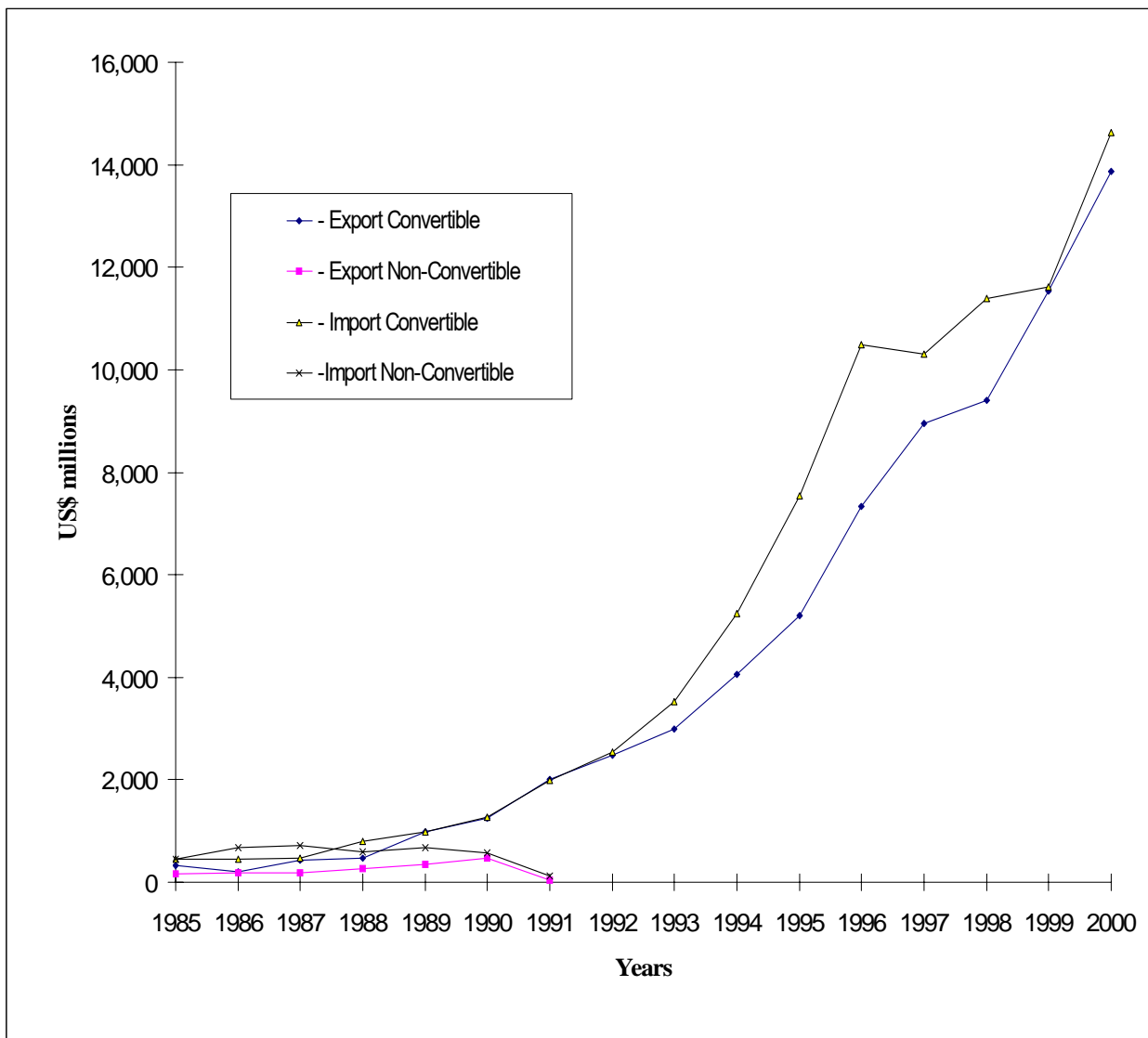
<sup>2</sup> Non-oil exports, which averaged 25% annual growth during 1991-1997, grew by 5% in 1998, 16.3 % in 1999 and 16.1% for 2000. Similarly, GDP growth averaged 9% during 1994-97, but was 4% in 1998 and 1999 and 5.5% in 2000 [<http://www.worldbank.org.vn/site.htm>].

## 1.2 The trade success story

International trade is part of the Vietnamese transitional success story. Figure 1.1 shows the dramatic rise in the volume of trade during the reform period. The relative insignificance of CMEA trade in the late 1980s is apparent. Even if we adopt a 1:1 rouble:dollar exchange rate, the volume of trade in 1988 was less than one-quarter the volume in 1998.

Note also that after macroeconomic stabilization in 1989, including setting of a realistic exchange rate, trade grew steadily every year – there was no “J-curve” in Viet Nam’s transition. Trade grew from about 32 per cent of GDP in 1989 to 84 per cent in 1997, declining only in 1998 to 78 per cent but rising again to 92 per cent in 2000.

Figure 1.1: Growth in Viet Nam’s trade, 1985-2000



Exchange rates: (1985-1988 US\$1 = 2.55 transferable roubles; 1989-1993 US\$1 = Rb2.4).

Sources: General Statistics Office (2001). *Viet Nam Economic Times*, February 2001.

The composition of Viet Nam's exports explains much of its transitional success (Table 1.1). As a poor developing country, Viet Nam exported raw materials and agricultural produce. For these goods, new markets were easy to find. In 1992, after the initial period of trade restructuring, petroleum, rice and agricultural products constituted 60 per cent of exports. In 1997, these three groups made up 41 per cent of exports, so that the reform period has seen both a diversification and growth in Viet Nam's exports.

**Table 1.1: The composition of Viet Nam's trade (US\$ millions)**

|                           | 1991 | 1992 | 1993 | 1994 | 1995  | 1996  | 1997  | 1998  | 1999  | 2000 (e.) |
|---------------------------|------|------|------|------|-------|-------|-------|-------|-------|-----------|
| <b>Principal Exports:</b> |      |      |      |      |       |       |       |       |       |           |
| Petroleum                 | 581  | 756  | 844  | 866  | 1,024 | 1,024 | 1,024 | 1,226 | 2,020 | 3,397     |
| Rice                      | 225  | 300  | 363  | 429  | 549   | 855   | 870   | 1,099 | 1,027 | 702       |
| Coal                      | 48   | 48   | 70   | 75   | 81    | 115   | 111   | 170   | 92    | 86        |
| Rubber                    | 50   | 54   | 74   | 133  | 181   | 163   | 191   | 142   | 138   | 157       |
| Coffee                    | 74   | 86   | 110  | 238  | 495   | 337   | 491   | 603   | 589   | 515       |
| Marine products           | 286  | 307  | 427  | 551  | 626   | 653   | 790   | 852   | 969   | 1,445     |
| Textiles and garments     | 158  | 219  | 334  | 555  | 850   | 1,154 | 1,350 | 1,030 | 1,673 | 1,860     |
| Foot-wear                 | 6    | 18   | 69   | 122  | 294   | 530   | 964   | 1,030 | 1,408 | 1,431     |
| <b>Principal Imports:</b> |      |      |      |      |       |       |       |       |       |           |
| Petroleum products        | 485  | 615  | 614  | 696  | 856   | 1,079 | 1,094 | 828   | 1,023 |           |
| Fertilizers               | 246  | 320  | 189  | 247  | 339   | 643   | 425   | 540   | 465   |           |
| Steel                     | 25   | 104  | 233  | 211  | ...   | 651   | 529   | 575   | 581   | 927       |
| Materials for clothing    | 42   | 13   | 59   | 82   | 196   | 156   | 893   | 713   | 1,092 | 258.4     |
| Machines and equipment    | 30   | 41   | 118  | 105  | 114   | 189   |       |       | 628   | 2,538     |

Sources: World Bank (1995), Viet Nam: Economic Report on Industrialization and Industrial Policy, 17 October. GSO, (2000), *Statistical Yearbook*. Ha Noi.

World Bank (1998), Viet Nam: Rising to the Challenge. Ha Noi.

Viet Nam Economic Times, February 2001.

The impressive rates of trade growth tend to draw attention away from some absolute realities. Table 1.2 places Viet Nam's development in regional context. It shows that Viet Nam remains far behind ASEAN neighbours despite a period of rapid growth rates in the 1990s. The volume of international trade per capita, for example, still remains about one half of Indonesia's and less than ten per cent of Thailand's. Comparison of per capita data for cement and electricity production present a similar picture: the path to "catching up" is long indeed, and a period of relative stagnation – say, of GDP growth less than five per cent each year – could add decades to the task.

**Table 1.2: Viet Nam compared to some ASEAN economies**

|  | Viet Nam | Indonesia | Thailand | Malaysia |
|--|----------|-----------|----------|----------|
| Percentage of male labour force in agriculture (2-97)* | 71       | 41        | 49       | 19       |
| Percentage of 1998 GDP in:                             |          |           |          |          |
| Agriculture  | 26       | 20        | 11       | 13       |
| Manufacturing  | ...      | 25        | 32       | 29       |
| Services   | 42       | 35        | 48       | 43       |
| US\$ trade per capita (1995)                           | 172      | 441       | 2,148    | 6,053    |
| Gross domestic savings as percentage of GDP (1998)     | 21       | 24        | 42       | 48       |
| Per capita production of (1995):                       |          |           |          |          |
| Rice (kg)  | 338      | 255       | 346      | 52       |
| Cement (kg)  | 73       | 114       | 563      | 509      |
| Electricity (kwh - 1993)                               | 147      | 247       | 1,093    | 2,055    |

Source: GSO (2000), *Viet Nam Statistical Yearbook*, Statistical Publishing House, Ha Noi; World Bank (2000).

\*: most recent year.

Further rapid rates of growth in Viet Nam remain dependent upon policy reforms that push it further towards a competitive market economy. If this process has stalled then the process of “catching up” will be prolonged.

## 1.3 Understanding Viet Nam

This chapter provides some insight towards understanding the trade policy regime described in the subsequent chapter. An understanding of the strategic purpose of policy regimes helps towards forecasting the direction of future reforms, and in determining if particular policies are NTMs or NTBs. The analysis takes the form of discussing six interrelated propositions (or problems) relevant to or about Viet Nam’s foreign trade policy regime. The first proposition is about the general vision behind the trade regime, while the following five detail aspects of that regime.

### 1.3.1 Proposition 1: The strategic vision: revealed schizophrenia

Viet Nam’s trade and investment policies can be characterized as “export-led protectionism”, whereby import substitution is encouraged with trade protection, and export industries promoted by providing subsidies to countervail the high relative costs of intermediary products. This should not be interpreted as simply some “South Korean model”, but rather central planning monopoly-based protectionism paired with a crude interpretation of export-led development.

The legacy of central planning is, most importantly, a strong belief in self-sufficiency through import substitution. Another important aspect is the lingering belief in the role of government to

manage and frequently “fine tune” the whole economy, and a consequent disregard for the costs of price distortions and uncertainty created by this approach in a market economy. The legacy of central planning is also manifested in common characteristics and problems with the trade regime, as noted by the OECD (1997, p.93):

“Some of the problems encountered in transition economy markets include: frequent changes in tariff and non-tariff measures, difficulties in customs valuation procedures used to counter under-invoicing problems, taxations schemes not based on national treatment, vestiges of state trading and exclusion from preferential arrangements among some transition economies.”

Viet Nam has all of these features noted by the OECD, except that old preferential arrangements are now irrelevant. One can also include an attitude of excessive secrecy concerning trade data. To these problems can be add those typical of a poor developing economy: low public sector salaries, weak capacity to implement policies, and import taxes constituting a high share of total government revenue.

The faith in monopoly-protectionism is a “path dependent” consequence of the central planning experience<sup>3</sup>. Thus, to many Vietnamese officials, Viet Nam’s present trade and investment policy regimes have the contradictory objectives to provide protection for domestic producers, while also removing trade protection<sup>4</sup>. Indeed, it is hard to escape the conclusion that Viet Nam’s membership of regional and global organizations are more politically motivated than out of any consensus about the virtues of free trade. In this context, some look to NTBs as an avenue for subtle protectionism:

“Increasing the tariff rates is only a temporary [protectionist] measure. They cannot be long-term solutions as we are due to join AFTA and WTO... We’ve got to think about non-tax barriers, the methods that are being used by a number of countries. It can definitely work for us.”  
(Le Dang Doanh, *Viet Nam Investment Review*, July 6, 1997)<sup>5</sup>

“The non-tariff barriers that ASEAN nations employ are of great diversity, the most sophisticated ones being specifications of technical standards. For the case of Viet Nam, non-tariff measures are rudimentary ones such as licences and quotas. In order to ensure domestic protection, we are studying the introduction of similar non-tariff measures before the time comes for their removal.”  
(Ha Huy Tuan, 1996, p.3).<sup>6</sup>

“Parallel to the formation of the protection policy, effective non-tariff measures should be built and perfected to the international norm. A well-planned policy will provide reasonable protection for domestic producers when the time comes to remove tariff barriers.”  
(Ha Huy Tuan, 1996, p.10).

“It is very difficult for local enterprises when non-tariff measures are lifted because domestic production’s competitiveness is still modest. The Government should consider supplementary measures which conform with international trading practices and are usually applied by other countries for a certain period to protect domestic production ... It is not easy for Viet Nam to meet all the CEPT requirements and protect local production at the same time. The Ministry [of Trade] is expected to apply other measures such as quality and hygiene standards, labor safety

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<sup>3</sup> The cause of this “faith” may be a genuine majority belief in the intuitive logic of protectionist arguments, or more a reflection of the ongoing relative strength of state commercial interest groups.

<sup>4</sup> See Le Bo Linh (in Vo Dai Luoc, 1998. pp.17-55) for an attempt to grapple with the issues of “what to do to speed up export; how to conceive protectionism in the condition of trade liberalization” (p.17).

<sup>5</sup> Professor Doanh is Director of the Central Institute for Economic Management, in the Ministry of Planning and Investment.

<sup>6</sup> Mr Tuan was from the AFTA Viet Nam National Office.

and surcharges. The ministry is also considering new tariffs [tariff quotas], anti-dumping, anti-discrimination ... It needs sufficient and modern management to apply these measures, and the new tariffs must cover all imports. Not so easy."  
(Cao Cuong, *The Saigon Times Weekly*, 29 August 1998).

Thus, the first “schizophrenia” proposition is essentially that the policy ideas of central planning remain entrenched and exist uncomfortably alongside the argument for free trade. As Riedel and Turley (1999) have noted, such ideas have shaped actual policy outcomes: “Interests seeking protection from international competition would not have got their way so easily, however, if ideas that had long been discredited elsewhere did not still exercise a hold on many policymakers.”

### **1.3.2 Proposition 2: Policy making is largely Ministry-specific**

The Vietnamese Laws are generally vaguely worded statements of intent and policy direction. As such they are as much policy pronouncements as legal documents, with the specification of detailed implementing documents left mainly for relevant Ministries to decide. Thus, at the Ministry level, there is much discretion about the design and implementation of policies. Ministries can also initiate changes within their allocated sphere of responsibility (e.g. the Ministry of Finance decides on tariff rate changes, and does so quite often). Ministries do discuss and debate policy changes with each other, but this process is secondary to Ministry-led policy formulation. Microeconomic policy reform is therefore largely decentralized and uncoordinated<sup>7</sup>.

This decentralized policy approach “compartmentalizes” the reform process. That is, while the general trend may be towards liberalization, there can still be pockets of stubborn protectionism. If these “pockets” are dominant in key Ministries, then reform can be stifled or even reversed, despite the exhortations of higher authorities. Looking at the overall picture, reform may seem to be always “taking two steps forward and one step back [sometimes two]”. What is needed is a general perception or “vision” about the direction of the reform process stretching down to the Ministry level. To expect this of an economy in transition may be too much, and anyway there is general consensus about some policy directions – such as the AFTA commitment to reduce all tariffs to five per cent or less by the year 2006.

Decentralized policy making will therefore remain a feature of the Vietnamese policy-making process for some time. One consequence of this structure is that concerns expressed by higher authorities tend to produce a rash of minor regulatory reforms at the Ministry level. A recent example is the concern about the fall in foreign direct investment, which has prompted many Ministries to “do something” within their sphere of authority. Consequently, visa regulations have been relaxed, new tax incentives introduced, FDI was allowed in new economic sectors, and the regulatory approval process simplified. Typically, however, MOLISA took a “step backwards” by tightening control over the employment of local staff.

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<sup>7</sup> Macroeconomic policies, such as monetary policies, involve much more “consensus management” and sometimes require a leading role by the Office of Government. The Office of Government may be viewed as a “dispute resolution centre”, rather than an organisation ensuring a consistent and focused policy reform process.

### **1.3.3 Proposition 3: Excessive numbers of policy objectives for each policy instrument.**

Almost every major Vietnamese policy instrument is laden with the burden of multiple policy objectives. “Each tax instrument attempts, to a certain extent, to encourage certain types of industrial development, to promote progressivity of the tax burden, while at the same time trying to raise revenues” (Shukla & El-Hifnawi 1998, p.4). Tax and other policy instruments also sometimes reflect regional development concerns, an ongoing bias against services in favour of goods (“material products”), and a desire to raise the rate of accumulation and investment (high taxes on consumption). This “objectives heavy” approach may reflect the lack of a centralized policy-making process, but also a limited awareness about the costs of having numerous and frequently changing price distortions in market economies. This approach introduces needless economic and administrative costs to an economy with an already limited capacity for policy implementation.

Trade taxes are a major source of revenue, but they are also used to “influence industrial policy by providing protection to the domestic manufacture of import substitutes such as automobiles, as well as to promote equity by imposing higher tax rates on what are likely to be luxury goods. These objectives are not necessarily consistent and are better accomplished using different tax instruments” (Shukla & El-Hifnawi 1998, p.26).

### **1.3.4 Proposition 4: Policy instruments are changed frequently for “fine-tuning” purposes.**

Viet Nam's trade-related legal framework is not so much "in transition" as continually on the boil. The quantity of legal pronouncements issued every few months to “fine tune” the policy regime is daunting. Freshfields (1998), for example, report 27 documents involving trade policy changes from July to September 1998: two about quotas; four changing import duties; six about import duty exemptions [e.g. for re-exports]; three clarifying tariff line definitions; two about stamping imports; six on customs administration [e.g. anti-smuggling]; and four about exemptions and changes to other taxes which have trade implications [e.g. sales tax].

This unpredictability is itself a barrier – an additional cost - to trading with Viet Nam, as well as for domestic producers<sup>8</sup>. Tariff rates and various NTMs, such as surcharges and quotas, are changed regularly and often only marginally. This volatility in the policy regime has been noted by the American Trade Compliance Centre (1998): "formal rules in many areas of the [Vietnamese] trading system have not been defined; while in others, the measures and their practical interpretation are frequently changing." <sup>9</sup>

Surcharges, tariff rates, tariff exemptions, finance measures, quotas, and import stamping are all changed or modified quite regularly, and at least every year. This practice is a legacy of the perceived micro-management role of the State under central planning, now applied comprehensively only to “strategic goods”. A lack of awareness about the economic costs of generating price distortions and uncertainty in markets compounds the problem. Uncertainty

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<sup>8</sup> Thang and Toan (in Vo Dai Luoc, 1998. p.103) note “The change of import taxes twice a year, even four times a year, does not conform to the production cycle of informatic-electronic items producing businesses”.

<sup>9</sup> See <http://infoserv2.ita.doc.gov/tcc/>

and weak management and information systems exacerbate other problems, as the OECD (1997, p.10) noted:

"The main insufficiency of new trade regimes in many transition economies, especially in the Newly Independent States (NIS), is their lack of transparency and predictability, ...the unstable trade and investment framework is often accompanied by considerable discretionary powers given to governmental officials, thus increasing the risk of rent-seeking activities."

#### **Box 1.1: Fine-tuning electronics industry protection in Viet Nam**

From the *Viet Nam Investment Review*, 30/11/98 (p.2):

"The Government is going to nationalize the country's electronics sector by raising tax levies on imported picture tubes and electronics spare parts to a 30 per cent minimum. Banks have been prohibited from selling hard currency to companies that import these products...The Government also agreed that taxes on incomplete knockdown and complete knockdown parts would be abolished and that single parts would attract tax levies in isolation, not as a spare parts package."

This Decision follows ongoing disputes about what exactly constituted IKD and SKD kits (interviews 21 and 22)<sup>10</sup>.

### **1.3.5 Proposition 5: The language of legal documents remains unclear.**

"Ambiguity of laws and discretion in administration increase compliance costs and provide plenty of opportunities for irregularities that also serve to reduce government revenues" (Shukla & El-Hifnawi 1998, p.4). Indeed, a weakly defined legal code could be considered as an NTB in its own right.

Ambiguity arises because the higher-level legal documents are also policy statements, and hence imprecise language is not seen as a serious problem. Some imprecision may also be what particular interest groups may desire. It is generally left to the Ministries to add precision and to clarify definitions, but the lag in doing so can be considerable.

Some examples from Viet Nam's answers to the WTO questions (GoV 1998) illustrate the sort of problems:

- Lists specifying where the State "has the exclusive right to conduct commercial activities" are not yet formulated (p.10).
- The list of "important lines of activities" in which large national Corporations are to specialize was not available (p.13 and p.32).
- There is no legal definition of "morally pernicious" or "depraved cultural and reactionary products" (p.121).
- "There is so far no definition of monopoly (i.e. what market share would constitute monopoly) in the provisions of existing Vietnamese laws." (p.189).

In addition to the WTO country definitional queries, we could also ask, *inter alia*, for the Vietnamese understanding of:

- "imported fixed assets which cannot be produced locally";

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<sup>10</sup> For list of interviews, see Appendix 1.

- "dumping" and "too low [import] prices due to assistance" (89/1998/TT-BTC); and
- special sales tax exemptions: "natural disasters and other sudden incidents", "small scale beer producers suffering losses", and "small scale manufacturers" having trouble (109/1998/TT-BTC).

### **1.3.6 Proposition 6: Not all legal documents are systematically collected and published.**

Publication of official policy documents is apparently a legal requirement (GoV 1998, p.93), but in practice many important documents are not readily available. This is a particular problem for Official Correspondence, the circulation of which seems to be more at the discretion of issuing Ministries. It is rare if higher-level documents cannot be found in the Government gazette (*Cong Bao*) or in the National Assembly collection.

The problem, however, is that Official Correspondence can include very important documents – particularly when they clarify definitional ambiguities. Documents relating to sensitive and lucrative industries, such as petroleum, are “hard to find”. Then again, Ministries may decide not to advertise policy changes by keeping directions about such changes an “internal matter”.

Much important information does not get published. For example: “Prices controlled by the Government are not published in the Official Gazette but can be found in the daily Market and Price Bulletin” (GoV 1998, p.16). The policies of the State commercial banks are also not available for scrutiny (interviews 27 & 28). Thus the analysis of important issues, such as the deposit policies for opening letters of credit, had to be based on interview information.

The system for translating official documents could also be improved. Official translations of most important documents do appear, but sometimes after delays. Many documents, however, are not officially translated, and so can lead to problems in interpretation and unnecessary misunderstandings.

## **1.4 Conclusion**

The above propositions about Viet Nam’s trade policy processes and regime give an insight into the research challenge of surveying Viet Nam’s trade regime. Many policy instruments are used, and most are complex in their design and administration. While most legal documents were accessible through databases,<sup>11</sup> some important ones were not and had to be sought through various channels. Even then, interpretation is sometimes difficult. Many concepts introduced in legal documents, as discussed above, remain unspecified. Nevertheless, we have managed to pull together a fairly comprehensive overview of Viet Nam’s trade policy regime, as presented in the next chapter, which is a baseline study upon which others can build.

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<sup>11</sup> These databases include the National Assembly archive (in Vietnamese only), the VCCI legal database, various regular publications such as *Cong Bao*, *Freshfields*, *The Viet Nam Law Journal*, and *Freehill, Hollingdale & Page*.

## **Chapter 2 : Viet Nam's trade regime**

**- Adam McCarty -**

### **2.1 Introduction**

This chapter is a detailed overview of Viet Nam's trade policy regime. As such, it constitutes a "stocktake" of existing trade policies, and of the scope of nature of interventions of protectionist measures in Viet Nam. The overview is therefore an introduction to the extent of the ASEAN integration challenge facing Viet Nam, which is the subject of subsequent chapters. The analysis extends into early 1999 and although many minor policy changes continued to be enacted on a regular basis, the basic framework of the trade regime has remained basically *the* same into early 2001.

The "stocktake" utilizes the internationally recognized UNCTAD classified scheme for trade policy regimes. The ASEAN classification scheme does not include all the policies identified by UNCTAD, and where this is the case it has been noted. We have also added some additional items to the UNCTAD classification where the particular circumstances of Viet Nam warrant, and of course these additions are also noted.

### **2.2 Tariffs**

Customs duties now make up about 25 per cent of government revenues. This, however, is only one of the objectives assigned to this policy instrument. Consequently, the tariff schedule is complex and constantly changing. The number of tariff rates fell from 36 in 1995, to 31 in 1996, then jumped back to 35 in 1997, but was subsequently beaten down to 26 rates, ranging from zero to 60 per cent, in 1998 and decreased to 18 rates in 1999. The schedule in January 1999 identified 6,174 separate items (Viet Nam import-export tariff lists from 1995 to 1999, and within one item there may be many relevant minimum import prices applied (discussed below).

The point of such complexity is largely to fine-tune protection and consumption. Protection is afforded to most import-substituting industries, which often includes assembly operations. Tariff protection of assembly operations requires differentiation within the tariff schedule to highly tax assembled unit imports, and to tax imports of parts for assembly at much lower rates. Imports of consumer goods are, in any case, invariably highly taxed, being labeled "unnecessary".

The tariff schedule and applicable rates are changed frequently in response to the opaque policy dialogues that occur behind the closed doors of Ministries and Corporations. It is a club, and the problems inherent in institutionalizing such a cosy relationship between policy makers and commercial interests is not even acknowledged.

The complexity of the tariff schedule introduces new problems. Smuggling remains rampant in Viet Nam and, like corruption, is largely a consequence of a trade policy environment trying to provide protection and economic rents. Smuggling for many products, such as bicycles and electronic products, seems to negate most attempts at protection, thereby maintaining competitive pressures.

Corruption is a serious and pervasive problem for Viet Nam's Customs service (Williams, 1997). In mid-1998, the Saigon Times Group held a conference about "administrative reform in Customs" in which participants "singled out the professional ethics of customs personnel as the most important factor in performing their duties" (*Saigon Times*, 11/7/98. p.29).

Customs, however, is trying to operate in an environment of generally accepted tax avoidance. The problem is that the tariff schedule is so complex that, evasion and corruption aside, just doing the job requires detailed technical knowledge. Customs officials lack the required technical knowledge, and there is no systematic case study history upon which they can draw. Training in product identification and valuation, combined with stronger supporting information systems is required to better implement the existing tariff schedule. A better option is to simplify the tariff schedule.

## 2.3 Para-Tariff Measures

### **Para-Tariff Measures (2000)**

Measures that increase the cost of imports in a manner similar to tariff measures, i.e. by a fixed percentage or by a fixed amount, calculated on the basis of value and quantity, respectively.

#### Customs surcharges (2100)

The customs surcharge, also called surtax or additional duty, is an ad hoc trade policy instrument to raise fiscal revenue or protect domestic industry

#### Additional taxes and charges (2200)

Additional charges comprise of various taxes and fees, which are levied on imported goods in addition to customs duties, and surcharges and which have no internal equivalent.<sup>12</sup>

- tax on foreign exchange transactions (2210)
- stamp tax (2220)
- import licence fee (2230)
- consular invoice fee (2240)
- statistical tax (2250)
- tax on transport facilities (2260)
- taxes and charges for sensitive product categories (2270)
- other (2280)

#### Internal taxes and charges levied on imports (2300) [not included in ASEAN]

- general sales tax (2310)
- excise tax (2320)
- taxes and charges for sensitive product categories (2370)

#### Decreed customs valuations (2400)

Customs duties and other charges on selected imports can be levied on the basis of a decreed value of goods. This practice is presented as a means to avoid fraud or to protect domestic industry. The decreed customs valuation transforms an ad valorem duty into a specific duty.

<sup>12</sup> It should be noted that Article VII of GATT states that fees and charges other than customs duties and internal taxes shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.

### 2.3.1 Customs surcharges (2100)

Despite the ASEAN agreement to remove all surcharges by 1996, Viet Nam maintains surcharges on a small number of important products. During the past three years, customs surcharges have been applied for various periods of time to imported petroleum, some types of steel and iron, and fertilizer. Exports of coffee, unprocessed cashew nuts, and rubber have also had surcharges applied in recent years, purportedly as part of a price stabilization fund process (GoV 1998, p.118).

The surcharge rates have been changed with an alarming frequency. Since mid-1994, the rates on petroleum products have been changed fourteen times (GoV 1998, p.115). Rates on petroleum products differed between northern and southern Viet Nam until 1996. Rates of between two to ten per cent are applied to eight different types of iron and steel products.

In May 1997, surcharges only applied to imported iron and steel, and ten per cent on exports of unprocessed cashew nuts (GoV 1998, p.22). The surcharge for petroleum products, however, was reintroduced in July 1997 (GoV 1998, p.116), and then raised in March 1998 (305/CP-KTTH)<sup>13</sup> and in August 1998 (71/1998/QD/BVGCP-TLSX), with a 40 per cent surcharge presently applied to gasoline. Four months later, the surcharge on fertilizers was also reintroduced (2766/1998/TC/TCT)<sup>14</sup>, including a three per cent surcharge on urea. On 12 August, the Ministry of Finance then introduced a new five per cent surcharge on imported plastic goods made from PVC "to support the Mitsui-Vina joint venture" (3039/1998/TC/TCT)<sup>15</sup>.

Surcharges seem to be applied sometimes as *ad hoc* solutions to particular problems. On 14 August 1998, Customs introduced an additional "special consumption tax" on trucks converted into passenger cars, that applied immediately to all such imports since 1 January 1997. Viet Nam's practice of counting the seats of vehicles, rather than engine size, to determine the tariff rate was apparently being abused.

There seems no intention to abolish customs surcharges, and nor have there been any government statements to that effect. Recent pronouncements actually suggest a rapid increase in their use is imminent (4670/VPCP-KTTH)<sup>16</sup>. The surcharges seem mostly designed to extract windfall revenue gains for the government from international price fluctuations at the expense of Vietnamese consumers and export producers. This is not entirely true, as the government does try to apply price stabilization policies through subsidization mechanisms. It sets ceiling prices in the domestic market for "essential goods" like petroleum, urea fertilizers, paper, cement, and steel, and uses import quotas, directed credit and subsidies to support these prices (GoV 1996, p.8). State-owned companies that have and must fulfill urea fertilizer import quotas, for example, can expect to be bailed out if they suffer losses due to government price

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<sup>13</sup> See Freehill et al., April-May 1998; "This surcharge is not regarded as an import duty and therefore exemptions from import duties do not apply" (p.7).

<sup>14</sup> All legal documents quoted may be identified in more detail by searching the NTB Legal Database produced by this project.

<sup>15</sup> This is a fascinating instance of interest groups in conflict. The vibrant plastic goods industry in Viet Nam is resisting protection for the downstream Mitsui-Vina joint venture, which would see a significant increase in the cost of PVC resin. For a detailed discussion, see "Viet Nam and AFTA: By Choice or Obligation?", Report No. 4: Frank Flatters, September 1997; at <http://www.undp.org.vn/projects/vie95015/#inter>. Also, *Saigon Times* (12/09/98 and 09/05/98).

fixing (interview 12).

An explicit balancing of specific commodity surcharge revenues and subsidies, however, does not appear to happen. This is typically the objective of price stabilization funds, but Viet Nam's WTO Accession Memorandum (GoV 1996) suggests that it may only apply in this manner to coffee exports:

"Establishment of price stabilisation funds from charges on export/import prices with a view to partly balancing the differences between international and domestic prices during price fluctuation period. The Fund is used to cover interest of bank loans or to subsidise prices. To present, this has just been applied to coffee." (p.8).

A similar rice price stabilization fund, based on extracting a surcharge from rice exports, has been proposed (*Viet Nam Investment Review* 26/5/97, p.10), but as yet does not seem to have been implemented.

### **2.3.2 Additional taxes and charges (2200)**

The long list of additional border taxes and charges (see Appendix 2) are not applied or cannot be considered as barriers to trade in Viet Nam. Licence fees may exist for obtaining import and export quotas, but they are unlikely to be significant. Official customs fees and charges are also reportedly reasonable (interviews 20, 26, & 19). The present practice is for 100 per cent inspection of both export and import containers, and this involves a fee when inspection is conducted at places other than the official venues.

Fees are also applied for (GoV 1998, p.119):

- Re-certifying or re-issuing customs documents of goods and luggage.
- Escorting and sealing of containers.
- Customs warehousing.
- Wharfage charges.
- Storage and port space rentals.

Some examples of fee rates are (GoV 1998, p.121):

- Embarkation of goods on wharf: US\$0.0035/GRT; anchorage US\$0.0012/GRT
- Storage and customs warehousing fee:
  - for goods not in container, US\$0.2/MT/day; and
  - for 40 foot container, US\$3/day (loaded); US\$1.5/day (empty).

### **2.3.3 Internal taxes on imports (2300)**

Most taxes in Viet Nam, as noted above, aside from raising revenues, are also designed to promote industrialization policies of one form or another: import substitution, technology transfer, accumulation and investment, regional development, export promotion. In this section we discuss those that explicitly discriminate against imports and are collected at the border, while other taxes are discussed under Internal Measures (9000).

## **Special sales tax (2310)**

The Luxury Tax Law came into effect on 1 January 1999. This Law introduced a controversial new special sales tax regime (also called the special consumption tax), that replaces the 1990 Law of Special Sales Tax and its subsequent amending articles. The new Law explicitly discriminates against "filter cigarettes produced mainly from imported raw materials". These cigarettes faced a 65 per cent special sales tax, while those "mainly from domestic raw materials" were taxed at 45 per cent.

The new special sales tax removes the previous explicit sales tax imposed on imported cars, which had existed since October 1995 and which had afforded an effective rate of protection of over 200 per cent for domestic assembly operations (CIE 1998a, p.40). However, the scope for exemptions suggests little change in reality. In the Law, exemptions of various degrees were specified for businesses encountering difficulties due to "natural disasters and other sudden incidents"; for small-scale beer producers "suffering losses"; and for domestic automobile assembly operations (60-100 per cent up to ten years) and golf courses (30 per cent for five years)<sup>17</sup>.

The Ministry of Trade then expanded the scope for exemptions on 31 July 1998 (109/1998/TT-BTC). The amendment stated "that small scale manufacturers who have paid their special sales tax in full, and then experience production growth and encounter difficulties and losses will be considered for a reduction [of up to 50 per cent] in special sales tax" (Freehill *et al.*, August-September 1998, p.10). Given the fungibility of Viet Nam's accounting and auditing systems, which do not yet correspond to international norms, the scope for tax evasion through exemptions must be considerable.

## **The Value-Added Tax [VAT] (2320)**

The VAT took effect from 1 January 1999 (02/1997/QH9). There are four tax rates: zero per cent for exports; five per cent for education and agricultural goods and services, and medicines; 20 per cent for some services; and 10 per cent for all other goods and services. The VAT is therefore applied on a destination basis — imports are subject to VAT, and exports have a zero rate. Another aspect of the VAT is that it is collected at ports upon clearance of goods, unlike the previous system that allows 30 to 270 days of delayed payment of import duties. There are 26 specified exemptions from the VAT, some of which have direct implications for trade (89/1998/TT-BTC):

- "goods and services that are subject to special sales tax are not subject to VAT during production or importation;
- imported fixed assets (e.g. specialized machinery and transportation equipment) which cannot be produced locally;
- imported international aid;
- technology transfers;

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<sup>17</sup> See *Viet Nam Economic News*, 1998, No.26, pp.39-42, for a translation of the Luxury Tax Law.

➤ exported unprocessed minerals." (Freehill *et al.*, August-September 1998, p.10). The lack of precise definitions for concepts such as fixed assets "which cannot be produced locally" will inevitably "involve high degrees of judgment by collecting authorities, scope for widespread evasion and/or erosion of protection for local imperfect substitutes for the equipment." (CIE 1998a, p.67).

Some degree of VAT avoidance by domestic producers occurs, giving a lower real taxation of domestic products compared to imports. The solution to this problem, however, can only come through a further strengthening of existing tax collection and accounting systems in Viet Nam. Concern about increased scope for exemptions and VAT tax write-offs are warranted. Tax write-offs are commonly applied in Viet Nam for "enterprises in trouble", and this practice is also applied to the VAT.

### 2.3.4 Decreed customs valuation (2400)

Viet Nam utilizes minimum import prices (discussed under 3110) to determine the tariffs for many imported goods. For goods not covered by the minimum price list, the "contract price"<sup>18</sup> is used. However, if "the contract price cannot be used or [if the goods were] imported by method other than normal purchase in which payments are not made through banks", then Customs "is authorized to set (with agreement from Ministry of Finance) the minimum customs valuation import price" for the goods (GoV 1998, p.149). Decreed customs valuations are therefore the last and unusual step in the valuation process.

Viet Nam has committed itself to introducing the GATT customs valuation system by the year 2000, and there have been steps and statements in this direction. In March 1998, for example, Phan Van Dinh, Head of the General Department of Customs, reported that: "We are now trying to eliminate the three-way tariff classification in favour of an official method based on values stated in invoices. Of course, these documents must be genuine to prevent losses to the State." (*Viet Nam Investment Review* 9/3/98).

## 2.4 Price control measures

### **Price Control Measures (3000)**

Measures intended to control the prices of imported articles for the following reasons:

- to sustain domestic prices of certain products when the import price is inferior to the sustained price;
- to establish the domestic price of certain products because of price fluctuation in the domestic market or price instability in the foreign market; and
- to counteract the damage caused by the application of unfair practices of foreign trade.

Most of these measures affect the cost of imports in a variable amount calculated on the basis of the existing difference between two prices of the same product compared for control purposes.

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<sup>18</sup> "The term 'contract price' is construed to be the price indicated on the contract ... Therefore, the 'contract price' is not exactly a synonym of 'transaction value' used in the Agreement on Implementation of Article VII of the GATT" (GoV 1998, p.145).

### Administrative pricing<sup>19</sup> (3100)

By administrative price fixing, the authorities of the importing country take into account the domestic prices of the producer or consumer; establish floor and ceiling price limits; or revert to determined international market values.

    minimum import prices (3110)

### Voluntary export price restraint (3200)

A restraint arrangement in which the exporter agrees to keep the price of his goods above a certain level.

### Variable charges<sup>20</sup> (3300)

Variable charges bring the market prices of imported agricultural and food products close to those of corresponding domestic products, in advance, for a given period of time, and for a pre-established price.<sup>21</sup> [Based on a target domestic price of imports, a levy is imposed so that the price of imports reaches the target price whatever the costs of imports.]

    variable levies (3310)

    variable components (3320)

    compensatory elements (3330)

    flexible import fees (3340)

    other (3390)

### Anti-dumping measures (3400)

Imposition of a special import duty when the price of imports is alleged to lie below some measure of the costs of production of foreign firms. Minimum foreign prices may be established to “trigger” anti-dumping investigations and actions.

    anti-dumping investigations (3410)

    anti-dumping duties (3420)

    price undertakings (3430)

### Countervailing measures (3500)

Imposition of a special import duty to counteract an alleged foreign government subsidy to exports; normally required that domestic injury be shown.

    countervailing investigations (3510)

    countervailing duties (3520)

    price undertakings (3530)

### Other price control measures (3900)

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<sup>19</sup> Referred to as official prices, minimum import prices or basic import prices.

<sup>20</sup> Known as reference prices, threshold prices or trigger prices.

<sup>21</sup> Primary commodities may be charged per total weight, while charges on processed foodstuffs can be levied in proportion to the primary product contents in the final product (known respectively as variable levy and variable component in the EU).

## 2.4.1 Administrative pricing (3100)

### Minimum import prices (3110)

As noted above (2400), Viet Nam employs a schedule of minimum import prices as its first step in valuing imports. The list of 34 categories of merchandise subject to government management in terms of import prices for customs valuation (975 TC/QD/TCT) of 29 October 1996 was replaced by a list of 21 categories of merchandise (918 TC/QD/TCT) in 11 November 1997. The detailed list is as follows (from GoV 1998, p.146):

**Table 2.1: Viet Nam's Minimum Price List, 1997**

| No. | Items   | Harmonized System Tariff Code  |
|-----|---|--|
| 1.  | Milk powder, condensed milk and fresh milk  | 0401, 0402, 0403   |
| 2.  | Wheat flour, grain flour, tonic drinks  | 110100, 110190, 21069020, 21069090   |
| 3.  | Vegetable oil of all kinds  | From 150700 to 151800  |
| 4.  | Monosodium glutamate  | 210300   |
| 5.  | Sugar and confectionery   | 170100, 170200, 1704, 180600, 1905   |
| 6.  | Beverages of all kinds  | 220100, 220200, 20300, 20600, 220400, 220500   |
| 7.  | Cement, plaster   | 2523   |
| 8.  | Paint and varnishes of all kinds  | From 3208 to 3210  |
| 9.  | Shampoos, soaps   | 350510, 340100   |
| 10. | Plastics and plastic products:  | 392500, from 3919 to 3921, 391800  |
|     | - plastic roofing;  |  |
|     | - plastic doors and windows;  |  |
|     | - plastic ceiling boards;   |  |
|     | - thin plastic layer for packing purposes.  |  |
| 11. | Tyres and tubes of all kinds  | 4011, 4012, 4013   |
| 12. | Papers and boards of all kinds: with HS codes from 4801 to 4816 and 4818 and tariff rates of more than 10%. |  |
| 13. | Sanitary porcelain ware, ceramic tiles  | 9200, 691000, 691100, 91200, 732400, 741800, 61500, 681599, 690100, 90200, 690400, 690700, 90800 |
| 14. | Construction glass  | 00300, 700400, 700800  |
| 15. | Iron and steel of all kinds, aluminum structure   | 72, 7610 except 761020   |
| 16. | Gas cooker  | 732100   |
| 17. | Electric appliances and components  |  |
|     | - Electric pump;  | 41350, 841360, 841370, 41381   |
|     | - Electric fans;  | 41451, 841859  |
|     | - Air conditioners and parts;   | 41510 to 841590 and 8418   |
|     | - Refrigerators and parts;  | 8450   |
|     | - Washing machines and parts;   | 851610   |
|     | - Electric water heaters;   | 851660   |

| No. | Items  | Harmonized System Tariff Code                        |
|-----|--|--|
| -   | Electric cookers;                                  | 850910   |
| -   | Vacuum cleaners;                                   | 851821, 851822, 51829                                |
| -   | Speakers;  | 851840, 8519   |
| -   | Amplifiers;  |  |
| -   | Radio cassette and parts;                          | 52200  |
| -   | CD players and parts;                              | 52810, 852820, 52100                                 |
| -   | LD players and parts;                              | 51640  |
| -   | Television sets and parts;                         |  |
| -   | VCRs and parts;                                    |  |
| -   | Iron.  |  |
| 18. | Accumulator, battery                               | 850710 to 850780, 506                                |
| 19. | Automobiles and components                         | 70200, 8703, 8704, 870600, 70700, 870900, 8715, 8716 |
| 20. | Motorcycles and parts                              | 71100  |
| 21. | Chairs and tables, beds and wardrobes of all kinds | 40100, 94020030, 940300                              |

Within these tariff headings, brand name items are identified, so that, for example, over 3,000 prices were specified in the minimum prices list for the 34 commodities. Minimum export prices are also set for some products such as paddy rice (GoV 1998, p.14). The minimum price list above was replaced by another (590A/1998/QD-BTC) on 29 April 1998 and again in every subsequent year. The 1998 list covers 45 pages of prices, with most detailed in its listings of motor vehicles. The Toyota Landcruiser, for example, has 14 minimum prices specified depending on the specific model and year of production. The 1998 list also continues to specify higher prices for many products coming from G7 countries. G7 photocopy paper, for example, has a minimum import price of US\$1.50 per ream, compared to US\$1 from elsewhere. Powdered milk from Holland, Australia and Denmark is priced at US\$4, while any other is US\$3.5. Brazil, China, Indonesia, Sweden and the USA are just some of the countries that also feature in country-specific minimum prices. The latest list (177/2001/QD-TCHQ) issued in March 2001 is similar to that above, but is more detail with 137 pages. This list is much less country-specific but products coming from China often have different prices. And the 2001 list is much more brand-specific for most of commodity categories. It is clearly a document in need of revision to facilitate entry to the WTO.

Other minimum price changes have focused on prices for imported spirits (1334/1998/QD-BTC), including one specifically for Martell Medallion VSOP liquor (766/1998/QD-BTC). Customs is authorized to adjust prices actually used in duty assessment by five per cent, based on observed variations in actual import prices. Dutiable prices for imported second hand goods are set at 70 per cent of the price of a new good in the same category (CIE 1998a, p.116).

On 27 May 1998, a Decision (155/1998/QD-TCHQ) was issued to clarify the valuation process. Contract prices would be used if they were above the minimum price, and the minimum price used in other cases. But then, for "goods imported for direct use as materials and supplies in production and assembly, if the CIF price is higher than 60 per cent of the minimum price in the price index, the dutiable value will be the CIF price." (Freehill et al., June-July 1998, p.6). This constitutes a significant fall in the levied tariff for the import of intermediary products, although tariff rates for many of these were already low. The tariff rates on assembly operations,

however, are high and hence this Decision implies a sharp fall in the effective protection afforded to these industries<sup>22</sup>.

Decision 155 may have been a response to ongoing complaints about the inflexibility of the minimum price system, especially given sharp price changes in the prices for many goods in 1998 (*Viet Nam News*, 4/4/98, p.3). The US Trade Compliance Centre had noted this problem: "In practice, [Vietnamese] customs valuation remains non-transparent and is highly discretionary. Although in principle, reference prices are used to counter the practice of under-invoicing, the system is not responsive to world market price fluctuations. In the household electrical appliances sector, for example, the higher taxes paid on components have translated to a higher price on the finished product, as much as a 20 per cent inflation over Thailand, Malaysia and Singapore."<sup>23</sup> The interviews also revealed discontent about the rigidity of the minimum price system. Sharp falls in the price of Indonesian margarine and urea in 1998, for example, were not reflected in reductions of minimum prices for duty assessment (interviews 23 & 12)<sup>24</sup>.

The minimum price lists are applied rigidly and therefore set, in effect, a set of specific rates for imports. Discretion, however, is often involved in determining the particular tariff code to apply. This was a common problem raised in interviews and it is discussed in section 8300 of this report.

Viet Nam has made a commitment to ASEAN to implement the GATT valuation system by the year 2000. This will require a comprehensive programme of activities, but little seems to have been achieved to date (CIE 1998a, p.118). It is most likely that some form of minimum price system will continue for some years.

## **Maximum import prices (3120)**

Since at least April 1994 (Decree 33/CP), Viet Nam has taken the unusual step of setting maximum import prices "for certain imported goods which are of prime importance to the Vietnamese economy" (GoV 1998, p.21). These are imposed on fertilizer, petroleum, iron and steel and certain machinery and equipment (GoV 1998, p.14, 21).

Setting maximum import prices is a mechanism for avoiding transfer-pricing fraud by State trading companies. That may have had some relevance in the less competitive trading environment of 1994, but now it seems a crude and unnecessary solution to that problem. The purpose may also be to set the domestic prices for some of these goods. The objective for urea is, for example, "to supply farmers with the necessary urea quantity at reasonable prices" (GoV 1998, p.21). Thus, State importers are assigned urea quotas, which they must fulfill and sell at regulated prices, with any subsequent losses compensated for by the Government (interview 12). They might buy above the maximum import price to meet their quotas, but cannot sell above it domestically. On the other hand, enforced and low maximum import prices for import substitution goods like iron and steel may effectively constitute a ban on such imports.

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<sup>22</sup> On the other hand, it may only apply to imported raw materials, for which minimum prices have generally not been applied in practice anyway (interview 12).

<sup>23</sup> See <http://inforserve2.ita.doc.gov/tcc/...>

<sup>24</sup> Margarine was reportedly imported CIF for US\$665 per ton, but the minimum price was US\$990 per ton.

## **Minimum export prices (3130)**

Crude oil and rice are subject to minimum export prices (GoV 1998, p.162). This policy, like that of having maximum import prices, seems peculiar to retain in a market economy. In fact, their origins seem to be based on the need to control the activities of State-owned trading companies. Until recently, and possibly still, these companies could expect to be “bailed out” when they made losses. Also, the highly distorted price and incentive structure made crude policy instruments seem relatively sensible.

The need for these price control policies now is not apparent. Rice exports have been liberalized, and it is hard to see how setting a minimum export price for crude oil could be useful.

## **Administrative pricing (3190)**

In July 1997, the Government decided to regulate prices for the import of rubber wood from Cambodia "to avoid competition causing price raising and losses" (3159/1997/CV-VPCP-KTTH).

### **2.4.2 Anti-dumping (3400) and countervailing measures (3500)**

The Laws on Import and Export were amended in May 1998 to include, amongst other things, provisions to impose "an additional tax" on the following:

- "Import goods which are dumped in Viet Nam, hindering the development of the local production of goods of the same kind;
- Goods imported into Viet Nam with too low prices due to assistance from the exporting country, hindering the development of the domestic production of goods of the same kind;
- Goods imported from countries applying a strict tax policy and other procedures to Vietnamese commodities." (*Viet Nam Economic News*, 1998 No.26. p.39)

This amendment may be unveiling a new policy instrument for "fine-tuning" protection in Viet Nam. The distinction between "dumping" and "too low prices due to assistance" obviously needs more explanation. The latter probably reflects concerns about "unfair competition" or “unbalanced competition” often cited by Vietnamese business managers and officials (e.g. *Viet Nam Investment Review*, 20/7/98). This is another vague term, which in most applications can be equated with "strong competition". It is part of the Vietnamese protectionist rhetoric, and the fear is that this amendment will become its policy tool.

When Viet Nam joins the WTO, then imposing countervailing duties for anti-dumping will be much more difficult. The case must be argued convincingly and in detail to the WTO before any actions may take place. In effect, it would rule out this policy option for Viet Nam<sup>25</sup>.

When a country embraces the concept of dumping and countervailing duties, it also embraces an interpretation of barriers to trade, which extend beyond border measures. It may be more practical to take a stance that trade policies are border policies, particularly if your development

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<sup>25</sup> See CIE 1998a, pp.103-108, for a full discussion of this issue.

strategy is one of export-led protectionism — like Viet Nam. In this case, indignation about imports "with too low prices due to assistance from the exporting country" must ring hollow given Viet Nam's explicit and substantial export subsidization policies.

## 2.5 Finance measures

### **Finance Measures (4000)**

Measures that regulate the access to and the cost of foreign exchange for imports and define the terms of payment. They may increase the import cost in a fashion similar to tariff measures.

#### Advance payment requirements (4100)

Advance payment of the value of the import transaction and/or related import taxes, which is required at the moment of the application for, or the issuance of, the import licence.

#### Advance import deposit (4110)

Obligation to deposit a percentage of the value of the import transactions for a given time period in advance of the imports, with no allowance for interest to be accrued on the deposit

#### Cash margin requirement (4120)

Obligation to deposit the total amount corresponding to the transaction value, or a specified part of it in a commercial bank before the opening of a letter of credit; payment may be required in foreign currency.

#### Advance payment of customs duties (4130)

Advance payment of all or part of customs duties, with no allowance for interest to be accrued.

#### Refundable deposits for sensitive product categories (4170)

The deposit refunds are charges that are refunded when the used products or its containers are returned to the collection system

regulations concerning terms of payments for imports [see 4500]

transfer delays, queuing [see 4600]

other (4190)

#### Multiple exchange rates (4200) [not included in ASEAN]

#### Restrictive official foreign exchange allocation (4300) [not included in ASEAN]

Prohibition on [or priority access to] foreign exchange allocation (4310)

bank authorization (4320)

#### Foreign exchange surrender requirement (4400) [added for this study]

This is the requirement of the Central Bank that all "excess", or a specified percentage of foreign currency earnings must be converted into local currency.

#### Regulations concerning terms of payments for imports (4500)

Special regulations regarding the terms of payments of imports and the obtaining and use of credit (foreign or domestic) to finance imports

#### Transfer delays, queuing (4600)

Minimum permitted delays between the date of delivery of goods and that of final settlement of the import transaction (usually 90, 180 or 360 days for consumer goods and industrial inputs and two to five years for capital goods). Queuing takes place when the prescribed delays cannot be observed because of foreign exchange shortage, and transactions are settled successively after a longer waiting period.

“Foreign exchange control regulations date back to 1988, and a great number of governmental and SBV measures have been taken since then. They are part of a very complicated and unclear legal structure<sup>26</sup>. The goal of the exchange control policy has always been the same: to limit the outflows of foreign currency, to regulate transactions in foreign currency (“de-dollarization”), and to channel the foreign currency flows inside Authorised Credit Institutions.” (Gide, *et al.* 1998, p.36).

## **2.5.1 The State of Play as of November 1998**

In 1998 foreign exchange management controls became a more prominent economic policy tool in Viet Nam. The controls are being used to meet macroeconomic and specific trade and industry policy objectives. The renewed emphasis on foreign exchange controls is best illustrated when comparing the Government’s 1997, 1998 and 2000 annual lists of “non-essential imports”:

13 January 1997:

“Proceeding from the need of protecting domestic production, efficiently using foreign currencies and restricting the import of non-essential and luxury commodities ... [the government] shall adjust in time the import duties at appropriate rates and restrict to the minimum the granting of import permits”. [*Decision 28/1998/QD-TTg, Import-Export Management Mechanism in 1997. Article 5: “On the import of Consumer Goods”*].

23 January 1998:

“The imported consumer goods shall be regulated by taxes and payment modes of banks ... along the direction of restricting to the minimum the import of consumer goods which are not really necessary and goods which are produced in the country. [*Decision 11/1998/QD-TTg, Import-Export Management Mechanism in 1998. Article 5: “On the import of Consumer Goods”*].

30 December 1998:

“Consumer goods and a number of import materials shall be regulated by taxes and payment modes of banks ... Enterprises importing consumer goods shall have to balance their foreign currency demands by themselves and make the immediate lump-sum payment therefor. [*Decision 254/1998/QD-TTg, Management of Goods Import and Export in 1999. Article 5: “On the import of Consumer Goods”*].

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<sup>26</sup> Freshfields have characterised Viet Nam's foreign exchange regulations as like reading the turgid “*Finnegan's Wake*”: the words are certainly there but deciphering the exact meaning requires considerable assistance.” (Freshfields, August-September 1998, p.2).

The increased emphasis on financial controls preceded the removal of import licensing (see 6100), and was most probably a response to the Asian financial crisis and dwindling capital inflows. That is, an emerging “shortage of dollars” promoted a strengthening of foreign exchange controls that, as usual, were then also used to pursue other development strategy objectives.

The foreign exchange management controls discussed in this section affect both the size and composition of imports and can therefore be classified as NTMs (see UNCTAD 1994)<sup>27</sup>. To be considered as barriers, exchange management control NTMs should have a clear distortionary influence by impeding the import of goods, either through restrictive foreign exchange allocation (together with foreign exchange surrender requirements) or by restricting the availability of import finance.

The foreign exchange controls are described below as they relate to the various categories of the modified UNCTAD definition specified above. As an introduction, however, it should be noted that the evolution of these controls over the past two years has largely been driven by an inability to enforce them. What seem highly restrictive NTBs are, in practice, only partially implemented, if at all. The impression gained from interviews was that the State commercial banks place profit-maximizing concerns well before implementing the vague exhortations of government bodies. For this reason, the Government has had to impose crude but precise measures when vague ones were flouted. For example, the February 1998 regulation requiring enterprises and corporations to sell “surplus” foreign exchange to the banks [157/1998-CV-NHNN7], had to be followed up in September by a Decree that fixed the amount to sell at 80 per cent [173/QD-TTg].

The direction of foreign exchange management control policy is not encouraging. It seems headed towards stronger and cruder instruments of exchange rationing. The central issues are, however, to what extent are these controls circumvented, and how serious is the “shortage” of foreign exchange anyway?

## **2.5.2 Advance payment requirements (4100)**

### **Cash margin requirement (4120)**

During 1996/97, Viet Nam faced serious problems concerning a build-up of short-term international debt through Letters of Credit (LoCs). Defaults by the Vietcombank to honour some small LoCs caused concern about the level of foreign exchange reserves, and about Viet Nam’s commitment to international financial arrangements (Forster, 1998. P.8). In March 1997, it was reported that Vietnamese banks owed in excess of US\$1.3 billion in outstanding LoCs, of which US\$65 million was overdue (Freshfields, October 1997).

One response by the Government was to amend the target that imported consumer goods should not exceed the value of 20 per cent of total exports [864/1995/QD-TTg], turning it into a

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<sup>27</sup> These current account controls need to be distinguished from capital account controls, more generally known as “capital controls”, which manage foreign exchange flows entering and leaving a country and affect imports only indirectly. Viet Nam has always maintained capital controls, but they are not NTMs. Capital account controls were tightened in August 1998 under Decree 63/ND-CP.

specific list of consumer goods to be restricted from importing. The first general direction to make this list, quoted above, was issued in January 1997. The Ministry of Planning and Investment (MPI) then announced the list the next month [948 BKH/TMDV], and in doing so asked the State Bank to “control the opening of LoCs” to restrict these imports. The 1997 list of restricted consumer goods is shown below. Apparently, a more recent list exists, but we were unable to obtain a copy, although we were informed that it is very similar (interview 1).

**Table 2.2: List of consumer goods to be restricted from import.**

| <b>HS classifications</b>    | <b>Description of goods</b>                       |
|------------------------------|---|
| 0401, 0402, 0403, 0404       | Dairy produce                                     |
| 1509 to 1514                 | Vegetable fats and oils                           |
| 1701 to 1704, 2105, 2106     | Sugars and confectionery                          |
| 1801 to 1806                 | Cocoa and cocoa preparations                      |
| 190510 to 190540             | Breads  |
| All 22, except 2207 and 2209 | Beverages and spirits                             |
| 2009                         | Fruit and vegetables juices                       |
| 0901 to 0903                 | Tea and coffee preparations                       |
| 0701 to 0712                 | Edible vegetables                                 |
| 0801 to 0813                 | Edible fruit and nuts                             |
| 201 to 2009                  | Preparations of vegetables, fruits, nuts          |
| 2103, 2104                   | Miscellaneous edible preparations                 |
| 0201 to 0210                 | Meat and edible meat offal                        |
| 0301 to 0307                 | Fish and crustaceans                              |
| 3920                         | Film  |
| 4419                         | Tableware & kitchenware of wood                   |
| 7321, 7323                   | Kitchenware metal items                           |
| 711810                       | Coins (not gold)                                  |
| 761510                       | Kitchen and household aluminium items             |
| 8215                         | Forks, spoons, knives                             |
| 691110                       | Ceramic toilet and household products             |
| 7013                         | Glass household and kitchen products              |
| 9403, 9404                   | Bedding and similar furnishings                   |
| 9105                         | Other clocks                                      |
| 6301, 6302, 6303             | Textile items: curtains, blankets, linen          |
| 6910, 7324                   | Sanitary wares: steel and ceramic                 |
| 9617                         | Vacuum flasks                                     |
| 611220, 621120               | Clothing accessories                              |
| All 61                       | Clothing, knitted                                 |
| 640311                       | Footwear  |
| 6503 to 6506                 | Headgear and parts thereof                        |
| 6601                         | Umbrellas   |
| 3303 to 3307                 | Perfumes and cosmetics                            |
| 3401                         | Soap and washing preparations                     |
| 9613 to 9616                 | Lighters, pipes, combs, scent sprays              |
| 850610, 8509                 | Batteries, electro-mechanical domestic appliances |
| 8510                         | Shavers, hair clippers                            |

| HS classifications  | Description of goods                        |
|---|---|
| 8516  | Electrical water heaters                    |
| 85361010, 85362010, 85363010,<br>85365010, 85366110, 85371091, 85372091 | Domestic electrical appliances              |
| 8539, 8540, 9405  | Lamps and lights                            |
| 84181010, 84182111, 84182112  | Refrigerators                               |
| 84145111, 84145119 to 84145910  | Domestic fans                               |
| 84137011 to 84137012  | Household-type water pumps                  |
| 84151000 to 84152000  | Air conditioners                            |
| 84501110, 84501210 to 84501910  | Washing machines                            |
| 8519  | Record players and sound equipment          |
| 8520, 8522  | Tape recorders, parts & accessories thereof |
| 85281110, 85281210 to 85281310  | Televisions                                 |
| 852110  | Video players                               |
| 85271200, 85271300 to 85271900  | Radio cassettes                             |
| 90065110, 90065210, 90069190, 90069910                                  | Cameras and parts thereof                   |
| 900711 to 900719  | Video recorders                             |
| 900840  | Photocopiers                                |
| 87120010  | Bicycles                                    |

Source: 948/1997/BKH/TMDV

Note: HS codes are specified in the document, which makes it an exception.

In July 1997, the State Bank announced that a deposit equal to 80 per cent of a Letter of Credit was required to import goods on the restricted consumer goods list [515/CV-NH7]. This cash margin requirement constitutes a dramatic increase in import costs for reliable and profitable companies. These companies typically pay deposits of between zero to 30 per cent towards opening a LoC. Higher deposits of up to 100 per cent are required of less creditworthy customers, but the guiding criteria seems to be entirely commercial (interviews 19, 27 & 28). The Industry and Commercial Bank of Viet Nam (ICBV) did mention that higher deposits were required for consumer goods imports (interview 28), but the Vietcombank official interviewed said that product-specific cash margin requirements were not implemented in practice (interview 27). This was confirmed in interviews with trading companies, who reported that cash margin requirements depended on the Vietcombank ranking of their company, not on what was going to be imported (interviews 19 & 25). Thus, what seems to be a dramatic NTB is, in practice, something of a fiction.

### 2.5.3 Restrictive foreign exchange allocation (4300)

#### Prohibition on [or priority access to] foreign exchange allocation (4310)

The necessary rationing of foreign exchange has required the Government to specify who has priority access and who does not. This, therefore, has evolved into a mechanism for promoting the Government's development priorities.

Foreign invested enterprises (FIEs) are obliged to balance their foreign currency requirements and this was reaffirmed in mid-1997 [02/TT-NH7]. This does not apply to those FIEs that produce “import-substitution” products (together with specified Infrastructure Projects and Important Projects). These enterprises have “guaranteed access” to foreign exchange. FIEs involved in these projects can apply for a priority “conversion certificate” to obtain their required foreign exchange.

This setting of rationing priorities has, of course, required the production of many lists, as shown in Tables 2.3, 2.4 and 2.5. These generalized lists have been converted into lists that specify actual projects with exchange priority. The Ministry of Planning and Investment has selected 500 of its 1,829 listed FIEs for priority access to foreign exchange. The State Bank has also reportedly “given rights to 289 projects enabling them to convert their dong earnings into foreign currencies” (*Viet Nam Investment Review*, 28 December 1998. p.15).

**Table 2.3: List of infrastructure projects guaranteed foreign exchange.**

- Road, railway and inland transportation
- Domestic telecommunication systems and rural telecommunications
- Water supply and drainage
- Construction of industrial zone infrastructure and new urban areas
- Public transport projects in urban areas using advanced technology
- Bridge, port and airport construction
- Power plant and power distribution and transmission
- Urban and industrial waste treatment plants
- Construction of international schools and hospitals

Source: Freshfields, September 1997 [5158/BKH/QLDA-TC].

On 6 July 1998, the State Bank announced that FIEs which fall into the priority lists could apply for a “priority conversion certificate” to ensure that their foreign exchange requirements were met [585/CV-NHNN7]. Later that month, it was decided that, without specific State bank approval, commercial banks were not permitted to sell foreign currency to FIEs that did not have priority conversion certificates [844/CV-QLNH2]. These announcements were followed by a strengthening of foreign exchange surrender requirements (4400), which made being a “priority” FIE dubious value (discussed in next section).

**Table 2.4: List of important projects guaranteed foreign exchange.**

- Oil refinery and petro-chemical plants
- Mineral exploitation and processing projects
- Aircraft repair projects
- Telecommunications equipment manufacturing plants
- Industries producing new materials, biological technology, microelectronics information, laser and isotopic radiation technology
- Research and development projects
- Pharmaceutical production
- Labour intensive industries (5,000 or more employees)
- Production of plant seeds and animal species of high productivity
- Ferrous and non-ferrous metallurgical products

- Shipbuilding and repair projects
- Automobile and motorcycle parts manufacturing plants producing import substitutes
- Plants for “construction vehicle” manufacturing
- Investment projects in hi-tech zones using advanced technology (“where technology transfer is less than five years”)
- Afforestation projects
- Agricultural product processing
- Projects contributing over VND 100 billion per annum for the state budget
- Industries which are subject to special investment incentives in their investment licence

*Source:* Freshfields, September 1997 [5158/BKH/QLDA-TC].

So do these lists matter? If foreign exchange reserves continue to decline in the context of a relatively fixed exchange rate regime, then these lists constitute an increasingly strong barrier to trade – if they are implemented. The reality is that such regulations force commercial businesses to work outside the banking system. Even within the banking system the regulations, and in particular these lists, are interpreted somewhat as guidelines rather than directives.

The commercial banks have to balance three strong claims to obtain foreign exchange:

- 1) The priority for access due to inclusion on Government lists;
- 2) the foreign currency demands from trading companies which have deposited their export dollars at the bank, and,
- 3) the need to make profits from, and to maintain the custom of reliable trading companies.

The interviews clearly indicated that enterprise deposits in foreign exchange entitled that enterprise to withdraw the full amount for import activities (interviews 19, 20, 25 & 27).

If you earned dollars, you could get them back<sup>28</sup>, although recent surrender requirements (4400) have raised doubts even about this right. The question for banks was therefore how to divide remaining foreign currency reserves between “listed” enterprises and net importing trading companies. The returns from financing trading companies were quicker and larger. Financing of listed enterprise imports could entail long delays in repayments and higher risks, even with the expectation of eventual “bail-outs”.

**Table 2.5: List of essential import substitutes guaranteed foreign exchange.**

|                         |   |  |                                  |  |
|-------------------------|---|--|----------------------------------|--|
| Milk and dairy products | Aluminium structures for construction             | Televisions                                  | Neutral bottles of glass and PET | Handling machines (including lifts and escalators) |
| Steel pipes             | Phosphoric acid, hydrochloric acid, glutamin acid | Paints and raw material for paint production | Laminated steel                  | Construction and industrial glass                  |
| Cement                  | Electric lamps                                    | Electricity and water metres                 | Sugar                            | Vegetable oil                                      |
| Electrical              | Vaccines  | Kraft packaging                              | Lubricant oil                    | Metal roofing                                      |

<sup>28</sup> Letter 585 [6 July 1998, 585/CV-NHNN7] enshrines this right for FIEs, but the re-purchase of foreign exchange must happen within six months and be for specific purposes (see Freehill et al., June-July 1998, p.2).

|                            |  |  |  |                                |
|----------------------------|--|--|--|--------------------------------|
| transformers               |  | paper                                      |  |                                |
| Sodium carbonate           | Bulbs and components                               | Cars and motorcycles                       | Electrical equipment                                       | Bitumen                        |
| Radios, cassette players   | Tyres and tubes for cars, tractors and motorcycles | Mechanical equipment and industrial moulds | Chemicals for soap and detergent                           | Electricity control panels     |
| Electricity cables         | Coated steel                                       | Animal feed                                | Fertilizers  | Chemicals used in construction |
| Gasoline or diesel engines | Garment materials                                  | Metal and plastic boxes                    | Electronic components                                      | Pesticides                     |
| <hr/>                      |  |  |  |                                |
| Medical equipment          | Wheat flour  | Sodium hydroxide                           | Natural fibers   | Steel housing frames           |
| Agricultural equipment     | PVC for the production of plastic articles         | Starters for florescent bulbs              | Fabrics, including fabrics used in the production of tyres | Disposable plastic syringes    |

Source: CIE 1998 (p.33) and Freshfields, December 1997 [7273/BKH/QLDA-TC]

This conflict of commercial and regulatory requirements produces a balance whereby listed enterprises get some or most of their operational requirements, but may still complain, and trading companies get the balance which, for the moment, seems to be sufficient (interviews 19 & 25). “Priority access” to foreign exchange thus means, in reality, some preference backed by implicit government guarantees. This is not always enough. The steel-making joint venture, Posco Viet Nam, claims to be only able to obtain about one quarter of the US\$5-6 million “needed” each month, and in March 1998 it was reported that the Vietcombank was unable to supply Petrolimex with dollars from the company’s own current account (EIU 1998, p.32). The tensions inherent in such a rationing arrangement will increase if foreign exchange reserves dwindle further.

## 2.5.4 Surrender requirements (4400)

For some time, speculation about a further devaluation of the dong caused enterprises and individuals to hoard foreign exchange. This speculation was well founded and the dong was devalued by seven per cent in 1998. Nevertheless, it is clear that the dong remains rather overvalued, as indicated by a flat inter-bank market and stories in newspapers.<sup>29</sup> Surrender requirements have subsequently emerged as a principle mechanism for limiting this hoarding by enterprises. In practice, it is pushing an increasing share of financial saving and transactions outside of the banking system.

The surrender requirement saga continued throughout 1998. It began, on 10 January 1998, with a reminder to commercial banks that enterprises are only allowed to retain sufficient funds in their accounts to meet their operating requirements for that quarter [38/1998/CV-NHNN7]. So enterprises began using multiple bank accounts. In February, the Prime Minister declared that

<sup>29</sup> Viet Nam News 9/11/98, p.2; Viet Nam Economic Times, October. 1998 p.22; CIE 1998a, p.34.

enterprises could only maintain one foreign exchange bank account, and that all others had to be closed by 31 March [37/1998/QD-TTg]. That caused an outcry and so was revised to allow multiple bank accounts, but only with State Bank permission. On 23 February, and 21 March 1998, the State Bank issued implementing Correspondence about Decree 37 [157/1998/CV-NHNN7 & 249/1998/CV-NHNN7]. These stated that enterprises should sell their “surplus” foreign exchange to banks. The spectre of appropriation emerged, and was not much diminished by information provided to Freshfields at the time: “Due to protests the State Bank has informally advised that the implementation of mandatory sales is temporarily suspended” (March 1998).

The “surplus” being sold was, not surprisingly, minimal. The Prime Minister therefore bit the bullet and issued Decree 173/QD-TTg in September. The Decree stated that all Vietnamese enterprises, Corporations and FIEs with priority foreign exchange rights must sell at least 80 per cent of foreign currencies collected from their commercial activities within 15 days of obtaining them. Later documents provided the complicated details of implementation [08/NHNN7], and confirmed that Decree 173 would be implemented without exceptions [1297/CP-KTTH].

One commentator said Decree 173 “smacked of desperation, and will just fuel a speculative frenzy” (Le Duc Tan, in *Viet Nam Economic Times*, October 1998, p.22).

“Even if the measures do stop speculation, they will further reduce the liquidity and free flow of funds between buyers and sellers” (G. Thissen, Director of ABN-AMRO Bank in *Viet Nam News*, 27/9/98, p.3). According, however, to the State Bank Governor, Nguyen Tan Dung, Decree 173 is only “a temporary administrative regulation which the Government will repeal when other effective economic solutions come to light” (VIR, 2/11/98, p.18).

Foreign exchange transactions were already being conducted outside of banks. CIE (1998, p.34) reported in early 1998 that there was “anecdotal evidence that a ‘grey’ market in foreign exchange was developing where enterprises with foreign exchange flows were contracting to import goods on behalf of other enterprises, rather than selling foreign exchange into the bank/inter-bank market at the official exchange rates”<sup>30</sup>. Decree 173 will strengthen the trends toward “outside” transactions and speculative hoarding, and it will continue so long as the dong is perceived to be overvalued. “Outside” dealers can obtain more dong for their dollars.

Banks, it seems, have also been bending and sometimes breaking rules to charge more for their dollars:

“Immediately after the State Bank admonished five commercial banks for transgressing Viet Nam’s foreign-exchange rules, Vietnamese companies started reporting that they now have to buy their foreign currency at prices higher than the set rate – but without receipts ... banks have been selling foreign currency at a premium above the ceiling price. But previously they issued receipts and explained the difference as a commission or other expenses. Before that, the banks took advantage of the price difference between spot rates and forward rates and signed forward contracts, but delivered the money immediately. Now, they dare not give buyers proof of any higher amount for fear of being punished by the State Bank. Enterprises have to find their own way to account for the extra ‘tea money’, some by listing it as corporate entertainment expenses.” (*Viet Nam News*, 9 November 1998, p.2).

Within the banking system, enterprises were slow to sell their foreign exchange to the banks. By mid-October, only US\$388 million of an estimated US\$1 billion in bank foreign exchange

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<sup>30</sup> See also *Viet Nam Economic Times*, October 1998, p.22.

holdings had been sold (*Viet Nam News*, 19/10/98, p.4). The fifteen-day grace period for selling of foreign funds has also been utilized to transfer them between accounts when possible (*Saigon Times*, 12/11/98). Enterprises expected losses on exchange rate margins from having to sell dollars and then repurchase them later and, of course, to lose considerably more if the dong was devalued further. There is also uncertainty about their future access to “their” dong-denominated foreign exchange, which is now regulated:

“All these businesses need to do, according to the State Bank, is present sufficient documents and agreements relating to their operations and indicating they need foreign currencies for legitimate business purposes.” (*Viet Nam News*, 19/10/98 p.6)

Decree 173 has made foreign exchange rights of dubious value for FIEs. Some such firms have asked to stop receiving guarantees, which may have prompted the State Bank to specifically announce a list of the 225 FIEs with guarantees who are therefore required to convert 80 per cent of their foreign bank account funds into dong (*Saigon Times*, 12/11/98).

The surrender requirement saga is probably far from over. A further twelve commercial banks were recently reprimanded by the State Bank for selling foreign currencies “at prices higher than stipulated” (*Viet Nam News*, 25/11/98, p.4). If Decree 173 is indeed only a “temporary administrative regulation”, then it will most likely be followed by more. Well-founded expectations that the dong must devalue will drive this futile regulatory game until either a substantial devaluation does occur, or until there are no dollars left.

This regulation was tightened in December 1998 (Decision 418/1998/QD-NHNN7) requiring immediate selling of 80 per cent of foreign exchange earnings from current account transactions. Moreover, all foreign currency holdings have been required to be deposited in banks where they are subject to the rule concerning sale to the State Bank. Enterprises could repurchase foreign exchange for use in permissible activities, mainly in payment for “permitted” imports. The surrender requirement was relaxed somewhat in late 1999. Economic organizations are now permitted to sell at least 50 per cent instead of 80 per cent of foreign exchange earnings from current account transactions.

## **2.5.5 Regulations concerning the terms of payment for imports (4500)**

Foreign exchange rationing seems to be mainly achieved through the instruments discussed above, namely: LoC deposit requirements; priority access lists; and surrender requirements. Control over what companies could import, however, is in practice very weak. The interviews revealed no concerns relating to the ability to open LoCs, which seems to be still based entirely upon commercial criteria and at the discretion of the banks. If this changes, as it did for foreign loans in September 1998 [897/CV-NHNN7], then it would introduce a new and potent NTB.

The requirement for State enterprises to register their foreign loans with the State Bank had been in effect since 1996 [58/CP and 07/TT-NH7]. In September 1998, however, the State Bank ordered that all State enterprises “must lodge their foreign loan agreement with the State Bank for approval before signing the agreement” [897/CV-NHNN7]. Letters of Credit for over 12 months were also defined as foreign loans. This, if implemented in practice, constitutes a strong regulatory discipline on the capital account transactions of State enterprises. If the foreign exchange situation deteriorates further, the Government may be tempted to introduce

such discipline to the current account. Indeed, a 1998 newspaper report mentioned a new Government Decision that bans “banks from selling hard currency to companies that import” picture tubes and electronics spare parts (*Viet Nam Investment Review*, November 30, 1998. p.2). There may be more to follow.

## 2.6 Automatic Licensing Measures

### **Automatic Licensing Measures (5000) [not included in ASEAN]**

Automatic Licence (5100)

Import Monitoring (5200)

retrospective surveillance (5210)

prior surveillance (5220)

prior surveillance for sensitive product categories (5230)

Surrender Requirement (5700)

### 2.6.1 Import monitoring (5200)

#### Retrospective surveillance (5210)

Viet Nam's Customs department conducts retrospective surveillance of imports because many tariff rates and exemptions are classified on an end-use basis. This places a significant administrative burden upon Customs, who must try to ensure that imports given tax breaks based on end-use criteria do not "leak" to other uses or users. There are also substantial costs involved for end-users, which must regularly prove that they have indeed consumed the goods for which they were given tax breaks. This Customs monitoring role covers the following areas of tariff reductions and exemptions:

- Foreign invested enterprises and business cooperation contracts receive import duty exemption for fixed assets and some specialized transport equipment. This is based on approval of a project business and import plan (see Gide, *et al.* 1998 p.58 for details).
- Raw materials and goods imported for the implementation of BOT and BT projects are duty-free.
- Plant and animal species, chemicals imported for agricultural, forest and aquatic projects are duty free.
- "Other goods and materials necessary to encourage investment projects, as provided by the Prime Minister" (Gide, *et al.* 1998 p.58).
- Construction material imports by foreign-invested enterprises are duty free unless they are on the list of “construction materials that can be made locally” (2317/TCHQ-KTTT, 8/7/98).
- Duty drawbacks and refunds, duty exemptions or the 270-day suspension system (9110).

- Temporary import systems, manufacturing in bond procedures or export-processing zones (9110).
- Imports for security, national defense, scientific research and education.
- Various exemptions for Government agencies and foreign diplomatic and aid organizations.

The retrospective surveillance task assigned to Customs is thus considerable, indeed unrealistic. Customs must maintain a complex computer system for the tracking of Customs duties owed (interview 5), as all imports obtain suspended payment for between 30 to 270 days. Bad debts of such Customs duties were reported to have exceeded 500 billion dong (about US\$36 million) in early 1998 (*Viet Nam News*, 16/1/98, p.11).

The complex network of duty exemptions specific to projects, organizations (foreign investments, Ministries), or to promote exports, places an additional administrative burden on Customs. It is clearly the consequence of placing too many objectives upon the one policy instrument. This leads to needless complexity, higher administration costs, and opportunities for corrupt practices.

## 2.7 Quantity control measures

### **Quantity Control Measures (6000) [not included in ASEAN]**

#### Non-automatic licensing (6100)

- licence with no specific ex-ante criteria (6110)
- licence for selected purchaser (6120)
- licence for specified use (6130)
  - linked with export trade (6131)
  - for purpose other than exports (6132)
- licence linked with local production (6140)
  - purchase of local goods (6141)
  - local content requirement (6142)
  - barter or counter trade (6143)
- licence linked with non-official foreign exchange (6150)
  - external foreign exchange (6151)
  - importers own foreign exchange (6152)
- licence combined with or replaced by special import authorization (6160)
- prior authorization for sensitive product categories (6170)

#### Quotas (6200)

- global quotas (6210)
  - unallocated (6211)
  - allocated to exporting components (6212)
- bilateral quotas (6220)
- seasonal quotas (6230)
- quotas linked with export performance (6240)
- quotas linked with purchase of local goods (6250)
- quotas linked with local supply and demand (6260)
- quotas for sensitive product categories (6270)

### Prohibitions (6300)

May be selective with respect to commodities and countries of origin/destination

- total prohibitions (6310)
- suspension of issuance of licences (6320)
- seasonal prohibition (6330)
- temporary prohibition (6340)
- import diversification (6350)
- prohibition on the basis of origin (embargo) (6360)
- prohibition for sensitive product categories (6370)

### Export Restraints Arrangements (6600)

Restrictions imposed by importing country but administered by exporting country; administered multilaterally and bilaterally; requires system of licensing.

- voluntary export restraint arrangements (6610)
- orderly marketing arrangements (6620)
- multi-fibre arrangement (6630)
- quota agreement (6631)
- consultation agreement (6632)
- administrative cooperation agreement (6633)
- export restraint arrangements on textiles outside MFA (6640)
- quota agreement (6641)
- consultation agreement (6642)
- administrative cooperation agreement (6643)

### Enterprise-specific Restrictions (6700)

- selective approval of importers (6710)
- enterprise-specific quota (6720)

The discussion of Viet Nam's quantity and monopolistic controls becomes rather repetitive to fit within the UNCTAD classification system. The situation, in brief, is that a mix of direct quantity control and monopolistic measures are applied to a small number of important import and export goods. The importing of some other goods is regulated by various line Ministries, sometimes including quantity controls. Trading in most other products is unrestricted, particularly since the recent abolition of import licensing [57/1998/NP-CP].

This chapter and the next therefore detail the wide range of controls employed to maintain state control of trade in a select number of industries. The purpose is mostly to fine-tune protection for domestic producers, either state enterprises or FIEs, although revenue raising and food security are reasons for controlling some products.

## **2.7.1 Non-automatic licensing (6100)**

Licences are required to import some of the "goods regulated to balance the economy" (see section 6200) and for some goods under the authority of specific line Ministries. Government control of trade activity also typically extends down through Corporations to individual state enterprises. Corporations give permission or trade directly on behalf of their member enterprises, but this is a generalized system of control rather than licensing as such. Licences linked to foreign exchange, specified use or selected purchasers are not utilized. Some foreign

investment licences, such as for automobile assembly, include local content requirements and can thus be considered *production* licences linked to local production.

## **List of exports and imports subject to licences**

This falls under the category of non-automatic licensing (6100).

The products include:

- Petrol and oil
- Fertilizers
- Motorbikes and their complete assembly components
- Twelve- and under-twelve-seat automobiles
- Steel and iron
- Cement
- Refined and raw sugar
- Writing and printing papers
- Alcohol
- Construction glass
- Products under specialized control by line Ministries, approved by the Government

All these products should have a licence issued by the MoT. In addition, products under category line Ministries should have an authorization from relevant Ministries. These goods include chemicals, animals and plants, pharmaceuticals and cosmetics, and media products. As the regulations, including licensing, are predominantly of a technical nature these line Ministry controls are discussed under section 8000 (chapter 10).

Apart from the goods listed above, however, Viet Nam does not use import licences to micro-manage trade activity. Export promotion, for example, is pursued through foreign exchange rationing, subsidized credit and tax concessions (internal measures), and through import-duty exemptions. Exporters do not, however, have any special rights to import particular goods.

Licensing of the right to trade has, however, been an important NTB until its removal under Decree 57 [57/1998/ND-CP]. This system of licensing was very much a hangover from central planning. It did not exist to direct the allocation of resources, but rather to ensure that enterprises conducting trading activity were financially viable and had the “required skills” to conduct the business. It was a typically blunt policy mechanism by which the state attempted to control the effectiveness of its enterprises.

## **What is Decree 57?**

On 31 July 1998, the Government of Viet Nam enacted the Decree No. 57/1998/ND-CP providing details for the implementing the Commercial Law taking effect on September 1, 1998. Before Decree 57, only those enterprises that obtained Export-Import Business Licences issued by the Ministry of Trade (MoT) were able to conduct export and import activities. To get that licence, an enterprise had to meet certain financial and personnel capability criteria. Moreover, the enterprises were confined to trade in products that were specified in their Export-Import Business Licence.

Decree 57 stipulates "traders of all economic sectors established under the laws can export and import the products inscribed in their Certificates of Business Registration" (Article 3). MoT Circular 18/1998/TT-BTM of 28 August 1998, however, limits "traders" to enterprises established under the law, thereby excluding cooperative organizations and individuals from

direct foreign trade activities.

The only thing enterprises have to do before conducting export and import activities is register at the Customs Authorities. Enterprises register their Code Numbers and the products inscribed in their Certificates of Business Registration and receive a Certificate of Code Number Registration in return. This is once-for-all registration.

Circular No. 03/1998/TT-TCHQ of 29 August 1998 issued by the General Department of Customs guides the implementation of the Decree 57. This Circular sets out the procedures of Code Number registration by enterprises as follows:

The Code Number of an enterprise conducting export and import activities is identical to the Code Number given to it by Taxation Authorities of the Ministry of Finance in its Certificate of Tax Registration.

Enterprises register their Code Numbers at the Customs Departments of the provinces or cities where their headquarters are located. Upon application for Certificates of Code Number Registration, each enterprise has to present the following documents:

1. Certificate of Tax Registration issued by taxation authorities of the Ministry of Finance.
2. Certificate of Business Registration issued by provincial Departments of Planning and Investment or the Ministry of Planning and Investment.
3. Application Form for Code Number Registration.

The Customs Department will check the correctness of information provided in the Application Form and issues a Certificate of Code Number Registration of Export-Import Enterprises to the enterprise within five days.

### **What will be the impact of Decree 57?**

Decree 57 means that virtually all enterprises are now eligible to conduct export and import activities. The previous licensing regime had been fairly restrictive. Table 10 shows that, as of 30 November 1997, only 1,630 out of more than 32,000 domestic enterprises had Ministry of Trade Import-Export Business Licences, and the majority of these were State-owned enterprises. Further, the range of trading activity for individual enterprises has expanded, as the Business Registration Certificates are not as product specific as the previous Export-Import Business Licences.

**Table 2.6: The number of enterprises with trading rights as of 30 November 1997**

| Type of Enterprise              | Number |
|---------------------------------|--------|
| <i>By ownership:</i>            |        |
| State-owned enterprises         | 1,361  |
| Non-State                       | 269    |
| <i>By forms of enterprises:</i> |        |

| Type of Enterprise     | Number |
|------------------------|--------|
| Production enterprises | 867    |
| of which non-State     | 219    |
| Trading enterprises    | 763    |
| of which non-State     | 50     |

Source: Tran Dong Phuong (1998b).

Decree 57 therefore implies increased competition in trading activity, and this was the impression gained from the interviews. The situation, however, was already very competitive, aside from the short list of managed products [11/1998/QD-TTg]. Commissions for importing goods were slim, generally one per cent or less, and certainly much lower than the prevailing five to seven per cent in the early 1990s (McCarty, 1993). The net impact may be less than anticipated, but at least it removes one important and unnecessary bureaucratic hurdle for enterprises involved in trade.

### **Barter or counter trade (6143)**

The Government has authorized barter trade with Laos, and has even specified the commodities that can be exchanged. The principal activity seems to be Vietnamese rice for CKD “Dream 2” motorbikes (from Thailand). CKD motorbike imports are controlled through quotas, and an increase in the quotas was rejected in mid-1998 – except for companies that barter motorbikes with Laos (*Viet Nam News*, 15/9/98). At the same time, the Prime Minister asked relevant authorities “to quicken the localization programme for the motorbike industry”, and ordered the “Finance Ministry to issue guidelines for an automobile and motorbike component import tax that accords to their rate of localization” [1079/CP-KTTH] (p.3).

### **2.7.2 Quotas (6200)**

The export and import products controlled by quotas are:

- Rice exports (seasonal quotas linked to food self-sufficiency concerns).
- Products controlled by quotas allocated to Viet Nam by international economic organizations and foreign countries (e.g. clothing export quotas to the EU, Canada and Norway – see 6600).
- Goods “required to balance the economy” as specified in an annual Decision from the Prime Minister.

Rice export quotas are flexible throughout the year depending on seasonal output. The process was outlined in response to WTO questions:

“According to the Decision No. 141/TTg of the Prime Minister On the Administration of Rice Exports and Fertilizer Imports in 1997 dated 8 March 1997, rice export quotas are allocated to provincial people's committees based on the output of rice paddy in commercial quantity in each province. Provincial people's committees, in turn, allocate quotas to enterprises based on their actual export capacity. Quotas are also distributed to some Central Food Corporations based on

their capacity. In addition, to be eligible for quotas, enterprises must be members of the Vietnamese Foods Association.

The number of rice export channels is limited at a necessary level to prevent monopoly, encourage fair competition, and protect interests of producers and the prestige of the country.

According to the same Decision, any enterprise which is not able to fulfil the allocated quotas must report promptly and timely to the Ministry of Trade and the Ministry of Agriculture and Rural Development. These two Ministries report to the Prime Minister who would re-adjust the quotas and transfer to other enterprises that are able of fulfilling the quota. No form of quota sale or transfer is permitted.”  
(GoV 1998, p.161).

Rice exporting was significantly liberalized in 1998, and is now much more competitive. Quotas however, remain, despite the waning of food security as a reasonable rationale. Improved internal rice marketing and a decade of rice output exceeding population growth rates have made the prospect of localized famines remote. Continued control by export quota is probably only justifiable, if at all, as a second-best response to other incentive and price distortions, such as the need to maintain control of SOEs and to ration access to hard currency.

Controls on goods “required to balance the economy” are specified in an annual Decision from the Prime Minister. Decision No. 11/1998/QD-TTg of 23 January 1998 specifies the controls for 1998, and Circular No. 01/1998TM/XNK of 14 February 1998 of the Ministry of Trade guides its implementation. Ten products are controlled under these Decisions:

### Petroleum products

Decision No. 11/1998/QD-TTg set the quota for 1998 petroleum imports at seven million tonnes. The Ministry of Trade is responsible for the administration of importation within the prescribed quota. Petroleum Import-Export Corporation (PETROLIMEX) is assigned 60 per cent of the quota. The remaining quota is allocated to other state enterprises specialized in the petroleum business. These enterprises are those determined have adequate facilities for handling petroleum products such as tankers, tanks for storing petroleum, and safety equipment (Tran Dong Phuong, 1998b).

### Fertilizers

The importation of fertilizers is regulated by Decision No. 12/1998/QD-TTg of 23 January 1998 of the Prime Minister on “The administration of rice export and fertilizer import for the year 1998”, and MoT Circular No. 01/1998TM/XNK of 14 February 1998.

The Decision sets quotas for the importation of fertilizers in 1998 as follows:

**Table 2.7: Quota of fertilizers imported in 1998.**

| Kind of fertilizer | Quota (tonnes) |
|--------------------|----------------|
| Urea               | 1,600,000      |
| DAP                | 300,000        |
| SA                 | 250,000        |
| NPK                | 350,000        |

The Decision also provides that the MoT, in coordination with the Ministry of Agriculture and Rural Development (MARD), allocates the quotas to provinces and some selected central enterprises. It is a once-off allocation early in the year. Quotas are allocated to the selected central enterprises and provinces on the basis of the need of agricultural production in each province. The provinces then allocate the quotas to enterprises under their management. Thirty-five state-owned central and local enterprises were selected.

Non-state enterprises could, in theory, also be considered for licences, subject to the following requirements:

- having fertilizers or agricultural production materials noted in their Certificates of Business Registration;
- having a legally established distribution network; and
- having a sound financial situation, capable of raising funds and import payment for a minimum import amount of 50,000 tonnes per year.

### Motorbikes and their complete assembly components

MoT Circular No. 04/1998/TT-BTM of 12 March 1998 regulates the import of IKD-form components of motorbikes for 1998. Enterprises satisfying the following criteria can be licenced:

- Enterprises which have invested in the production or assembly of motorbikes in 1997 and were issued with licences to import IKD-form components for assembly in 1997;
- Newly invested enterprises of IKD-form assembly, which match the following conditions:
  - Having feasibility studies approved by their relevant direct managing authorities (Ministries or Provincial People's Committees)
  - Written approval by the Ministry of Industry
  - Certified by the Ministry of Science, Technology and Environment on their technical capability of IKD-form motorbike assembly, and on the list of in-imported components and the list of localized components in accordance with the Decision 65/TDC-QD of 16 March 1995 of the General Department of Standardization, Quality and Measurement.

### Automobiles of up to twelve seats

Decision No. 11/1998/QD-TTg prohibits the import of passenger automobiles of up to twelve seats, and MoT Circular 01/1998TM/XNK of 14 Feb. 1998 further specifies import prohibition of the following:

- Automobiles of up to twelve seats, and two and three-wheel motor vehicles, including in complete and SKD forms;
- Used automobiles and two and three-wheel motor vehicle engines;
- Two-wheel motor vehicle frames, except those as parts of imported CKD and IKD components;

- Cabins, chassis and chassis installed with engines of automobiles which are subject to special consumption taxes, except those as parts of imported CKD and IKD components;
- Used ambulance cars; and
- Automobile of dual purposes (i.e. used for the transportation of both passengers and goods).

## Steel and iron

The following products are temporarily prohibited from import:

- Construction smooth steel rods (HS 721310) of diameter 6-40 mm;
- Construction twist steel rods (HS 721310) of diameter 10-40 mm;
- L-figured steel rods (HS 721600) of height 20-100 mm;
- and I-figured steel (HS 721600) of height under 120 mm;
- Welded steel pipes (HS 7306) not coated and zinc-coated of diameter 14-115 mm;
- Zinc-coated flat steel sheet (HS 7212) of thickness 0.25-0.55 mm and length up to 3,500mm and zinc-coated and colored wave-profiled steel sheet; and
- Steel wire not coated or zinc-coated (HS 731300) and wire net (7314).

Other steel products can be imported freely.

## Cement

Circular No. 01/1998TM/XNK estimates demand for imported black cement in 1998 at 200,000 tonnes, of which 50,000 tonnes is allocated to the Sao Mai Joint-Venture Company. The importation of the remaining 150,000 tonnes is permitted only on the basis of permission by the Ministry of Construction (MoC) “when the need arises” (Tran Dong Phuong, 1998b).

## Refined and raw sugar

### **Box 2.1: Balancing supply and demand for sugar**

Edited highlights from *Viet Nam Investment Review* sugar industry articles during 1995-1997 give a flavour to the peculiar process of government-led “market balancing” (and rent distributing):

(30/10/95) “Viet Nam’s sugar farmers are bitter over sugar import quotas which have proven to be far in excess of demand and leaving them with no one to sell their crop to this harvest...Dang Minh Tan, General Director of the Vietnamese Union of Sugarcane Production, said sugar prices could fall five or six per cent. However, he said further imports could be stored until later in the year in order to even out the pricing and supply...The Government Price Board also submitted a proposal to re-establish the import tax at a rate of 20 per cent for raw sugar and 30 per cent for white sugar.”

(5/8/96) “The Ministry of Agriculture and Rural Development (MARD) has proposed that the Ministry of Trade should temporarily halt importing raw sugar from July 15 following a bumper sugar cane crop in 1995-96...Viet Nam expects to produce 1.5 million tonnes of sugar in 1998-2005. Under the Government plan, introduced in late 1994, Viet Nam will more than double its current annual production, to one million tonnes by 2000. With current domestic demand at 400,000 tonnes per year,

Viet Nam may not have to import sugar in 1997, said a ministry official, and could even move into the export market. The international price of sugar... has slumped to US\$221/tonne this year because of falling international demand.” (7/10/96) “The Ministry of Agriculture and Rural Development has called on the Ministry of Trade to halt sugar imports...Last year, Viet Nam consumed about 450,000 tonnes of sugar, of which 50,000 were imported. This year, imported sugar was reduced to 20,000 tonnes.”

(9/12/96) “Sugar executives welcomed last week’s announcement that sugar imports would be suspended in 1997, thereby keeping the Vietnamese market protected. ‘The sugar companies assume that market will remain protected but with Viet Nam trying to join the World Trade Organisation and APEC, it’s not clear that Viet Nam will continue to do that. These companies are definitely taking a risk,’ said a sugar company official...Even before the ban was announced, high tariffs on sugar imports kept the price of sugar in Viet Nam more than double the world price of about US\$300/tonne...At present, Viet Nam has 16 existing sugar factories with 27 under construction...The Vietnamese sweet tooth and a protected market go a long way towards explaining why foreign sugar companies are scampering to set up factories in Viet Nam despite a glut in the world sugar market.”

(3/2/97) “The Ministry of Trade has sanctioned new imports of [10,000 tonnes of] sugar [by two companies] to meet peak demand over Tet (Lunar New Year) despite a MARD pledge made late last year to support Viet Nam’s own sugar industry by blocking additional shipments...A January 25 cut-off was announced, after which no more foreign sugar would be allowed into the country.” (14/7/97) “Viet Nam plans to import 35,000 tonnes of raw sugar over the next month to help fulfil demand from the sugar refining industry.”

(11/8/97) “The price of sugar could be set to skyrocket due to poor domestic output and delayed imports which are in danger of causing shortages throughout Viet Nam in the mid-Autumn festival season, say officials. As scheduled, 5,000 tonnes of refined sugar and 35,000 tonnes of raw sugar should have arrived at Vietnamese ports before August 20. But so far, none has arrived, and authorities fear a rise in the cost of sugar is in the cards...The question of whether sugar should be imported or not is raised every year, although many industry experts believe that often it is not necessary and is based on inaccurate figures on production and consumption.”

Circular No. 01/1998TM/XNK sets the quota of imported sugar in 1998 at approximately 80,000 tonnes, of which:

- Raw sugar (HS 170111): 60,000 tonnes allocated to enterprises designated by the Ministry of Agriculture and Rural Development. The shipment should arrive at the latest by 30 August 1998.
- Refined sugar (HS 170191): 20,000 tonnes. The importation is administered by the MoT in coordination with the Ministry of Planning and Investment and the Ministry of Agriculture and Rural Development, and is permitted only “when market demand arises”.

## Writing and printing paper

Also by Circular No. 01/1998TM/XNK, imports of the following kinds of paper are temporarily suspended:

- Paper for newspaper (HS 480100);
- Normal writing and printing paper (HS 4802); and
- Paper for making packages (HS 480421).

## Alcohol

MoT Circular No. 06/1998/TT-BTM of 26 March 1998 sets provisions on the importation of alcohol in 1998. Importers of alcohol bottled in foreign countries are selected from licenced State-owned enterprises that were undertaking alcohol import during 1996-97 of above US\$200,000. Authorized enterprises can only import US\$150,000 of alcohol of 30 proof or more, unless otherwise authorized by the MoT.

## Construction glass

Circular No. 01/1998TM/XNK sets the approximate import demand for transparent sheet-shape glass of 2-7 mm thickness (HS 7003) at 2.5 million square metres. Enterprises under the management of the MoC are allocated 1.5 million square metres, and other enterprises one million square metres. The quotas are allocated on the first-come, first-served basis.

### 2.7.3 Prohibitions (6300)

#### List of prohibited goods in 1998

- Weapons, ammunition, explosives and military technical equipment
- Narcotics of various kinds
- Toxic chemicals
- Reactionary and immoral cultural products
- Firecrackers of all kinds, and toys detrimental to personality education and society's order and security
- Cigarettes (except for personal use in a prescribed amount)
- Used consumer goods (except those of private property of migrants, including of diplomatic officials of foreign countries and international organizations, as well as those in the form of personal luggage the quantity of which is limited)
- Right-handed steering automobiles and motor vehicles (including those in incomplete-knock-down form)
- Used spare parts of automobiles, two and three-wheel motor vehicles, including used automobile chassis with engines<sup>31</sup>.

Viet Nam is also issuing specific lists of goods to be banned if they are, or sometimes if they could be made in Viet Nam. In March 1998, for example, the Ministry of Health asked hospitals to draft a list “of indispensable drugs, none of which may be imported if locally made versions are available” (*Viet Nam Economic Times*, August, p.28).

### 2.7.4 Export restraint arrangements (6600)

Garment export quota arrangements are utilized for exports to the European Union (EU), Canada and Norway. EU quotas are issued in batches over the course of a year: 40 per cent in September of the year before, 20 per cent in December, and 30 per cent in March of the actual quota year. The remaining 10 per cent are allocated less systematically. The main criteria for obtaining a quota seem to be prior performance in fulfilling them (interview 14), which restricts

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<sup>31</sup> Although used automobile engines are included in the list of import prohibition, MoT Circular No. 08/1998/TT-BTM of 28 April 1998 allows for their importation.

competition. Given the vigorous black market in selling EU clothing quotas, this rationing criterion does not seem to have much justification in reality. Obtaining an EU shirt quota presently costs US20 cents, which includes both formal and informal payments (interviews 24, 26, & 14), these often involve provincial authorities, which receive quotas, but in reality have little capacity to fulfill them. Apparently plans are being developed to auction 30 per cent of some EU quota categories (interview 14). Some trial auctioning has taken place. The trials provoked criticism about “small and medium” enterprises missing out on quotas as larger enterprises could pay more, which was an innovative approach to justifying non-transparent allocation systems (*Viet Nam News*, 11/1/99).

Private companies receive no allocation of EU quotas, so all rents accrue to state enterprises and officials. Private companies need special connections to obtain a share of rents, or otherwise they operate as low-margin subcontracting operations.

In return for their quotas, EU imports to Viet Nam across 243 tariff lines are subject to tariff reduction over a ten-year period, which started from 1 January 1996 [Decree No. 18/CP] (GoV 1998, p.106). Viet Nam reduced taxes on garments and textiles imported from the EU by two per cent during 1998-1999, and 3-5 per cent in 2000-2001.

Material imported for re-export is exempted from duties, but this requires a complex system of post-clearance monitoring. “Quota books” are issued whereby imported materials and corresponding exports are recorded by Customs authorities. Customs officials may visit production sites to measure material used for making a shirt. The whole system is administratively complex and time-consuming and, in the end, easily evaded. Further, anti-smuggling efforts concerning textiles and clothing have been generally ineffective, despite an apparent “informal ban” on fabric imports from China (interview 14).

## **2.7.5 Enterprise-specific restrictions (6700)**

### **Selective approval of importers (6710)**

#### **Enterprise-specific quota (6720)**

All of the quantity controls discussed above involve specifying which enterprises and Corporations have the right to import and how much they can import. These enterprises and Corporations are typically also producing that product in Viet Nam, or they may be trading companies belonging to the Ministries involved in making the decision. Some quotas get allocated to provincial authorities. The process for selecting enterprises is not clear. GoV (1996), however, provides some insight into the apparent criteria:

“In principle, the allocation of import quotas for a certain item shall not depend on whether the enterprise to which the quota allocated produces that item. The most important criterion is the enterprise’s ability of implementation. If an importer enterprise is considered to be unable to fulfil the allocated quota, the licensing authority has the right to revoke the quota for allocation to other requiring importers (this is also applied to licences under quantitative management, ensuring the import plan). In case the importation of a certain item cannot be implemented due to objective reasons (e.g. the import duty is too high), the State can consider a reduction of import duties, enabling the importers to fulfil the allocated quotas.” (p.3)

## 2.8 Monopolistic measures

### **Monopolistic Measures (7000)**

Measures which create a monopolistic situation, by giving exclusive rights to one or a limited group of economic operators, for either social, fiscal or economic reasons

#### **Single or limited number of channels for imports (7100)**

All imports or imports of selected commodities have to be channeled through state-owned agencies or state-controlled enterprises. Sometimes the private sector may also be granted exclusive import rights.

state trading administration (7110)

sole importing agency (7120)

#### **Compulsory national services (7200)**

Government-sanctioned exclusive rights of national insurance and shipping companies on all or a specified share of imports.

compulsory national insurance (7210)

compulsory national transport (7220)

“The present system of allocating quotas and granting permits is aimed essentially at creating a kind of monopoly profit for state-owned businesses and foreign investors”  
(Le Bo Linh in Vo Dai Luoc [ed], p.55).

The extent of monopolistic measures depends crucially on the definition of “monopoly” one adopts. It can range from a definition requiring a single importing enterprise, to a more general but in some ways more satisfying concept of “the absence of competition”.

This report adopts the latter definition that, as discussed above, required some extension of the UNCTAD classification scheme.

### **2.8.1 Single or limited number of channels for imports (7100)**

As Table 2.8 shows, Viet Nam’s largest fifteen import and export companies conducted only a modest 10.2 per cent of total trade during the first five months of 1998. The Food Corporation of Viet Nam (FCV) dominates with a 3.7 per cent of total trade, and its share of particular agricultural exports must be considerable. Several import-substituting joint ventures are major importers. Seven companies appear in both lists. It would appear that trade as such is not monopolized, but that monopolistic activity may be prevalent for particular products and industries.

**Table 2.8: Largest import and export companies in the first five months of 1998.**

| <b>Companies</b>                           | <b>Imports</b> | <b>Companies</b>               | <b>Exports</b> |
|--|----------------|--------------------------------|----------------|
| FCV  | 161,760        | FCV                            | 166,842        |
| GMV JV Co                                  | 43,486         | Viet Nam Floating Glass Co.    | 29,225         |
| Tae Kwang Vina Industrial Co               | 38,781         | Tae Kwang Vina Industrial Co   | 28,498         |
| VietsoPetro                                | 36,339         | Pouchen Viet Nam Co. Ltd.      | 22,758         |
| Honda Viet Nam Co.                         | 30,296         | VPS                            | 21,464         |
| Vinakyoei Steel JV Co.                     | 21,351         | Haulon Corporation Viet Nam    | 20,692         |
| Petroleum Exploration and Exploitation Co. | 21,297         | Orion-Hanel TV tube Co.        | 18,432         |
| Sam Yang Viet Nam Co. Ltd.                 | 20,923         | Daewoo-Hanel                   | 16,046         |
| Orion-Hanel TV tube Co.                    | 20,221         | Vedan joint-stock Co. Ltd.     | 15,266         |
| Chang Shin Viet Nam Co. Ltd                | 19,605         | Chang Shin Viet Nam Co. Ltd    | 15,007         |
| Vedan joint-stock Co. Ltd.                 | 17,332         | Sony Viet Nam Co.              | 13,379         |
| Pou Yuen VN Joint-Stock Co. Ltd.           | 16,833         | Samyang Viet Nam Co. Ltd.      | 12,838         |
| Pouchen Viet Nam Co. Ltd.                  | 15,322         | Lac Cuong Footwear Co.         | 11,922         |
| Wei Xern Sin Industrial Co.                | 14,414         | Sai Gon Steel Pipe Corporation | 11,409         |
| My Duc Enamel Tile JV Co.                  | 12,614         | VMS                            | 11,243         |
| Total of 15 companies                      | 490,574        | Total of 15 companies          | 415,021        |
| Total imports to end-May 1998              | 4,833,000      | Total exports to end-May 1998  | 4,024,000      |

*Source:* Viet Nam Economic News, No. 29, June 1998, p.43.

The high level of direct trading by Government Ministries and provincial authorities is probably of greater concern than the imports by individual companies. The moral hazard posed by this situation is immediate: those who make commercial policies are also making the profits. Table 2.9 shows that trade is dominated by the state, although the data on provincial and city authorities may be for all businesses in those areas (i.e. not just the Government). Nevertheless, the eight central Government agencies listed conducted 56 per cent of Viet Nam's exporting, and 48 per cent of its importing, during the first three months of 1998.

**Table 2.9: Exports and Imports by Ministries and Provinces,**

| <b>January to March 1998 (US\$ millions)</b>  |                |                |
|---|----------------|----------------|
| <b>Ministries and Provinces</b>               | <b>Exports</b> | <b>Imports</b> |
| Ha Noi City                                   | 62,734         | 138,758        |
| Government Office                             | 342,701        | 15,577         |
| Ministry of Agriculture and Rural Development | 232,688        | 84,708         |

| <b>January to March 1998 (US\$ millions)</b> |                |                |
|--|----------------|----------------|
| <b>Ministries and Provinces</b>              | <b>Exports</b> | <b>Imports</b> |
| Ministry of Defense                          | 22,380         | 91,415         |
| Ministry of Fisheries                        | 20,602         | 41,231         |
| Ministry of Health                           | 2,706          | 33,325         |
| Ministry of Industry                         | 158,658        | 280,430        |
| Ministry of Trade                            | 87,412         | 318,578        |
| Ministry of Transport and Communications     | 43,483         | 81,816         |
| Ba Ria-Vung Tau                              | 18,421         | 57,794         |
| Dong Nai                                     | 82,981         | 118,640        |
| Hai Phong                                    | 55,864         | 77,737         |
| Ho Chi Minh City                             | 342,184        | 589,478        |
| Long An                                      | 51,226         | 34,150         |
| Tien Giang                                   | 51,934         | 555            |
| Vinh Long                                    | 44,196         | 5,311          |
|  | 1,620,170      | 1,969,503      |
| Total trade for the three months             | 2,138,000      | 2,720,000      |
| Above list as per cent of total trade        | <b>75.8</b>    | <b>72.4</b>    |

Sources: Viet Nam Economic News, No.18 May 1998, p.44.

Trade totals from *Viet Nam Economic Times*, February 1999, p.29.

At the national level, competition to import quantity-controlled goods (6000) is highly restricted. For petroleum there are only five designated “focal point” enterprises (GoV 1996, p.186). All other goods that involve quotas and line Ministry management also involve, to varying degrees, monopolistic practices. Similarly, the particular enterprises allowed to export rice or coffee, and to the EU under quota arrangements, involve non-transparent processes of selection. Most “selected” enterprises for quota imports are domestic producers of the same goods, or trading enterprises belonging to Ministries making the policy decisions. The moral hazard problem is obvious. One consequence has been erratic price fluctuations as Corporations and others have been tempted to exploit their monopoly positions. Sugar, discussed above, suffered from “hoarding” and “artificial shortages”. Cement has had a similar experience:

“Just months after being established, the Viet Nam National Cement Corporation – one of the first if Viet Nam’s new ‘state corporations’ – came under intense government criticism for allegedly exploiting its semi-monopolistic position as the dominant manufacturer and major importer of cement, by hoarding and speculating during the key construction period just before the rainy season.” (Freeman 1996, p.393).

The actual scope of monopolistic activity, however, is probably wider than the list of quantity controlled products. Firstly, the state sector continues to dominate importing, where informal barriers continue to constrain the private sector. Exports of agricultural products also involve state enterprise cartels with little scope for competition. Secondly, localized provincial monopolies are prevalent, which restrict the choices of producers (farmers). Countervailing this pessimistic picture are observations of evident competition between state enterprises: between those owned by Central authorities (Ministries, the Army, the Party) and those owned locally (provincial, sub-provincial). The formation of the corporations, however, has limited this intra-state sector competition. Also, the scope for monopolistic behaviour is directed correlated to the ability of interested parties to control trading activity. Smuggling remains rampant in Viet Nam and, like corruption, is largely a consequence of a trade policy environment trying to provide protection and economic rents. Smuggling maintains competitive pressures which for many products, such as bicycles and electronic products, seem to negate most attempts at protection (interviews 7,8,21, and 22).

## 2.8.2 Compulsory national services (7200)

These do not seem to be much of a problem in Viet Nam. The insurance industry remains tightly controlled by state enterprises, despite strong pressures for entry by foreign companies. The struggle for market control seems to be between *Bao Viet*, which holds a virtual monopoly at present, and various Corporations that want to establish their own insurance operations to cover enterprises under their control. For international trade, however, enterprises do seem to have choice. This also applies to valuation services, with about four foreign valuation companies operating in Viet Nam.

## 2.9 Technical measures

### **Technical Measures (8000)**

Measures referring to product characteristics such as quality, safety or dimensions, including the applicable administrative provisions, terminology, symbols, testing and test methods, packaging, marking and labeling requirements and they apply to a product.

### **Technical Regulations (8100)**

Regulations that provide technical requirements, either directly or by referring to or incorporating the content of a standard, technical specification or code of practice, in order to protect human life or health (sanitary regulation); to protect plant health (phytosanitary regulation); to protect the environment and to protect wildlife; to ensure human safety; to ensure national security; to prevent deceptive practices.<sup>32</sup> [Regulations designed for domestic objectives but which may discriminate against imports]

Product characteristics requirements (8110)

Technical specifications prescribing technical requirements to be fulfilled by product.

Marking requirements (8120)

<sup>32</sup> The regulation may be supplemented by technical guidance that outlines some means of compliance with the requirements of the regulation, including administrative provisions for customs clearance, such as prior registration of the importer or obligation to present a certificate issued by relevant governmental services in the country of origin of the goods. In certain cases, a prior recognition of the exporter or certificate issuing service by the importing country is also required.

Measures defining the information for transport and customs that the packaging of the goods should carry (country of origin, weight, special symbols for dangerous substances, etc.).

Labeling requirements (8130)

Measures regulating the kind and size of printing on packages and labels and defining the information that may or should be provided to the consumer.

Packaging requirements (8140)

Measures regulating the mode in which goods cannot be packed in conformity with the importing country handling equipment or for other reasons and defining the packaging material to be used.

Testing, inspection and quarantine requirements (8150)

Compulsory testing of product samples by a designated laboratory in the importing country, inspection of goods by health authorities prior to release from customs or a quarantine requirement in respect of live animals and plants.

Pre-shipment Inspection (8200)

Compulsory quality, quantity and price control of goods prior to shipment from the exporting country, effected by an inspecting agency mandated by the authorities of the importing country. Price control is intended to avoid under invoicing and over invoicing so that customs duties are not evaded or foreign exchange is not being drained.

Customs formalities (8300)

*Special formalities (8310) UNCTAD:* Formalities which are not clearly related to the administration of any measure applied by the given importing country such as the obligation to submit more detailed product information than normally required on the basis of the customs declaration, the requirement to use specific points of entry, etc.

*Customs efficiency (8320):* The general processes and efficiency of Customs.

*Corruption (8350):* Corruption in Customs activities.

## 2.9.1 Technical Regulations (8100)

Viet Nam has adopted European Quality Standards and is a member of various international organizations. Thus, in the opinion of the European Union: "Given the existing regulations and the [Vietnamese] Government's commitment to improve it constantly and consistently, making the WTO's requirements on Technical Barriers to Trade (TBT) should not pose major problems"<sup>33</sup>.

In general, Viet Nam does not use technical measures to serve as NTBs (McCarty, 2000). The exceptions to this are some goods controlled by specific Ministries, which are discussed below. Viet Nam's protection is achieved through the use of crude policy tools, so there is no need for less transparent policies. The ongoing process of global integration may, however, see a trend towards the use of technical barriers to trade in Viet Nam as pressure increases to remove more obvious measures, such as quotas. As elsewhere, if national policy makers are not convinced about the benefits of unilateral trade liberalization (or are "captured by interest groups), then technical measures become a useful option for maintaining protection.

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<sup>33</sup> See <http://mkacddb.eu.int/mkdb/sec1.pl>

## 2.10 Quality control measures

During 1994-1996, the number of cases where inspected import shipments of goods that did not meet Vietnamese standards were as follows (GoV 1998, p.173):

**Table 2.10: Import Inspection Results, Viet Nam 1994-96.**

|                                      | 1994  | 1995  | 1996  |
|--------------------------------------|-------|-------|-------|
| Number of inspected lots             | 4,500 | 6,200 | 8,400 |
| Number of lots not meeting standards | 50    | 80    | 90    |
| Percentage                           | 1.1%  | 1.3%  | 1.1%  |

**Table 2.11: Agencies carrying out state compulsory inspection for traded commodities**

| Product  | State Inspection Agencies   |
|--|---|
| <b>Imports:</b>  |   |
| Milk, Flour, sugar, monosodium glutamate, alcohol and non-alcoholic beverages, food additives. | Quality Assurance and Testing Centres 1,2,3 (MOSTE); Nutritional Institute (MoH); Nha Trang Pasteur Institute (MoH); Public Health Hygiene Institute of Ho Chi Minh City (MoH).   |
| Fertilizers  | Quality Assurance and Testing Centres 1,2,3 (MOSTE)   |
| Insecticides, fungicides, herbicides   | Quality Assurance and Testing Centres 1,2,3 (MOSTE); North and South Centres for Pesticide Inspection (MARD).   |
| Explosives and related accessories   | Laboratory of Mine-Chemical Enterprise of Quang Ninh (Ministry of Industry); Explosives Centre of Military Technical Institute (Ministry of Defense)  |
| Fish (other processed fish), crustaceans, mollusks (processed crustaceans and molluscs)        | Department of Aquatic Resource Protection (Min. of Fisheries); The National Fisheries Inspection and Quality Assurance Centre (Min. of Fisheries); Quality Assurance and Testing Centres 1,2,3 [except breeding shrimp] (MOSTE) |
| Goods under management of MOSTE  | Quality Assurance and Testing Centres 1,2,3 [except breeding shrimp] (MOSTE)  |
| <b>Exports:</b>  |   |
| Fish (or processed), crustaceans, molluscs (or processed).                                     | Department of Aquatic Resource Protection (Min. of Fisheries); The National Fisheries Inspection and Quality Assurance Centre (Min. of Fisheries); Quality Assurance and Testing Centres 1,2,3 [except breeding shrimp] (MOSTE) |

Source: GoV 1998, Annex 5. See also MOSTE 2386/1998/QD-BKHCNMT for the latest quality control list, effective 1 January, 1999.

“Goods that did not meet the set standards are mainly home electric appliances and devices, food and foodstuffs (wheat flour, cooking oil, milk powder and food additives) and some consignments of fertilizer and insecticide.

Standards which have not been met are:

electrical safety requirements;  
food hygienic standards; and  
standards concerning maximum level of activators (fertilizers, insecticide).”  
(GoV 1998, p.173)

“State administration of product quality is carried out principally through the two following measures:

- "Registration of product quality" - applied to domestically produced goods.
- "State inspection on quality" - applied to exported and imported goods (Table 14).

So far, Viet Nam has issued about 4,000 national standards<sup>34</sup>, of which 100 standards are mandatory. The mandatory standards are those related to environmental hygiene, safety and to products important to the national economy. Governmental agencies are empowered to announce the mandatory standards as for application to specific products within areas of their management.” (GoV 1998, p.174)<sup>35</sup> Other technical requirements, such as labelling (MoT Decision 636-TM-QLCL), can be demanding but, nevertheless, do not appear designed as barriers to trade<sup>36</sup> (McCarty, 2000).

### **2.10.1 Goods subject to specialized control by line Ministries**

The government bodies involved in the administration of foreign trade in specific products include:

- Ministry of Industry
- Ministry of Agriculture and Rural Development
- Ministry of Public Health
- Ministry of Aquaculture
- Ministry of Culture and Information
- Ministry of Labor, Invalids and Society
- Viet Nam State Bank
- General Department of Posts and Telecommunications

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<sup>34</sup> Up to “approximately 5,000” according to *Viet Nam News*, 19/7/98, p.2.

<sup>35</sup> See GoV. 1998, Annex 5 for a list of “Agencies Carrying out Registration of [Domestic] Products”.

<sup>36</sup> See <http://infoserv2.ita.doc.gov/tcc/> for a detailing of Vietnamese labeling requirements by the US Trade Compliance Centre.

In addition to import licence issued by the Ministry of Trade, the products subject to specialized control should have a written approval from respective Ministries before their importation.

1. The list of products under the control of the Ministry of Industry includes chemicals, toxic chemicals and intermediate materials for their production. The importation of such products is regulated by Decision No. 28/TTg dated 13 January 1997 of the Prime Minister, and Circular No. 03 dated 26/03/1997 of the Ministry of Industry.
2. The list of products under the control of the Ministry of Agriculture and Rural Development includes wild animals, pesticides and materials for their production, veterinary drugs and materials for their production, feeds and materials for their production, and animals and plants for breeding. Regulations on the importation of such products are set in Decision No. 28/ TTg dated 13 January 1997 of the Prime Minister and Circular No. 02/NN-KNKL/TT dated 01/03/1997 of the Ministry of Agriculture and Rural development.
3. The list of products under the control of the Ministry of Public Health includes pharmaceuticals, substances that may cause addiction, pre-substances, and cosmetics that may have impacts on human health, and medical tools and equipment.

The Ministry of Health (MoH) is responsible for managing the import of pharmaceutical products. This is done with the explicit aim of protecting domestic production, probably all of which is done by state enterprises. Only 38 enterprises are authorized to import pharmaceutical products, all of which belong to the MoH (interview 3). Though there was a decision to allow 35 foreign companies to import specified medicines in September 1998 [2434/1998/QD-BYT]. Most raw materials are duty-free, except amoxycillin and ampicillin, which are taxed at 7 per cent to protect a Korean joint venture with Pharmaceutical Factory Number 24 (interview 17).

Pharmaceuticals for retail sale face tariffs and a licensing system. A licence is required to import any particular pharmaceutical product. At present there are some 3,000 registered pharmaceutical products, with licences issued for between one to three years (interview 3). Licence numbers must be printed on boxes, and instructions must be in Vietnamese. Fees are charged for product assessment and registration [65/1993/TTLB]. There is an intention to restrict the number of registrations “of common types” of pharmaceutical products (interview 3). In 1996, a list of 62 pharmaceutical products was announced for which no new licences would be issued [1203/BYT-QD]. Existing import licences continue to be issued, but for only one year periods while an outright ban on importing these products is pending approval of a draft Decree (interview 3).

4. The list of products under the control of the Ministry of Aquaculture includes aquatic breeds, aquaculture feeds and materials for their production and chemicals for the protection of aquatic life. The importation of these products should have a prior written authorization by the Ministry of Aquaculture. Enterprises that need to import aquaculture feeds must submit their annual import plan to the Ministry of Aquaculture. After obtaining the approval of the Ministry of Aquaculture, these enterprises shall register for product quality inspection in accordance with the Decision No. 1184QD/KHCN dated 21 December 1996 of the Ministry of Aquaculture and then proceed with the import procedures at the Customs Office.
5. The list of products subject to approval by the Ministry of Culture and Information includes printed works (books, newspapers, magazines, paintings, photographs and calendars), cinematic works, recorded audio and videotapes and disks, and certain kinds of special printing equipment. Regulations regarding these products are set in Decree

No. 89/CP dated 15 Dec. 1995 of the Government and the inter-ministerial Circular No. 26/TTLB dated 19 Apr. 1994 of the Ministry of Culture and Information and the Ministry of Trade.

6. The Ministry of Labor, Invalids and Society approves the importation of products relating to labour safety such as pressure-resistant equipment (boilers, tanks and containers for storing liquid and gasses under high pressure), lift vehicles, elevators and explosive materials.
7. Viet Nam State Bank authorizes the importation of specialized banking equipment
8. General Department of Posts and Telecommunications controls the importation of radio transmitters, receivers, and other radio emitting equipment, telephone exchanges.

## **2.11 The import of machinery and technology transfer**

The MoH is also responsible for evaluating imports of pharmaceutical production lines. They have a Medical Equipment Department for this. The response was general confusion when, during an interview, MoH officials were asked the apparently hypothetical question of whether a private sector importer of a pharmaceutical production line required MoH inspection and approval (interview 3). As elsewhere, it was simply presumed that production in this industry would remain a state enterprise activity, with direct ownership controls imposed through the Ministry.

Protection of the mechanical and engineering industry in Viet Nam is generally achieved through import bans, as tariff rates are low. Machinery that is being produced in Viet Nam is mostly protected from formal competition from overseas. The Sugar Industry Steering Board at MARD, for example, maintains a list of “machinery made in Viet Nam” that is not allowed to be imported (interview 13). Protection from second-hand machinery imports was increased in 1998 through a regulation that required such equipment to be “80 per cent of its original quality” (2019/QD-BKHCMNT and 491/TB-TDC, 29 April 1998). The fuel consumption of the used machinery was also to be no more than 10 per cent greater than the new equivalent. This has required inspections upon importation and after assembly in Viet Nam. Several valuation disputes were reported during interviews (interviews 16, 18), but the more general impression was that the new regulations had halted the import of used equipment almost entirely.

A final word on this complicated area involves Technology Transfer contracts, which must be channeled through MOSTE (45/1998/ND-CP, 1 July 1998). If technology transfer is deemed to occur, then the importation is subject to certain exemptions and tax concessions.

### **2.11.1 Customs formalities (8300)**

#### **Special formalities (8310)**

The 8300 UNCTAD classification only mentions “special” customs formalities in this section, which can be loosely interpreted as “additional and generally unacceptable import and export requirements”. In this narrow sense, the stamping of certain imported goods constitutes one such NTB. We have, however, adopted a broader definition of the category to encompass a discussion of the processes and efficiency of Customs in general, which should be considered as a potential – if unintentional - barrier to trade.

The stamping of goods has been generally viewed as a failure, although there were some short-term positive effects (interviews 8, 22, & 19). The stamps, which are actual stickers glued to each product, were placed on the entire existing stock of goods in Viet Nam through vast campaigns. The idea was that subsequent non-stamped goods could be clearly identified as smuggled. The problem, however, was that the system was quickly circumvented by either the sheer volume of non-stamped goods coming in, or by widespread fraud (buying real or fake stamps, or using stamps again). By one estimate, only one third of televisions sold have stamps (interview 22).

The stamping of imported bicycles is a good case study. Imported bikes are often smuggled in from China to avoid the 60 per cent tariff. Introduced in 1997, stamping caused sales of domestic bikes to double for a few months. Soon, however, smuggling of bike parts increased markedly, and systems to obtain or re-use stamps became established. By mid-1998, the price of Chinese bicycles was only 5-10 per cent higher than it had been before stamping (interview 8).

The administrative cost of stamping, for both Customs officials and importers, is substantial and probably not justifiable. This is particularly so when stamps are required on low-value high-quantity products. The stamping of ceramic tiles, for example, requires the importer to remove all 1,600 boxes from each container have them stamped, and then put them back in. There are plans to expand the use of stamping (*Saigon Times*, 15/8/98), but really what is required is a detailed cost-benefit analysis of the previous stamping efforts.

### **Customs efficiency (8320)**

One company reported that Customs were becoming more pedantic about trade documentation, and that certified copies of original documents were no longer accepted (interview 20). The requirement to inspect 100 per cent of both export and import containers is both unrealistic and institutionalizes “side payments” (“envelopes”). Many interviews reported the need to “grease the wheels” of customs inspections, or as one put it: “without giving envelopes they are likely to count every shoelace”. Side payments were reportedly modest, but private companies were charged more than state enterprises or other importers “with connections”.

Typical disputes with Customs that came through the interviews included:

- Sheets of fibreglass (one per cent tariff) were defined as “ceiling boards” (ten per cent tariff). The company had to pay the 10 per cent and then seek assistance from VINACONTROL to argue for a refund.
- Vinyl floor tiles (three per cent tariff) were classified as “ceramic floor tiles” (40 per cent)
- Dried sheets of paper pulp were classified as paper.
- Television sets imported as CKD were later classified as IKD and the importing company had to pay the higher tariff retrospectively.

Retrospective payment of higher import duties was reported in several interviews, as were cases of refunds by Customs for wrong valuations - although these normally took the form of equivalent subsidies on subsequent imports by that company. The legal basis for the demand of retrospective payments is unclear, although a pending Decree and the draft Customs Law are apparently designed to explicitly give this authority to Customs (interview 5).

The interviews, of course, only recorded one side of the story. Customs is trying to operate in an environment of generally accepted tax avoidance, and some examples were cited. Much paper is imported as “school paper”, when it is not, to avoid higher tariff rates (interview 9). Similarly, computer parts are sometimes imported as parts for fax machines to obtain a lower tax rate.

The problem is that the tariff schedule is so complex that, evasion and corruption aside, just doing the job requires detailed technical knowledge. Customs officials lack the required technical knowledge, and there is no systematic case study history upon which they can draw. Training in product identification and valuation, combined with stronger supporting information systems is required to better implement the existing tariff schedule. A better option is to simplify the tariff schedule.

## **Corruption (8350)**

Corruption is a serious and pervasive problem for Viet Nam’s Customs service (Williams, 1997). In mid-1998, the Saigon Times Group held a conference about “administrative reform in Customs” in which participants “singled out the professional ethics of customs personnel as the most important factor in performing their duties” (*Saigon Times*, 11/7/98. P.29).

Trivial public service salaries make the giving of “envelopes” accepted practice. The problem, however, is that it blurs the distinction between a legitimate payment and corruption. It undermines the authority of formal channels for conducting economic activity. For example, inspection of a container for export requires a payment to Customs of 60,000 dong, for which a receipt is given, but then envelopes for the specific Customs officials doing the job come to about an additional 200,000 dong – without receipts. The informal payments are made openly and on a regular basis, so is that corruption?

Corruption is not a problem exclusive to the Customs Office, and perhaps it should be considered as a form of para-tariff measure. The Police, for example, extract a reasonable income from container trucks that flout regulations in urban areas. Particular licences are required to travel at certain times or in certain areas, but the cost of obtaining such licences may be greater than just paying regular informal payments. Corruption in Ministries, mostly in relation to obtaining quotas of various sorts, was sometimes mentioned in the interviews. Viet Nam ranks 74 out of 85 countries listed in the Corruption Perceptions Index<sup>37</sup>: better than Russia and Indonesia, but worse than China, Thailand, India, and the Philippines. There is clearly room for improvement. Viet Nam could look to corruption fighting models in the region, such as the Independent Commission Against Corruption (ICAC) in Hong Kong<sup>38</sup>, and similar systematic attempts to tackle the problem in Malaysia and Australia.

## **2.12 Internal measures**

### **Investment measures (9100)**

These include non-tax domestic policies that, while not explicitly discriminating against imports, provide subsidies in one form or another to selected enterprises or enterprise groups, thereby indirectly influencing the level and composition of exports or imports.

### **Export promotion (9110)**

<sup>37</sup> See Transparency International at [ysiwyg://contents.28/http/www...rency.de/documents/cpi/index.html](http://www.transparency.de/documents/cpi/index.html)

<sup>38</sup> See [www.icac.org.hk](http://www.icac.org.hk)

Investment

Industrial policy (9120)

Taxation concessions (9200)

Procurement (9300)

Under one definition, all internal price distortions caused by Government intervention influence trade and can therefore be considered as NTMs or NTBs. In practice, this definition is rarely applied, as it would, for example, encompass welfare payments. In this section we briefly survey some of the main price distortions caused by Government, although it would take another report to do justice to the subject.

### **2.12.1 Investment measures (9100), Export promotion (9110), and Industrial policy (9120)**

Viet Nam typically loads all or most of its policy objectives on each of its policy instruments. Internal taxation and subsidization, and exemptions are therefore as complex as the external trade regime. Consider the turnover tax: “In addition to generating revenues, this tax is used to promote regional development by providing tax deductions for investments undertaken in rural and remote areas; to influence industrial policy through a reduction in the tax burden for import substitution projects; and to promote equity by imposing higher tax rates on goods and services that are likely to be consumed by high-income individuals” (Shukla & El-Hifnawi 1998, p.10). To this we can add turnover tax exemptions for exporters. It is unclear how, or if, turnover tax exemptions will carry over now that the value-added tax has, reportedly, replaced it.

Price distortions come through soft bank loans, taxation schedules and exemptions and licensing controls. Some examples:

- At the Industry Bank, about 30 per cent of loans are made at the preferential interest rate of 0.9 per cent per month, instead of at the normal 1.15 per cent (interview 28). Preferential loans are given to “strategic and export-producing customers”.
- Fourteen import-substituting domestic products will receive a 50 per cent reduction in turnover taxes for one year for “items which take less than six months to produce” and two years “for those taking more than six months to produce” (*Viet Nam Investment Review*, 9/7/1998, p.10). The Mitsui-Vina PVC joint venture also gets a 50 per cent tax reduction [MPI 3070/BKH/TMDV and 1028/BKH-TMDV].
- New foreign investment in remote areas or in “particularly encouraged” activities may receive five years of import tax exemptions. Reductions or exemptions in profit taxes are also possible for FIEs licenced after 23 November 1996 [63/1998/TT-BTC, May 13 1998].
- “Imported fixed assets e.g. specialized equipment, machinery and transportation which cannot be produced locally will be exempted from VAT” [MoF 89/1998/TT-BTC, 27 June 1998]. As are all exported goods.
- Foreign investment licences in some areas are restricted only to investors who will export over 80 per cent of output [229/1998/QD-BKH]. New ventures in cement joint ventures have been banned.

The box below, which reports on changes to the Law on Domestic Investment, passed by the National Assembly on 7 May 1998, gives a flavour to the complexity of the internal regime of price distortions.

## **Box 2.2: Amendments to the Law on Encouragement of Domestic Investment**

(Selected quotes from *Viet Nam Economic News*, No.22, June 1998)

Investors in projects within the scope of investment preferences are subject to 50 per cent exemption of land-use charges...Land-use tax is also cut by half in the first three to ten years for investment in localities encountering socio-economic difficulties...To boost exports, the amended law also gives corporate tax preferences as bonuses for businesses that are able to export for the first time or find new export markets, and corporate tax imposed on export profits is reduced by half. Businesses that either export large amounts of products or have stable export markets are subject to three to five per cent corporate tax rate reductions levied on export profits. In cases when export value is higher than in the previous year, corporate tax on export profits is cut by 50 per cent...Investors contributing capital in the form of intellectual property rights, technical know-how or technological processes are exempt from taxes relating to technology transfer. Article 2 also stipulate that income tax exemptions aimed at forming fixed assets for prioritized domestic projects are the same as those applied to foreign-invested projects...foreign invested businesses (not including petroleum) are subject to four profit tax rates of 10, 15, 20 and 25 per cent. Foreign-invested businesses are exempt from import tariffs levied on machines and equipment used for forming fixed assets, in the meantime domestic businesses may only have their import taxes reduced or eliminated when necessary. However, domestic businesses are exempt from luxury tax, but foreign-invested businesses must, however, pay it, as well as tax on transferring profits abroad. They are also obliged to pay higher rates for electricity, telephones and transport.”

### **2.12.2 Taxation concessions (9200)**

Tax concessions are often granted as part of a package of support for developing particular industries or enterprises. The Dong Da television assembly enterprise is, for example, about to diversify into producing medical equipment. The aim is to replace some of the US\$40 million of medical equipment imported by the Ministry of Health each year, and the deal will involve soft loans and a two-year exemption from turnover tax (interview 22). Such expansion through government patronage remains the norm in Viet Nam, which lacks a capital market and long-term commercial bank lending to the private sector.

### **2.12.3 A final comment about Internal Measures**

The extent to which internal policies cause distortions to the volume and structure of trade requires a further research effort. They cannot, however, as noted above, be ignored if the principle of dumping is also embraced. The argument for countervailing measures is simply that internal policies created protectionist barriers.

This report has only highlighted the complexity and depth of Viet Nam's internal policies relating to trade. Further research would include more detailed consideration of those noted above and the following:

- Domestic content and localization policies.
- Government and bank lending.
- Government procurement.
- Industrial, state enterprise and regional development strategies.
- Government research and technology policies.
- National systems of taxation and social insurance.

- Foreign investment policies.
- Immigration and labour policies.

There is scope, therefore, for further research. Indeed, even as you read this it is already dated, for Viet Nam's trade policies change by the week. The foundation is here, however, upon which others can build: to update, to include a more detailed evaluation of internal measures, and to measure the impact of particular NTBs.

## 2.13 Conclusion: stepping stone or new path?

Vietnamese trade policy reforms during the past few years may be interpreted as generally protectionist, although in some instances they were merely codifying existing policies. The salient feature has really been one of contradictory liberalization: both protectionist and liberalizing measures were being introduced every year. Publishing the CEPT tariff reduction schedule<sup>39</sup> and abolishing import licences point one way, while foreign exchange controls, and the creeping increase in the use of quotas, bans and surcharges point the other.

It is hard, therefore, to say that Viet Nam is firmly on the path to fulfilling its AFTA and APEC trade liberalization commitments. Table 2.12 indicates, if anything, that trade policies have become more restrictive since 1996. Most NTBs have become stronger, with only licensing and rice exporting notably weaker. The modest reduction in the scope of the minimum price lists is not remarkable. Tariff protection has increased marginally, but the (unofficial) publication of the CEPT reduction schedule must be counted as a positive move.

**Table 2.12: A summary of actual trade policy directions since about 1996**

| Type of NTB/NTM                         | Stronger     | Much the same | Weaker        |
|---|--------------|---------------|---------------|
| Customs surcharges                      | X            |               |               |
| Special consumption tax, internal taxes | X            |               |               |
| Minimum price lists                     |              | X             |               |
| Restrictive foreign exchange            | X            |               |               |
| Foreign exchange surrender requirement  | X            |               |               |
| Trade licensing                         |              |               | X (Decree 57) |
| Quotas and prohibitions                 | X            |               |               |
| Monopolistic measures                   |              |               | X (rice)      |
| Special customs formalities             | X (stamping) |               |               |
| <b>Tariff protection</b>                |              | X (CEPT)      |               |

The future direction for reform also remains unclear. Regional agreements contradict the dominant vision of economic development in the minds of most Vietnamese policy-makers, which remains largely influenced by their experiences under central planning. A certain fixation

<sup>39</sup> It is not clear, however, that this CEPT reduction schedule is a finalized and formal Government pronouncement. According to the *Saigon Times* (18/7/98), the schedule "has been approved by the Government. However, Viet Nam will annually submit a specific tariff reduction list to ASEAN" (p.21).

with achieving targets and a pervasive lack of faith and understanding of market forces, combine to support a “fine-tuning” protectionist trade policy regime. A recent Official Letter from the Office of Government [4670/VPCP-KTTH, 16/11/98] encapsulates this vision of protectionist trade policy as a ministry-level micro-planning tool:

“The Government has asked ministries and relevant agencies to take prompt action to boost exports and restrict imports to reduce the trade deficit between now and the end of the year. This includes the continued revision of import taxes or the imposition of surcharges for such imports as steel billets, clinker, glass, paper, pharmaceutical materials, and tobacco and luxury goods. Foreign currency for importers of these commodities is to be restricted. However, the foreign exchange needs of companies that produce goods for export should be met.”  
(*Viet Nam News*, 25/11/98, p.5).

Given the above approach to controlling the trade deficit, it is not surprising that Viet Nam’s trade regime remains restrictive by international standards. The Vietnamese policy framework is still very much a legacy of central planning. The planning vision of development and role of the state stifle the pace of liberalization. Entrenched interest groups, particularly state enterprises and corporations, slow the liberalization process even further. Such a cauldron of conflicting ideologies, interests and economic perspectives cannot be expected to produce a “liberal” trading regime in the short term.

### **Box 2.3: Why do policy makers use NTBs?**

In the 1980s, the use of NTBs seemed to be on the rise (see Coughlin and Wood 1989). But in the 1990s concerted bilateral, regional and international efforts have enabled a decline in at least the prevalence of NTBs (Laird, 1996; OECD 1997). They are, however, still very common in the trade policy regimes of both developed and developing countries. Why?

The economics of trade protection points unequivocally to using tariffs rather than NTBs to achieve protectionist objectives. NTBs are crude and inefficient “second-best” policy instruments for protection, but in the context of international tariff reduction commitments that is precisely how they may be viewed. For countries committed to provide trade protection for certain domestic interest groups, maintaining high tariffs may not be an option.

There are other explanations, however. NTBs offer more certain and quantifiable protective effects. Also, domestic businesses, foreign invested enterprises, and politicians can more easily capture the distribution of the benefits (“economic rents”) from NTBs. “Such an allocation of benefits increases the probability that the political process generates larger amounts of non-tariff barriers relative to tariffs” (Coughlin and Wood 1989, p.45). Finally, the adverse effects of NTBs are generally less obvious to consumers and trading partners than the effects of tariffs. Lack of clarity, in some policy contexts, may be seen as a virtue.

Fundamental to the liberalization challenge is the ongoing role of the State in commercial activities. State enterprises continue to dominate corporate sector activity, and still in an environment of poor accounting and financial controls. This causes the State to rely on blunt “second best” policy instruments for control and micro-management:

“As is the case in other areas of policy, the retention of controls on foreign exchange access seems to reflect the absence of stronger and more direct disciplines on SOEs. For example, it is widely reported that some SOEs took advantage of their Government backing to negotiate long-

term letters of credit and used the proceeds for speculative purposes have lost heavily and are defaulting. This suggests that financial and budgetary discipline on SOEs are still weak.” (CIE 1998a, p.10).

The question for outsiders is whether to wait for privatization (or at least a stronger division between the ownership and management of State commercial activities), or to pursue other options for liberalizing trade. In the context of cooperation rather than confrontation, a WTO Working Paper has argued that transitional economies be afforded some form of temporary status within the WTO, which would lead to full membership “once necessary conditions are fulfilled.” (Drabek 1996, p.2). The author argues “it is vitally important that the countries [in transition] are effectively integrated into the international trading system and follow the same ‘rules of the game’ as all other countries. Otherwise, these countries are likely to seek other forms of cooperation that may be based on rules that are inferior to those of GATT/WTO. Some may even be forced to revert back to protectionism and isolationism.... Wrong policies can be introduced now but will be difficult to abolish later” (Drabek 1996, pp.3-4). Mr Drabek is right, and we can only hope that it is not too late for Viet Nam.

## **Chapter 3 : The export-orientation experience of Viet Nam's neighbours**

**- Frank Flatters -**

### **3.1 Introduction**

Viet Nam has made great progress over a short period of time in restructuring its economy and integrating with world markets. The agricultural sector, and to a lesser but still significant extent, the manufacturing and service sectors have responded with rapid growth, and more importantly, increased competitiveness in world markets, as witnessed by strong export growth of a number of products throughout the 1990s. While this economic performance has been impressive, it has not been uniformly distributed across all sectors. Some industries and activities have made the transition much more successfully than others have. This is not surprising due to both the rapid changes that have been occurring throughout the region and the many distortions that needed to be eliminated as Viet Nam began to reorient its economy towards international markets.

The transition process in Viet Nam is far from complete. Much more adjustment will be needed to ensure a continuation of recent economic performance. This will require an acceleration of economic reforms. As has been recognized from the beginning, the benefits of its renovation programme accrue primarily to the Vietnamese people, and not to others. Trade liberalization, which is an important element of the reform process, does not need to be accomplished in the context of international treaties and agreements, such as AFTA and the WTO. Nevertheless, AFTA can provide a useful part of the framework within which to continue the reform process.

Viet Nam's trade challenge, and therefore one of its major development needs, is to enable its existing and potential new labour intensive manufactures to compete in global markets. The growth of its manufactured exports to all world markets will be an important measure of Viet Nam's success over the next decade. The major barriers facing Viet Nam are not import restrictions in other markets. The obstacles are domestic policies, which are within the control of Vietnamese policy makers. Viet Nam has considerable power to control its own destiny in international markets. While Viet Nam's manufactured export performance has been quite good so far, it could be much better. The experience of Viet Nam's neighbours demonstrates that a continuation of domestic reforms will be necessary just to maintain current performance, let alone improve it. Three areas of domestic policy are likely to be critical in determining Viet Nam's manufactured export performance in coming years:

- trade liberalization
- state enterprise reform
- macroeconomic management (particularly exchange rate management)

Trade liberalization is important for export growth for a number of reasons:

- i. The protection of firms in the domestic market breeds inefficiency and makes it more profitable (privately, but not economically) to sell locally, rather than to try compete in world markets.
- ii. Import restrictions, whether they are in the form of tariffs, quotas, import licences, high costs of port and customs clearances, or any other barriers, raise domestic costs of production and hence directly impede local producers from competing internationally. Imported goods are a direct and indirect element of the costs of exporting, and anything that raises their domestic prices hurts exporters and the workers who are employed in these activities.
- iii. Export processing zones and/or duty drawback or exemption programmes for exporters, if they work well, can alleviate some of the direct costs of protection in the short run (see End Box on duty drawback). However, as export production moves beyond the simple assembly of imported components, which it must do to remain sustainable in the long run, it becomes increasingly difficult and ultimately impossible to shield exporters from the costs of protection. This becomes especially critical if and when inefficient and highly protected upstream heavy industries become entrenched. The only solution in the longer run is to reduce all forms of protection. The more rapidly and comprehensively this is done, the faster will be the development of a successful, sophisticated and internationally competitive export sector. Viet Nam has a significant advantage over many other countries by not being burdened with protected upstream producers of basic industrial raw materials.
- iv. An import-substitution based protection regime also hurts exporters indirectly by causing an artificially high value of the exchange rate. An overvalued exchange rate is an especially potent killer of export industries.

State enterprise reform also has a major bearing on export performance. State-owned enterprises (SOEs) are often burdened with social obligations that make it difficult for them ever to become competitive. Because of this “social role” and because of their bureaucratic and political strength, they also tend to impede exports indirectly by their support for high-cost import protection regimes. It is particularly dangerous for exporters when SOEs become involved in upstream heavy industry.

Macroeconomic management has many direct and indirect effects on manufactured export performance (see Box 3.1). The single most important manifestation of inappropriate macroeconomic policies from this perspective is an overvalued exchange rate. An inappropriate exchange rate is a natural result of high levels of import protection. This can be aggravated by policies that allow large current account imbalances to persist without corrective action to restrain domestic aggregate demand, improve the competitiveness of exporters, and/or adjust the exchange rate itself. Excess demand often arises from uncontrolled public sector deficits and/or lack of control over losses accruing to state enterprises. Capital controls add to the problems of an overvalued exchange rate.

## 3.2 Sectoral Lessons and Perspectives

Viet Nam's export performance across sectors since the renovation process began has been variable. In order to analyze why greater export success was not achieved and to help promote future export expansion the issues listed below will be examined with the use of case studies. In so doing, the determinants of, and impediments to future rapid export growth will be considered.

- Successful outward orientation
- Access to industrial raw materials
- Forced increases in local content
- Inward orientation: unintended effects of protection
- Ad hoc protection and policy instability
- Special burdens on state enterprises
- The exchange rate

### Box 3.1: Why has Thailand's manufactured export growth stalled?

Thailand's initial phase of export-oriented manufacturing was primarily in the form of assembly of labour intensive products in which South East Asia's comparative advantage had been shaped by the post-Plaza Accord currency realignments. The Plaza Accord (1995) was in part a signal of the successful industrialization of Japan and other East Asian economies, and of the graduation of these original "Asian Tigers" from simple labour intensive manufacturing. A major factor in the initial success of Thailand's manufactured exports was its ability to insulate exporters from the costs of domestic protection and other cost-raising effects caused by its economic and bureaucratic regimes. A continuation of export growth, and graduation to more integrated, internationally competitive manufacturing sectors, however, will require some fundamental changes and improvements. These include:

1. The development of "supporting industries," which, in turn, requires internationally competitive supplies of basic industrial raw materials, from either domestic production or from imports.
2. Increased attention to "fundamentals" such as education, infrastructure, flexibility and competition in markets for basic services (telecommunications, ports, transport, etc.), as well as a sound and stable legal environment.

These tasks are made more urgent by the rapid economic development of China, especially as an exporter of labour intensive products, as well as potential competition from other countries in the region such as India and Viet Nam, and from Latin America and Eastern Europe.

Thailand has relied too long on the "insulation of exporters" as a major tool of export promotion.

It can no longer remain complacent to the need to deregulate the economy in order to lower the costs of domestic production. Examples of excessive regulation include a high and variable tariff rate regime and measures to protect "infant" upstream industries such as steel and plastics. There is also a wide variety of other special interest protectionist policies which help particular bureaucratic interests, firms or industries, but at the same time raise the general costs of doing business. Government-sanctioned monopolies in basic service industries such as transportation and telecommunications impose high costs, as does corruption in policy design and implementation, from ports and customs to infrastructure development. An efficient and competitive private sector requires a parallel performance from the public sector in the form of "good governance."

The recent financial crisis is forcing a realization that a policy mentality based on a “culture of protection” is not sustainable. In a modern economy, the high costs of poor government policies cannot simply be passed on to final consumers or absorbed by the rents from abundant natural resources and/or rapid economic growth. Costs incurred to protect one part of the economy inevitably harm other sectors. This is especially true of export activities, whose supporting industries cannot be shielded from high cost upstream producers.

### 3.2.1 Successful outward orientation

In the 1970s and 1980s, Viet Nam’s few manufactured exports were sold in the Soviet Union and other CMEA (Council for Mutual Economic Assistance) countries. The products were generally of low quality (and value) and were uncompetitive in non-communist markets. The collapse of the CMEA markets was potentially disastrous for Viet Nam’s fledgling manufactured exports. However, the footwear and travel bag industries are good examples of industries that have survived and prospered. Starting from an uncompetitive and fractured industry in 1991, these sectors have become world-class, and continue to develop their inter-industry linkages with the domestic economy. Viet Nam’s footwear and travel bags manufactures are now world class (see Box 3.2).

#### Box 3.2: Two successful outward-oriented industries

##### The footwear industry

The state-owned footwear producer *Leaprodexim Viet Nam*, previously exported footwear uppers to the Soviet Union and other Eastern Bloc countries. With the collapse of this market in 1991, this enterprise could have followed the examples of many other sectors by retreating behind the barriers of high protection, to try to survive on the basis of sales to the domestic market. Instead, they sought out partnerships with international designers and marketers of athletic shoes and have become a major player in one of Viet Nam’s most successful export sectors.

This sector is now Viet Nam’s third largest exporter, accounting for US\$1,402 million of exports in 2000. Total employment in this labour intensive sector is about 500,000 workers. It consists of a broad range of enterprises — SOEs, joint ventures and private enterprises.

Viet Nam has captured a significant share of the world production of athletic footwear. The main competitors are China and Indonesia. To ensure security of supply, major world buyers prefer to diversify production across a number of countries. Since Viet Nam’s share is already quite large, foreign buyers are unlikely to increase the share of goods sourced in Viet Nam significantly. To remain competitive and to increase its share of total world production, therefore, the Vietnamese footwear industry will have to move upmarket into the assembly of higher quality (and higher priced) products and also increase the local content provided by domestic supporting industries. This will require open and efficient markets for raw materials, capital equipment, and intermediate inputs. The assembly of shoes and of uppers is the most labour intensive part of shoe production, and has been the source of Viet Nam’s initial advantage in this industry. As skills improve, Viet Nam will continue to move upmarket. And as supporting industries develop domestic content will also continue to increase. Local content of some athletic shoes is already as high as 50 to 60 percent.<sup>40</sup>

<sup>40</sup> Increased local content has occurred as a “natural” part of the development of the industry. There have been no explicit government programmes to encourage this evolution. The only role of the government has been to maintain tax- and other import restriction-free access to components and, most importantly, industrial raw materials. This stands in stark contrast to the motorcycle industry, for instance, in which the government has implemented a complex set of sanctions and incentives to force development of local supporting industries. The problems with forcing local content are discussed further below.

The two biggest potential barriers to continued export growth for this sector would be:  
lack of skill development among Vietnamese workers, and  
policy-imposed restrictions on imports of raw materials and/or machinery used in making shoes and their components.

### **Travel bags and luggage industry**

A less noticed, but similarly successful export industry is travel bags and luggage. Like footwear, this is also labour intensive. Many of the successful bag exporters are closely linked with footwear producers. Like footwear, a large portion of travel bag export production is done under contract with western buyers. Travel bags are Viet Nam's eighth largest export, and accounted for US\$145 million of exports in 1995.

The principal lesson from the footwear and travel bag industries is that Vietnamese manufacturers who choose to be outward-oriented can succeed in world markets. Viet Nam does have a comparative advantage in labour intensive industries. Both state-owned and private firms are able to compete internationally if they form relationships with foreign buyers and technical experts, and have easy access to necessary intermediate imports.

In light of the international competitiveness of Viet Nam's footwear and travel bag goods, it is surprising that these sectors are still protected in the domestic market by quite sizeable tariffs. Footwear imports face tariffs of 40-50 per cent, while travel bag import duties are 30 per cent. These tariffs, together with the very low import duties on raw materials provide effective protection for domestic market production in the order of 60-200 per cent.<sup>41</sup> This is an unnecessary subsidy to domestic producers, and is provided at the expense of consumers of a basic commodity. If the government wishes to tax higher priced shoes in the domestic market, the appropriate instrument would be a sales tax on footwear above some threshold value. This would be much more effective and would have the additional advantage of avoiding domestic production distortions that arise from the use of import tariffs.

In the ASEAN context, Viet Nam's pattern of comparative advantage for exports is very similar to those of other ASEAN countries such as Indonesia and Thailand. While the protection of ASEAN local markets will disappear with the full implementation of AFTA, this will have an insignificant impact on their imports of these products from Viet Nam. It is not protection, but rather the similarity in patterns of comparative advantage that is the "barrier" to Vietnamese exports to these markets. On the import side, there is some possibility of developing ASEAN-wide supporting industries for certain key components. But the economic basis for such cooperation is not large. Therefore, AFTA is unlikely to result in significant increases in intra-ASEAN trade in footwear or travel bag components. Viet Nam's free access to world supplies of components and raw materials has been and will continue to be a key factor in export performance for outward-oriented producers.

### **3.2.2 Access to industrial raw materials**

Manufacturing development depends on, among other things, ready and reasonably priced access to industrial raw materials, especially steel and other metals, and plastics. In the early stages of Viet Nam's development, as has been the case in other South East Asian economies,

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<sup>41</sup> Based on calculations, under various assumptions about local content. The lower bound is for bags with 50 per cent domestic content and the upper bound is for shoes with only 25 per cent domestic content.

this access has been largely indirect, since a great deal of manufacturing production has been based on assembly of imported components. In the longer run, however, as the complexity of the industrial structure increases, and as domestic supporting industries are established, direct use of industrial raw materials will rise. Access to these materials can be through imports or through domestic production. Viet Nam does not yet have significant upstream steel or plastics industries. As a result, imports of most basic industrial raw materials are relatively free of import restrictions (see Boxes 3.3 and 3.4). This confers a great advantage on domestic users of these products. This advantage should not be given away in order to provide special privileges (and excess profits) to large, and mostly foreign, investors.<sup>42</sup>

### Box 3.3: The Steel Industry

Despite the lack of import restrictions, there still exist sizeable problems in the steel industry which has ramifications for a number of other industries. Existing steel mills are inefficient, high-cost producers of low-grade products whose main use is in construction. Most domestically produced construction steel is protected by import duties of 30 per cent. Galvanized steel, which is produced with imported sheet, faces a 15 per cent import duty. Domestically produced downstream products, such as tubing, barbed wire, steel screens and mesh, steel nails, screws and nuts face import duties of 15 to 30 per cent. Motorcycle and bicycle chains, and parts thereof face very high import duties of 50 and 60 per cent respectively. In addition to these import duties, the industry is protected by a complex set of import quotas that classifies steel imports into three categories.<sup>43</sup>

- Types of steel sufficiently manufactured in the country and not to be imported,
- Types of steel not yet manufactured or insufficiently manufactured in the country to be imported, and
- Types of special purpose steel for which the import procedures are to be administered solely through customs.

The Ministry of Trade regulates imports of steel in the first two categories. Most of them are construction steel, and are the same ones that are protected by relatively high import duties, as described above. Imports in the first category are banned, and quotas are set for those in the second. Forty per cent of the import quota is assigned to the Viet Nam Steel Corporation and the remainder is allocated to enterprises that are granted import-export business permits for these goods. In the case of cast steel, however, the entire quota is assigned to steel rolling mills or firms approved by these mills. Imports in the third category are regulated only by customs and can be made, in principle, by any customs approved firm for its own use. Based on limited discussions, industrial steel users appear to be able to obtain import licences, at least for products in the third category, and some also get exemptions from import taxes. Most of the products in the third category are not produced locally, have low rates of import duty, and are essential inputs into many manufactured products in Viet Nam. No possible purpose is served by regulating these imports.

Even with substantial protection, high production costs make it difficult for domestic steel producers to compete against imports. According to newspaper reports, many manufacturers built up substantial stockpiles of unsold steel in 1997. Most steel and metal products used in manufacturing industries are not yet produced domestically and can be imported at low rates of duty - generally zero to five per cent. Imported steel is used in a very wide range of industries, producing for both domestic and international markets. Based on limited discussions, there appears to be no significant difficulties faced by importers

<sup>42</sup> In response to the 1997 currency crisis, Indonesia announced reductions in import duties on a wide range of industrial raw materials and intermediate inputs. This was directly aimed at increasing the competitiveness of her downstream manufacturing industries.

<sup>43</sup> For Import/Export Management Policy for 1997 see Circular 02/TM-XXN (21 February, 1997) on the implementation of Decision 28/TTg (13 January, 1997).

of steel or other metal materials. A number of investments are being planned for the domestic production of industrial steel. Products will include pig iron, rolled steel, and alloy steel. A critical issue to be faced in the very near future will be whether to provide import protection to such investments. These decisions will play an important role in Viet Nam's industrial policy as well as in its commitments to trade liberalization within AFTA.

Viet Nam's practice to date, as illustrated by construction steel and small number of industrial steel products, has been to provide high protection to any manufacturing activity that begins domestic production. When protected products are final consumption goods, the cost is borne by final consumers. The costs of protection of basic steel products, however, will be borne primarily by downstream industries that use these materials. Regulation-free and tax-free access to such products in world markets has been an important advantage for Vietnamese manufacturers, and will be essential for the further development of downstream industries. Despite this advantage, inward-oriented downstream users still find it difficult to become internationally competitive.<sup>44</sup> A broad range of downstream manufacturing industries would be adversely affected by increases in protection for steel materials.<sup>45</sup>

To ensure the continued development of an internationally competitive manufacturing sector, Viet Nam should think very carefully before providing any additional protection to upstream steel manufacturers. To meet its international commitments (and serve its own self-interest) Viet Nam should dismantle existing non-tariff barriers (NTBs) on steel products and refrain from imposing any new quotas or other import licensing arrangements.

### **Box 3.4: The Plastics Industry**

Plastics are another basic input into a wide range of final consumer goods, and are an essential component in almost all industrial products manufactured in Viet Nam. They are also used in packaging of goods for export and the domestic market. Since 1990, the plastics products sector has been growing at an average rate of almost 30 per cent, about double that of the entire industrial sector and more than triple the rate of growth of the economy. In 1995-96, it grew by more than 45 per cent. Production of plastic products directly employs more than 40,000 workers. More than half (about 55 per cent) of current production of plastics is for household consumption goods, with another 25 per cent for packaging material, 12 per cent for construction materials (especially polyvinyl chloride (PVC) pipe), and the remainder inputs into industrial products. Continuation of the industrialization process will change this structure considerably, with the shares of final consumer goods and of packing materials falling to about 30 per cent each, and that of industrial components rising to 30 per cent, by the end of the decade. About two thirds of the latter is predicted to be in motor vehicles and electronics products.<sup>46</sup> An important sign of the dynamism of the plastics industry has been the role of the private sector. From 1991 to 1996 the private sector grew at more than 70 per cent per year, increasing its share from about 25 per cent to 55 per cent of sectoral output. State owned enterprises, while continuing to grow, are losing market share, and are finding it increasingly difficult to compete.

A crucial factor in the success of the plastics products industry has been the free availability of competitively priced raw materials. Imports of plastic raw materials (PVC resin, polyethylene (PE),

<sup>44</sup> The bicycle industry is one such manufacturing sector that is highly dependent on steel imports. An increase in steel prices could be the final blow to this struggling industry. The case of the bicycle industry is discussed further below.

<sup>45</sup> Agro-based industries that rely on tin plate for cans would also be hard hit by increases in import duties on this steel product. For several years in the mid-1980s, import restrictions on tin plate were a major barrier to the development of Indonesia's canned pineapple industry. Removing these restrictions permitted this to become one of Indonesia's most successful agro-based export industries.

<sup>46</sup> Information on market shares comes from Viet Nam Plastics Manufacturers Association & Saigon Plastics Association, *Viet Nam Plastics*, No. 15, April/May 1997. Projections of shares in particular industrial sectors should be treated as indicative only.

polypropylene (PP), polystyrene (PS)) are free of import duties and are not restricted by quotas or other non-tariff barriers (NTBs). Access to raw materials, therefore, is not contingent on access to special licences, quotas or other regulations. Restrictions on access to raw materials have not been a barrier to entry of new enterprises. Competitive prices of these inputs have enabled domestic producers of plastic consumer products to compete against imports. Producers of final consumption goods made from plastic benefit not only from low cost and reliable supplies of raw materials, but also from import duties on final products of 20 to 40 per cent.<sup>47</sup> For a typical plastic goods producer, whose raw materials account for about 75 per cent of the total costs of production, the import tariffs on final products, together with duty free access to raw materials, provides effective protection of production for the local market of 80 to 160 per cent. This protection is unnecessary. Competition among domestic producers of most basic consumer products already results in market prices far below the world price plus tariff. The “natural protection” provided by transport costs alone is sufficient to shelter domestic producers from foreign competition. Therefore substantial tariff reductions could be undertaken, for the benefit of domestic users of these basic products, at little or no cost to domestic producers.

Plastics production so far has been largely for the domestic market. Only about ten per cent of output is exported. This is because Vietnamese producers still specialize in relatively low value household goods whose high bulk-to-value ratio makes them difficult to export competitively. However, a continuation of current trends and policies will bring about new patterns:

As domestic incomes rise and as expertise increases, domestic producers will produce higher valued products for local consumption and for export. For this to happen, access to internationally priced plastic raw materials must remain unimpeded.

Producers, and especially exporters, in other sectors such as electronics, electrical appliances and vehicle parts, will begin to demand inputs from local supporting industries (e.g. cases for VCRs and TVs, motor cycle components, liners and shelves for refrigerators and other appliances). This will increase the indirect export of plastic products. Export competitiveness and the development of supporting industries are symbiotic — each one needs the other. Exporters (and internationally competitive producers for the domestic market) do not need to be forced to increase local content. Japanese and Korean electronics producers in South East Asia make great efforts to persuade both domestic entrepreneurs and suppliers from their home countries to establish themselves in proximity to their South East Asian factories. To make such investments attractive requires access to basic industrial raw materials at internationally competitive prices.

Growth of the domestic plastics industry will create a sufficiently large market to support domestic production of plastic raw materials. In the longer run, Viet Nam’s petroleum resources could also make this a competitive location for feedstocks used to produce plastic raw materials. However, local production of plastic raw materials and feedstocks is not necessary for a competitive plastics industry. These commodities are freely available in the international market.

Their production is highly capital intensive, and because of the competitive nature of the world market, margins are small. Unlike downstream manufacturing, these industries do not generate much domestic employment. The greatest danger in developing an upstream petrochemical industry is that the

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<sup>47</sup> In addition, the high bulk-to-value ratio of many plastic consumer products provides considerable “natural protection” against imports.

<sup>48</sup> Based on calculations from Indonesian data.

<sup>49</sup> While the absence of import duties on plastic raw materials has been a key factor in the dynamism of the plastic products industry, it has also represented a lost revenue opportunity. Plastic raw material imports totaled US\$275 million in 1995. A modest five per cent import duty would have yielded almost \$14 million of revenue. With projected raw material demand growth of 25 per cent per year, imports would rise (at constant prices) to about US\$840 million in 2000. This would yield revenues of US\$42 million with a five per cent import tariff. To the extent that domestic PVC production displaces imports, of course, tariff revenues would be correspondingly reduced. At this point, therefore, the long run revenue contribution of an import duty on plastic resins is likely to be very small.

government will be persuaded to protect it. This would impede the growth of downstream manufacturers.

Viet Nam has licenced several investments in plastic raw materials production. Among the first are joint ventures that are already producing PVC compound. This is a low-tech, low value-added activity. More significant is the joint venture project that is under way between Japan's Mitsui Corporation and the state-owned Viet Nam National Plastics Corporation (Vinaplast) to manufacture PVC resin from PVC monomer. This is due to come on stream in April 1998, at a planned capacity of 80,000 tonnes per year. This will be roughly equal to Viet Nam's entire domestic market demand next year. Vinaplast and Mitsui are considering a further investment that would double this capacity and enable them to meet local market demand for many years to come. Another PVC project has been approved, but is now being reconsidered by the investors in light of the Vinaplast/Mitsui projects. These upstream investments will be beneficial if they can become competitive exporters and/or make plastic raw materials more easily available to Vietnamese producers. Unfortunately, these investments may not improve the raw material supply situation facing downstream producers. The government has been petitioned to impose a 25 per cent import duty on all PVC resin imports. If this proposal is accepted, it will create excess profits (rents) that will accrue largely to foreign investors, and raise the cost of this basic industrial raw material to all downstream industrial users.

Upstream investors often seek special treatment; and it is common for governments to be swayed by their pleas for "infant industry" protection. In the mid-1980s, Indonesia imposed a series of import controls, and high tariffs on imports of plastic resins. Thailand has also succumbed to pressure to increase tariffs on plastic raw materials. These actions have hurt downstream producers in both countries, and have deterred investments in potentially competitive export industries.

Upstream producers in these countries, meanwhile, benefit from unusually high protection-induced rates of return. In Indonesia, a 20 per cent tariff on polystyrene provided a subsidy of more than one and a half times the total capital invested in the project.<sup>48</sup> On a per worker basis, the annual subsidy from protection is equivalent to about 15 times the average worker's wage. Upstream producers have been able to use their influence to maintain high levels of protection. Indonesia's current tariffs on plastic raw materials range from 15 to 40 per cent. This has caused so much harm to downstream industries that the government has had to provide blanket tariff exemptions to several key downstream sectors. This, of course, just concentrates the damage on other less fortunate producers, and on sectors that will never have a chance to develop until the protection is removed.

Plastic raw materials are not an infant industry. In fact, the basic products being produced in Indonesia and Thailand and which soon will be manufactured in Viet Nam are relatively simple commodities, produced with well-known and well-tested technologies. If investors are correct in their claim that Vietnamese production cannot compete with imported products, they should not invest here. If they are able to compete, they need no subsidies.

Protection will harm downstream industries, whose future is critical to Vietnamese workers and to the country's industrial development. Viet Nam should not provide protection to upstream plastic raw materials industries. Plastic resins are Viet Nam's eighth largest import from ASEAN (based on 1995 data). Almost 40 per cent of Viet Nam's plastics imports come from ASEAN. Therefore, the treatment of these products under the CEPT is of considerable importance. Most of these products (Chapter 39 in the HS tariff code) have not yet been included under any CEPT category. Polypropylene (HS 3902) has been placed on Viet Nam's CEPT Inclusion List, but the treatment of all other important categories in this chapter is still unspecified. This is odd for such a major ASEAN import.

From a trade policy and economic development perspective, the import duty on these basic plastic raw materials should remain at zero. For revenue purposes, and as a means of providing a modest level of protection to upstream industries, the government might wish to impose a five per cent tariff on imports.<sup>49</sup> If imposed, however, this tariff should be applied to plastic materials imports from all sources. To impose it only on non-ASEAN imports would deprive Viet Nam of access to competitive

imports from the rest of the world, leave Vietnamese plastic users at the mercy of a potentially oligopolistic ASEAN producers, and invite diversion of imports from low cost world suppliers to higher cost ASEAN sellers.

Competitively priced, high quality plastic industrial components will be an important factor in the development of an internationally competitive industrial sector. Successful and competitive plastics industries will help ensure the development of vibrant manufacturing industries, and vice versa. Access to low cost plastic raw materials will be necessary for these synergies to work.

### **3.2.3 Forced increases in local content**

It is sometimes argued that the only way to increase local content is to restrict imports of components that could be produced locally. This type of policy has been pursued in several sectors in a number of ASEAN countries. The most common target of such policies, however, has been automotive and other motorized vehicle industries (see Box 3.5). In some cases, governments simply dictate a timetable for “deletion” of imported components from the vehicle’s “kit”. These highly detailed “deletion programmes” are required to be followed by local producers. Any required deletion that would not be voluntarily undertaken, of course, raises the cost of local production of the final product, while at the same time giving (implicitly) very high protection to local production of the “deleted” components. The cost-raising effect of deletion means that a standard by-product of these programmes is the granting of very high levels of protection to the final product. This is true of automobiles in almost all ASEAN countries.

In addition to these general costs, specific deletion programmes such as those just described are inefficient for another reason. Given that the government wishes, for whatever reason, to increase local content, it would be more cost-effective to allow producers of the final good to choose, on the basis of relative costs of the alternatives, which particular components to delete in order to meet the government’s local content targets. Better still, of course, would be to set explicit ceilings on the costs that the government would be willing to incur in order to achieve local content goals. This could be achieved, in principle, by providing a series of explicit subsidies or incentives that embody these “acceptable costs” of deletion.

Restricting imports to increase local content is generally unnecessary and is always counter-productive. It is unnecessary because producers themselves wish to raise local content wherever it is cost-effective, in order to take advantage of close access to and communication with component suppliers. And it is counter-productive because it raises the cost of producing the final goods, and so impedes the development of the downstream industry upon which all other supporting industries depend.<sup>50</sup>

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<sup>50</sup> For instance, footwear producers have faced no difficulties in importing components and raw materials. This is one reason for this sector’s success in generating exports and employment for Vietnamese workers. Forcing the industry to meet local content requirements that are not cost-effective would jeopardize the success of this industry. Imposing local content rules on electronics and electrical appliance makers would further delay investment and the emergence of internationally competitive exporters of these products in Viet Nam. The only deletion programmes that have been “sustainable” in other ASEAN countries have been in sectors which, for general reasons, or because of the deletion programmes themselves, are unable to be internationally competitive, and survive only on the basis of high costs imposed on domestic consumers.

### Box 3.5: Local Content — The Motorcycle Industry

The Vietnamese incentive system for increasing local content of motorcycle production actually bears a superficial resemblance to an “ideal” deletion programme — i.e. one which avoids some of the high costs of achieving local content goals. The motorcycle and parts sector faces a tariff schedule on imported parts, which provides higher levels of effective protection for achieving higher levels of local content. This is done by defining different types of “kits” (SKD, CKD1, IKD1, IKD2, and IKD3, which are distinguished by what is excluded from the set of imported parts), and imposing lower tariff rates on those which exclude more parts.<sup>51</sup> The excluded parts are those that will be sourced locally. The import tax savings from using kits with lower import content is the protection or subsidy provided achieving higher domestic content. Subject to these incentives, producers are free, in principle, to choose the cost-minimizing level of local content. The first effect of this programme, through the high tariff (60 per cent) and occasional bans on imported CBUs, is to raise the domestic price of motorbikes. The complex structure of “deletion rates” for import tariffs is the source of several additional problems and costs. First, the definitions of the various types of kits specify the particular components that must be excluded, rather than setting general local content levels, say, as a proportion of the total production cost. Thus, producers are not permitted to find the least cost manner to meet any proportionate local content rate. Second, the implicit subsidies to incremental local content under the existing scheme are extremely high, thus encouraging considerable economic waste in order to increase local content.<sup>52</sup>

### 3.2.4 Inward orientation: unintended effects of protection

High tariffs, import bans and non-tariff barriers against imports are intended to protect domestic producers of similar products. Import tariffs are also an important source of government revenue. Protection is a form of subsidy whose costs are borne by domestic consumers. When protection is given to industrial goods, as seen above, the price is paid by other producers, making protection self-defeating. There are limits to the amount of protection that can be provided, even to consumer goods. Excessive protection often fails to achieve its protection goals and always hurts government revenues (see Box 3.6).

### Box 3.6: Failed protection: two case studies

#### The Bicycle Industry

Until mid-1997, Viet Nam’s bicycle producers were protected by a 60 per cent import tariff. Following complaints that this protection was insufficient, largely due to smuggling of bicycles from China, the tariff was increased to 70 per cent. This provided no increase in protection or in government revenues. Even at 60 per cent, the tariff provided such a large subsidy to bicycle smugglers that very few Chinese bicycles entered Viet Nam through official channels. The China-Viet Nam border is long and porous; it is almost impossible to prevent smuggling when import duties make the returns so high. The principal market effect of the high import tariff is to make non-Chinese, non-Vietnamese bicycles unavailable, or at least much more difficult and expensive to obtain for Vietnamese consumers. In the central and southern parts of Laos, by contrast, Chinese bicycles are rarely seen in the market. Retailers say that bicycles from other ASEAN countries, while slightly more expensive than those from China, are much preferred because of their higher quality. High but unenforceable tariffs on bicycles reduce government revenues, do not succeed in protecting the local industry, and deprive low-income consumers of valuable market choices.

<sup>51</sup> The tariff rates range from 55 per cent for an SKD kit to 10 per cent for an IKD3.

<sup>52</sup> To give an idea of the basic cost of protection of motorcycle production, a Honda Dream II, which currently costs about US\$2500 in the local market, can be obtained on the Lao side of the border at Lao Bao for about US\$1600. The Centre for International Economics (1997b) provides some illustrative calculations of the very high levels of protection to (and economic waste caused by) incentives for incremental local content.

### **The Electric Fan Industry**

In 1997, to save foreign exchange by reducing imports, and at the same time to protect local producers, a number of goods were banned from further import.<sup>53</sup> For one of the goods, electric fans, the ban added to the protection that was already provided by 40-50 per cent import tariffs. Two and a half months later, these bans were quietly removed. Aside from the fact that they violated Viet Nam's commitments under AFTA, there were two other reasons the bans were rescinded. First, since fans could not be legally imported at any tariff rate, the ban resulted in reduced import tax revenues. Second, smuggling of fans increased in order to circumvent the new policies. In the northern provinces of Viet Nam smuggled fans come from China. In the central and southern provinces they come from many sources, including Thailand and even Laos.<sup>54</sup>

### **3.2.5 Ad hoc protection and policy instability**

Any major economic and systemic restructuring process inevitably creates uncertainties. These uncertainties relate to the speed of reform, its sequencing, and sometimes even the direction of change. Measures intended to reduce the effects of this uncertainty for certain investors often have the unintended effect of increasing systemic uncertainty. "Made-to-measure" protection of the type that has been seen in the steel industry and which is being considered for PVC resin in the plastics industry (see above), might create some temporary certainty of protection against imports for the upstream industries. At the same time, however, these types of policies increase systemic uncertainty for existing and potential investors in all downstream industries. This is a major deterrent to downstream investments, which are the ultimate source of demand for products of the upstream industries (see Box 3.7).

Arbitrary, made-to-measure protection of upstream industries is a vicious circle. The use of import quotas and other NTBs is another source of policy uncertainty. Quotas create uncertainty because of the impossibility of designing clear and transparent rules about the quantities of imports that will be available to consumers at any point of time. Allocating import licences to domestic producers of similar goods, as is done for steel in Viet Nam, increases the arbitrariness of import licensing regimes. The recent imposition and subsequent removal (only two and a half months later) of import bans on several groups of products illustrates how much uncertainty can be created by quota systems. Policy uncertainty imposes many direct costs on the economy. In addition, uncertainty about government policies induces investors to allocate entrepreneurial resources to manipulating policy processes. This is seen as a necessary cost of doing business and, by the creation of special privileges, also promotes a sense of unfairness about government policies. These perceptions undermine the legitimacy of the policy regime and of the economic reform programme. There are many ways to reduce policy uncertainty and its associated costs and inequities, including the following:

- Cease using import quotas and all other forms of NTBs, other than those required for public health or security reasons. This is a requirement of AFTA and of WTO membership.

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<sup>53</sup> The five categories of goods whose imports were banned were writing and printing paper, construction steel, white construction glass, cement, and consumer goods such as bicycles and fans (Decree 49/CP 6 (May), Circular 5071/TM-XNK (9 May)).

<sup>54</sup> On the Lao-Viet Nam border, warehouses are stacked with fans that enter Viet Nam through a well-established "back door" that circumvents official customs procedures. This channel is used for a wide variety of electronic and electrical products, as well as motorcycles, and motorcycle parts.

- Simplify the tariff schedule. Reduce the number of rate categories, and eliminate all high rates. This is required with respect to AFTA; but the principle should be applied as quickly as possible on a MFN basis. Viet Nam has been slow so far to take advantage of AFTA to introduce substantive reductions in its import tariffs.
- Announce a timetable for tariff reform, which includes the dates and rules whereby rates will be reduced to achieve the final targets. Viet Nam has been very slow to set out a public schedule for tariff reductions even under the CEPT. It has made even less progress recently in implementing or even announcing more general tariff reform.
- Abolish the system of “made-to-measure” protection immediately. All new investors should be protected according to the tariff schedule only. This will eliminate all the costs and the perceptions of inequities and special privileges created by the current system of import protection.<sup>55</sup>

In addition to undertaking these measures, there should be a comprehensive review of all other aspects of the policy environment that contribute to the “hidden costs” of doing business in Viet Nam. It is a widely held view among investors and other observers that these costs are very high, and that they are substantially undermining many of Viet Nam’s competitive advantages. An objective review will reveal which of these views are undeserved myths, and will assist the government to dispel them. And it will identify the areas in which policy actions are required (see Box 3.8)

### **Box 3.7: The Electronics Industry – The uncertainties of policy**

Consumer electronics and electrical products are sectors in which Viet Nam should be internationally competitive. Many parts of this industry are labour intensive. It is a sector that is well developed in ASEAN, with portions of it allocated to different countries according to historical choices and patterns of relative costs. Because of changing labour costs, the ASEAN industry continues to evolve rapidly, with many products that used to be produced in Malaysia and Singapore, for instance, now moving to Thailand and Indonesia. Malaysia and Singapore now specialize in more capital and/or skill-intensive components and products. As a deliberate strategy of Japanese and Korean investors, this specialization is accompanied by considerable intra-ASEAN trade in components and sub-components. Viet Nam should be well placed to participate in this regional division of production.

In making their location decisions, international investors in this region consider not only Viet Nam and other ASEAN countries. China is, of course, one of the major alternatives. How does Viet Nam compare? Within ASEAN, Viet Nam has a number of advantages, mostly related to the quality and cost of its labour. However, in order to compete with other ASEAN locations, Viet Nam must be able to maintain good access to intra-regional trade in components and raw materials. Major electronics investors are not yet convinced by any actions that have been revealed so far that Viet Nam is fully committed to free trade within ASEAN. In particular, the recent arbitrary import bans have been widely noted and has created doubt among electronics investors. In addition, other “hidden costs” of doing business in Viet Nam have been a major source of concern. This aspect of the customs system is often cited by investors.

China has some of the same advantages and disadvantages of Viet Nam. This has caused major investors to be cautious about commitments to China as well. However, China has one large advantage over Viet

<sup>55</sup> Rejecting the request for protection of PVC production would be a significant first step in this regard (see above).

Nam — the size of its market. The Chinese market is large enough on its own to support not only assembly of a wide range of final products, but also local manufacture of many sub-components. This scale factor alone is sufficient for many investors to overcome many of the other drawbacks of investing in China. Viet Nam does not have this luxury. One major Asian electronics investor has provided data indicating it has invested US\$550 million in new factories in Asia-Pacific countries (ASEAN plus China and India) since 1994. Of this amount, only 1.2 per cent has come to Viet Nam. And the Viet Nam investment is only for assembly of final goods for the local market.<sup>56</sup> This is a sector in which Viet Nam can be internationally competitive. Uncertainties about the direction, speed and methods of policy reform, however, are creating barriers to the realization of this potential.

### **Box 3.8: Indonesia — Customs Reform to remove "Hidden Costs"**

In the early 1980s the corruption and inefficiency of the Indonesian customs administration were well known. Cartoons in local newspapers depicted administrative procedures that were designed to maximize the number of approvals (and hence bribes) required to clear goods through customs. Despite their low official salaries, customs officials were known to have large incomes. At the same time, import procedures were notoriously slow, with two to three month clearance times at the port being quite normal. Rather than trying to simplify import procedures, senior customs officials worked with counterparts from other ministries to develop increasingly complex tariff and exemption structures and broaden the scope of non-tariff import restrictions, thus increasing the discretionary authority of customs and hence their scope for corruption.

In 1984, the government announced a complete transformation of import procedures. Under the new system, imports were not inspected by customs. Instead, they were inspected in the country of export by a Swiss surveying firm, Societe General de Surveillance (SGS). Under the pre-shipment inspection (PSI) system, SGS inspectors determined the description, customs classification and value of the shipments, and then sealed them to prevent any tampering. The PSI report was forwarded to the Indonesian importer and to the relevant government departments and banks. The importer used this report to clear all import tax obligations, often before the arrival of the goods. The only role of customs was to verify that SGS seals had not been tampered with and that there was documentation of payment of taxes. In the absence of clear evidence of tampering, customs was not permitted to interfere in any way with shipments supported by SGS documents. Only goods in consignments of less than \$5,000 could be imported without SGS inspection. In such cases, importers had the choice of following SGS procedures or clearing their goods through customs in the "normal" manner. The workload of customs was enormously reduced. However, no officials were fired. They were required to report for work as usual, and were paid their normal government salaries. But, with the opportunities for corruption reduced, their actual incomes fell drastically.

The immediate results of this reform were spectacular. Within months, members of the Indonesian Importers' Association reported that importing costs had fallen by 20 per cent. Clearance times for imports at the ports fell from weeks and months to a few hours. And import tax revenues rose. While this was only the first in a series of trade policy reforms involving special measures for exporters, decreased reliance on non-tariff import barriers, and lowering of import tariffs, it was arguably Indonesia's most important trade liberalization measure of the 1980s. The initial SGS contract was for three years. It was the government's intention from the beginning to use the PSI system as a temporary measure until it could prepare a new customs law and regulations, and reform its customs service. This process of administrative, legal and regulatory reform took much longer than expected, and was finally completed on 1 April 1997.

<sup>56</sup> By contrast, 85 per cent of this company's post-1994 Asia-Pacific investment has gone to China, and almost all of this is for production of components, including some which are quite technically advanced.

### **3.2.6 Special burdens on State-Owned Enterprises**

State-Owned Enterprises (SOEs) are pointed out by many to be major stumbling blocks in the path of continued economic reforms. These enterprises operate under an ambiguous system of incentives. The most important incentive, however, is the perception that SOEs will not be allowed to fail. To ensure this, SOEs are protected by a variety of methods, including tariffs and NTBs, which shield them from import protection. The strong government commitment to the survival of SOEs, together with the SOEs' alliances with powerful ministries, form a potent coalition to obstruct further reforms.

A principal reason for the desire to protect SOEs is a wish to safeguard the economic security of the workers in these enterprises. The close links between enterprise security and worker security is due to the traditional lifetime employment system in SOEs. There can be no argument with the government's desire to protect workers' economic security. However, maintaining SOEs at any cost is a counterproductive form of social safety net for the young and for the elderly. The most effective safety net for the young is rapid employment growth; and the most effective form of security for their parents is economic success for their children. Tying workers' security to their firms is inefficient and ineffective, especially in a time of rapid economic change and restructuring. Vietnamese workers and entrepreneurs can be very creative and adaptive. Allowing these abilities to express themselves will be the basis for Viet Nam's long-term success.

During the conducted case studies, it was apparent that SOE managers are aware of the need for change. In some cases, for example footwear, they have been very successful already. In other cases, however, special social burdens and obligations were hindering their ability to adapt. The lifetime employment system was an unspoken but clearly important constraint. A number of firms have already found creative ways to overcome this obstacle by creating new types of employment contracts and relationships. This has enabled some enterprises to engage in investments and new productive activities that would have been impossible under the traditional system. In the process of economic restructuring it is inevitable that some state-owned and private enterprises will fail. To tie the fate of the workers to the fate of the firms themselves is cruel and unnecessary. And it hinders the ability of the economy to adapt and to grow. What is important is to find other means to provide long-term security to workers. As mentioned above, rapid growth and expanding overall employment opportunities is one means to this end.

### **3.2.7 The exchange rate**

The exchange rate is a key macroeconomic variable that, among other things, determines the relative prices of tradable and non-tradable goods. An important determinant of the success of the "second tier Asian tigers"<sup>57</sup> since the early to mid 1980s has been macroeconomic policy regimes which ensured low rates of inflation and kept their currencies closely tied to the US dollar. The appreciation of the Japanese yen (and other East Asian currencies) relative to the dollar as a result of the Plaza Accord in 1985 kept the values of their currencies low relative to the yen.

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<sup>57</sup> This term is used to describe Indonesia, Malaysia and Thailand over the entire past decade, and now includes the Philippines, whose economic reform efforts in recent years have begun to pay off in terms of substantially improved economic performance.

This ensured the competitiveness of the manufacturing sectors of these countries as East Asian production moved offshore in the face of rising domestic costs. In addition, Indonesia and Thailand both engaged in intentional devaluations to further strengthen the competitiveness of their tradable goods sectors at critical times over the period.<sup>58</sup>

Under these policy regimes, these countries enjoyed high rates of economic growth, rapid industrialization and employment growth, and the development of increasingly competitive manufactured export sectors. In early 1996, however, at the same time as the US dollar began to strengthen against the Japanese yen, some warning signals began to appear, most particularly in a slowdown of export growth and widening of the current account deficits of all of these countries. The problem was most serious in Thailand, but affected all four countries to some extent. Underlying the decline in export growth and the other economic difficulties that have ensued has been a number of important structural and policy issues. Part of the problem, however, was that exchange rates had become out of line. Once again, the issue was most serious in Thailand, and it was aggravated by policy makers who treated the exchange rate as a matter of national pride and delayed action for too long. Ultimately, as is now very well known, Thai authorities recognized the need to abandon their overvalued exchange rate, and the other three countries followed soon thereafter.

**Table 3.1: Comparative ASEAN Exchange Rates**

|             | Exchange Rate (National Currency/\$US) |        |        |        |        |        | Depreciation (%) |           |
|-------------|--|--------|--------|--------|--------|--------|------------------|-----------|
|             | At Year<br>end:<br>1995                | 1996   | 1997   | 1998   | 1999   | 2000   | 1995-1997        | 1997-2000 |
| Indonesia   | 2,302                                  | 2,353  | 4,798  | 7,630  | 7,126  | 9,407  | 108.4            | 96.1      |
| Malaysia    | 2.540                                  | 2.524  | 3.763  | 3.799  | 3.799  | 3.800  | 48.1             | 1.0       |
| Philippines | 26.21                                  | 26.26  | 37.68  | 39.05  | 40.61  | 49.95  | 43.8             | 32.6      |
| Singapore   | 1.414                                  | 1.399  | 1.648  | 1.651  | 1.675  | 1.736  | 16.5             | 5.3       |
| Thailand    | 25.16                                  | 25.57  | 43.89  | 36.20  | 38.25  | 43.27  | 74.4             | -1.4      |
| Viet Nam    | 10,980                                 | 11,055 | 12,280 | 13,893 | 14,021 | 14,498 | 11.8             | 18.1      |

Notes: Depreciation is measured as the percentage fall in the \$US value of the currencies.

Source: Basic exchange rate data collected from *The Economist*, *Asian Wall Street Journal* and *Viet Nam News* (various issues).

<sup>58</sup> Prior to 1997, Indonesia devalued twice over the period, in 1983 and 1986. It then switched to a “managed float” in which the rupiah slowly depreciated within a band set and managed by Bank Indonesia. Over the same period, Thailand devalued the baht once, in 1987, and then kept it pegged to a basket of currencies, in which the major weight was assigned to the US dollar.

Table 3.1 shows the values (in \$US) of the Thai baht, Philippine peso, Malaysian ringgit, Indonesian rupiah, the Singapore dollar and the Vietnamese dong (VND) since the end of 1995. Exchange rates are shown at points prior to the devaluations of the ASEAN currencies in early September 1997, and after the devaluations up to the end of 2000. During 1995-1997 as the final column shows, all of these currencies have depreciated substantially versus the dollar. The Viet Nam dong depreciated the least, only 11.8 per cent, while the depreciation of the other currencies ranged from 16 to over 108 per cent. During the period 1997-2000, only Thai baht appreciated slightly by 1.4 per cent while other currencies in the region fell with Indonesian rupiah depreciated the most, 96.1 per cent.

As reported in local newspapers,<sup>59</sup> Viet Nam's monetary authorities take justifiable pride in their decision in 1997 to let the VND depreciate gradually against the US dollar. As Table 3.1 shows, the VND has depreciated by 11.8 per cent against the dollar during the period of 1995-1997. However, this depreciation has been quite small relative to the other ASEAN currencies. The only other currency whose depreciation has been (almost) as low has been the extremely strong Singapore dollar. The other ASEAN currencies have depreciated from 16 to 108 per cent during the period of 1995-1997, much more than the VND. Looked at another way (see Table 3.2), the VND has appreciated by 13 to 87 per cent against the other ASEAN currencies (except Singapore dollar) during the period of 1995-1997; and appreciated against Indonesian rupiah and Philippine peso and depreciated against the Malaysian ringgit and the Singapore dollar during the period 1997-2000. The appreciation since the end of 1995 to the end of 1997 has been the greatest against the baht (55.2 per cent) and the rupiah (87 per cent). Thailand and Indonesia are the two ASEAN countries against which Vietnamese exporters are in closest competition.

**Table 3.2: Appreciation of VND Against ASEAN Currencies**

|             | Value of Dong (National Currency/VND) |         |         |         |         |         | Appreciation (%) |           |
|-------------|---------------------------------------|---------|---------|---------|---------|---------|------------------|-----------|
|             | At Year end: 1995                     | 1996    | 1997    | 1998    | 1999    | 2000    | 1995-1997        | 1997-2000 |
| Indonesia   | 0.20893                               | 0.21366 | 0.3907  | 0.5472  | 0.5082  | 0.6488  | 87.0             | 66.0      |
| Malaysia    | 0.00023                               | 0.00023 | 0.00031 | 0.00027 | 0.00027 | 0.00026 | 13.0             | -16.1     |
| Philippines | 0.00239                               | 0.00238 | 0.00307 | 0.00281 | 0.00290 | 0.00345 | 28.5             | 12.4      |
| Singapore   | 0.00013                               | 0.00013 | 0.00013 | 0.00012 | 0.00012 | 0.00012 | 0                | -7.7      |
| Thailand    | 0.0023                                | 0.00232 | 0.00357 | 0.00261 | 0.00273 | 0.00298 | 55.2             | -16.5     |

Notes: Appreciation is measured as the percentage increase in the VND against each respective currency.

Source: Calculated from data in Table 3.1.

Do economic fundamentals in Viet Nam justify such an appreciation of the VND? In the same newspaper report that discussed the “good” performance of the VND over the past few years, it

<sup>59</sup> Viet Nam News, 10 September, 1997.

was also mentioned that there was an increasing need to protect Vietnamese producers against imports from ASEAN and elsewhere. Declining competitiveness of producers of tradable goods is a sure sign of currency overvaluation.

If Vietnamese producers truly are becoming less competitive, a close look at the exchange rate might be in order. The recent Thai experience illustrates the very high costs that arise from delaying necessary exchange rate adjustments.

Viet Nam is, of course, different than Thailand and other ASEAN countries. In particular, Viet Nam's foreign exchange laws allow for much more direct intervention in foreign exchange markets than in other ASEAN countries. The legal requirement that foreign investors balance their demands and supplies of foreign currencies, for instance, is a strong weapon if the government wishes to restrict the supply of foreign exchange. Direct controls on foreign exchange transactions can be used to mask underlying foreign exchange imbalances. In countries with freer foreign exchange markets, such imbalances would soon lead to pressures on foreign exchange reserves and thus on the exchange rate.

While direct controls provide extra degrees of freedom to policy makers, they at the same time mask important economic signals, and can impose high costs on the economy. The use of direct controls is almost always arbitrary and non-transparent. Variations in the implicit subsidies and taxes that result from the use of exchange controls seldom bear any relation to underlying economic factors. They seriously distort the price signals given by the market. And the uncertainty they create is a serious barrier to new investment and subsequent growth.

An overvalued exchange rate is a tax on producers of tradable goods — import-competing and exports. The tax is borne across all sectors, including both agriculture and industry. Failure to ensure a realistic exchange rate is the single most effective way to undermine any programme of trade liberalization (see Box 3.9). The use of exchange controls to preserve or to delay necessary adjustments to an overvalued exchange rate aggravates the underlying problems and introduces additional economic distortions. Two important lessons from the economic success of ASEAN member countries over the past decade and a half are:

- the need to maintain competitive and realistic exchange rates, and
- the benefits of relatively unrestricted foreign exchange regimes<sup>60</sup>

A lesson from the most recent events in these countries is that the costs of delaying necessary exchange rate adjustments are high.

### **Box 3.9: The Exchange Rate and Exporters**

Exchange rate devaluations assist exporters by raising the local currency price of their sales. At the same time, of course, devaluation raises the local currency price of any imported inputs. The argument is sometimes made that, since many of Viet Nam's manufactured exports have very high import content, a devaluation will not help them very much, and might even harm them. This is not correct. The proportional assistance provided to exporters by devaluation is independent of the amount of import content in their production.

<sup>60</sup> Indonesia abolished all capital controls in its foreign exchange markets in 1970. This has served as a strong incentive for foreign and domestic investors and as a discipline on monetary authorities to ensure that the macro policy environment remains stable and attractive.

Consider an exporter that sells a product in world markets for US\$100. At an initial exchange rate of 1000 VND, say, this brings local currency revenues of 100,000 VND. Following 20 per cent devaluation, the local currency value of these exports rises to 120,000 VND. Suppose that this exporter's production has high local content, say 60 per cent. Such an exporter needs to import US\$40 of imports for each US\$100 of exports. His net local production (or value-added), therefore, is US\$60, or 60,000 VND at the initial exchange rate. After the devaluation, the same exports (and associated imports) bring net revenues of 72,000 VND to cover local costs. This is 12,000 VND more than the 60,000 VND pre-devaluation value-added.

The effect of the 20 per cent devaluation, therefore, is to provide a 20 per cent subsidy to the exporter's local value-added. Suppose instead that local content was only ten per cent. The pre-devaluation domestic value-added per US\$100 of exports would be US\$10 (US\$100 minus \$90), or 10,000 VND. After the devaluation the domestic currency value of this local value-added would increase to 10,200 VND. The net subsidy to this exporter's local production resulting from the 20 per cent devaluation is 2000 VND, or 20 per cent of pre-devaluation value-added. Devaluation gives the same assistance to exporters with high import content as it does to those with low import content. And overvaluation, of course, taxes all exporters at the same rate.

### **Box 10: Duty Drawbacks and Exemptions for Exporters**

Import taxes and NTBs raise the cost of imported inputs used by domestic producers. Producers who sell only in the local market can be "compensated" for this cost disadvantage by the use of import taxes on their final products, which enables them to sell at a higher price than foreign competitors. If import taxes on final products are equal to or exceed the average rate of import tax upon imported inputs, import competing domestic producers will actually gain from protection. In the absence of export subsidies, however, exporters cannot be compensated for the cost-raising effects of protection in the same way — in order to export, they must sell at internationally competitive prices. Taxes or other restrictions on imported inputs, therefore, put exporters at a competitive disadvantage.

A standard and internationally accepted procedure for dealing with this problem is to find ways to exempt exporters from import taxes and other import restrictions, or to give them rebates of taxes paid on imported inputs used in export production. These rebates are called duty drawbacks. WTO rules permit such drawbacks as long as they do not exceed the actual import duties paid on inputs and raw materials used to produce goods for export. Payments in excess of this are regarded as export subsidies and are hence countervailable. Duty drawback schemes that meet WTO requirements can be relatively complex to design and to implement. They have proven almost impossible to design for indirect exporters, i.e. domestic producers of inputs for exporters. The only effective long run solution to the cost-raising effects of protection on exporters is to reduce protection.

Viet Nam currently provides exemptions to firms producing in export processing zones and to other exporters on the basis of export promotion privileges. This does not cover all actual and potential exporters, especially those who sell both domestically and internationally. Those who do not benefit from exemptions must rely on drawbacks. According to information obtained from case studies and from secondary sources, duty drawbacks work relatively well for many Vietnamese exporters. The reason for this appears to lie, not in the excellence of design of the drawback system, but rather in Viet Nam's peculiar system of import tax collection. Viet Nam does not collect import taxes at the time of import. Rather, importers are given a substantial period of time after the date of import to clear import tax obligations. This is a rare kind of system by international standards. By allowing taxes to be paid after the release of goods, customs gives away much of its leverage to collect these taxes. An important side effect of this system for exporters, however, is that, as long as they export goods before import tax collections on inputs are enforced, there is never a need to collect a drawback. As Viet Nam modernizes its import tax collections, it is very likely that it will also have to redesign its duty drawback system for exporters.

## **Chapter 4 : Viet Nam in ASEAN**

**- Jose L. Tongzon -**

### **4.1 ASEAN Cooperation**

#### **4.1.1 An Overview of ASEAN Cooperation**

The establishment of ASEAN was launched through the Bangkok Declaration of 1967, which declared ASEAN's objectives: to “accelerate the economic growth, social progress and cultural development of the region through joint endeavours and partnerships to strengthen the foundation for a prosperous and equal community of South East Asia”. Despite the political motivation underpinning its establishment, ASEAN's initial collaborative activities were functional in nature and aimed at fostering mutual confidence and trust among member states. ASEAN's formative years faced formidable challenges, the core of which were issues relating to national sovereignty and the integrity of individual countries. However, by the end of the 1970s cooperation in various economic and social areas were in place. These were primarily in the form of: collaborative activities and projects; joint positions on issues of common interest in international forums; promotion of cross-border exchanges of goods (i.e. preferential trading arrangements); financial resource pooling and market sharing (e.g. ASEAN industrial projects); and commitments to peace and security arrangements. Since the 1990s, economic cooperation has accelerated and has become much more far-reaching in its impact on the ASEAN member countries. More generally, the changing form of ASEAN cooperation is due to a number of regional trends that include:

- the growing sense of regional cohesion in ASEAN;
- the increasing dynamism of the private sector;
- the emerging technological advances that have linked the region closer together.

#### **4.1.2 Functional Cooperation: Building Blocks for Regional Cohesion**

During the early years of ASEAN, member countries desired to consciously develop intra-ASEAN contacts and networks in order to foster mutual trust and attain a sense of regional cohesion. ASEAN regional projects were functional in nature — that is, they involved collaboration among ASEAN officials and professionals through regional networks and institutions. Functional cooperation became a strategic mechanism for promoting participation in ASEAN affairs. Among the political, economic and social areas of cooperation in ASEAN, functional cooperation provided the basis for maintaining continuing dialogue and interaction among member countries. Also, since functional cooperation has always been relatively less sensitive than other forms of cooperation, it served as an effective mechanism for confidence building especially during the earlier years of ASEAN. A strong and cohesive ASEAN aided the region by building a spirit of solidarity that has since become a unifying element for its collaborative endeavours.

To a considerable extent, the openness with which ASEAN member countries speak today about economic integration could be traced to an increased ASEAN consciousness brought

about by sustained social and cultural interactions. There is a constant need to strengthen the notion of ASEAN in all its members, and functional cooperation has played a key role in bringing this about.

ASEAN functional cooperation is essentially project-driven thus implying a dominant role for government. Unlike many of the activities in ASEAN economic cooperation that are governed by rules-based framework agreements, functional cooperation projects do not require domestic policy changes for collaborative activities to take place because no cross-border transactions are involved. For the most part, functional cooperation activities address common needs or institutional interactions where regional cooperation could add value or maximize comparative advantage. Because of its project orientation, most functional cooperation activities tended to proceed in an ad hoc fashion in the past. However, since 1992, medium-term plans and programmes of action in various functional cooperation areas have put more coherence in the design, prioritization and implementation of functional cooperation projects. Initially, ASEAN functional cooperation focused on socio-cultural activities involving the exchange of information on national programmes and projects and a few cooperative projects. As regional cooperation gained momentum, functional cooperation expanded into new areas of concern that reflected emerging national, regional and international concerns and priorities. At present, functional cooperation in ASEAN covers the fields of science and technology; environment; culture and information; social development; drug and narcotics control; and civil service matters (see Box 4.1).

#### **Box 4.1: ASEAN Functional Cooperation: Unity in Diversity**

##### Culture and Information

ASEAN cooperation in culture and information lies at the core of building an ASEAN sense of “oneness” — a factor that was crucial in ASEAN’s formative years. Initially, the countries of ASEAN were largely unaware of each other’s cultural diversity alongside their commonality. Cultural activities and social exchanges served to diffuse political tensions and issues of national sovereignty that initially threatened the stability of ASEAN. Through numerous cultural programmes and exchanges, using various forms of media, a sense of “ASEAN-ness” was gradually shaped over the years. An ASEAN University network has now been established to institutionalize efforts at promoting an ASEAN identity.

##### Social Development

ASEAN cooperation in social development is motivated by shared aspirations among member countries to maximize the full potential of their people. Various dimensions of human resources development are covered by ASEAN initiatives — education, health and nutrition, population and migration, labour and employment. The focus of ASEAN cooperation in these areas are directed at a number of special concerns, which include:

- i. the integration of ASEAN awareness in the educational curricula;
- ii. improvements in health delivery systems to reduce deprivation especially in remote rural areas;
- iii. increased participation of youth in the development process through employment opportunities;
- iv. employment promotion and improvements in working conditions of ASEAN’s expanding labour force;
- v. the protection of the interests of special groups (women, children, the elderly, and the disadvantaged); and
- vi. the prevention and control of drug abuse and HIV/AIDS.

### Science and Technology

ASEAN cooperation in science and technology (S&T) has received increasing emphasis in recent years as member countries began to attain industrialized country status. Efforts are directed towards intensifying cooperation among S&T institutions in the region through: networking and various forms of exchanges (e.g. information, scientific personnel, research results, etc.); activities to support commercialization and the adaptation of technology; and joint research in selected priority areas.

There are eight priority areas that have been identified:

- i. food science and technology;
- ii. biotechnology;
- iii. microelectronics and information technology;
- iv. materials science and technology;
- v. non-conventional energy research;
- vi. marine sciences;
- vii. meteorology and physics;
- viii. Science and Technology infrastructure and resources development.

### Environment and Natural Resources

The preservation of the ASEAN region's ecosystem has motivated joint initiatives in the field of the environment and natural resources. Aspects of cooperation activities include: building environmental awareness and institutional capacities for environmental management and natural resource accounting; common approaches to heritage sites preservation and nature conservation; the development of environmental quality standards; and joint action in international issues and activities of common interest. Programmes and activities are also in place for addressing transboundary environmental concerns such as the haze caused by forest fires; air and quality management; transfrontier parks and other protected areas; shared marine resources; and the protection of biological diversity through linked ecosystems.

Viet Nam's entry point into ASEAN was through functional cooperation. When Viet Nam signified its wish to join ASEAN, member countries decided that initially it could participate (with observer status) in meetings of the ASEAN functional committees. Projects in the functional areas were pragmatic, results-oriented, and did not involve policy debates. It was therefore a useful avenue for building confidence and promoting friendly interaction between Viet Nam and the other ASEAN member states.

## **4.1.3 Economic Cooperation: Towards Integration**

It was not until 1976, ten years after its founding, that economic cooperation began to figure prominently in the ASEAN agenda. The Declaration of ASEAN Concord signed at the First ASEAN Summit Meeting in 1976, represented the first time that specific guidelines on ASEAN economic cooperation activities were formulated. The coverage of sectors was comprehensive — trade, industry, agriculture, transportation, communications, minerals and energy, and finance and banking. However, the depth and quality of cooperation in these sectors were varied and uneven and overall lacked any encompassing framework. In the area of trade, for instance, the impact of the Preferential Trading Arrangement (PTA) on intra-ASEAN trade was

only minimal on account of the complex procedures for determining the coverage of products and their corresponding degrees of protection. ASEAN industrial cooperation schemes in the early years were also flawed. The decision-making processes did not involve the private sector, and being public sector driven, were based mainly on non-economic considerations. Even when the schemes were eventually modified to involve the participation of the private sector, member governments required complex procedures that actually served as a disincentive for private sector participation (see Box 4.2 and 4.3).

Only in the last five years have economic cooperation activities begun to focus more on the enabling of the regional environment, to ensure that market forces are able to work more efficiently. During this time a number of important ASEAN economic cooperation agreements have been launched: the ASEAN Free Trade Area (AFTA) (1992), the ASEAN Framework Agreement on Services (1995) and the ASEAN Intellectual Property Cooperation Agreement (1996). Additionally, the ASEAN Investment Area (AIA) was signed in 1998. AFTA is by far the most ambitious economic cooperation scheme to date. Unilateral trade liberalization in ASEAN, and the emerging competition from China, as well as regional trade agreements in North America and Europe, converged to make AFTA politically feasible. Initially, AFTA was to be realized through a Common Effective Preferential Tariff (CEPT) of zero to five per cent on intra-ASEAN traded goods (with the subsequent removal of non-tariff barriers). Initially, the timeframe for completion was fifteen years but this was reduced to ten years ending in 2003. Although the CEPT is the main instrument for realizing the goals of an ASEAN free trade area, the spirit of AFTA extends to other areas of economic cooperation. These include harmonization of technical standards, reciprocal recognition of tests and certification of products, removal of barriers to foreign investment, macroeconomic consultations, rules for fair competition, and promotion of venture capital.<sup>61</sup>

#### **Box 4.2: Areas of ASEAN Economic Cooperation**

Agriculture: Despite the rapid industrial development of member countries, ASEAN cooperation in agriculture has remained active. A significant initiative in the field of agriculture is the establishment of the regional food security reserve scheme, which requires member countries to provide emergency rice reserves, over and above their national reserves, for the purpose of meeting member countries' requirements. Other initiatives that have clearly addressed regional interests include improvements in grains post-harvest facilities and handling technology, aquaculture development, cooperation in afforestation, forest and watershed management, and timber technology.

Transport and Communication: The difficulty of physically linking ASEAN countries, which are not geographically contiguous, except for Thailand, Malaysia, Singapore and Viet Nam, did not deter cooperation in the transport sector. Initiatives in maritime, train and air transport were taken primarily to facilitate trade and investment flows. Activities that have made good progress are in the areas of maritime transport safety, prevention of pollution from ships, and

air space management. Discussions have started towards a competitive air services policy in ASEAN, which is considered an initial step towards an open skies policy within the region. In the telecommunications sector, technological advancements have linked the region closer together. ASEAN cooperation projects have included the submarine cable linking ASEAN countries. The expansion and

<sup>61</sup> There was an immediate need to synchronise the schedule of tariff concessions under the Brand-to-Brand Complementation (BBC) with those under AFTA. The situation led to the formulation of the ASEAN Industrial Cooperation Scheme (AICO) enabling the participating companies to enjoy the preferential tariffs of zero to five per cent immediately upon approval without having to wait for the AFTA schedule to take effect.

liberalization of the telecommunications sector has now raised the need for closer policy consultation and coordination on interconnectivity and pricing policy, as well as the overall deregulation of the sector.

Energy: ASEAN cooperation in energy is presently focused on petroleum security, conservation and the search for alternative fuels. These thrusts reflect the recognition that energy will continue to play a significant role in sustaining economic growth. A Petroleum Security Agreement is in place that requires member governments to make available crude oil and/or petroleum products for countries in short supply. Studies for a Trans-ASEAN Gas Transmission System and an ASEAN Power Grid have been initiated with the objective on ensuring a reliable supply of energy to the region. Notable progress has also been made in cooperation activities related to natural gas utilization and development and energy management.

Finance and Banking: Cooperation in the finance and banking sector was initially limited to projects within the purview of monetary authorities but now a diverse regional capital market for ASEAN exists, less a result of a specific cooperation activity in ASEAN but due to unilateral liberalization measures.

International Relations: A separate area of ASEAN cooperation is in international relations. ASEAN coordinates its position on issues of common interest in the international and regional forums. This was evident, for instance, in international commodity agreements dealing with timber, natural rubber, as well as in the recently concluded Uruguay Round of trade negotiations under the GATT. In the area of sustainable agricultural development, ASEAN has made efforts to align its follow-up actions to Agenda 21 as adopted by the United Nations Conference on Environment and Sustainable Development (UNCED). In addition, ASEAN takes a common stand in agricultural promotion schemes to strengthen its bargaining position in the world markets. ASEAN cooperation in less critical sectors also reflects various dimensions of regional collaboration. ASEAN cooperation in tourism complements national promotional efforts for the industry. ASEAN airlines offer an “ASEAN fare” package and national tourism brochures usually feature other ASEAN destinations. Collaborative programmes of a regional nature include joint marketing activities, provision of transport and tourism related infrastructure, and simplification of immigration procedures.

#### **Box 4.3: ASEAN Industrial Cooperation: Lessons from the Past**

To complement domestic industrialization policies, the ASEAN Industrial Projects Scheme (AIPs) was realized where ASEAN countries agreed to establish production capacities in “designated” products for the ASEAN market. The aim of this scheme was twofold: to achieve economies of scale with lower unit production costs and promote an equitable distribution of income and employment in the region. Only two AIP projects eventually took off. The basic flaw of the scheme was that it was public sector driven. Investment decisions were often made based on non-economic considerations. The AIP scheme was eventually abandoned. When the ASEAN Industrial Complementarity (AIC) Scheme was later developed as a successor scheme to the AIP, ASEAN member countries made sure that the private sector was involved. The AIC

would promote horizontal specialization by having four or five countries specialize in producing different components or parts of a single product. However, because of the highly complicated procedures and driving role of the public sector, only one AIC package was eventually approved. The AIC Scheme was subsequently modified to the ASEAN Industrial Joint Venture (AIJV) Scheme, involving just two countries. Later the Brand-to-Brand Complementarity (BBC) Scheme was established to promote specialization within a brand. BBC’s moderate success was most apparent in the automobile sector, with single companies sourcing automotive components in several ASEAN countries. The AIP, AIJV and BBC schemes had one common feature — the granting of margins of preference on existing tariffs by participating countries on the products covered. AFTA, which was launched in 1992, replaced this form of concessionality with the across-the-board lowering of nominal tariffs on intra-ASEAN traded goods.

#### 4.1.4 Emerging Trends in ASEAN Cooperation

Towards the end of the 1980s, it became evident that ASEAN economic cooperation schemes and activities made slow progress and little impact. In retrospect, the past economic cooperation schemes in ASEAN were largely uncoordinated, with adjustments taking place as the need arose. The objectives of economic cooperation were essentially inward looking and the goals were less than visionary. There was occasional ambivalence with respect to the role of the private sector in investment projects, compounded by little consciousness, it seems, at that time, to reduce the government's role and let market forces operate. In the functional areas, most ASEAN activities had a national focus. It was easy to put an ASEAN label to an activity that was simply an aggregation of national activities or common needs (e.g. a seminar on rural entrepreneurship attended by ASEAN participants). Many activities were also ad hoc in nature, resulting from instantaneous responses to divergent needs only remotely relevant to regional cooperation (e.g., training in national archiving), thus spreading resources thinly and reducing impact. Despite its traditionally cautious stance, or perhaps because of it, ASEAN learned its lessons the hard way. ASEAN went through a long process of experimentation that had limited success. At the same time, it was probably these experiences that promoted greater familiarity and promoted understanding among member states — factors that have galvanized the foundations for regional cohesion. Notwithstanding its weak start, ASEAN managed to maintain mutual interest in the search for collective action.

Viet Nam's membership to ASEAN came at a time when ASEAN, having taken stock of its previous cooperation experiences, was undergoing transformation. Since the Fourth ASEAN Summit in 1992, crucial changes in the structure and modalities of ASEAN cooperation have begun to unfold. Economic cooperation has now taken gradual but clear steps towards further economic integration. The external economic challenges, combined with the regional confidence that has been built through all of its 30 years of existence, has fostered regional cohesion. ASEAN cooperation initiatives are forcing domestic policy initiatives to take on broader regional and global perspectives. In the field of functional cooperation, there is greater importance place on the need for a regional focus, and more importantly, a long-term plan for the activities to be self-funded. In the past, ASEAN has always avoided the use of the words "economic integration" largely because of its political and legal nuances. This has become less obvious in recent years when it has become evident that member countries are willing to take the path of successive and accelerated liberalization initiatives to reduce impediments across their borders. The vision of a borderless ASEAN now appears on the horizon — with goods and people freely moving across boundaries and enjoying the benefits of growth and prosperity in the region.

ASEAN's economic cooperation agenda today basically addresses the removal of barriers that impede transactions across national borders (see Box 2.4). The idea is to use collective action in removing these distortions in order to:

- reveal comparative advantages;
- use resources more efficiently; and
- enhance the ability of both individual countries and the region to compete in the global market.

#### Box 4.4: A Perspective of ASEAN's Economic Integration Agenda

| IMPEDIMENTS  | ASEAN INITIATIVES   |
|--|---|
| A) Physical Impediments: (infrastructure)              | ASEAN highway<br>Multi-modal transport systems<br>Singapore-Kunming Railways link   |
| B) Policy-based Impediments                            | CEPT for AFTA<br>Framework agreement on services  |
| 1) border barriers to:                                 | ASEAN Investment Area<br>Human resource development<br>Cooperation in technology transfer<br>Intellectual property rights |
| a) products and services                               |   |
| b) factors of production                               |   |
| 2) differences in domestic policy:                     | cooperation in standards and quality<br>mutual recognition of tests and certifications                                    |
| a) standards   |   |
| b) commercial legislation                              | trade and customs facilitation<br>quarantine procedures   |
| 3) arbitrariness and transparency of domestic policies | macroeconomic consultations<br>policy exchange mechanism  |
| 4) inadequacy in dispute settlement procedures         | dispute settlement mechanisms   |

Source: APEC (1995).

Despite its critics, ASEAN has made considerable progress in reducing these impediments and deepening the integration process. There is evidence to show for this progress. The implementation of the CEPT for AFTA was shortened to ten years from fifteen; agriculture products, which were previously excluded, has now come under the CEPT; harmonization of tariff nomenclature and customs valuation procedures are well in progress; and mechanisms for macroeconomic consultations are in place. While the breadth, depth and quality of these initiatives have been debated, there is little doubt that ASEAN has every intention of pushing ahead at much faster pace. Cooperation in services, over and above the commitments made under the WTO will begin in 1998; and an ASEAN Investment Area, which would extend national treatment to ASEAN investors within the region, is also expected to be adopted in 1998. Thus, the ASEAN cooperation and institutional environment that Viet Nam faces today is not only headed towards closer integration. There is also a discernible sense of urgency that ASEAN must forge ahead quickly if it is to survive and prosper in the global economy. While national interests still dominate the decision-making process, ASEAN cohesion and vision has led member countries to consider their national interests within a broader regional and global perspective.

## 4.2 ASEAN Institutions and Processes

The important changes that have been happening in ASEAN since the 1990s have not been confined to the pace and direction of its cooperation agenda. Important changes were also taking place in the workings and structure of the ASEAN machinery. These changes were directed at reinforcing a regional perspective for ASEAN, fostering a greater degree of hierarchical coherence among various ASEAN bodies, and promoting a more rule-based regime for ASEAN cooperation. The restructuring of the ASEAN machinery applied mainly to the economic areas, leaving the structures in the functional cooperation areas largely unchanged.

### 4.2.1 ASEAN Decision-Making

At the Fourth ASEAN Summit in 1992, the five sectoral economic committees, which previously had set much of the ASEAN cooperation agenda, were abolished. It had been found that the activities of the committees were too uncoordinated, resulting in outcomes that were ad hoc in nature and variable in impact. This move was intended to streamline and centralize the formulation and implementation of integration-oriented economic cooperation activities with the Senior Economic Officials Meeting (SEOM). The SEOM reports to the Economic Ministers Meeting (AEM), which oversees the formulation process and provides policy guidance). The AEM in turn reports to the ASEAN Heads of Government during an ASEAN Summit, the highest authority within the ASEAN institutional framework (see Box 4.1).

Despite high-level institutional changes, internally within the ASEAN machinery, decision making continues to be made by technocrats from various ASEAN member line ministries. Their influence on the content and pace of the ASEAN agenda is pervasive. They can accelerate or retard collaborative action, provide broad or strict interpretations of ministerial-level decisions, and influence the ranking of priorities. The relative capabilities of national technocrats participating in ASEAN meetings determine the effectiveness by which national interests are pursued without sacrificing ASEAN cohesion.

#### Box 4.5: The Major ASEAN Bodies

The ASEAN Heads of Government: The highest authority is the meeting of the ASEAN Heads of Government, the ASEAN Summit, which lays down the directions and initiatives for ASEAN activities. Formal Summits are held every three years with informal summits at least once in between.

ASEAN Ministerial Meetings (AMM): The ASEAN Foreign Ministers meet annually during the AMM. As provided in the Bangkok Declaration of 1967, the AMM is responsible for the formulation of policy guidelines and coordination of ASEAN activities, with focus on political, security cooperation and ASEAN external relations.

ASEAN Economic Ministers Meeting (AEM): The ASEAN Economic Ministers Meeting (AEM) meet annually and is responsible for economic cooperation. With the establishment of AFTA, an AFTA Council was also established and reports to the AEM.

The ASEAN Standing Committee (ASC): The ASC carries on the work of the AMM in between the meetings of the AMM. The ASC comprises the Chairman, who is the Foreign Minister of the country hosting the AMM, the Secretary General of ASEAN, and the Directors-General of the ASEAN National Secretariats. The main focus of the ASC's responsibilities is in the areas of functional cooperation and external relations although it also receives reports of the SEOM.

Senior Officials Meeting (SOM): The SOM serves as the technical arm of the AMM responsible for ASEAN political and security cooperation.

Senior Economic Officials Meeting (SEOM): The SEOM serves as the technical arm of the AEM responsible for economic cooperation matters. With the abolition of the five sectoral economic committees in 1992, the SEOM has been mandated to determine the need for establishing task-oriented, ad hoc bodies on a case-by-case basis based on the priorities set by ASEAN.

ASEAN Meetings with Dialogue Partners: The Meetings between ASEAN and its Dialogue Partners is convened under the joint chairmanship of ASEAN and the Dialogue Partner. While ASEAN Meetings with Dialogue Partners are under the purview of the ASC, the AEM has recently began to also meet separately with their counterparts from the Dialogue Partners.

ASEAN Functional Cooperation Committees: These are: the Committee on Science and Technology (COST), the Committee on Culture and Information (COCI), the Committee on Social Development (COSD). These committees carry out their tasks through a system of subsidiary bodies.

The ASEAN Secretariat: The ASEAN Secretariat was established in 1976 to assist the member countries in the implementation of policies, projects and activities of the various ASEAN bodies.

ASEAN National Secretariats: Each ASEAN country has a National Secretariat under the Foreign Ministry which organizes and implements ASEAN-related activities at the country level.

At the ministerial level there exists a dichotomized decision-making structure between officials responsible for economic and non-economic (e.g. political and functional) cooperation. This dichotomy has made it difficult to pinpoint the locus of authority both at the ASEAN level as well as at the level of national governments. At the ASEAN level, this is most apparent in the conduct of dialogue meetings with Dialogue Partners. Although the dialogue with Third Countries is under the purview of the ASEAN Ministerial Meeting (AMM), the increasing economic content of ASEAN external relations has resulted in separate meetings between the ASEAN Economic Ministers (AEM) and the Dialogue Partners in recent years. At the national level, this duality has often given rise to subtle rivalries between foreign and economic ministries, with one taking primacy over the other. The distinction between primary and secondary agencies is important for some countries like Singapore and Malaysia, but less so in others. In the Philippines, for example, the increasing importance of economic parameters in foreign policy (or development diplomacy) has made the distinction between primary and secondary agencies less pronounced. The relative strength of foreign and economic ministries at the national level provides a useful gauge of the country's position on a given issue.

The consideration of Viet Nam's bid for membership in ASEAN presents a good example of the dichotomous decision-making structure at work. While ASEAN's political leaders essentially shared the same view regarding the importance of Viet Nam's early admission into ASEAN, decision makers were divided on the question of the modalities for admission. For the foreign ministers, it was important to immediately begin the process of integration of the "former Indochina" in order to stave off a possible reversal of the peace process in the region. Viet Nam's accession to the Treaty of Amity and Cooperation (which commits the signatories to the furtherance of peace, harmony and stability in the region, and abstention from the use of force to settle disputes) was considered as a necessary and sufficient condition for entry into ASEAN. The economic ministers, on other hand, were demanding a stiffer "entrance fee" in terms of accession to AFTA under the same terms as the six original members. The differences

within ASEAN became apparent to Viet Nam who took advantage of the situation to exact the concession of a three-year year grace period prior to implementing AFTA.

The decision to strengthen the ASEAN Secretariat at the Fourth Summit in 1992 also supported regional cohesion. Previously, the ASEAN Secretariat was composed of seconded national officers who, by virtue of the political nature of their appointment, tended to support national rather than ASEAN interests. The present merit-based system of recruitment in the ASEAN Secretariat has allowed the building of a core of professionals with a regional perspective and strengthened the capabilities of what has now become a truly regional organisation. In addition to the professionalization of its staff, the ASEAN Secretariat was given three new mandates in 1992, namely:

- to take initiatives;
- to provide advice; and
- to implement ASEAN decisions and projects.

These mandates were very significant when one considers that the Secretariat functioned only as a coordinating body in the past. The position of Secretary-General of ASEAN was elevated to ministerial rank for more effective liaison with the AMM, AEM and other ASEAN Ministers.

## **4.2.2 Changes in the ASEAN Way**

### **4.2.2.1 National Interests**

Notwithstanding the move towards greater ASEAN integration, the national interest of ASEAN member countries remains the primary determinant of the form and substance of regional cooperation. ASEAN has no supranational authority that has the mandate to exercise operational control of the various geographically dispersed ASEAN bodies. Geographic dispersal is manifested principally by the practice of rotation based on the principle of equal sharing of the burden by member countries. ASEAN mechanisms are designed to harmonise national interests up to the limits of political and economic compatibility. Intra-ASEAN differences can make collective action vulnerable to isolated, individualistic approaches.

The United States capitalized on ASEAN differences with respect to the character of APEC, which was originally vetted as a forum of dialogue until it eventually became a regional bloc. Although ASEAN had strongly articulated its preference for APEC to remain as a dialogue forum, it was left with little choice when APEC was eventually institutionalized. ASEAN now participates in APEC as individual member economies and not as a collective grouping. ASEAN consultative meetings held prior to APEC meetings have been limited to exchange of views rather than joint approaches to APEC issues. There is also evidence that in the past, member countries have pursued their own external trade links, even at the expense of their neighbours. At the APEC Summit 1995, Indonesia gave full support to the Bogor Declaration even though Malaysia clearly had a different view. Also, Viet Nam exploited this ASEAN weakness, when at the height of the Cambodian crisis in 1997, the Vietnamese Foreign Minister made periodic visits to ASEAN capitals to gauge differences among the member states.

As a result of growing regional cohesion, or perhaps because of it, intergovernmental rigidities in ASEAN are loosening up. Summit meetings of the Heads of Governments, which were held infrequently and irregularly in the past, are now held regularly every three years, with an “informal” meeting at least once during the period. ASEAN Economic Ministers go on “retreats” for a candid exchange of views on new directions and initiatives, without being circumscribed by an official agenda from their senior officials. ASEAN as a collective entity is beginning to influence the strategies and policies of its members — a situation which ASEAN was not capable of doing in the past. Viet Nam may still be operating at the stage where national interest is the primary motivation and substance of its ASEAN participation, but this may have to give way soon to a more centrist, integration-oriented approach.

#### **4.2.2.2 Consensus**

With the expansion in its membership, ASEAN is rethinking its present system of deciding by consensus. Because ASEAN countries always act in their national interest instead of towards a common vision or destiny, the process of building consensus is often slow and tedious. Hence, it is sometimes necessary to forge a general consensus first (i.e. agreement at the level of principles) before details are actually worked out. AFTA’s rules were set out only in broad terms in the beginning until it evolved to more detailed and specific arrangements in its present form. By way of contrast, the North American Free Trade Area (NAFTA) began with a detailed set of rules before it was ratified by its members.

There is a concern that membership expansion will heighten ASEAN’s vulnerability to diverse national interests that may not easily lend themselves to harmonization considering the level of development and institutional capabilities of the new ASEAN members. There have been discussions about possible changes in the consensus formula, in favour of the “9 minus x” principle.<sup>62</sup> There are views that the consensus rule could apply only to decisions on political cooperation and external relations while the “9 minus x” could be made to apply to decisions in the economic and functional areas, especially in project-oriented activities. ASEAN has in fact allowed a limited application of the latter decision rule on a case-by-case basis. ASEAN’s expansion to include Laos and Myanmar has also raised the question of whether granting a special treatment to these new members was necessary. Viet Nam, as the first among the new entrants, has set a precedent in terms of obtaining a longer time frame for reaching the goals of AFTA.

ASEAN’s willingness to be more flexible with respect to the consensus principle indicates a high level of confidence and goodwill among the member states. This flexibility could provide Viet Nam with opportunities for enhancing bilateral relations with member states. While the original ASEAN countries have exhibited a tendency to take initiatives on an all-ASEAN basis, there may be a good case of Viet Nam, as a new entrant in the international arena, to start cooperative experiments at the bilateral level. This need not preclude the possibility of ASEAN “rationalization” at a later stage. This approach could be applied to joint marketing, procurement, research, human resource development, or other activities (e.g. activities to curb smuggling at the border), that could provide Viet Nam with useful experience for eventual ASEAN projects, and still make a sound contribution to regionalism.

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<sup>62</sup> This principle allows ASEAN (consisting of nine member states) to proceed with a decision even though ‘x’ members decide not to participate.

#### **4.2.2.3 Code of Behaviour**

Interactions among ASEAN member states are governed by codes of behaviour. Seniority is important. Indonesia has always performed the role of ASEAN's big brother, by virtue of its founding role in ASEAN, and the fact that its Head of State is the most senior political leader among the heads of other member states. It has exercised this role on many occasions, among others during the Cambodian crisis in 1997, and efforts to ease tensions among competing claimants in the South China Sea. At another level, the support of a senior government official can spell the difference between the success and failure of a debate on an ASEAN issue. Administrative styles are equally important. Singaporeans and Malaysians tend to be more formal and strict compared to Indonesians and Filipinos.

Thus, in budget and auditing activities, for example, the former would tend to be more tedious and meticulous compared to the latter.

### **4.3 Future Challenges to Viet Nam's Institutional Capacities**

Viet Nam stands to gain considerably from a deeper understanding of how ASEAN mechanisms operate. Experiences may vary with different committees depending on a number of factors — the extent to which national interests converge on a given issue, the nature of the decision-making process, seniority, and administrative behaviour among others. Taken as a whole, these experiences can be very useful in mapping out a strategy for ASEAN participation, and in the ordering of priorities. Viet Nam should be able to sift through these experiences and draw valuable lessons from them. Vietnamese nationals working in the Secretariat can provide a rich resource from which national agencies involved in the ASEAN process can obtain insights and advice on the workings of the ASEAN machinery. Viet Nam's currently perceived handicaps in negotiations, and project preparation, could be addressed through training, but perhaps more effectively through practical experiences within the ASEAN process itself. Negotiating in ASEAN is likely to be different from that found in other international forums. Since national interests are central to ASEAN decisions, an extensive knowledge of ASEAN member country's national priorities would be required in order to determine possible areas of standstill and compromise in the negotiation process. However, it remains true that the starting point of any negotiations is an assessment of the implications for Viet Nam through the identification of the inherent risks and opportunities.

Viet Nam's concern about its ability to propose regional projects that responds to the needs of other member countries is probably less difficult. Knowledge of member countries common priorities and needs is a fundamental step in addressing the problem, but where this knowledge is weak or absent, there will always be an opportunity for countries to add elements that could make the project more regionally focused. Furthermore, as long as the projects do not require domestic policy changes, or where cost sharing is applied, the "9 minus x" principle could be invoked. Finally, there are training tools that are available in the ASEAN Secretariat that could be used to improve Viet Nam's capacity for preparing regional projects (see Box 4.6).

The plan to implement a cost-sharing scheme for financing the implementation of projects (in particular for science and technology projects) in the wake of dwindling Dialogue Partner funds, could seriously hamper the ability of the new ASEAN members such as Viet Nam to participate more fully in ASEAN projects. In an interview with an official from the Ministry of

Foreign Affairs, a suggestion was made for ASEAN to consider some kind of “differential treatment” for new members with respect to the cost-sharing scheme. The alternatives to this would be to request the Dialogue Partners to set up a cost-sharing fund for new members, or to allow the proposed ASEAN Foundation (which would be the vehicle for receiving private sector contributions) to support new members’ cost-sharing requirements. Although ASEAN functional cooperation may not have received as much attention as the economic cooperation programmes, they provide the basic foundations for building confidence and capacities in ASEAN. As it happened, the original ASEAN members spent most of its first ten years in functional activities, an approach that was applied also to Viet Nam, as well as Laos, Cambodia and Myanmar, in their initial exposure to ASEAN. The wide sectoral coverage of the functional committees is a means to expose as many national agencies as possible to the ASEAN process, thus increasing awareness, familiarity and confidence.

#### **Box 4.6: The Concept of an ASEAN Regional Project**

To qualify as an ASEAN regional project, the following conditions must be met:

##### Primary criteria:

The problem or need is regional, not national, by definition. The problem is one that exists above the national level. Examples meeting this criterion includes: regional trade and investment; transportation and communications systems; tourism; labour migration; and law of the sea.

The problem or need requires regional cooperation in order to bring about a solution. Examples here would include such cross-border transactions as: drug trafficking; transmission of human and livestock diseases; and air and water pollution.

##### Secondary criteria:

There is a comparative advantage or value-added to be gained by approaching an issue on a regional basis. An example here would be trade negotiations with Dialogue Partners.

There are economies of scale realized by regional specialization. A single institution may serve the needs of the region in lieu of each member country having its own institution or programme. An example here might be the Singapore Civil Aviation Training Centre for certain types of highflying level training.

The solution to the problem or need would promote regional integration. This criterion applies mainly in the economic areas. An example here might be the development of regional tax policies in order to encourage intra-ASEAN trade and investment.

*Source:* ASEAN Secretariat (1997)

Viet Nam hosted the Sixth ASEAN Summit in December 1998 — a milestone in the history of its ASEAN membership. Viet Nam, which followed Thailand in the alphabetical sequence of hosting the Summit, could have chosen to pass its turn to Brunei, on the excuse that it will not yet be ready to host such a big event. Yet, Viet Nam saw this as an opportunity to demonstrate, at the highest level, its full participation in ASEAN.

# **Chapter 5 The economic reform agenda under AFTA**

**- Jose L. Tongzon -**

## **5.1 Overview**

The uneven and slow pace of ASEAN cooperation did little to affect member countries individual economic growth performance. Towards the latter part of the 1980s, domestic reforms towards liberalization, combined with appropriate macroeconomic management, led to unprecedented economic growth rates in most of the ASEAN countries. By the 1990s, most of the ASEAN economies were growing at the rate of seven to ten per cent. Viet Nam's historic decision to commence the period of economic renovation was partly motivated by the goal of catching up with its successful ASEAN neighbours. The success of export-led growth by the East Asian economies persuaded Viet Nam that the way forward was to adopt outward-oriented policies that gave firms easier access to imports and promoted exports. Viet Nam observed that a predictable economic environment, transparent rules, adequate infrastructure, and politically stable conditions were the critical combination of factors that led to the success of its ASEAN neighbours.

Viet Nam's goal of catching up will not be easy. Although Viet Nam's economy performed creditably well over the last fifteen years, many important policy issues remain. At the beginning of the reform process in 1986, Viet Nam accepted the market mechanism as a means of allocating resources and the need to reorient its economic institutions accordingly. Although the reforms were initially a response to domestic challenges, they quickly shifted into the areas of foreign trade and investment evidenced by the partial liberalization of capital and goods flows. However, there remains a tendency towards self-reliance. This has been manifested by efforts to create large-scale state conglomerates that can compete with foreign companies and the restriction of foreign investment in certain key sectors. Viet Nam's institutional environment may be seen to be evolving towards a more level playing field for local and foreign capital. However, Viet Nam's own efforts to open its economy and expand its ties to the outside world were a key factor for its impressive economic performance.

Viet Nam's membership in ASEAN has reinforced its trade and investment links with its ASEAN, as well as its East Asian trading partners. Viet Nam's economy complements the more developed ASEAN economies (i.e. Singapore and Malaysia); while having a mix of complementary and competition with Thailand, the Philippines and Indonesia. Similar to Viet Nam, these three economies rely heavily on the production of labour intensive manufactures for export. Viet Nam's largest foreign investors are from those countries from which it also imports heavily. The four largest foreign investors in Viet Nam are Taiwan, Hong Kong, Singapore and South Korea.

Apart from enhancing its trade and investment links within the region, Viet Nam's membership in ASEAN serves as an important mechanism to bind the government to policy decisions and to guard against possible policy reversals. Viet Nam's membership in ASEAN will put pressure on policy makers to push through further reforms at a greater pace. International commitments can help bind these reforms, while mitigating domestic resentments in the short-run. The manner in which Viet Nam uses its role in ASEAN will be a key factor in determining its particular path towards openness and transformation.

### **5.1.1 Regional free trade and policy reform**

The extent to which ASEAN is able to influence the direction and pace of reforms in Viet Nam has been put to test in respect with the ASEAN Free Trade Area (AFTA). AFTA is by far the most ambitious economic cooperation scheme in ASEAN to date. The importance of Viet Nam's participation in AFTA has been argued on several grounds. Accession to AFTA will expand Viet Nam's markets and bring about an increased flow of investments. Viet Nam's access to an ASEAN market of 500 million people will provide an opportunity to achieve greater production efficiency, thereby resulting in a price advantage. Lower priced inputs from ASEAN countries can help reduce costs further for Vietnamese exporters and thus improve their competitiveness in the world market. Domestic consumers will also benefit from lower prices. For a number of agricultural products where Viet Nam is the sole exporter, an expanded ASEAN market will ultimately be of great benefit.

With respect to the impact AFTA has on foreign direct investments (FDI) arguments have been made on both sides. It is likely that FDI in Viet Nam will increase from sources both outside and from within ASEAN. As long as cost differentials exist, investors from within ASEAN will be encouraged to locate in Viet Nam. They will also invest in areas that are still protected by Viet Nam (although this could mean that these products would not receive CEPT concessions). For non-ASEAN investors, the 40 per cent local content rule for CEPT concessionality could be a factor to locate in Viet Nam to gain access to the ASEAN market. On the negative side, the profitability of FDI in Viet Nam may be affected if sectors are eventually liberalized. In the past, there was a deliberate policy of protection for some industries to encourage FDI to bring in capital and technology (as in the case of automobiles). If protection is eventually dismantled, and ASEAN competition enters the market, then the viability of these companies may be affected since in general, they have a small production capacity and are not ready for international competition.

Viet Nam's policy makers however, continue to grapple with major issues concerning participation in AFTA. One issue concerns the revenue impact that tariff reductions will have on the state budget. A solution being contemplated is to restructure Viet Nam's tariffs' within the zero to five per cent band permitted by AFTA. Another issue is Viet Nam's ability to compete with ASEAN products that could flood Viet Nam's economy and eliminate its infant industries. Given the low level of capital and product technology, domestic industries are likely to experience difficulties when cheaper ASEAN products enter the market. Industries that are most vulnerable are those that are highly protected which are predominantly in the state owned enterprises (SOEs) sector producing products such as petroleum, steel, chemical fertilizers and cement. This is significant since SOEs employ about 25 per cent of the workforce and contribute 50 per cent of the state budget. Other industries that could be affected are those that produce capital-intensive manufactures. A final issue is Viet Nam's ability to enter into capital intensive, high technology manufactures and the concern that the relatively advance state of its ASEAN neighbours could make the catching up process difficult if not impossible.

Although Viet Nam has made strong commitments to AFTA, recent delays in the implementation of these commitments have raised strong concerns by ASEAN. An ASEAN senior economic official expressed the view that the pace of Viet Nam's participation poses the potential of slowing down the whole AFTA process.

This view is shared by an ASEAN Secretariat official who emphasized the importance of meeting the expectations of Viet Nam's international partners towards continued reforms and

internationally accepted policies. Viet Nam's deliberate approach to its AFTA commitments appears to reflect the "dualism" that has characterized its reform process - on the one hand trying to join the world economy, but at the same time wishing to maintain a planned centralist economy. Although Viet Nam may consider this approach as a more realistic path to transformation, there is always the danger that this could retard the necessary institutional changes that are critical to the process of globalization. ASEAN membership should therefore be used to put pressure on policy makers to step-up Viet Nam's reform process.

It could be surmised that ASEAN's long legacy of flexibility and consensus building has assisted Viet Nam in going slow on its AFTA commitments. Thus, instead of using ASEAN membership as a policy lever, Viet Nam seems to have maximized the flexibility allowed under the CEPT framework, as well as in the ASEAN processes themselves, to pursue a more deliberate pace in meeting its CEPT obligations. Given the national goal of "catching up" with its ASEAN neighbours, Viet Nam's present AFTA strategy may yield more inimical results in the long run. The reciprocity principles for the exchange of concessions under the CEPT imply that the benefits for Viet Nam are postponed if the conditions for the enjoyment of these concessions are not met. Already, a three-year extension has been accorded to Viet Nam to meet the targets under AFTA. A more judicious approach should be to try to shorten this extension rather than delay it. ASEAN liberalization in trade (through AFTA) and in the services sector will be Viet Nam's key areas of concern. Although the overall direction of Viet Nam's domestic policies is clear in respect of these two areas, their scope and pace are divisive issues. Based on the initial years of Viet Nam's participation in AFTA, it seems that Viet Nam has not taken full advantage of these schemes to push for further market-opening measures. The areas for improvements are many. Continuing reforms of state-owned enterprises should be taken in order to remove many of the non-tariff barriers that could impede the enjoyment on concessions under AFTA.

### **5.1.2 The ASEAN Free Trade Area (AFTA)**

The ASEAN Free Trade Area (AFTA) seeks to reduce tariffs to between zero and five per cent and remove all other trade restrictions on virtually all commodities traded within ASEAN by the year 2003. The mechanism adopted to achieve this is the Common Effective Preferential Tariff (CEPT). The agreement to implement the CEPT arrangements was signed on 28 January 1992 and subsequently amended on 15 December 1995. Prior to AFTA there had been a loose tariff preferences scheme in existence for ASEAN members dating from 1977. Even with some enhancements in 1987, it did not provide momentum for further trade liberalization since it only requirement was that a margin of preference over most-favoured nation (MFN) tariff rates be maintained. AFTA can be seen as a major departure from this earlier approach as it directly addresses tariff levels rather than simply the margin of preference available. There are three main aims embodied in the AFTA agreement:

- to promote the region as a centre of international trade;
- to counter the growing strength of the two main world trading blocs, the European Union (EU) and the North American Free Trade Area (NAFTA);
- to promote the region as an international production centre and so attract an increasing share of foreign direct investment (FDI) from the developed economies.

AFTA was originally conceived, in part, as a response to the development of other major regional trade blocs. Furthermore, AFTA was signed when the GATT Uruguay Round was

stalled and a final resolution was in doubt. While AFTA retains a defensive element, it was never conceived as an inward-looking trade pact. On the contrary, AFTA is said to represent a form of "open regionalism" — an outward-looking scheme to provide enhanced benefits to its members while they continued to pursue programmes of global trade liberalization. There is an expectation that MFN rates will continue to be reduced as part of domestic tariff reform programmes and the implementation of Uruguay Round commitments. At the same time, CEPT rates will fall faster providing additional benefits to AFTA partners.

Another key characteristic of AFTA is that it is a comprehensive arrangement that addresses a range of trade issues in addition to tariffs. Among the more important commitments and areas of cooperation are: harmonization of tariff nomenclature; customs valuation; the elimination of non-tariff barriers; harmonization of product standards and mutual recognition of certification of products; the removal of restrictions on foreign exchange transactions affecting goods covered by the CEPT scheme and the elimination of barriers to foreign direct investment.

In 1998, the ASEAN region accounted for only about 1.5 per cent of world output and 4.5 per cent of world trade. While the CEPT arrangements are specifically designed to foster intra-regional trade (which represents 20 per cent of total ASEAN trade) it is hoped that trade with other major trade partners such as the European Union (14 per cent); the United States (17 per cent); and Japan (19 per cent) will be boosted. AFTA will serve the dual purpose of integrating the economies of the member states and improving their economic competitiveness, which will enable ASEAN to increase its share of the world market.

**TABLE 5.1: AFTA Implementation and Policy Action Matrix**

| <u><i>Viet Nam's Major Obligations</i></u>   | <u><i>Status</i></u>   | <u><i>Actions Required</i></u>  |
|--|--|---|
| <b>1.) To extend Most Favoured Nation (MFN) and National Treatment (NT) status to ASEAN countries on a reciprocal basis.</b>   | MFN and NT obligations met in principal however no legal enactment. Currently CEPT rates are equivalent to general tariff rates so MFN criteria satisfied. A sales tax, which appears to contravene NT, remains in operation on certain products.  | To determine whether CEPT tariff reduction will take place on a MFN or preferential basis. If preferential, a separate CEPT tariff column must be created. The sales tax on products where different rates apply to imports and domestic substitutes must be revoked. |
| <b>2.) To determine CEPT Lists and tariff reduction process.</b>   |  |   |
| i.) To determine which products are to be classified into the four CEPT Lists: Inclusion List (IL), Temporary Exclusion List (TEL), and General Exceptions List (GEL). | The CEPT Lists were submitted to ASEAN in 1995. Only the Inclusion List products for 1996 and 1997 have been published. A number of IL goods included in the initial submission to ASEAN are yet to be legally enacted – their status remains unclear. The legitimacy of some products on the General Exception List needs to be reviewed. | Need to resolve “missing” Inclusion List products. Some products on the General Exception List will need to be shifted to the Temporary Exclusion List (TEL).   |
| ii.) To provide tariff reduction plan for CEPT products to 2006.   | No tariff reduction framework has been publicly released.  | Announce tariff reduction schedule for CEPT products (and avoid “bunching” of tariff reduction). Include phasing-in process for TEL products.   |
| iii.) Produce a single legal enactment for the entire tariff reduction programme.  | Issued legal enactment of Inclusion List products for 1996 and 1997 only.  | Complete tariff harmonization process. Assign tariff codes to those CEPT goods currently unclassified. Prepare a single legal enactment for entire tariff reduction programme to 2006.  |
| <b>3.) To determine CEPT Lists and tariff reduction process for Unprocessed Agricultural Products (UAPs).</b>  | UAPs do not have separate CEPT Lists. Currently, they are included in the general CEPT Lists.  | Compile CEPT Lists for UAPs by separating them from general CEPT Lists. Determine tariff reduction and phasing-in processes.  |

| <u><i>Viet Nam's Major Obligations</i></u>  | <u><i>Status</i></u>  | <u><i>Actions Required</i></u>  |
|---|---|---|
| <b>4.) To provide ASEAN a list of Viet Nam's quantitative restrictions (QRs) and non-tariff barriers (NTBs). For goods on the CEPT Inclusion List prepare for the immediate removal of QRs and the removal of NTBs within five years.</b> | Each year a list of Quantitative Restrictions is submitted to ASEAN. A list of NTBs is yet to be completed. | The identification of all NTBs and their submission to ASEAN is urgently required. Remove all remaining QRs on Inclusion List goods immediately. Prepare for removal of NTBs. |
| <b>5.) Trade Facilitation Measures</b>  |   |   |
| i.) To adopt the ASEAN Harmonised Tariff Nomenclature (AHTN) by 2000.   | The process of harmonization is continuing.   | Complete harmonization using AHTN 6400 tariff lines as a model and complete by 2000 at the latest.  |
| ii.) To adopt the GATT Transaction Value (GTV) valuation method by 2000.  | Has not been adopted and no timetable for adoption is in place.   | Study ways of dealing with fraud under GATT valuation agreement (GVA). Reduce usage of reference pricing system.  |
| iii.) Improve Customs Procedures  |   |   |
| a.) Issue ASEAN Customs Handbook  | Published.  | Once new Customs Law is promulgated then need to revise Handbook.   |
| b.) To adopt the ASEAN Common Declaration Form  | Unable to adopt due to lack of nationwide coding system and insufficient management capacity                | Must reform coding system, management and data collection system so as to meet international norms.   |
| iv.) ASEAN Green Lane System.   | Applied since 1996 under legal enactment. Ineffective to this point in time.                                | Publicity campaign and simplification of customs procedures related to Green Lane required.   |
| v.) Harmonies technical standards.  | Lack of harmonization in product standards and sanitary and phytosanitary (SPS) measures.                   | Continue harmonization of technical standards. Need for mutual recognition arrangements (MRAs).   |
| vi.) To eliminate customs surcharges.   | Two surcharges remain in use. No timetable is given for their elimination.                                  | Must specify the date for removal of remaining surcharges.  |

## 5.2 The CEPT Scheme of AFTA

The aim of the original CEPT agreement was to reduce all tariff rates for intra-ASEAN trade to the level of zero - five per cent by January 2008. Products were divided into three categories: fast track; normal track and a temporary exclusion list. Of the 44,095 tariff lines notified to the ASEAN Secretariat in December 1993, there were 14,855 in the first category, 25,918 on the normal track and 3,322 temporarily excluded. Initially, coverage did not extend to include unprocessed agriculture products (UAPs).<sup>63</sup> In December 1995, the agreement was substantially modified. The main changes were as follows:

- a new framework for phasing in temporary excluded products was outlined;
- CEPT product coverage was broadened to include UAPs;
- a new “sensitive” category for certain UAPs was created for which a different liberalization mechanism would be applied;
- the AFTA implementation date was advanced five years to 2003.

As of December 1995, about 89 per cent of all products were either on the fast or normal track, 7.1 per cent were temporary excluded and 2.9 per cent fell into the UAP category (including sensitive products). The remaining balance was covered by the CEPT general exception clause, which was maintained in conformity with Article XX of the GATT.<sup>64</sup> It was expected that by 2003, 99 per cent of products would be brought under the CEPT. The tariff reduction framework for products in each CEPT category are dealt with as follows:<sup>65</sup>

### 5.2.1 Inclusion List (IL) Products

#### 5.2.1.1 Normal Track:

- products with rates at or below 20 per cent: rates reduced to zero - five per cent on 1 January 2000.
- products with tariff rates above 20 per cent: rates reduced to 20 per cent on 1 January 1998, then from 20 per cent to zero - five per cent by 1 January 2003.

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<sup>63</sup> In the CEPT Agreement, Unprocessed Agricultural Products (UAPs) are defined as agricultural raw materials/unprocessed products covered under Chapters 1-24 of the Harmonised System (HS) and similar agricultural raw materials/unprocessed products in other related headings, or products that have undergone simple processing with minimal change in form from the original products.

<sup>64</sup> This allows goods to be exempt from the liberalisation process in order to protect national security, public morals, human, animal or plant life and health, and to protect articles of artistic, historic and archaeological value.

<sup>65</sup> The normal/fast-track system is not applicable to Viet Nam. Viet Nam is subjected to different time frames and a somewhat different set of obligations, the details of which will be discussed in the next section.

#### **5.2.1.2 Fast Track:<sup>66</sup>**

- products with rates at or below 20 per cent: rates reduced to zero - five per cent on 1 January 1998.
- products with rates above 20 per cent: rates reduced to zero - five per cent on 1 January 2000.

### **5.2.2 Temporary Exclusion List (TEL) Products**

There was agreement to phase all TEL products onto the Inclusion List over the period 1 January 1996 to 1 January 2000 in five equal installments. Furthermore, in order to ensure an orderly tariff reduction programme it has been agreed that tariff rates should be reduced at least once every three years following entry onto the Inclusion List.

### **5.2.3 Unprocessed Agricultural Products (UAPs)**

Unprocessed Agricultural Products have been categorized into their own three groups: Inclusion List (IL), Temporary Exclusion List (TEL) and Sensitive List (SL) and were treated as follows:

- Immediate inclusion products were transferred to the “normal” or “fast track” on 1 January 1996, with duties to be reduced to zero - five per cent by 1 January 2003;
- Temporarily excluded products were/are to be transferred into the Inclusion List in equal yearly installments, beginning 1 January 1997 and ending 1 January 2003. The CEPT tariff target of zero - five per cent by 2003 applies;
- Most UAPs on the Sensitive List are to be phased into the CEPT by 2010. The precise phasing-in arrangements are still to be negotiated.

### **5.2.4 General Exception List (GEL) Products**

These goods are totally excluded from the CEPT scheme.

### **5.2.5 State Trading Enterprise (STE) Products**

For products produced by STEs (as defined by the WTO), “priority market access” together with the CEPT preferential tariff would be given to ASEAN member countries. End year for tariff reduction is 2010 with ending tariff rates of zero - five per cent.

In order to simplify the tariff reduction process, ASEAN mandated in September 1996 that one legal enactment be prepared by each member country to cover their entire tariff reduction process up to the year 2003. ASEAN estimates that AFTA will produce the following profile of CEPT tariffs for member countries in 2003 (see Table 5.2).

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<sup>66</sup> The products in the Fast Track List are electronics, copper cathodes, ceramics/glass, leather, gems/jewellery, fertilisers, pharmaceuticals, wooden/rattan furniture, chemicals, cement, pulp/paper, rubber, vegetable oil, plastics and textiles.

| <b>Table 5.2: Average CEPT tariff rates by country</b> |             |             |
|--|-------------|-------------|
| <b>Year</b>  | <b>1996</b> | <b>2003</b> |
| Brunei   | 2.0         | 1.4         |
| Indonesia  | 11.6        | 4.3         |
| Malaysia   | 6.1         | 2.6         |
| Philippines  | 8.2         | 3.3         |
| Singapore  | 0.0         | 0.0         |
| Thailand   | 14.1        | 4.6         |
| Viet Nam   | 0.9         | 0.9         |
| ASEAN  | 7.7         | 2.9         |

*Source:* ASEAN Secretariat (unpublished)

To qualify for CEPT preferential treatment, goods must have a minimum ASEAN content of 40 per cent.<sup>67</sup> Also, eligibility depends on the product concerned being on the Inclusion List of both the exporting and the importing country and being in the same tariff category, defined as more than 20 per cent, or 20 per cent and below. These provisions are designed to ensure reasonable symmetry of trade access opportunity between competing producers in ASEAN member states. They also provide an incentive for member countries to bring products on to the Inclusion List and to lower tariffs below 20 per cent as quickly as possible.

In addition to the tariff reduction programme, the removal of quantitative restrictions (QRs) and non-tariff barriers (NTBs) are an important component of the CEPT scheme. Quantitative restrictions for all products on the Inclusion List are required to be removed immediately following inclusion. ASEAN classifies NTBs into five categories: para-tariff (e.g. customs surcharges, additional charges, decreed customs valuation);<sup>68</sup> price control; financial; monopolistic; technical standards (e.g. sanitary and phytosanitary regulations).<sup>69</sup> In general, non-tariff barriers are to be eliminated within five years of the enjoyment of CEPT concessions for a particular product. Customs surcharges and technical standards NTBs have been prioritized because of their prevalence within ASEAN. Customs surcharges are border charges additional to normal customs duty, maintained to provide revenue or extra protection for domestic industries. All customs surcharges affecting CEPT products were to be removed by the end of 1996. Technical measures are those standards and regulations specifying product quality, safety, description, packaging, testing and labeling. They are required to be

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<sup>67</sup> An alternative rule of origin for textiles and textile products has been adopted. These products can be subjected to the “substantial transformation process” criterion whereby products that are substantially transformed through a number of specified processes shall be accorded CEPT status.

<sup>68</sup> Para-tariffs are defined as measures that increase the cost of imports measures by a fixed percentage or amount in a manner similar to tariffs.

<sup>69</sup> Sanitary standards are for the protection of human and animal life and health. Phytosanitary standards are for the protection of plant life.

eliminated (or harmonized) no later than the year 2003.<sup>70</sup>

ASEAN countries have recognized the importance of customs cooperation to facilitate the flow of goods across borders within ASEAN and in so doing supplement and complement the CEPT. They have agreed to implement a number of measures to simplify and harmonize customs activities.<sup>71</sup> These measures include the harmonization of tariff nomenclature, the greater use of customs valuation systems, and the simplification of customs procedures. In addition to this, a special customs lane for CEPT products began on 1 January 1996.

### **5.3 Viet Nam's AFTA Commitments**

The Protocol for the Accession of the Socialist Republic of Viet Nam to the Agreement on the Common Effective Preferential Scheme (CEPT) for the ASEAN Free Trade Area (AFTA) was signed on 15 December 1995 during the Fifth ASEAN Summit in Bangkok. By signing this Protocol, Viet Nam is subject to the terms and conditions agreed upon between Viet Nam and ASEAN, and is legally bound to fulfil its commitments. These AFTA commitments are essentially the same as those of the other ASEAN members. The primary difference is that Viet Nam has been granted a longer phasing in period prior to full AFTA implementation in recognition of its special transitional difficulties. Viet Nam's current obligations and commitments under AFTA are outlined below:<sup>72</sup>

- 1) Most-Favoured Nation (MFN) and National Treatment (NT). Extend reciprocal MFN and NT on turnover tax, luxury tax, exchange rate determination, foreign exchange control and other measures to ASEAN members. Also, provide relevant information on its trade regime as and when requested by ASEAN.
- 2) CEPT tariff reduction process. Classify products into three lists according to their involvement in the CEPT process. Prepare tariff reduction schedule to 2006 with accompanying legal enactment. More specifically:
  - i.) Prepare an Inclusion List (IL) of products for tariff reduction and begin tariff reductions effective 1 January 1996 and ending at a zero - five per cent tariff rate in the year 2006.
  - ii.) Phase-in annually products which are temporarily excluded from the CEPT in five equal installments beginning 1 January 1999 and ending 1 January 2003 (Temporary Exclusion List (TEL)).
  - iii.) Submit a list of products that are excluded from the CEPT process (General Exceptions List (GEL)).
- 3) CEPT tariff reduction process for unprocessed agricultural products (UAPs). The same requirements as above except with a different time frame and an additional CEPT list for "sensitive" products.

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<sup>70</sup> Since all NTBs are subject to WTO rules, AFTA will also strengthen the implementation of WTO codes.

<sup>71</sup> The ASEAN Agreement on Customs Cooperation was signed in September 1996.

<sup>72</sup> These obligations are taken from a number of sources including the CEPT Agreement ratified by Viet Nam and decisions made by various ASEAN committees involved in the AFTA implementation process.

- i.) Prepare a list of UAPs for tariff reduction and begin tariff reductions effective 1 January 1996 and ending at a zero - five per cent tariff rate in the year 2006.
- ii.) Phase-in annually UAPs which are temporarily excluded from the CEPT in seven equal instalments beginning 1 January 2000 and ending 1 January 2006.
- iii.) Submit a list of sensitive UAPs and their planned tariff reduction schedule (Sensitive List (SL)).
- iv.) Submit a list of UAPs that are excluded from the CEPT process.

4) Quantitative restrictions (QRs) and other non-tariff barriers. Remove all QRs associated with products on the Inclusion List and provide a list of all NTBs by 1998. Other non-tariff barriers must be removed on a gradual basis within a period of five years after the enjoyment of concessions applicable to those products.<sup>73</sup>

5) Specific trade facilitation initiatives:<sup>74</sup>

- Adopt the ASEAN Harmonized Tariff Nomenclature (AHTN);
- Implement the GATT valuation method;
- Improve customs procedures;
- Establish a “Green Lane” customs system for CEPT products;
- Harmonies technical standards;
- Eliminate customs surcharges.

These five sets of commitments, together with Viet Nam’s implementation progress, are discussed in more detail in the following section.

## **5.4 Viet Nam’s AFTA Commitments and Implementation Progress**

### **5.4.1 Extending, on a reciprocal basis, Most-Favoured Nation and National Treatment to ASEAN Member Countries**

Most-Favoured Nation (MFN) treatment implies that Viet Nam is obliged to apply the principle of non-discrimination, as embodied in the Article I of the GATT, to its trade with other ASEAN countries. Article I of the GATT states:

“With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the methods of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation....any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”

<sup>73</sup> The timetable for the elimination of non-tariff barriers for some priority sectors has been accelerated by ASEAN. This will bring forward Vietnamese commitments in this area.

<sup>74</sup> Some of these initiatives are CEPT-based while others are taken from the ASEAN Agreement on Customs Cooperation, which is seen as a supplement to the CEPT and was ratified in September 1996.

In other words, the treatment applied to ASEAN products must be no less favourable than that extended to any other third country.<sup>75</sup> The National Treatment provision is based on Article III of the GATT, which states:

“The contracting parties recognise that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.”

The National Treatment implies that imports from other ASEAN countries shall not be subjected, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to similar domestic products. For example, a sales tax on an imported product cannot be higher than that levied on the same product produced domestically. Additionally, regulations on the trade of imported products cannot be more difficult or complicated than those on domestic products.

As a precondition for the implementation of this obligation, Viet Nam had to observe the principle of transparency by providing ASEAN:

- a list of all trade agreements Viet Nam is party to;
- a report reviewing its existing regime, rules, practices and procedures that may violate MFN and NT and plans on how MFN and NT will be extended to ASEAN.

Viet Nam has reportedly fulfilled the above preconditions by submitted the required documents to the ASEAN Secretariat upon its accession to the CEPT Agreement. However, no government directive for this precondition has been issued.

## Most-Favoured Nation Extension

Government officials claim that up to this point in time, to issue a legal enactment for the extension of an MFN status to imports from ASEAN countries has not been necessary. This is because Viet Nam currently extends a general tariff status to all imports regardless of origin. However, it is expected that from 1998 the CEPT rate will become lower than the general tariff rate. Therefore, there will be a need for Viet Nam to reconsider this issue.

Also to be decided is whether Viet Nam should implement a one- (MFN), two- (CEPT, MFN), or three- (CEPT, MFN, general) column tariff code. There are both trade policy and legal aspects involved in this issue. A one-column tariff code would imply that Viet Nam intends to undertake its CEPT tariff reduction programme on an MFN basis (i.e. lower tariffs will be available to all). For a two-column tariff code, the CEPT column would indicate the duty rates applicable to AFTA applicable imports. The MFN column would apply to non-

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<sup>75</sup> It would appear, therefore, that the preferential basis of the CEPT would contravene GATT rules. However, Article XXIV of the GATT, allows the formation of free trade areas or customs unions provided that they contribute to the overall objective of GATT, which is the expansion of world trade. To ensure that they are consistent, the GATT requires that the duties and regulations of commerce or the general incidence of such duties and regulations under the preferential trading arrangements shall not be made higher or more restrictive to outside countries.

ASEAN imports and to ASEAN imports in the absence of any preferential CEPT rate. For practical purposes, the MFN rate could simply be the existing tariff rate.<sup>76</sup> If a three-column tariff code were chosen, the third general column would be required for countries with which Viet Nam had no bilateral MFN agreement or to non-members of the WTO (once Viet Nam became a member of the body). The number of countries in the "general" category is likely to be small. Rather than establishing a third tariff column, a simple solution would be to legally specify that a tariff loading would apply to some or all tariff lines in respect of imports from the designated countries. There is an ongoing discussion over these issues and a position draft on this issue had been submitted to the government for consideration.

## National Treatment Extension

Government officials have stated that Viet Nam has accorded NT status to imports from ASEAN in accordance with its obligation. However, from January 1996 a special sales taxes were imposed on six groups of items, namely tobacco, beverages, fireworks, automobiles and petrol. In the cases of automobiles and cigarettes different rates apply to imports and domestic substitutes and thereby appear to act against the principle of national treatment.

## 5.5 CEPT Tariff Commitments

| <b>Table 5.3: Viet Nam's 1995 CEPT Lists</b> |                               |                                |
|--|-------------------------------|--------------------------------|
| <b>CEPT List</b>                             | <b>Number of tariff lines</b> | <b>Percentage of Total (%)</b> |
| Immediate Inclusion                          | 1,633                         | 54.1                           |
| Temporary Exclusion                          | 1,189                         | 39.5                           |
| Sensitive                                    | 26                            | 0.9                            |
| General Exception                            | 165                           | 5.5                            |
| <b>Total</b>                                 | <b>3,013</b>                  | <b>100</b>                     |

*Source:* ASEAN Secretariat (unpublished).

In 1995 following Viet Nam's membership to ASEAN four CEPT lists were submitted to the ASEAN Secretariat (see Table 5.3). Viet Nam did not submit separate lists for unprocessed agricultural products (UAPs).<sup>77</sup>

The following table (Table 5.4) gives a summary of Viet Nam's CEPT List status up to 1998. The changes in the CEPT lists are due to both the re-categorizing of goods on the CEPT lists and the tariff harmonization process.

<sup>76</sup> In order to meet the CEPT obligations, the CEPT does not have to be lower than the MFN rate (that is, there is no requirement to create a margin of preference). However, the CEPT rate can never be higher than the MFN rate. When Viet Nam accedes to the WTO, the MFN rate would become legally applicable to all WTO members, or to any individual country with whom a reciprocal MFN agreement was negotiated.

<sup>77</sup> Viet Nam will need to separate the UAPs from the other CEPT products since they are accorded different rules under the CEPT scheme.

| <b>Table 5.4: Viet Nam's CEPT Product Lists to 1998</b> |                                     |              |              |              |
|---|-------------------------------------|--------------|--------------|--------------|
| <b>CEPT List</b>  | <b>Total Number of Tariff Lines</b> |              |              |              |
|   | <b>1996</b>                         | <b>1997</b>  | <b>1998</b>  | <b>1999</b>  |
| Immediate Inclusion                                     | 857                                 | 1,497        | 1,661        | 1,895        |
| Temporary Exclusion                                     | 1,189                               | 1,143        | 1,317        | 1,547        |
| Sensitive   | 26                                  | 26           | 26           | 18           |
| General Exception                                       | 146                                 | 146          | 213          | 122          |
| <b>TOTAL</b>  | <b>2,218</b>                        | <b>2,812</b> | <b>3,217</b> | <b>3,582</b> |

*Source:* Ministry of Finance (unpublished); ASEAN Secretariat (unpublished).

### 5.5.1 Inclusion List (IL)

For Viet Nam, all goods on the CEPT Inclusion List must have tariffs from zero to five per cent by the year 2006. During the tariff reduction process, products that have tariffs of 20 per cent or less will be able to enjoy the concessions under the CEPT scheme on a reciprocal basis. Goods from the Temporary Exclusion List will be phased-in to the Inclusion List. Quantitative Restrictions (QRs) on a product have to be removed as soon as it enters the Inclusion List while non-tariff barriers (NTBs) must be removed within a period of five years from inclusion.

Viet Nam's initial list submitted to the ASEAN Secretariat in 1995 contained 1633 products (54.1% of all products). However, only 857 products were legally enacted in 1996 followed by additional 640 products in 1997. Therefore the total number of tariff lines submitted for CEPT inclusion and covered by legal enactment is 1,497. The remaining 136 products have not yet been legally enacted because they are subject to quantitative restrictions, which must be removed before a product can enter the Inclusion List. Vietnamese authorities have indicated that these products will be included "as soon as possible".

The two legal enactments in 1996 and 1997 involved no actual tariff reduction for the Inclusion List products. The CEPT rate remained the same as the general tariff rate. In any case, most of the products on the Inclusion List already have tariff rates within the zero to five per cent range and therefore will require no further action under the CEPT. Those products on the Inclusion List that have tariffs higher than five percent are either products that Viet Nam exports or those that have little economic significance. Viet Nam has yet to announce its tariff reduction plan for these products. According to government officials, the tariff reduction schedules for these products will soon be submitted to the government for approval. The average CEPT tariff rate as calculated by the ASEAN Secretariat from Viet Nam's initial 1995 Inclusion List is 0.88 per cent. The 54.1 per cent coverage is smaller than the commitments made by other ASEAN countries.

### 5.5.2 Temporary Exclusion List (TEL)

Products that are on the Temporary Exclusion List (TEL) are to be phased in to the Inclusion

List in five equal installments beginning on 1 January 1999 and ending on 1 January 2003 such that by 2006 the tariffs for these products will be within the zero to five per cent range. When Viet Nam prepares and submits its tariff reduction schedule for the TEL products it will need to take into account the "non-bunching" tariff reduction undertaking agreed to by ASEAN members in September 1996. This states that once a product is phased into the CEPT, the product's tariff must be reduced every three years or less. This is meant to stop member countries from delaying until the final possible moment all of their AFTA tariff reductions. Unprocessed agricultural products (UAPs) that are temporarily excluded are to be phased in annually from 1 January 2000 and ending 1 January 2006. Viet Nam's temporarily excluded UAPs are currently included in their general TEL list.

The government is yet to issue a directive concerning its Temporary Exclusion List products. In 1995 Viet Nam did submit its TEL to the ASEAN Secretariat and it consisted of 1,189 or 39.5 per cent of total tariff lines. Most of the products in the TEL are consumer goods and strategically important goods such as cement, fertilizers, pulp and paper, many of which are protected by QRs and NTBs.

There exists two areas of uncertainty concerning the TEL: Which groups of products will be moved on to the Inclusion List in each of the five years of transition and what will be the tariff reduction track that will be followed to achieve the zero to five per cent tariff level by 2006? The options range from early tariff cuts ("front loading"), linear tariff reductions, or delaying reductions until the last years of transition ("end loading"). The end-loaded option would maintain protection of domestic industry and revenue derived from AFTA imports for several years longer than the other two options. For example, the tariff cuts could be delayed until the last three years of the transitional period, i.e. 2004-2006. However, this approach runs counter to the ASEAN decision aimed at avoiding the bunching of tariff reductions. It would also mean a very steep fall in tariff revenue in the final years and equally rapid decrease in industry assistance, raising problems of adjustment. The linear adjustment track is therefore the preferred option, as it would spread the period of adjustment over a longer period.

According to a government official, the delays concerning the TEL are mainly due to the task of harmonizing Viet Nam's tariff code with the ASEAN harmonized tariff nomenclature (AHTN). There is a clear need for the government to publicly announce its decision on the TEL products without delay. This would provide producers and would-be investors with an important signal of the government's commitment to the programme. Otherwise poor investment decisions based on expectations of continued protection may occur. If the tariff reduction programme were accelerated, the benefits of the adjustment would flow through the economy more rapidly. There would be a need for early adjustment in the more heavily protected import substitution activities but the effects could be spread over some years.

Viet Nam's list of unprocessed agricultural products (UAPs) which are temporarily excluded were submitted in the general TEL sent to the ASEAN Secretariat in 1995. A separate UAP TEL List has not yet been compiled but will need to be done if Viet Nam wishes to take advantage of the slower tariff reduction schedule available for TEL UAPs.

### **5.5.3 Sensitive List (SL)**

All Sensitive List products are UAPs. Products in the Sensitive List are to be phased in from 1 January 2004 (with flexibility but no later than 1 January 2006) and ending on 1 January 2013

(three years later than the other ASEAN member countries). There has been no agreement on the starting tariff rates for sensitive products or on the tariff reduction schedule.<sup>78</sup> A special arrangement, with features outside of the CEPT framework, has been created for some “Highly Sensitive” UAP products.<sup>79</sup>

Viet Nam's Sensitive List (SL) covers 26 tariff lines based on the initial submission to the ASEAN Secretariat in 1995. The UAP products listed include meat and other animal products, poultry, eggs, fruits and paddy rice. Viet Nam does not have any products on the “Highly Sensitive” list at this stage.

## 5.5.4 General Exceptions List (GEL)

Goods on the General Exceptions List (GEL) are exempt from any CEPT trade liberalization measures. However, ASEAN member countries have confirmed two important principles governing goods on the GEL.

- the exception provisions must not be used to provide industry protection or to protect revenue;
- the GEL must be shorter than that applicable to the WTO.

The General Exceptions Lists of all ASEAN countries are now under review to determine the validity of their product inclusions. It is likely that the lists of some countries may be subject to revisions. This is one of the most contentious and difficult areas of negotiations within the CEPT scheme.

A General Exception List of 165 products was submitted to ASEAN in 1995.<sup>80</sup> Viet Nam has the longest GEL among the ASEAN countries as a proportion of total tariff lines (5.5 per cent). Other ASEAN countries have between 0.3 and 3.3 per cent of their total tariff lines classified under the GEL. The reason for this is that Viet Nam's GEL has a number of products that do not strictly satisfy the criteria for inclusion on the GEL. Goods such as cars and motorcycles and other vehicles (HS-87) are included “for the protection of the environment”. Petroleum goods (HS-27) are listed on the basis of “national security” while goods in the beverages and spirits category (HS-22) are included in order to protect “animal or plant life and health”. The economic importance of goods on the GEL in trade and revenue terms for Viet Nam is much greater than their minor share of tariff lines would indicate.

It is imperative that Viet Nam undertakes a review of its GEL to ensure that it is consistent with Article XX of the GATT. It is difficult to see the justification of a number of goods in the GEL. By means of the exception provisions of the CEPT, as it stands, Viet Nam is sheltering nearly 41 per cent of its intra-ASEAN trade, which accounts for 62 per cent of tariff revenue, from any AFTA adjustment.<sup>81</sup> Such figures raise questions about Viet Nam's

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<sup>78</sup> Some member countries prefer to use applied tariff rates as the starting rate for the tariff reduction while others are in favour of WTO tariff bindings.

<sup>79</sup> Currently applied to rice and sugar from Indonesia and rice from Malaysia. The trade liberalization features of the special arrangement will have to be more preferential than commitments under the WTO.

<sup>80</sup> Nineteen products were not assigned a tariff code and therefore a total of 146 products were officially classified by ASEAN.

<sup>81</sup> For more details concerning revenue implications of AFTA see following chapter.

commitment to regional trade liberalization.

### **5.5.5 Legal Enactment of CEPT Lists**

ASEAN mandated in September 1996 that one legal enactment be prepared by each member country to cover their entire tariff reduction process. To this point in time Viet Nam has only issued a legal enactment for its 1996 and 1997 Inclusion Lists. Viet Nam has stated that it would like to issue its legal enactment for the whole tariff reduction period, but only once the ASEAN Harmonized Tariff Nomenclature (AHTN) is in place. It is expected that Viet Nam's tariff code will be harmonized by the year 2000.

### **Elimination of Quantitative Restrictions (QRs) and Non-Tariff Barriers (NTBs)**

As a precondition for the eligibility of tariff concessions for Inclusion List products the CEPT Agreement stipulates that ASEAN members shall eliminate quantitative restrictions (QRs) immediately and non-tariff barriers (NTBs) within five years upon the products inclusion. Viet Nam's CEPT Inclusion List began in 1996, therefore all associated NTBs must be removed from Viet Nam's first Inclusion List products in 2001.

At the beginning of each year, Viet Nam issues a directive listing the quantitative restrictions that will be in place. However, Viet Nam is yet to submit an official list of QRs to ASEAN. Quantitative restrictions need to remove from a number of goods that were on Viet Nam's Inclusion List submitted to ASEAN in 1995 in order for these goods to be legally enacted. With respect to NTBs, implementing this commitment will be quite difficult due to their pervasiveness in the economy and the general lack of transparency. A draft NTB list has been presented to the government consisting of submissions from all relevant government bodies. Various special interest groups with protectionist agendas appear to have contributed to the slow progress of this commitment. Health and environmental technical barriers are currently being applied to a number of commodities on the Inclusion List. They will need to be removed by 2001.

### **5.5.6 Specific Trade Facilitation Measures**

#### **Harmonization of Tariff Nomenclature**

Tariff nomenclature harmonization is necessary to ease the process of making products of trading partners comparable. This is particularly important under AFTA where CEPT concessions are only accorded to goods on a reciprocal basis. Viet Nam has an obligation to revise its tariff classification system in accordance with the ASEAN Agreement on Customs Cooperation, which states the following:

“The ASEAN Harmonised Tariff Nomenclature shall be based on the 6-digit Harmonised Commodity Description and Coding System (HS) of the World Customs Organisation (WCO) and the amendments thereto. Member countries shall, for tariff purposes, use a common tariff nomenclature at the 8-digit level. The ASEAN Harmonised Tariff Nomenclature beyond the 8-digit level may be used for statistical and other purposes.”

The ASEAN Harmonized Tariff Nomenclature (AHTN) is expected to have approximately 6,400 tariff lines.

The harmonization of the Viet Nam's 1992 Import-Export Classification List (six-digit HS)

into an eight-digit nomenclature began in 1995 and was adopted in 1996 (as part of Viet Nam's preparation for ASEAN membership). However, there are still significant differences between Viet Nam's current tariff classification system and the eight-digit ASEAN Harmonized Tariff Nomenclature (AHTN). For example, products included in a particular sub-group of Viet Nam's classification list are not listed in the corresponding AHTN sub-group. Generally, this is because Viet Nam's classification of some products is based on use rather than type. In these instances, the need for interpretative notes to accompany the various tariff codes becomes critical. Problems of interpretation have led to conflicts and inefficient customs administration procedures.

According to government officials, Viet Nam is working on a revised tariff classification in conformity with AHTN and aims to complete the task by the end of 1998. This target date may be unrealistic given coordination difficulties between different government bodies involved in the task. This is perhaps reflected in the Viet Nam's official response to ASEAN that it intends to implement the AHTN by the year 2000. Given the importance of harmonization, Viet Nam must consider this activity as one of its top priorities.

## Customs Valuation

Customs valuation (i.e. the way to determine the value of the imported good by the receiving country) has three main purposes: to determine customs duties assessment, for quota and licensing requirements and for statistical purposes. Currently, there are three methods of customs valuation practiced by the ASEAN countries.

The GATT Transactions Value (GTV) (from the GATT Valuation Agreement) defines the basis for valuation as the price actually paid or payable for the good, as reflected in the seller's invoice or other documents against which payment is made.

The Brussels Definition of Value (BDV), currently used by most ASEAN countries, defines the basis for valuation as the price the good would fetch at the time duty becomes payable on a sale in the own market between a buyer and a seller. The sale cannot be influenced by any commercial, financial or any other relationship between the seller and buyer other than that created by the sale itself.

The Home Consumption Value (HCV) method, used by the Philippines, considers the value at the port of origin of the export as the basis for valuation.

The ASEAN countries have agreed to adopt the GATT Transactions Value method by the end of 1997. Viet Nam is expected to implement the GTV three years later in 2000.

To date Viet Nam has adopted a combination of the Brussels and GTV valuation methods as well as a reference pricing system for certain groups of commodities. Reference prices are "minimum" prices, used to calculate duty assessment.<sup>82</sup> In 1996 they were applied to 34 groups of commodities, which account for 70-80 per cent of the total import value. The reference pricing system is used to limit tax evasion by fraudulent pricing practices between a buyer and a seller, which could lead to loss of tax revenue, unfair competition and market failure. Government officials are of the opinion that the move toward a GTV system will be difficult for Viet Nam due to the existence of fraudulent activities in international trade. An

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<sup>82</sup> As determined by the Ministry of Finance.

adoption of this prescribed method will probably not occur until the government is satisfied that it would not lead to significant fraud and associated revenue loss. Also, the government will need to align legislation on customs and trade to ensure its smooth application.

Given the importance of this activity, Viet Nam should formulate a plan for GTV's implementation before 2000 and indicate whether technical assistance is needed. Currently, the General Department of Customs is in the process of studying and training officers on the GATT Valuation Agreement (GVA).

## Customs Procedures

Customs procedures represent an important administrative aspect of international trade. There is a need to simplify and harmonize customs procedures in ASEAN in order to facilitate intra-ASEAN trade. Trade conducted under CEPT is not only governed by standard customs clearance procedures for all goods but is also burdened by the additional requirement of determining the origin of the product. ASEAN has declared its commitment to promote transparency, consistency, efficiency and simplicity in its customs administration. Three areas related to customs procedures have been prioritized:

- customs declaration form (including certificate of origin);
- formalities prior to lodgment of goods declaration at time of import;
- customs clearance for home use and examination of goods;

The ASEAN countries have agreed to adopt an ASEAN common declaration form and a common set of customs formalities based on international best practices. To increase the momentum of harmonization, ASEAN decided to publish a handbook on the customs procedures of member countries.

Viet Nam's inconsistent administrative customs procedures, and its use of reference prices for customs valuation, make the harmonization of customs procedures another difficult commitment to implement. Viet Nam has not yet applied the ASEAN common declaration form because of the lack of a complete nationwide coding system (e.g. common commodity, currency, and country codes) together with an imperfect management system. Therefore, to apply the form, Viet Nam needs to improve its coding system, train its customs personnel about the new system, and improve its management processes.

Viet Nam submitted its contribution for the ASEAN customs handbook at the end of 1996, after encountering many difficulties in meeting its content requirements. The handbook was published in 1997. The handbook includes information on ASEAN customs institutions, export-import duties, and other customs procedures. Since Viet Nam is in the process of amending its customs law and trade policies, the guidebook will need to be updated as soon as these reforms are completed.

## The Green Lane System

The objective of the customs Green Lane system was to reduce the transaction costs of trading CEPT products and to expedite the customs clearance of CEPT products. The system began operating among ASEAN member countries on 1 January 1996. To qualify for the Green Lane system, the products must enjoy CEPT concessions and have a valid CEPT Certificate of Origin (C/O) as well as other normal customs documentation (i.e. declaration forms, bill of lading,

invoices, etc.). At present, the Green Lane systems of ASEAN member countries have two common elements: they involve the creation of a special lane/counter for the consignment of CEPT products and they carry out the random examination of CEPT products. In September 1996 ASEAN mandated that the Green Lane be regularly reviewed with the view of streamlining individual ASEAN countries' customs procedures for the benefit of importers and exporters.

Viet Nam began the Green Lane System on 1 January 1996 like the other ASEAN countries. The task now is for Viet Nam to review and assess its implementation, and to look for ways of improving the system. According to government sources there were only one hundred Certificates of Origin (C/O) issued under this system in 1996. The major reason for the insignificant portion of trade passing through the system was the low margin of preference between CEPT and general tariff rates (in Viet Nam, to date the rates are equivalent). This creates little incentive for importers/exporters to make use of the system. However, now is an opportune time for Viet Nam to increase the business community's awareness of the future advantages of this system in terms of cost and speed of processing.

## Harmonization of Technical Standards

Technical standards are a form of non-tariff barrier and an impediment to intra-ASEAN trade. ASEAN countries have decided to address the issue separately by harmonizing product standards and establishing mutual recognition arrangements (MRAs). The ASEAN members have agreed to priorities those sectors that figure widely in intra-regional trade, such as electrical appliances and machinery, base metals, plastics and chemicals. A list of twenty products has been targeted for harmonization by the year 2000.<sup>83</sup> ASEAN has also agreed on a framework for the harmonization of sanitary and phytosanitary (SPS) standards.

The Ministry of Science, Technology and Environment (MOSTE) is responsible for the management of standards, measurements and quality control. To date, Viet Nam has issued more than five thousand effective standards. At the same time, Viet Nam has been harmonizing technical measures and has implemented product, system and laboratory certification based on International Standards Organisation (ISO) standards and guidance. Viet Nam is also in the process of adopting the recommendations of the ASEAN Consultative Committee for Standards and Quality (ACCSQ) with respect to conformity assessment. Viet Nam's regulations regarding phytosanitary standards were enacted in 1993. Under these directives, imports that might contain substances harmful to the environment are subject to phytosanitary inspection.

## Customs surcharges

One of the most prevalent NTBs among ASEAN countries has been customs surcharges. ASEAN decided that member countries should produce a schedule for the elimination of customs surcharges by the end of 1996. Except for in Viet Nam, remaining surcharges have now been eliminated.

In Viet Nam, there are two commodity groups that are subject to customs surcharges: imports

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<sup>83</sup> The list of priority products are: air-conditioners, refrigerators, radio, telephone, television, video apparatus, printed circuits, monitor and generators, monitor and keyboard, mounted piezo-electric crystal, diodes (other than photosensitive), parts of TV and radio, loudspeakers and parts, inductors, capacitors, resistors, switches, cathode-ray tube, rubber gloves, and rubber condoms.

of construction steel and the export of cashew nuts. According to government officials, these remaining surcharges are expected to be removed in the future, but no target date has been given. Previously, Viet Nam had queried the need to remove “border charges” affecting certain essential commodities subject to price stabilization schemes. Viet Nam had argued that they were not customs surcharges. However, ASEAN judged them to be impediments to intra-ASEAN trade and therefore required removal. Viet Nam needs to eliminate these surcharges as soon as possible.

# **Chapter 6 : The revenue implications of AFTA for Viet Nam**

**- Peter Donovan & Adam McCarty -**

## **6.1 Introduction**

The direct tariff revenue impact of the ASEAN Free Trade Area (AFTA) on Viet Nam will be determined by both Viet Nam's CEPT and the growth of ASEAN imports into Viet Nam. However, AFTA makes up only one part of Viet Nam's trade policy framework and to determine the impact on total tariff revenue it is necessary to consider the wider economic and trade policy context (e.g. commitments related to Viet Nam's APEC membership and WTO accession). In addition, AFTA commitments will have an economy-wide ripple affect. An immediate negative fiscal impact of AFTA membership could be outweighed by the revenue effect of long-term trade growth within the region, coupled with the restructuring of the Vietnamese domestic economy. Some of the broader issues that will play a role in determining the revenue impact of AFTA are outlined below:

ASEAN represents a market of approximately 420 million people to which Vietnamese producers will have preferential access, as compared to the domestic market of 77 million people. Rather than concentrating on supplying the domestic market, Vietnamese producers will be able to set their sights on exporting to the ASEAN markets. The promotion of economic growth through the expansion of internationally competitive export industries has been a major factor in the success of all the newly industrialized economies (NIEs).

The reduction of CEPT rates over the period leading to AFTA will provide greater ASEAN competition to a number of protected Vietnamese industries leading to increased efficiency and better resource allocation within the economy. Such efficiency gains would be magnified if the reduction in import tariffs were not confined to ASEAN products. It must be recognized that not all enterprises will be able to compete successfully in the AFTA context. This underlines the importance of government policies to improve and restructure the industrial sector, including reducing the barriers to entry and exit of enterprises as market conditions change. The need for the even-handed treatment of state enterprises and the private sector with respect to the regulatory framework and access to capital and resources has also been raised.

The ASEAN market can be seen as a proving ground for Vietnamese enterprises to compete on world markets (a number are already successfully doing so). Trade prospects will be enhanced as Viet Nam gains MFN treatment from the United States through bilateral negotiation, or generalized MFN status through WTO accession. These developments will also provide additional attraction to foreign investors to locate new production activities in Viet Nam to take advantage of the abundant labour resources.

Both economic theory and the experience of many countries demonstrates that the reduction of industry protection has beneficial effects on the economy of a country: benefit is gained from tariff reform programmes even if there are no reciprocal concessions obtained in a trade negotiating context. This may seem paradoxical but the results of the GATT Uruguay Round show that the greatest gains will flow to those countries that were required to make the largest adjustments to their own assistance programmes, particularly for textiles and agriculture. In practice, many countries use tariff reductions as a bargaining tool in tariff negotiations, but the concessions won by this means should not be confused with the economic benefit of tariff restructuring.

## 6.2 Viet Nam's Tariff Structure

Viet Nam's trade regime still retains strong elements of government control and regulation. Since its renovation programme began Viet Nam has carried out selective liberalization of its tariff structure. The main positive outcomes of this process are:

- a reduction in Viet Nam's average nominal tariff level;
- a reduction in Viet Nam's maximum nominal tariff rate to 60 per cent;
- a decrease in the number of tariff lines subject to rates in excess of 50 per cent;
- an increase in the proportion of tariff lines subject to zero rates.

Table 6.1 below shows a detailed tariff matrix for the period 1992-1999 classifying the various tariff lines by their nominal tariff rates.

Overall, however, the tariff structure remains virtually unchanged. The two most striking aspects of the present Vietnamese tariff regime are the existence of some 26 tariff rates, many with very small differentials and a range of products with tariffs in the 40-60 per cent range. The average tariff collected on imported goods was estimated at 12.3 per cent for 1996 and around 12.98 per cent for 1999 and there is still a high incidence of smuggling. The main characteristics of the current tariff system are:

- the tariff rates on consumer items are generally higher than those on intermediate and capital goods;
- the nominal tariff on intermediate inputs are lower than those on the final good (i.e. the tariff rates escalates with each stage of production). This implies that Viet Nam's level of effective protection for final goods is much higher than what the nominal tariff indicates;
- there exists a wide range of tariffs together with multiplicity;
- the proportion of goods in the 30 to 60 per cent tariff rate category has in fact increased;
- the items that are attracting high tariffs include alcohol (60%), motor vehicles (55%), petroleum (55%), beverages (50%), air-conditioners & refrigerators (40%), and home electric appliances (30%).

**Table 6.1: Import Tariff Rates in Viet Nam: 1992 -1999**

| Rates        | Number of Tariff Codes |             |             |             |             |             | Percentage of Tariff Codes |            |            |            |            |            |
|--------------|------------------------|-------------|-------------|-------------|-------------|-------------|----------------------------|------------|------------|------------|------------|------------|
|              | 1992                   | 1995        | 1996        | 1997        | 1998        | 1999        | 1992                       | 1995       | 1996       | 1997       | 1998       | 1999       |
| 0            | 818                    | 976         | 1035        | 978         | 865         | 1966        | 30.7                       | 31         | 32         | 31         | 27         | 32         |
| 0.5          | 0                      | 1           | 1           | 1           | 0           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 1            | 422                    | 292         | 352         | 281         | 289         | 153         | 15.81                      | 9          | 11         | 9          | 9          | 2          |
| 2            | 57                     | 60          | 63          | 57          | 14          | 0           | 2.14                       | 2          | 2          | 2          | 0          | 0          |
| 3            | 9                      | 7           | 10          | 31          | 91          | 337         | 0.34                       | 0          | 0          | 1          | 3          | 5          |
| 4            | 0                      | 4           | 2           | 6           | 5           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 5            | 215                    | 281         | 326         | 322         | 384         | 667         | 8.06                       | 9          | 10         | 10         | 12         | 11         |
| 6            | 1                      | 1           | 1           | 1           | 1           | 0           | 0.04                       | 0          | 0          | 0          | 0          | 0          |
| 7            | 76                     | 55          | 54          | 58          | 26          | 7           | 2.85                       | 2          | 2          | 1          | 1          | 0          |
| 8            | 0                      | 5           | 4           | 6           | 5           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 9            | 0                      | 1           | 1           | 0           | 0           | 0           | 0                          | 8          | 0          | 0          | 0          | 8          |
| 10           | 198                    | 237         | 254         | 266         | 319         | 508         | 7.42                       | 0          | 8          | 9          | 10         | 0          |
| 12           | 0                      | 2           | 2           | 5           | 5           | 2           | 0                          | 2          | 0          | 0          | 0          | 1          |
| 15           | 79                     | 64          | 84          | 91          | 73          | 67          | 2.96                       | 0          | 3          | 3          | 2          | 0          |
| 16           | 0                      | 1           | 1           | 2           | 2           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 18           | 0                      | 1           | 1           | 1           | 0           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 20           | 333                    | 7           | 315         | 2           | 2           | 0           | 12.5                       | 18         | 0          | 0          | 0          | 9          |
| 22           | 0                      | 563         | 4           | 312         | 296         | 545         | 0                          | 0          | 10         | 10         | 9          | 0          |
| 24           | 0                      | 2           | 1           | 4           | 4           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 25           | 21                     | 1           | 38          | 1           | 1           | 0           | 0.79                       | 1          | 0          | 0          | 0          | 0          |
| 28           | 202                    | 37          | 280         | 41          | 38          | 2           | 0                          | 7          | 1          | 1          | 1          | 11         |
| 30           | 1                      | 0           | 0           | 3           | 0           | 0           | 7.57                       | 2          | 9          | 0          | 0          | 0          |
| 35           | 48                     | 49          | 51          | 241         | 294         | 658         | 1.8                        | 0          | 2          | 8          | 9          | 0          |
| 38           | 0                      | 1           | 1           | 26          | 27          | 0           | 0                          | 4          | 0          | 1          | 1          | 10         |
| 40           | 123                    | 123         | 162         | 1           | 1           | 0           | 4.61                       | 1          | 5          | 0          | 0          | 9          |
| 45           | 0                      | 20          | 20          | 234         | 229         | 626         | 0                          | 3          | 1          | 7          | 7          | 0          |
| 50           | 44                     | 95          | 108         | 18          | 21          | 2           | 1.65                       | 0          | 3          | 1          | 1          | 0          |
| 52           | 0                      | 1           | 0           | 126         | 136         | 586         | 0                          | 0          | 0          | 4          | 4          | 0          |
| 55           | 1                      | 0           | 6           | 0           | 0           | 0           | 0.04                       | 0          | 6          | 0          | 0          | 0.5        |
| 58           | 0                      | 1           | 0           | 4           | 4           | 1           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 60           | 1                      | 7           | 34          | 0           | 0           | 0           | 0.04                       | 0          | 1          | 0          | 0          | 0          |
| 70           | 7                      | 7           | 2           | 22          | 30          | 36          | 0.26                       | 0          | 0          | 1          | 1          | 0          |
| 80           | 3                      | 3           | 2           | 5           | 0           | 0           | 0.11                       | 0          | 0          | 0          | 0          | 0          |
| 87           | 1                      | 0           | 0           | 2           | 0           | 0           | 0.04                       | 0          | 0          | 0          | 0          | 0.5        |
| 100          | 6                      | 1           | 0           | 2           | 0           | 0           | 0.22                       | 0          | 0          | 0          | 0          | 0          |
| 120          | 3                      | 8           | 0           | 0           | 0           | 28          | 0.11                       | 0          | 0          | 0          | 0          | 0          |
| 150          | 0                      | 5           | 0           | 3           | 0           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| 200          | 0                      | 1           | 0           | 2           | 0           | 0           | 0                          | 0          | 0          | 0          | 0          | 0          |
| <b>Total</b> | <b>2669</b>            | <b>3135</b> | <b>3216</b> | <b>3126</b> | <b>3162</b> | <b>6174</b> | <b>100</b>                 | <b>100</b> | <b>100</b> | <b>100</b> | <b>100</b> | <b>100</b> |

Source: Viet Nam Import-Export tariff lists from 1995 to 1999.

## Box 6.1: Some Tariff Theory

Viet Nam has already embarked on a tariff reduction programme as part of a set of measures to improve the functioning of the economy. Even so, there is good reason to consider further tariff restructuring and to seek alternative sources of revenue. The main theoretical arguments for this are as follows:

Tariff policy stresses the adverse effects of high tariffs on economic performance. A tariff raises the cost of imported goods by the amount of the tariff. But the tariff affects not only the price of imported goods directly, it allows domestic producers of the same goods to raise their prices to match the duty-paid prices of imports (an activity known as "rent seeking"). There are other flow-on effects. Protected industries are in a position to pay higher prices for labour, land and capital than more lightly protected sectors. Not only are prices of scarce resources bid up, but their allocation will be less than optimal because such resources are flowing to the less efficient sectors of the economy. The effects of tariffs will be passed on throughout the economy, both through the price of goods subject to the tariff and more generally through the price of productive factors. It can be shown that tariffs act as a tax on those activities that are lightly protected or which receive no assistance. The effect is magnified for those producers that are not in a position to pass tariffs on, notably suppliers of goods and services for export, the prices of which are set by international competition. A high tariff regime is said to have a negative export bias. Where tariffs are associated with the use of quantitative restrictions the adverse effects are likely to be magnified, as the effective protection accorded by quantitative restrictions is often very high.<sup>84</sup>

In order to offset the negative effects of high levels of protection for certain goods, governments sometimes resort to reducing tariffs on inputs to lessen the cost of production of the goods, and/or provide a range of concessions for selected activities, often as part of a broad strategy to encourage investment. But there are drawbacks on both counts. First, reducing tariffs on raw materials or intermediate goods while maintaining the duties on the associated finished products, raises the effective rate of protection for the favoured industry, without ensuring that the benefit is passed on to consumers (the economic rent increases). Secondly, it is unlikely that tariff or other concessions will offset the negative effects of a distortionary tariff regime. While there may be some benefit to the companies receiving concessions, it is not just the cost of materials that is of concern. The price effects of high tariffs are spread throughout the economy and will be reflected in wage, finance and other costs. Finally, providing concessions to selected enterprises or sectors does not help the non-assisted sectors. On the contrary it raises issues of equity and can also create difficult administrative problems.

There is a further argument for reducing tariffs based on the dynamics of a free trade arrangement. On the formation of a free trade arrangement there is a transfer of tariff revenue from an importing country to the exporters of partner countries. The same mechanism applies when a new participant joins an existing arrangement. Analysis suggests that if tariff rates are

high and imports from partner countries substantial, such transfers can be considerable. Therefore, in the ASEAN context, there is an argument that countries with above average levels of protection, such as Thailand, Indonesia and Viet Nam, should urgently pursue unilateral trade liberalization.

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<sup>84</sup> The effective rate of protection measures the protection accorded to the value-added part of the output. There are three variables: the rate of duty on the imported content, the amount of value added to imported materials in manufacture and the rate of duty on the finished products. Depending on the circumstances, the effective rate of protection may be several times greater than nominal tariff. This may be the case even where the nominal tariff on the inputs and outputs is the same.

## Box 6.2: A rational tariff programme

Many countries have adopted the policy of "low and uniform" tariffs. This is a tariff regime where the dispersion between the top and the bottom levels is reduced and the average tariff rate is gradually moved down to a moderate level. This approach started during the 1980's throughout Latin America, Asia, Africa and, more recently, East Europe. The GATT Uruguay Round gave the process added impetus, as have commitments within regional trade agreements. However, in most cases, tariff reform was driven by domestic policy considerations rather than multilateral or regional trade commitments. Indeed much of the tariff restructuring of developing countries was not reflected in their Uruguay Round tariff commitments, as they were permitted to adopt ceiling bindings for goods that were not previously bound.<sup>85</sup>

There are different views as to what should constitute a "low and uniform" tariff regime. In developed countries, as a result of the Uruguay Round of tariff negotiations, the average trade weighted tariff on industrial goods will be between three and four per cent by the end of the transitional period.<sup>86</sup> However tariffs on sensitive products like clothing and footwear will be considerably higher and levels of agricultural protectionism remains a matter of concern. For developing countries, the IMF advocates moving all tariffs to a uniform level no higher than ten per cent, the precise figure being chosen to meet revenue needs.

The World Bank, on the other hand, recognizes that a more graduated scale may be appropriate for developing countries, with different tariff rates for goods grouped according to whether they are raw materials, intermediate goods, or finished products, with a view to promoting added value activity. The World Bank proposes that all goods should be assigned into one of the categories using objective criteria. At the same time tariff rates should be consolidated into one of a small number of tariff bands to match the categories chosen. Tariff peaks should be scheduled for early removal. These moves may be combined with the introduction of a minimum rate of duty where required for revenue purposes. This programme should result in a reduction of the average rate of duty and it will do much to eliminate anomalies in the treatment of different industries/products. It is also likely to improve the efficiency of tariff collection and simplify import entry procedures, as there will be greater uniformity of duty rates throughout the tariff code. Once the initial steps of reform have been taken, the World Bank advocates gradually reducing tariff rates to move the average trade-weighted tariff towards a level no higher than, say, 15 per cent. The World Bank cautions against the rapid reduction of tariffs where they constitute an important source of revenue since other revenue raising methods, if not carefully planned and implemented, may fail or be even less efficient than border taxes. Tariff reform should be taken in step with the overhaul of the fiscal system and, in particular, the introduction of other efficient means of raising revenue such as a value-added tax, excise taxes, profit and personal taxes.

The adoption of a low and more uniform tariff regime brings other benefits. Lower tariffs reduce the incentive for importers to engage in the illegal import of goods to avoid payment of customs duties. Indeed the highest tariff rates are often ineffective because traders seek ways to avoid paying them either through smuggling or by other illegal means such as falsification of description or values. Although estimates vary, smuggling is said to account for a very large volume of imports into Viet Nam, with a consequential loss of revenue. If duty rates on the goods commonly smuggled are reduced, the result may be an increase in the legal import of the goods, as the risks associated with

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<sup>85</sup> A ceiling binding is a tariff commitment at a level above the tariff actually in force. Its significance is that the applied tariff rate may be increased up to the ceiling binding level without the need to renegotiate the binding.

<sup>86</sup> The average trade weighted tariff measures the average tariff weighted by the trade value for each tariff line or group. It is regarded internationally as a more accurate measure of the tariff level than an unweighted average. In the Uruguay Round, the tariff-cutting target for industrial products by developed countries was a trade weighted average reduction of one third. The WTO calculated the Uruguay Round results on the basis of trade and tariff data submitted by each member. The same calculation may be used to provide the trade weighted average tariff and revenue forgone or gained as a result of tariff changes.

smuggling may come to outweigh the rewards. Thus the net revenue outcome of lowering some of the higher rates of duty may be favourable. Also, other forms of illegal activity may be reduced with less need for detailed checking of goods and documents and for administrative decisions. All this activity wastes the time of traders and officials and it also provides incentives for malpractice.

### 6.3 Viet Nam's Taxation Regime

The importance of trade taxes (import and export duties) has risen substantially in recent years both as a percentage of GDP and as a proportion of tax revenue (see Table 6.2).

| <b>Table 6.2: Trade Taxes (percentage)</b> |      |      |      |      |      |      |      |      |      |
|--|------|------|------|------|------|------|------|------|------|
|  | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
| Trade taxes (% GDP)                        | 1.4  | 1.4  | 2.0  | 4.7  | 5.9  | 6.0  | 5.8  | 4.4  | 4.2  |
| Trade taxes (% total revenue)              | 9.9  | 10.6 | 10.4 | 20.8 | 23.8 | 24.9 | 24.2 | 21.9 | 23.6 |

Source: World Bank (1998).

The following table (Table 6.3) shows import tariff revenue as a percentage of the value of imports.

| <b>Table 6.3: Value of imports and import revenue (US\$ million and percentage)</b> |       |       |       |       |       |       |        |        |        |
|---|-------|-------|-------|-------|-------|-------|--------|--------|--------|
|   | 1990  | 1991  | 1992  | 1993  | 1994  | 1995  | 1996   | 1997   | 1998   |
| Value of Imports (US\$)   | 2,280 | 2,200 | 2,530 | 3,500 | 5,820 | 8,200 | 11,140 | 11,592 | 11,495 |
| Import Tariff Revenue (US\$)  | 67    | 101   | 229   | 558   | 914   | 1,227 | 1,378  | 938    | 901    |
| Tariff Revenue (% imports)  | 2.9   | 4.5   | 9.0   | 15.9  | 15.7  | 14.9  | 12.4   | 8.1    | 7.8    |

Source: General Department of Customs (unpublished)

Revenue collected as a percentage of imports reached a peak in 1993 but has declined since. This reflects both a degree of tariff reform and some change in the composition of imports, as the import of low tariff investment goods has accelerated since the early to mid-1990s. In any case, the reliance on import duties as a major source of revenue remains high.<sup>87</sup>

Any tariff reductions, whether arising from unilateral tariff reform to promote economic efficiency or from trade negotiations will, other things being equal, reduce the revenue derived at the border. Indeed there may be a flow-on effect in that other forms of taxation, for example an excise or sales tax levied on the duty-paid price of goods, will also produce less revenue as tariffs are reduced. Even if initial adverse revenue effects are identified, this is no reason to slow down tariff reform or AFTA tariff reductions from which the economy will derive major long-term economic benefits.

<sup>87</sup> It should be noted that the percentage figures shown in Tables 6.2 and 6.3 also represent the average trade-weighted tariff on imports into Viet Nam.

A better policy option is to move as much as possible of the revenue content of the tariff into other forms of revenue, so that the tariff becomes primarily an instrument of industry assistance, and to some extent, a bargaining tool for tariff negotiations. If necessary, a low tariff on most goods could be imposed to maintain the revenue base. Alternative taxes on consumption (i.e. a value-added tax) income and profits do not increase the cost of imports nor protect domestic industries in the same way as border taxes and therefore, avoid the worst effects of tariff protection.

There is a special group of products that most countries regard as "high revenue" items. The most commonly included goods being alcoholic beverages, tobacco and petroleum products and sometimes automobiles and motorcycles. There is often also a social objective in imposing high taxes on these products. In the case of alcohol and tobacco, the motive is to discourage their use on health grounds, while the use of automobiles and motor spirits gives rise to environmental concerns. In Viet Nam, the average tariff on these major imports is:

|                         |     |
|-------------------------|-----|
| Automobiles, motorbikes | 55% |
| Alcohol                 | 60% |
| Petroleum               | 60% |

For these products in particular, it is clear that any reduction of tariffs, whether arising from domestic tariff reform, AFTA obligations, or, future WTO or APEC commitments, would significantly reduce revenue, but this should not be used as an argument against tariff reform. First, for revenue purposes and to meet social objectives there is a strong case for imposing a tax other than a tariff, so as not to distort the pattern of industry protection. The tariff would then be set at a much lower level consistent with overall industry assistance policies. Secondly, there is an argument that any reduction of the tariff on highly price elastic consumer goods would cause a surge in imports. This may well be so in the short term, but again, it is argued that maintaining a high tariff regime is not the best way to control overall consumer outlays. The experience of most countries confirms that the level of consumer spending is best addressed by a combination of monetary and fiscal measures, for example, by setting appropriate levels of interest rates and personal and indirect taxes.

### Box 6.3: Value added taxes

Viet Nam introduced a VAT tax in 1998. Unlike import duties or excise taxes, a value-added tax is imposed on consumption rather than on inputs. Other features of a VAT are:

- it does not have a cascading effect like an excise or sales tax;
- it has a neutral industry protection effect;
- it does not raise the cost of inputs.

Any tax paid on goods and services throughout the production or distribution chain is claimed back from the taxation authorities and the full amount of tax is added to the final cost of the goods and services. The tax is a particularly suitable measure for an export oriented economy because, if exports are zero rated, the tax does not increase the price of exports. Furthermore, producers of export goods can recover the whole of the VAT paid in the production of the goods. A duty drawback scheme can provide the same relief in respect of import duties, but such schemes are often slow and ineffective.

There appears to be a difference of view among policy makers about whether goods and services

should be subject to a single or differential rate of tax and the extent to which exemptions should be allowed. From the point of view of equity and effectiveness, a VAT tax should have the widest possible application, and a single rate set at the lowest level required to meet fiscal objectives. A very strong case can be made for imposing a single rate of tax, rather than trying to distinguish between goods and services on the grounds that some are more "necessary" than others, or used more by the poorer sections of the population, or to reflect other social objectives. A single rate scheme avoids protracted argument about what rate should be applicable to different types of goods and services, both at the outset of the scheme and subsequently. On the other hand a single rate scheme may have regressive effects, that is, it may bear more heavily on the poorer sections of the population, causing social strain. There is clearly a balance to be struck between equity, efficiency and social considerations in designing the scheme. The same remarks apply to the questions of exemptions. Ideally, in the interests of efficiency, exemptions should be kept to a minimum.<sup>88</sup>

Changes to the excise tax regime (see Box 6.4) and other domestic taxes are also under consideration in Viet Nam. Therefore, planning for the movement of revenue taxes away from

the border is well advanced and Viet Nam is therefore well placed to proceed with further tariff reform.

#### Box 6.4: Excise tax in Viet Nam

Viet Nam has had in place since October 1990 an excise tax regime (special consumption tax) on high revenue items, with the following rates:

|                               |        |
|-------------------------------|--------|
| Tobacco                       | 32-70% |
| Alcohol                       | 15-90% |
| Beer                          | 75-90% |
| Fireworks                     | 100%   |
| Passenger Motor Vehicles      | 0-100% |
| Petrol and Petroleum Products | 15%    |

In the WTO (GATT Article III), this class of taxes is known as national taxes. Such taxes may be maintained so long as they are not designed and do not act to provide assistance to a domestic industry. To conform to the WTO, the main requirement is that the rate of tax imposed on imported goods must be no higher than that applied to like domestic goods. Taxes that fall into this category include excise tax, sales tax, turnover tax and VAT. In Viet Nam, except in the case of automobiles, the same level of excise taxes are imposed on both domestically produced and imported goods so this WTO requirement is met. Imported automobiles are levied with a special tax of up to 100 per cent, which when combined with the tariff, results in a very high level of domestic assistance for the car assembly industry. The discriminatory nature of the excise tax is likely to complicate Viet Nam's WTO accession application.

An argument in favour of an excise tax rather than the tariff in the context of future domestic production of heavily taxed goods now subject to a tariff, or a combination of tariff and excise tax can be illustrated with the example of petroleum products. In the ASEAN context, Viet Nam's major import is petroleum products from Singapore. Given that there is no domestic refinery, the tariff has no protective effect but it is a major revenue earner. Indeed the tariff rates on petroleum imports was increased to a top rate of 60 per cent in May 1997 in order, according to the Ministry of Finance, to maintain revenue in the face of falling international prices. If a petroleum industry were established in

<sup>88</sup> In New Zealand, for example, the main exemptions cover residential rents and financial services. In addition, goods exported, most services provided overseas and international transport services are zero-rated (technically, the goods and services are subject to VAT but the rate of tax is currently zero).

Viet Nam, a tariff at 60 per cent on refined products would act as a very severe barrier to imports unless the domestic industry were grossly inefficient. The likelihood is that imports would fall dramatically so the revenue associated with the existing import trade would disappear. The more effectively the tariff acts as a protective mechanism, the less its value as a source of revenue. An excise tax, on the other hand would be unaffected by the change from imported to domestically produced petroleum, assuming, of course, that the tax was imposed equally on products from either source. The use of an excise tax as the main source of revenue would not rule out the retention of a moderate tariff designed to provide a degree of protection to a domestic industry, but it would avoid any revenue complications arising from trade liberalization policies or a switch from imported to domestic supplies.

It is worth noting that for the WTO, excise and similar taxes may be imposed even if there is no domestic production of the particular goods. Thus, Viet Nam imposes an excise tax on imports of refined petroleum and automobiles. Should the same goods be produced in Viet Nam at some future date, excise tax would have to be levied at the same rate as that imposed on imported goods.

Furthermore, an excise tax on imported products can continue to be collected at the border like a tariff. It is the character of the tax that determines whether it is classed as a tariff, rather than where and how it is collected. Customs surcharges, duties and other border charges applied only to imports would normally fall outside the definition of Article III of the GATT. In the AFTA context, customs charges have been classified as non-tariff barriers that are required to be removed. Viet Nam had disputed that additional variable charges imposed on a number of products for price stabilization purposes should be considered as customs surcharges. The Vietnamese position was not accepted by ASEAN and it is likely that a similar interpretation would be reached within the WTO. The WTO classifies additional border charges as either part of the ordinary customs duty, or as "additional duties and charges". This does not mean that they would necessarily have to be removed, but the variable nature of the charges is sure to be queried.

## 6.4 Analysis of Revenue Effects: Base Case

### 6.4.1 Data

The revenue analysis was developed using three sources of data: the four Common Effective Preferential Tariff (CEPT) lists of Viet Nam; the import tariff nomenclature of Viet Nam containing 3,217 tariff lines at the eight-digit HS-level; and Vietnamese import data for each of the ASEAN6 countries for 1996 at the six-digit HS-level.<sup>89</sup> To harmonies for analytical purposes a number of steps were taken. The eight-digit tariff lines were aggregated to six-digits using unweighted averages. At the six-digit level, the tariff lines could be matched with the aggregated ASEAN import data. ASEAN trade-weighted averages could then be used to calculate tariff rates at the four-digit HS-level. The four-digit HS-level data was used as the basis of the analysis.

There were some problems in harmonizing matching the data from the different sources.<sup>90</sup> This had repercussions for assessing accurately the revenue impact of AFTA. In particular,

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<sup>89</sup> The ASEAN6 are Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand.

<sup>90</sup> Harmonisation problems included the following: the CEPT lists were difficult to amalgamate because products were specified at different HS-levels; the total number of tariff lines included in the CEPT lists did not match the total of lines in the tariff nomenclature; in some instances import trade was recorded but there was no corresponding tariff line (these goods were assigned a starting tariff at the average rate, and treated like TEL goods for tariff reduction purposes). Despite these data deficiencies, the trade value of the anomalous items was less than five per cent of total trade.

the aggregation of the petroleum tariff lines proved difficult (see Box 6.5).

**Box 6.5 Details of petroleum oils tariff lines (May 1997)**

| <i>Viet Nam's tariff code</i>   | <i>Nominal rate</i> | <i>Description</i>   | <i>Probable HS code</i> | <i>Probable HS</i>  |
|---|---------------------|--|-------------------------|---------------------|
| 2710.00.10  | 60                  | Petrol kinds   | 2710.11.10              | Motor fuel (petrol) |
| 2710.00.20  | 32                  | Diesel oil kinds   | 2710.31.10              | Diesel fuel         |
| 2710.00.30  | 0                   | Mazout   | 2710.32.10              | Mazout              |
| 2710.00.40<br>(and 2710.11.20)  | 10                  | Aircraft fuel<br>(and Aviation fuel)                                     | 2710.12.00              | Jet fuel            |
| 2710.00.50  | 10                  | Common kerosene  | 2710.21.10              | Kerosene            |
| 2710.00.60  | 60                  | Naptha,<br>reforade components,<br>and others for<br>producing petroleum | 2710.19.20              | Naptha              |
| 2710.00.70  | 15                  | Condensate   | ?                       | ?                   |
| 2710.00.90  | 7                   | Other oils   | 2710.32.00              | Other fuel oils     |
| Average Unweighted Tariff HS-7110: 24.3%  |                     |  |                         |                     |
| Sources: General Statistics Office (1996, 1997).  |                     |  |                         |                     |
| <p>The example of petroleum oils (HS-2710) illustrates that Viet Nam's tariff code is not in accordance with the standard HS-coding system. Also, since import data was only available at the six-digit HS level, the eight tariff lines for HS 2710.00 had to be averaged, producing a tariff of 24.25 per cent. It is suspected that using the simple average will understates the true situation because of the overwhelming importance of petrol imports (with a duty rate of 60 per cent) compared with the imports of other petroleum products. As the whole tariff group HS-2710 is included in the CEPT General Exceptions List (GEL), the duties applicable to petroleum products do not affect the calculation of the revenue impact, but it would be necessary to determine the values accurately if the CEPT status of the goods changed.</p> |                     |  |                         |                     |

## 6.4.2 Methodology

For the analysis, the revenue impact is measured as the revenue difference between joining CEPT or not joining, given assumed import growth rates. Tariff reductions were assumed to happen in a linear fashion from the starting date applicable to each CEPT group. There will be some difference between the projected and actual fall in revenue during the transitional years leading to AFTA. This is because the actual year that Temporary Exclusion List (TEL) goods enter the Inclusion List (over a period of five years) is currently not known. In this analysis, all goods are shown as having their tariffs reduced linearly from 1999 to 2006. However, the variance is not expected to be great. The end result is the same as all tariffs are to be reduced to the zero to five per cent level in 2006. No tariff reduction was assumed by 2006 for goods on the Sensitive List (SL), as Viet Nam has until at least 2010 to complete the programme for such goods. By definition, goods on the General

Exception List (GEL) fall outside the CEPT tariff reduction commitments.

The analysis assumes a constant structure of imports for Viet Nam over the period, which is unlikely, but a study of structural change in Viet Nam's trade patterns was beyond the scope of this research. Also, the analysis does not capture any of the dynamic effects of trade liberalization such as growth of exports, growth of the economy, improved competitiveness and more efficient resource allocation. The methodology therefore provides only a partial view of revenue changes. To move from a partial analysis to an economy-wide model, it would be necessary, as a minimum, to have access to reliable input-output data, and import price elasticities.

### 6.4.3 Nominal versus actual revenue

The revenue analysis is based on changes to the legal duty rates (which is what the CEPT obligations require), producing estimates of nominal revenue, that is, the revenue that would accrue if all import duties were collected. In practice, this is unlikely to be the case because of duty exemptions, concessions, drawback, or administrative inefficiency.<sup>91</sup> To determine the revenue collection rate, the nominal duty arising from ASEAN imports would be compared with the actual duty collected in 1996. This ratio could then be applied to the 2006 nominal revenue, to determine the actual level of revenue expected to be collected. Unfortunately, this could not be done since the actual revenue figures for ASEAN imports were unavailable. A total revenue figure for all imports from all sources is available, however, the corresponding nominal revenue data was not available so a comparison could not be made on a global basis. The revenue figures in the following section should therefore be read more as of an indication of relative changes caused by the CEPT programme, than as an exact calculation of absolute revenue levels. However, it is reasonable to assume that actual revenue will change in the same direction and to approximately the same extent as our estimates, assuming no change in the revenue collection ratio between 1996 and 2006.

### 6.4.4 Base Data

A breakdown of the tariff nomenclature, showing the number of tariff lines in each CEPT category is listed below (see Table 6.4). Two hundred and four tariff lines at the eight-digit level have not yet been allocated to any CEPT list. At the four-digit HS level, which is the level used for the analysis, one hundred and sixty eight tariff lines could not be matched.

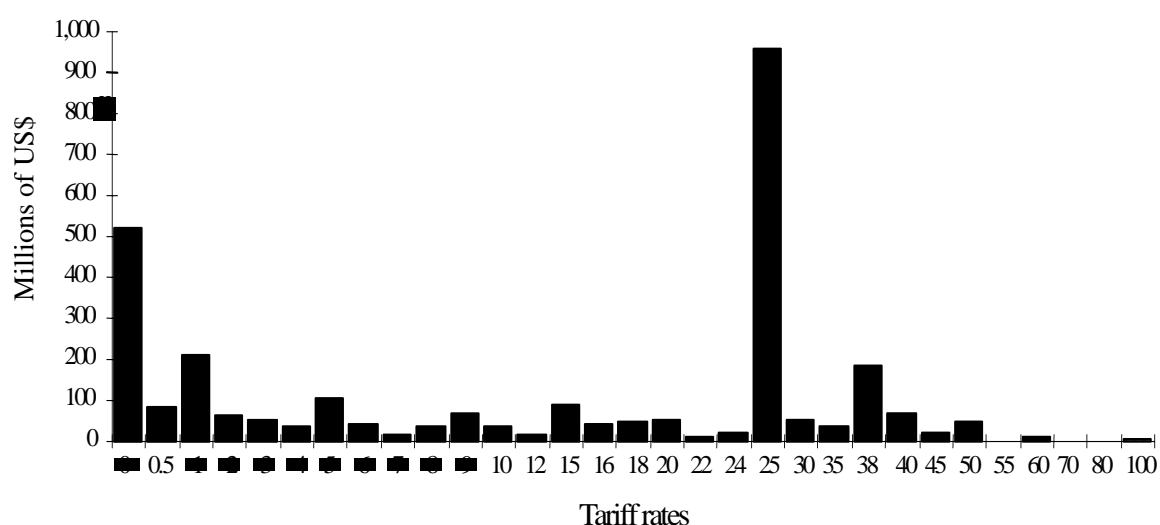
**Table 6.4: The CEPT categories**

|                  | <b>Total Tariff Lines</b> | <b>Inclusion List</b> | <b>Temporary Exclusion List</b> | <b>General Exceptions List</b> | <b>Sensitive List</b> | <b>Not specified</b> |
|------------------|---------------------------|-----------------------|---------------------------------|--------------------------------|-----------------------|----------------------|
| 8-digit HS level | 3,217                     | 1,633                 | 1,189                           | 165                            | 26                    | 204                  |
| 6-digit HS level | 2,543                     | 1,326                 | 881                             | 129                            | 25                    | 182                  |
| 4-digit HS level | 1,327                     | 629                   | 461                             | 62                             | 16                    | 168                  |
| 2-digit HS level | 96                        | 33                    | 45                              | 9                              | 4                     | 5                    |

<sup>91</sup> Other important considerations are whether duty is paid on any government imports, and how the foregone duty is accounted for in terms of government finances.

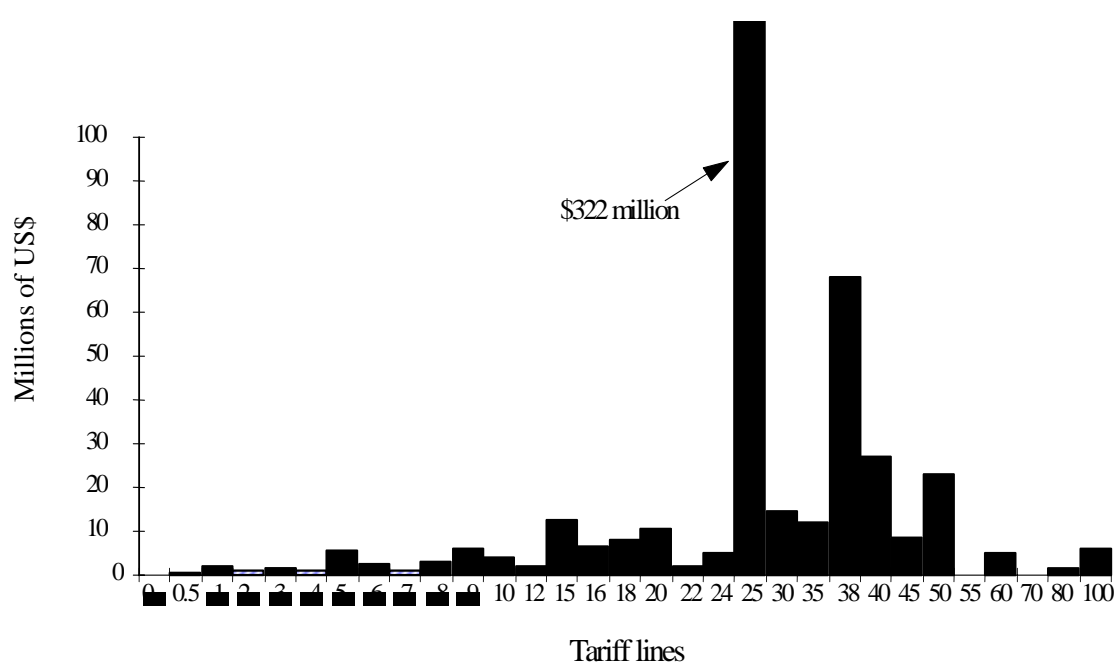
The two figures that follow (Figure 6.1 and 6.2) show total imports from ASEAN by tariff line and nominal ASEAN tariff revenue by tariff lines in 1996. The most noteworthy aspects of Figure 6.1 are that a large volume of ASEAN trade is already duty free, and that an even larger block subject to duty of 24-25 per cent – primarily petroleum products. The revenue significance of the imports of petroleum products, which were assigned an average tariff rate of 24.25 per cent, can now be clearly seen in Figure 6.2. Total revenue from this group of products was US\$232 million.<sup>92</sup>

**Figure 6.1: Total Imports from ASEAN Countries (1996)**



<sup>92</sup> For the reasons set out in Box 6.5, this is probably an underestimation of revenue from this source.

Figure 6.2: Nominal ASEAN Tariff Revenue by tariff line (1996)



Trade and revenue data before the CEPT tariff reduction takes place is summarised in Table 6.5. Of particular interest is the relative importance of the different CEPT lists to revenue collection.

Table 6.5: Profile of ASEAN imports by CEPT categories 1996

| CEPT Lists (4-digit HS)                  |           |                     |           |                   |             |       |
|--|-----------|---------------------|-----------|-------------------|-------------|-------|
|  | Inclusion | Temporary Exclusion | Sensitive | General Exception | Unspecified | Total |
| Tariff lines                             | 624       | 457                 | 16        | 62                | 168         | 1,327 |
| Volume of trade (US\$ million)           | 723       | 909                 | 1         | 1,198             | 118         | 2,948 |
| Percentage of ASEAN trade                | 24.5      | 30.8                | 0         | 40.6              | 4           | 100   |
| Nominal revenue (US\$ million)           | 21.8      | 132.6               | 0.1       | 295.3             | 25.2        | 475   |
| Percentage of total ASEAN tariff revenue | 4.6       | 27.9                | 0         | 62.2              | 5.3         | 100   |
| Average tariff (1996)                    | 4.4       | 21.4                | 11.0      | 14.06             | 23.29       | 13.16 |
| Average tariff (1999)                    | 4.7       | 23.5                | 15        | 25.4              | 31.7        | 12.9  |
| Average tariff (2006)                    | 2.1       | 4.2                 | 11.0      | 14.1              | 4.7         | 3.8   |
| Trade-weighted tariff (1996)             | 3.0       | 14.6                | 5.4       | 24.67             | 21          | 16    |
| Trade-weighted tariff (1999)             | 4.3       | 14.3                | 20.7      | 29.2              | 80.1        | 17.7  |

Key points from Table 6.5 are as follows:

Total nominal revenue from ASEAN imports in 1996 was calculated to have been US\$475 million, based on a simple average tariff rate of 13.16 per cent and an average trade weighted tariff rate of 16.11 per cent.

Goods on the Inclusion List (IL) covers 24.3 per cent of trade, but only 4.6 per cent of total revenue.

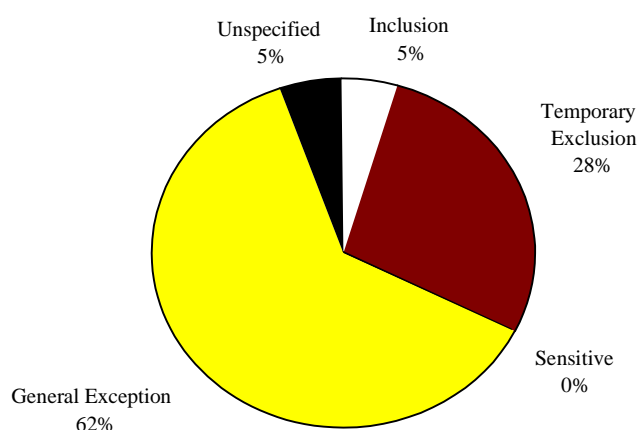
Goods on the Temporary Exclusion List (TEL), by contrast, cover 30.8 per cent of total trade and 27.9 per cent of total revenue.

The average tariff of the TEL group is forecast to fall from 21.36 per cent in 1996 to 4.15 per cent in 2006. The major effects of revenue adjustment will arise from the TEL commitments since the tariffs associated with goods on the Sensitive List (SL) and the General Exception List (GEL) are assumed to remain unchanged until 2006.

General Exception List goods accounts for 41 per cent of total imports from ASEAN and 62 per cent of total ASEAN tariff revenue

The significance of the General Exception List (GEL) category is highlighted in Figure 6.3. It is clear that if the CEPT obligations were applied to those GEL imports that are major tariff revenue earners, the revenue implications of AFTA would be much greater.

**Figure 6.3: ASEAN revenue share by CEPT categories (1996)**



The products on the CEPT Lists are considered on a tariff line basis in Table 6.6. Four out of the seven largest revenue earning tariff lines are found in the General Exceptions List (GEL). Many tariff lines that are currently on the Temporary Exclusion List (TEL) do have high tariff rates, which will have to fall to five per cent by 2006. Competition from ASEAN imports will increase markedly for many import-substituting industries, such as mineral water production

(HS-2202), paper (HS-4810), glass (HS-7003), shampoo (HS-3305), and electric fans (HS-8414). In many of these industries, reduced tariffs will be less important than removal of non-tariff barriers, which is also required by the CEPT agreement. Cement, for example, has only a nine per cent nominal tariff but the removal of import controls will force the industry to change dramatically. Similarly, the removal of import bans on cigarettes and paper imports will be more important than the lowering of their respective tariff levels.

**Table 6.6: Largest tariff lines of ASEAN trade (US\$ and per cent)**

| <b>4-digit<br/>HS<br/>code</b> | <b>Description</b>                  | <b>Volume of<br/>trade<br/>(US\$)</b> | <b>Average<br/>tariff in<br/>1996</b> | <b>Nominal<br/>revenue<br/>(US\$)</b> | <b>CEPT<br/>Group</b> | <b>Average<br/>tariff in<br/>2006</b> |
|--------------------------------|-------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|-----------------------|---------------------------------------|
| <b>2710</b>                    | Petroleum oils                      | 884,897,077                           | 24.3                                  | 214,587,541                           | GEL                   | 24.3                                  |
| <b>8711</b>                    | Motorcycles                         | 151,679,081                           | 36.7                                  | 55,615,663                            | GEL                   | 36.7                                  |
| <b>6217</b>                    | Clothing accessories                | 36,296,488                            | 50.0                                  | 18,148,244                            | ?                     | 5.0                                   |
| <b>2103</b>                    | Sauces, MSG                         | 34,243,250                            | 40.0                                  | 13,697,300                            | TEL                   | 5.0                                   |
| <b>2401</b>                    | Unmanufactured tobacco              | 50,681,917                            | 25.0                                  | 12,670,479                            | GEL                   | 25.0                                  |
| <b>8415</b>                    | Air conditioners                    | 22,080,560                            | 36.0                                  | 7,949,002                             | TEL                   | 5.0                                   |
| <b>8703</b>                    | Motor vehicles                      | 6,989,417                             | 85.7                                  | 5,989,542                             | GEL                   | 85.7                                  |
| <b>8528</b>                    | Reception apparatus for television  | 18,786,939                            | 24.4                                  | 4,579,316                             | TEL                   | 5.0                                   |
| <b>1511</b>                    | Palm oil                            | 26,127,978                            | 15.0                                  | 3,919,197                             | TEL                   | 5.0                                   |
| <b>2711</b>                    | Petroleum gases                     | 24,235,495                            | 15.5                                  | 3,756,502                             | TEL                   | 5.0                                   |
| <b>4011</b>                    | New tyres                           | 11,240,166                            | 32.5                                  | 3,653,054                             | TEL                   | 5.0                                   |
| <b>9608</b>                    | Pens                                | 12,596,782                            | 25.6                                  | 3,219,178                             | TEL                   | 5.0                                   |
| <b>8516</b>                    | Electric water heaters              | 8,300,865                             | 36.4                                  | 3,023,887                             | TEL                   | 5.0                                   |
| <b>5515</b>                    | Other synthetic fibre woven fabrics | 7,464,028                             | 40.0                                  | 2,985,611                             | TEL                   | 5.0                                   |
| <b>1516</b>                    | Fats and oils                       | 9,407,615                             | 27.5                                  | 2,587,094                             | TEL                   | 5.0                                   |
| <b>4810</b>                    | Paper and paperboard                | 12,261,099                            | 20.0                                  | 2,452,220                             | IL                    | 5.0                                   |
| <b>2523</b>                    | Cement                              | 27,237,039                            | 9.0                                   | 2,451,334                             | TEL                   | 5.0                                   |
| <b>9403</b>                    | Other furniture                     | 7,480,691                             | 30.0                                  | 2,244,207                             | TEL                   | 5.0                                   |
| <b>1704</b>                    | Sugar confectionery                 | 4,954,798                             | 45.0                                  | 2,229,659                             | GEL                   | 45.0                                  |
| <b>3403</b>                    | Lubricating preparations            | 13,734,230                            | 16.2                                  | 2,227,997                             | TEL                   | 5.0                                   |
| <b>1905</b>                    | Bread, pastry, cakes                | 5,392,184                             | 41.0                                  | 2,210,795                             | TEL                   | 5.0                                   |
| <b>7003</b>                    | Cast and rolled glass               | 6,411,926                             | 32.5                                  | 2,083,876                             | TEL                   | 5.0                                   |
| <b>2402</b>                    | Cigarettes and cigars               | 4,101,655                             | 50.0                                  | 2,050,828                             | GEL                   | 5.0                                   |
| <b>1901</b>                    | Malt extract, infant food           | 5,852,536                             | 35.0                                  | 2,048,388                             | TEL                   | 5.0                                   |
| <b>3921</b>                    | Plastic sheets and strips           | 14,585,229                            | 13.7                                  | 1,999,392                             | TEL                   | 5.0                                   |
| <b>2208</b>                    | Whisky, brandy, other spirits       | 3,356,798                             | 58.3                                  | 1,958,132                             | GEL                   | 58.3                                  |
| <b>8418</b>                    | Refrigerators and freezers          | 24,216,222                            | 7.7                                   | 1,862,786                             | TEL                   | 5.0                                   |
| <b>8450</b>                    | Washing machines                    | 4,572,250                             | 40.0                                  | 1,828,900                             | TEL                   | 5.0                                   |
| <b>8536</b>                    | Electrical circuit apparatus        | 6,332,712                             | 28.6                                  | 1,811,859                             | TEL                   | 5.0                                   |
| <b>1517</b>                    | Margarine, shortening               | 6,165,257                             | 27.5                                  | 1,695,446                             | TEL                   | 5.0                                   |

| <b>4-digit<br/>HS<br/>code</b> | <b>Description</b>                   | <b>Volume of<br/>trade<br/>(US\$)</b> | <b>Average<br/>tariff in<br/>1996</b> | <b>Nominal<br/>revenue<br/>(US\$)</b> | <b>CEPT<br/>Group</b> | <b>Average<br/>tariff in<br/>2006</b> |
|--------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|-----------------------|---------------------------------------|
| <b>6908</b>                    | Glazed and wall tiles                | 4,660,427                             | 35.0                                  | 1,631,149                             | TEL                   | 5.0                                   |
| <b>3305</b>                    | Shampoo, hair dyes                   | 2,694,164                             | 60.0                                  | 1,616,498                             | TEL                   | 5.0                                   |
| <b>1101</b>                    | Wheat                                | 17,732,045                            | 9.0                                   | 1,595,884                             | TEL                   | 5.0                                   |
| <b>6910</b>                    | Ceramic sinks, baths and wash basins | 3,339,934                             | 45.0                                  | 1,502,970                             | TEL                   | 5.0                                   |
| <b>6406</b>                    | Parts of footwear                    | 6,689,064                             | 20.0                                  | 1,337,813                             | IL                    | 5.0                                   |
| <b>7216</b>                    | Sections of iron or non-alloy steel  | 5,574,768                             | 23.8                                  | 1,324,007                             | TEL                   | 5.0                                   |
| <b>8452</b>                    | Sewing machines                      | 7,292,452                             | 16.7                                  | 1,215,409                             | IL                    | 5.0                                   |
| <b>1703</b>                    | Molasses                             | 11,961,972                            | 10.0                                  | 1,196,197                             | TEL                   | 5.0                                   |
| <b>7326</b>                    | Other articles of iron or steel      | 5,165,629                             | 22.5                                  | 1,162,267                             | TEL                   | 5.0                                   |
| <b>1507</b>                    | Soya-bean oil                        | 6,527,924                             | 17.5                                  | 1,142,387                             | TEL                   | 5.0                                   |
| <b>3703</b>                    | Photographic paper                   | 7,087,441                             | 15.0                                  | 1,063,116                             | TEL                   | 5.0                                   |
| <b>7321</b>                    | Stoves and cookers                   | 5,276,368                             | 20.0                                  | 1,055,274                             | TEL                   | 5.0                                   |
| <b>4802</b>                    | Uncoated paper                       | 6,480,192                             | 15.8                                  | 1,026,030                             | TEL                   | 5.0                                   |
| <b>8414</b>                    | Fans and air pumps                   | 7,019,017                             | 14.5                                  | 1,017,757                             | IL                    | 5.0                                   |
| <b>TOTAL (AVERAGE)</b>         |                                      | <b>1,556,217,320</b>                  | <b>31</b>                             | <b>409,038,947</b>                    |                       | <b>11</b>                             |

## 6.5 Analysis of Revenue Effects: Scenarios

### 6.5.1 The scenarios to test

Viet Nam's membership of AFTA will be completed over ten years. During this time, there are many variables that will affect the tariff revenue consequences of AFTA membership. The rate of growth of imports from ASEAN countries is obviously an important variable to take into account. Other variables include the type of tariff reduction schedule implemented by Viet Nam, and the extent to which trade diversion occurs. Other scenarios that should be considered are:

What if Viet Nam's General Exceptions List (GEL) is revised?

What is the revenue effect of implementing a five per cent minimum tariff?

What is the cost of completing AFTA membership by the year 2003?

All of these scenarios are explained in more detail below.

#### Reduction scenarios

Figure 6.4 shows the tariff reduction obligations of Viet Nam for each category of CEPT goods, assuming a linear tariff reduction for the goods on the Inclusion and Temporary Exclusion Lists. All tariffs above five per cent were reduced to the five per cent level while tariffs below 5 per cent were left unchanged. The end point tariffs, in 2006, correspond with

those in Table 6.5. Note that, given the way in which the goods in the TEL would be phased on to the Inclusion List, it is unlikely that the tariffs would fall uniformly. It is more likely the average tariff would fall in a stepped fashion. Therefore, the tariff reduction schedule for the intermediate years would not graphically correspond to a straight line.

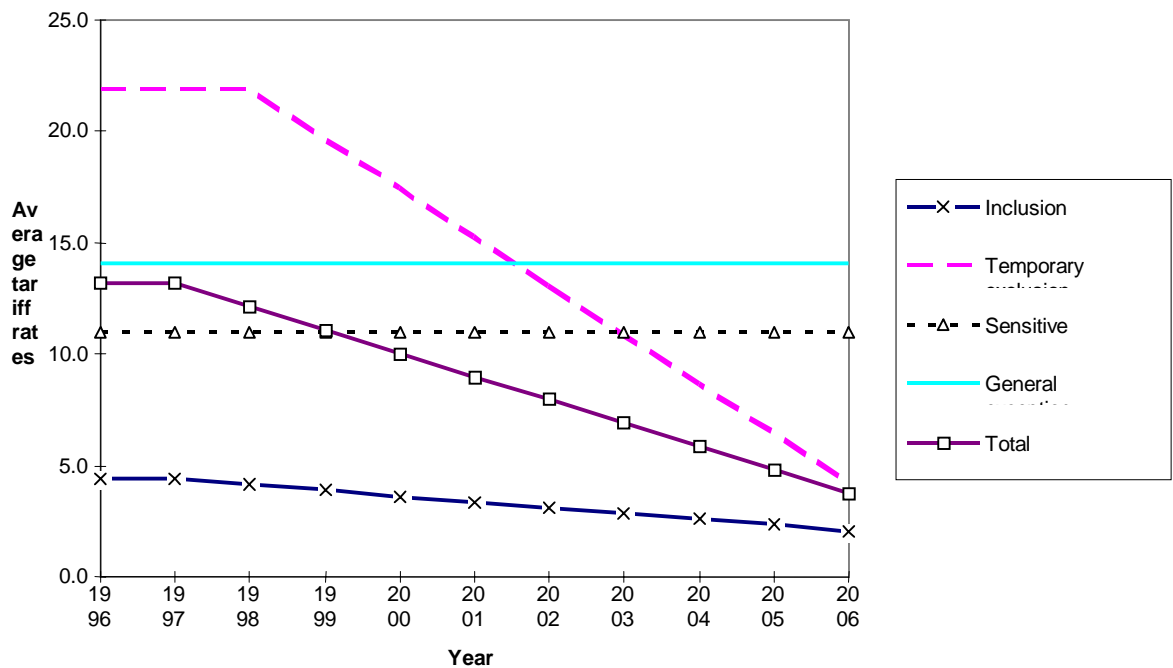
Instead of a linear tariff reduction schedule another option available is “end-loading”. That is, to delay tariff reductions until the last few years. This is generally not advisable as it squeezes the adjustment period into only a few years and goes against a recent ASEAN decision. Also, it implies that Viet Nam could, if it wanted to, carry out all tariff reduction requirements over a three-year period. This which would raise doubts as to whether Viet Nam needed the special concession of an extra three years to join AFTA in the first place. Nevertheless, the revenue consequences of this policy option are tested. The “end-loaded” scenario keeps all tariffs unchanged until 2003, with those on the Temporary Exclusion and Inclusion Lists subsequently falling rapidly to the levels required by 2006.

### Import growth rates

Imports from ASEAN have grown an impressive 33 per cent annually in the 1990s. The growth of trade has been from a very low base. Much of it has been “catching up” to trade volumes as a percentage of GDP more in line with those of other ASEAN countries. It is unlikely that this rate of growth would continue. Two import growth scenarios to 2006 are tested:

- i) twenty per cent annual import growth; and
- ii) ten per cent annual import growth (the “low growth” scenario).

**Figure 6.4: Reduction scenario for average CEPT tariff lines**



## Trade diversion

How much trade diversion will occur due to AFTA remains largely unknown. If Viet Nam's tariff reductions are done on an MFN basis (i.e. applicable to all countries), then trade diversion will be minimal. If not, then it is possible that trade diversion would be significant as ASEAN countries can supply many of Viet Nam's import requirements, albeit at higher than world prices. Trade diversion means that Viet Nam is paying more for a good and earning less revenue (see Box 6.6).

In this analysis, due to lack of detailed data, only a simple assumption for testing trade diversion effects is undertaken. Trade diversion will be most apparent for those tariff lines that are moving from high levels down to five per cent. Therefore it is assumed that trade diversion will occur only for tariff lines which begin at over 20 per cent. For these items it is assumed that the growth of imports from ASEAN will increase ten per cent faster than for other tariff lines due to trade diversion. Thus, in the 20 per cent import growth scenario, trade diversion means that the high tariff items are growing by 30 per cent. This means that the volume of ASEAN trade is growing faster and so is ASEAN tax revenue, but trade diversion means that this is at the expense of tax revenue and trade growth from the rest of the world.

### Box 6.6: Trade Diversion example

This box is included to illustrate the costs of trade diversion and is hypothetical. Assume that the annual demand for new car tyres remains stable at 962,000 tyres over a two-year period (it is assumed that the quality of all tyres is that same). The price per tyre is also unchanged over the two years, with ASEAN tyres being ten dollars more expensive (at US\$100 each) than tyres from the rest of the world. Given the same average tariff rates of 32.5 per cent in 1997, not many tyres are imported from ASEAN given the price difference. Viet Nam pays US\$87.7 million for the 962,000 tyres in 1997, and the government collects US\$28.5 million in taxes. Now what if the tariff on tyres imported from ASEAN is reduced to, say, 15 per cent? For Vietnamese consumers, the cost of an ASEAN tyre (US\$100 plus \$15 tax = \$115) is now less than one imported from elsewhere (US\$90 plus \$29.25 tax = \$119.25). So now a lot more tyres are imported from ASEAN (350,000 in 1998, compared to 112,000 in 1997). Trade has been diverted. Note, however, that this means that Viet Nam is paying more for the same quantity of tyres and is collecting less tariff revenue. These are the costs of trade diversion.

| <u>Imports from:</u> | <u>Number of tyres</u> | <u>Cost per tyre</u><br>(US\$) | <u>Total import cost</u><br>(US\$million) | <u>Tariff</u><br>(%) | <u>Import tax collected</u><br>(US\$million) |
|----------------------|------------------------|--------------------------------|---|----------------------|--|
| <b>1997</b>          |                        |                                |   |                      |  |
| ASEAN                | 112,000                | 100                            | 11.2                                      | 32.5                 | 3.64   |
| Rest of the World    | 850,000                | 90                             | 76.5                                      | 32.5                 | 24.86  |
| <u>Total Imports</u> | 962,000                |                                | 87.7                                      |                      | 28.5   |
| <b>1998</b>          |                        |                                |   |                      |  |
| ASEAN                | 350,000                | 100                            | 35  | 15                   | 5.25   |
| Rest of the World    | 612,000                | 90                             | 55.1                                      | 32.5                 | 17.9   |
| <u>Total Imports</u> | 962,000                |                                | 90.1                                      |                      | 23.15  |

## A revised General Exceptions List

It is possible that Viet Nam's General Exceptions List (GEL) will remain unchanged throughout its preparation for AFTA in the year 2006. However, it is equally likely that Viet Nam will be required to move many items on to the Temporary Exclusion List (TEL). It was therefore decided to test the revenue consequences of moving certain items onto the Temporary Exclusion List and applying the appropriate reduction schedule as shown in Figure 6.4. The items moved are listed in Table 6.7. The "revised" General Exceptions List scenario has all of these goods in the Temporary Exclusion List from 1998 onwards. A notable exclusion from Table 6.7 is petroleum. This is because, given no refining capacity in Viet Nam at present, a removal or reduction of tariff rates on petroleum can be easily replaced by an excise tax. It is assumed therefore, that there is no net revenue effect due to petroleum being on the General Exception or Temporary Exclusion Lists. This policy option is not applicable to other products, where import-substituting industries are already well established. An excise tax only on imported goods in this instance is not acceptable by either AFTA or WTO rules, and although Viet Nam seems to have done this for motorcars, it is unlikely to continue to be a policy option.

**Table 6.7: General Exception List items moved to the Temporary Exclusion List**

| Four-digit HS Code     | Description                               | Tariff rate in 1996 | Imports from ASEAN in 1996 (US\$) | Nominal Revenue (US\$) |
|------------------------|---|---------------------|-----------------------------------|------------------------|
| 401                    | Milk and cream                            | 4.25                | 323,493                           | 13,748                 |
| 402                    | Milk and cream, concentrated or sweetened | 2.00                | 14,206,973                        | 284,139                |
| 1704                   | Sugar                                     | 45.00               | 4,954,798                         | 2,229,659              |
| 2203                   | Beer                                      | 50.00               | 436,712                           | 218,356                |
| 2204                   | Wine of fresh grapes                      | 58.75               | 735,034                           | 431,832                |
| 2205                   | Vermouth                                  | 60.00               | 44,850                            | 26,910                 |
| 2208                   | Whiskies, rum, gin                        | 58.33               | 3,356,798                         | 1,958,132              |
| 2401                   | Unmanufactured tobacco                    | 25.00               | 50,681,917                        | 12,670,479             |
| 8471                   | Computers                                 | 0.42                | 21,407,726                        | 89,199                 |
| 8517                   | Telephone sets                            | 0.00                | 31,676,703                        | 0                      |
| 8703                   | Motor cars                                | 85.69               | 6,989,417                         | 5,989,542              |
| 8711                   | Motorcycles                               | 36.67               | 151,679,081                       | 55,615,663             |
| 9009                   | Photocopy machines                        | 10.00               | 3,538,336                         | 353,834                |
| <b>Total (average)</b> |   | <b>(33.5)</b>       | <b>290,031,838</b>                | <b>79,881,494</b>      |

With respect to petroleum products, when Viet Nam's planned oil refinery is completed, probably by about 2001, then the economic scenario will become more complex. It is probable that the refinery will not be competitive with imports, but at the same time, tariff protection may not be an option. Non-tariff barriers, particularly through controls on retailing networks may be utilized, although these will go against the spirit (and the letter) of Viet Nam's AFTA participation and, by then, probable WTO membership. In short, if Viet Nam is to continue its policies of import substitution, it must develop a long-term perspective on what levels and forms of protection it will employ. It cannot assume that Viet Nam's commitments to international trade agreements can be compromised as and when desired.

## AFTA by 2003?

Viet Nam is a developing economy, but that in itself is not an argument for requiring a longer period for economic restructuring. Indeed, it can be argued that Viet Nam's restructuring due to trade reform will be less substantial since its economy is still largely agricultural, with exports made up predominantly of raw or semi-processed products. In this context, Viet Nam should consider joining its ASEAN partners in implementing AFTA by the year 2003. This action would reaffirm Viet Nam's commitment to trade reform, and the efficiency gains from trade liberalization would take place earlier. Therefore the "year 2003" scenario is tested for its revenue implications.

## A five per cent minimum tariff

Viet Nam's tariff code, with its 26 individual tariff rates, is far too complex and encourages domestic industries to lobby for increased protection. It is recommended that a tariff code of only four tariff lines is introduced. Additionally, there is a good economic argument for maintaining a minimum tariff at a low level for revenue purposes, particularly when alternative sources of raising revenue are only slowly being developed. For this analysis, a five per cent minimum tariff on ASEAN trade from 1998 is tested to measure how it can compensate for the overall decline in tariff revenue due to CEPT.

## 6.6 Results

### 6.6.1 Overview of scenarios tested

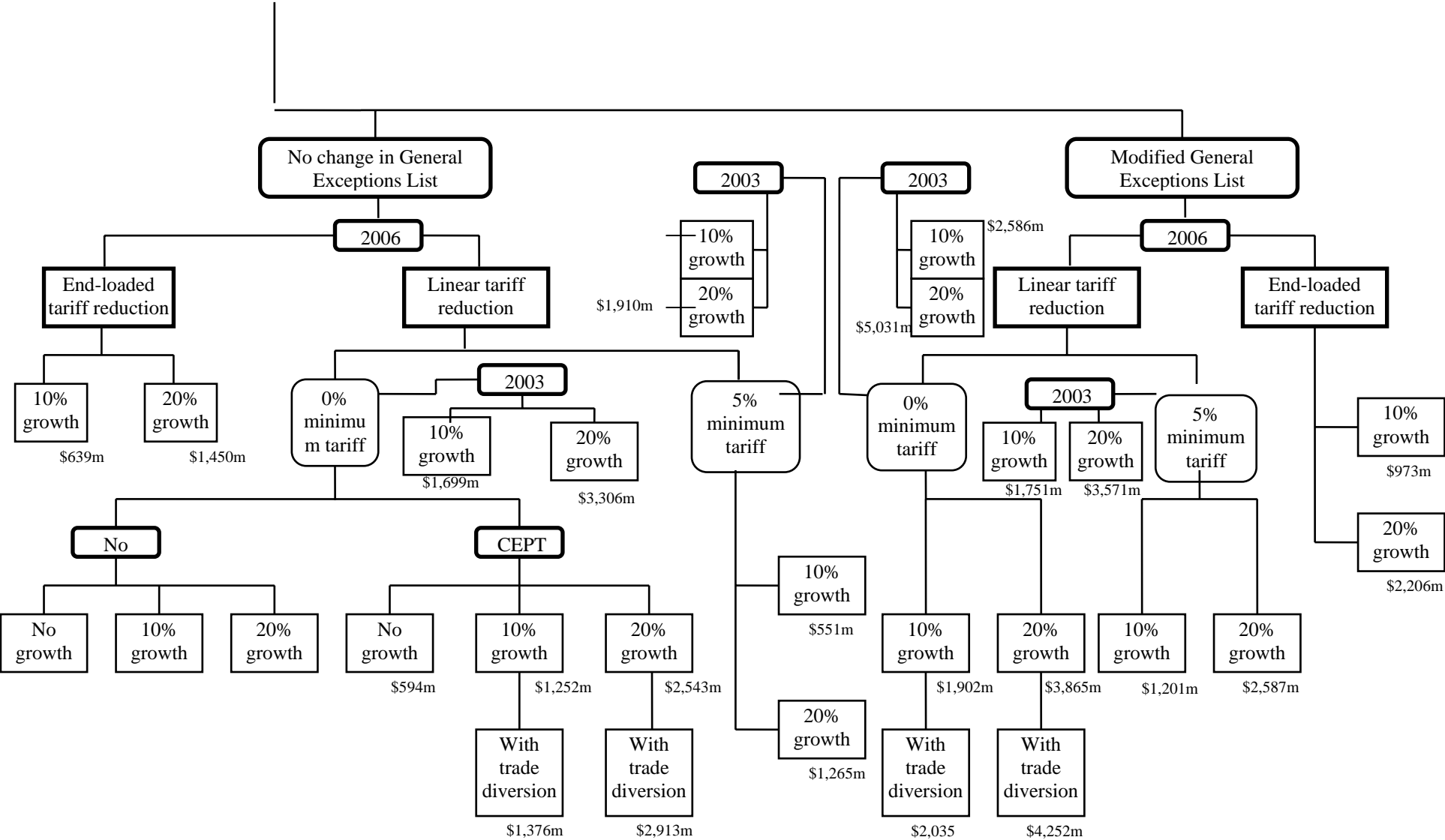
Diagram 6.5 shows the scenario-testing framework of the 28 permutations that were tested in this analysis. The scenario framework is subdivided in the follow order:

- i.) General Exception Lists (unchanged or modified)
- ii.) tariff reduction (linear or end-loaded)
- iii.) minimum tariff (no minimum tariff or 5% minimum tariff)
- iv.) AFTA completion date (2003 or no change (2006))
- v.) ASEAN import growth rates (0%, 10% or 20%)
- vi.) trade diversion (with or without)

The three "No CEPT" scenarios (shown in the bottom left corner of Figure 6.5) refer to Viet Nam's non-participation in AFTA. Tariff revenue totals for the three ASEAN import growth rates are calculated. These results are the base cases of the analysis and are used to determine the revenue

foregone due to AFTA, i.e. the tariff revenues produced by other scenarios are compared to the base cases, to determine the total tariff revenue “losses” of AFTA participation (as listed in figure).

Figure 6.5: Revenue Scenarios for AFTA Membership



## 6.6.2 Scenario Results

### Basic Scenarios

The results from the two scenarios – import growth rates and trade diversion - over the period 1997-2006 are presented in Table 6.8 (with and without CEPT involvement).<sup>93</sup>

- Constant (unchanged) level of ASEAN import trade over the period.
- ten per cent annual growth in ASEAN import trade with and without trade diversion.
- twenty per cent annual growth in ASEAN import trade with and without trade diversion.

The revenue “loss” over the period 1997-2006 for each scenario is calculated by subtracting revenue gained by participating in the CEPT (“CEPT” row) from the revenue received if not participating (“No CEPT” row).<sup>94</sup> The results of the two basic scenarios are explained in more detail below.

### Growth Rates

The three growth rates (0%, 10% and 20%) produce three different levels of imports from ASEAN in 2006. The difference between the “constant growth” and “20 per cent growth” volume of imports is dramatic. The total volume of imports over this ten-year period ranges from \$29 billion to \$101 billion. The rate of import growth is a more important factor than whether Viet Nam participates in the CEPT in determining total tariff revenue. For example, total import revenue with CEPT membership and 20 per cent import growth, is \$12,253 million. This is almost four billion dollars more than if Viet Nam did not join CEPT (i.e. no tariff reductions) and had only ten per cent growth in ASEAN imports each year. Nevertheless, if Viet Nam has import growth rate of ten per cent over the period then the total revenue forgone (“loss”) of participating in CEPT will be US\$1,252 million.<sup>95</sup> With an import growth rate of 20 per cent the total revenue “loss” will be US\$2,543 million.

### Trade Diversion

Trade diversion involves an additional annual increase in trade volume of ten per cent for goods on the Inclusion List or Temporary Exclusion List with 1997 tariffs of over 20 per cent. Trade diversion will increase revenue from ASEAN, but sees a greater reduction of revenue from the rest of the world. For example, in the 20 per cent growth scenario with CEPT, trade diversion causes an extra US\$8,923 million of imports from ASEAN and would reduce the total revenue loss by US\$1,067. However, the diverted trade would have earned US\$1,437 million in tariff revenue from non-ASEAN countries (based on trade-weighted protection of 16.1 per cent). Therefore the net revenue loss of the trade diversion is

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<sup>93</sup> Assumes a linear tariff reduction schedule and unchanged General Exception List.

<sup>94</sup> The average annual revenue loss for Viet Nam can be calculated by dividing the total loss by ten (years).

<sup>95</sup> To put this figure in perspective, this is slightly lower than Viet Nam’s import tariff revenue from all countries for 1996.

US\$1,437 minus US\$1,067 = US\$370 million resulting in a total revenue loss of US\$2,913 million<sup>96</sup>.

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<sup>96</sup> Trade weighted protection for 2006 remains unchanged at 16.1% for the “no CEPT” scenarios, but is lower for those with the CEPT. Trade diversion produces a slightly lower average trade weighted protection because it has involved increasing the share of goods being imported from ASEAN whose tariffs have been reduced to 5% by 2006. For the CEPT 10% import growth scenario the trade weighted protection falls from 11.7 to 10.8% with trade diversion. The rates would be considerably lower if petroleum was excluded. For example, in the 20 per cent growth scenario, excluding petroleum gives a trade weighted protection figure of 12.6% in 1997, which falls to 6.3% in 2006.

Table 6.8: Basic Scenarios (US\$ millions)<sup>97</sup>

| <i>SCENARIOS:</i>               |                        | <i>1997</i>             |                       |                                  | <i>2006</i>             |                       |                                  | <i>1997-2006</i>           |                             |                             |
|---------------------------------|------------------------|-------------------------|-----------------------|----------------------------------|-------------------------|-----------------------|----------------------------------|----------------------------|-----------------------------|-----------------------------|
| <i>Import growth</i>            | <i>Tariff schedule</i> | <i>Volume of import</i> | <i>Tariff Revenue</i> | <i>Trade-weighted protection</i> | <i>Volume of import</i> | <i>Tariff Revenue</i> | <i>Trade-weighted protection</i> | <i>Total ASEAN Imports</i> | <i>Total tariff Revenue</i> | <i>Total revenue "loss"</i> |
| <b>1.) Constant (0% growth)</b> | No CEPT                | 2,948                   | 475                   | 16.1                             | 2,948                   | 475                   | 16.1                             | 29,484                     | 4,750                       | -                           |
|                                 | CEPT                   | 2,948                   | 475                   | 16.1                             | 2,948                   | 344                   | 11.7                             | 29,484                     | 4,156                       | 594                         |
| <b>2.) 10% growth</b>           | No CEPT                | 3,243                   | 522                   | 16.1                             | 7,647                   | 1,232                 | 16.1                             | 51,688                     | 8,327                       | -                           |
|                                 | <b>CEPT</b>            | <b>3,243</b>            | <b>522</b>            | <b>16.1</b>                      | <b>7,647</b>            | <b>892</b>            | <b>11.7</b>                      | <b>51,688</b>              | <b>7,075</b>                | <b>1,252</b>                |
| <i>With trade diversion</i>     | CEPT                   | 3,243                   | 522                   | 16.1                             | 8,826                   | 761<br>(951)          | 10.8                             | 56,155                     | 6,951<br>(7,670)            | 1,376<br>(657)              |
| <b>3.) 20% growth</b>           | No CEPT                | 3,538                   | 570                   | 16.1                             | 18,256                  | 2,941                 | 16.1                             | 91,843                     | 14,796                      | -                           |
|                                 | <b>CEPT</b>            | <b>3,538</b>            | <b>570</b>            | <b>16.1</b>                      | <b>18,256</b>           | <b>2,130</b>          | <b>11.7</b>                      | <b>91,843</b>              | <b>12,253</b>               | <b>2,543</b>                |
| <i>With trade diversion</i>     | CEPT                   | 3,538                   | 570                   | 16.1                             | 21,069                  | 1,818<br>(2,217)      | 10.8                             | 100,766                    | 11,883<br>(13,320)          | 2,913<br>(1,476)            |

<sup>97</sup> For the trade diversion scenarios, revenue figures include the fall in revenue due to the reduction in non-ASEAN trade. Therefore, even though ASEAN imports are higher, total tariff revenue for Viet Nam will be at a lower level (the figure in brackets represents the unadjusted revenue level).

**Table 6.9: Further scenarios (US\$ millions)**

| <i>Scenarios:</i>                         | 1997    |         |                       | 2006    |         |                       | 1997-2006<br>(or 1997 – 2003) |                  |                            |
|---|---------|---------|-----------------------|---------|---------|-----------------------|-------------------------------|------------------|----------------------------|
|   | Imports | Revenue | T-w<br>ave.<br>tariff | Imports | Revenue | T-w<br>ave.<br>tariff | Total<br>imports              | Total<br>revenue | Total<br>revenue<br>"loss" |
| 1.) 5% min. tariff, 10% growth            | 3,243   | 522     | 16.1                  | 7,647   | 1,003   | 13.1                  | 51,688                        | 7,776            | 551                        |
| 2.) 5% min. tariff, 20% growth            | 3,538   | 570     | 16.1                  | 18,256  | 2,394   | 13.1                  | 91,843                        | 13,531           | 1,265                      |
| 3.) 10% growth, AFTA 2003                 | 3,243   | 522     | 16.1                  | 7,647   | 892     | 11.7                  | 51,688                        | 6,628            | 1,699                      |
| 4.) 20% growth, AFTA 2003                 | 3,538   | 570     | 16.1                  | 18,256  | 2,130   | 11.7                  | 91,843                        | 11,490           | 3,306                      |
| 5.) 5% min. tariff, 10% growth, AFTA 2003 | 3,243   | 522     | 16.1                  | 7,647   | 1,003   | 13.1                  | 51,688                        | 7,415            | 912                        |
| 6.) 5% min. tariff, 20% growth, AFTA 2003 | 3,538   | 570     | 16.1                  | 18,256  | 2,394   | 13.1                  | 91,843                        | 12,886           | 1,910                      |
| 7.) End-loaded reduction, 10% growth rate | 3,243   | 522     | 16.1                  | 7,647   | 892     | 11.7                  | 51,688                        | 7,688            | 639                        |
| 8.) End-loaded reduction, 20% growth rate | 3,538   | 570     | 16.1                  | 18,256  | 2,130   | 11.7                  | 91,843                        | 13,346           | 1,450                      |

### 6.6.3 Revised General Exception List Scenarios

#### Further Scenarios' Results

Three additional CEPT scenarios are presented in Table 6.2 – minimum tariff rate, AFTA 2003, and end-loaded tariff reduction.<sup>98</sup>

#### Minimum tariff rate

Adopting a five per cent minimum tariff, the revenue “loss” is reduced from US\$1,252 to US\$551 million with 10% import growth, i.e. a five per cent minimum tariff from 1998 onwards would produce additional revenue of about US\$100 million per year on average. With 20 per cent import growth, the revenue loss falls from US\$2,543 to US\$1,265.

<sup>98</sup> Assume an unchanged General Exception List.

## AFTA 2003

The middle four permutations in Table 6.2 test the consequences of achieving full CEPT commitments by 2003. With no minimum tariff and 20 per cent annual growth, total revenues over the ten years come to \$11,490 million, compared to \$12,253 million with linear reductions to the year 2006. When a five per cent minimum tariff is added to the 2003 deadline, the total revenue collected is \$12,886 million – greater than that for the basic 20 per cent growth scenario.

### End-loaded tariff reduction

The first six permutations involve a linear reduction in the tariff schedule, while the last two in Table 6.2 are “end-loaded”. The end-loaded scenarios produce higher revenues. With 10 per cent import growth, end-loading produces \$7,688 million compared to \$7,075 million in the equivalent linear reduction scenario. The revenue “saved” by end-loading varies from \$613 million to \$1,093 million, depending on growth rates (equivalent to between \$61 and \$109 million per year).

Some other permutations based on a revised General Exceptions List (GEL) are presented in Table 6.3. In these scenarios the GEL goods listed in Table 5.2 are moved to the Temporary Exclusion List (TEL) from 1998. Key results are:

The revenue “losses” in all of these scenarios are much higher.

The trade-weighted average tariffs are lower in 2006, down to 8.8 per cent with trade diversion effects.

“End-loading” has a more significant revenue impact as it applies to a higher share of imports.

With a five per cent minimum tariff introduced, the revenue collected is about the same as that collected with an unchanged General Exceptions List (GEL) and no minimum tariff. In other words, the revision to the General Exception List could be almost fully compensated, in terms of revenue, by introducing the five per cent minimum tariff.

### Revised General Exception List Scenarios for 2003

Table 6.4 shows results from a changed General Exceptions List (GEL) and with a target AFTA implementation date of 2003.

The revenue losses from these scenarios are very large

The five per cent minimum tariff reduces these losses considerably

The revenue loss with a 2003 target date and a five per cent minimum tariff is less than with a 2006 target date and no minimum tariff.

**Table 6.10: Scenarios with a changed General Exceptions List (US\$ millions)<sup>99</sup>**

| <i>Scenario:</i>                       | 1997    |         |                       | 2006    |                  |                       | 1997-2006        |                    |                            |
|--|---------|---------|-----------------------|---------|------------------|-----------------------|------------------|--------------------|----------------------------|
|  | Imports | Revenue | T-w<br>ave.<br>tariff | Imports | Revenue          | T-w<br>ave.<br>tariff | Total<br>imports | Total<br>revenue   | Total<br>revenue<br>"loss" |
| 1) 10% growth                          | 3,243   | 522     | 16.1                  | 7,647   | 715              | 9.4                   | 51,688           | 6,425              | 1,902                      |
| 2) 10% growth, trade<br>diversion      | 3,276   | 534     | 16.1                  | 8,826   | 584<br>(774)     | 8.8                   | 56,155           | 6,301<br>(7,020)   | 2,026<br>(1,307)           |
| 3) 20% growth                          | 3,538   | 570     | 16.1                  | 18,256  | 1,706            | 9.3                   | 91,843           | 10,931             | 3,865                      |
| 4) 20% growth, trade<br>diversion      | 3,574   | 582     | 16.1                  | 21,069  | 1,394<br>(1,847) | 8.8                   | 100,766          | 10,561<br>(11,998) | 4,235<br>(2,798)           |
| 5) 5% min. tariff, 10% growth          | 3,243   | 522     | 16.1                  | 7,647   | 826              | 10.8                  | 51,688           | 7,126              | 1,201                      |
| 6) 5% min. tariff, 20% growth          | 3,538   | 570     | 16.1                  | 18,256  | 1,971            | 10.8                  | 91,843           | 12,209             | 2,587                      |
| 7) End-loaded reduction,<br>10% growth | 3,243   | 522     | 16.1                  | 7,647   | 715              | 9.4                   | 51,688           | 7,354              | 973                        |
| 8) End-loaded reduction,<br>20% growth | 3,538   | 570     | 16.1                  | 18,256  | 1,706            | 9.3                   | 91,843           | 12,590             | 2,206                      |

**Table 6.11: Scenarios to 2003 with a changed General Exceptions List (US\$ millions)**

| <i>Scenario:</i>                 | 1997    |         |                       | 2006   |         |                       | 1997-2003        |                  |                            |
|----------------------------------|---------|---------|-----------------------|--------|---------|-----------------------|------------------|------------------|----------------------------|
|                                  | Imports | Revenue | T-w<br>ave.<br>Tariff | Import | Revenue | T-w<br>ave.<br>Tariff | Total<br>imports | Total<br>revenue | Total<br>revenue<br>"loss" |
| 1) 10% growth                    | 3,243   | 522     | 16.1                  | 7,647  | 715     | 9.4                   | 51,688           | 5,741            | 2,586                      |
| 2) 20% growth                    | 3,538   | 570     | 16.1                  | 18,256 | 1,706   | 9.3                   | 91,843           | 9,765            | 5,031                      |
| 3) 5% min. tariff, 10%<br>growth | 3,243   | 522     | 16.1                  | 7,647  | 826     | 10.8                  | 51,688           | 6,576            | 1,751                      |
| 4) 5% min. tariff, 20%<br>growth | 3,538   | 570     | 16.1                  | 18,256 | 1,971   | 10.8                  | 91,843           | 11,225           | 3,571                      |

<sup>99</sup> See Footnote 17 concerning trade diversion.

## Summary of Results (see Figure 6.1)

Depending on the policies chosen the total revenue forgone (“loss”) due to AFTA over the period 1997-2006 can range from:

US\$551 million to US\$2,586 million (assumed ten per cent annual growth rate of imports)

US\$1,265 million to US\$5,031 million (assumed 20 per cent annual growth rate of imports) (see also Box 6.7)

### Box 6.7: Some notes on the results

The tariff revenue “loss” calculated from this analysis will be higher than the reality for several reasons.

First, the revenue “loss” is calculated from nominal tariff rates, not actual revenues collected. Actual revenue collections would be significantly below nominal collections due to exemptions, inefficiencies and other reasons.<sup>100</sup> This would imply smaller revenue losses from the tariff reduction process. Total tariff revenue collected was 12.4 per cent of total imports to Viet Nam in 1996 (see Table 3.2). Nominal revenue for ASEAN imports was 16.1 per cent, as calculated from the trade-weighted tariff (Table 4.3). From this can be inferred an actual revenue collection rate of approximately 77 per cent.<sup>101</sup> Therefore the actual revenue “loss” from joining CEPT would only be about 77 per cent of the stated figures. However, detailed revenue collection data is required in order to calculate a more precise estimate of the revenue impact of reducing nominal tariffs.

Second, lowering tariffs reduces the incentive for smuggling, causing more goods to be legally imported. This analysis includes no estimate for the increase in tariff revenues due to a reduction in smuggling.

Third, imports from ASEAN without at least 40 per cent local content cannot benefit from the CEPT concessionality (local content rule). The bulk of ASEAN imports to Viet Nam come from Singapore. It is unknown what proportion of these have a 40 per cent local content, but it is presumably significantly below 100 per cent. Thus, the volume of trade subject to lower tariffs is less than in the scenarios tested above.

Taking the exemptions, smuggling and local content effects together (as well as dynamic growth effects), it is estimated that the revenue “loss” totals reported should actually be 20-30 per cent smaller.

### Box 6.8: A Research Update

Nguyen Ngoc Lan (2000) used the same methodology as Donovan and McCarty to analyze the revenue impact of AFTA using 1998 trade data. Lan’s study found that:

When joining AFTA Viet Nam’s tariff revenue will fall. Between the period of 2000-2006 CEPT commitments will cause a loss in the tariff revenue ranging from US\$313 to US\$3,292 millions and this loss depends on the growth of imports and other variables such as trade diversion, linear or end-loaded tariff reduction schedule, changed or unchanged GEL, or AFTA by 2003. The

<sup>100</sup> Exemptions are most common on high tariff lines, such as for motor cars, so that reducing the nominal tariff on these items has a much smaller proportionate impact on actual revenues collected.

<sup>101</sup> Calculated as  $(12.4/16.1)*100$ .

scenarios tested indicate that the major factor limiting the revenue effect is the composition of the General Exception List of Viet Nam combined with the end-loaded reduction programme. AFTA by 2003 with a five per cent minimum tariff rate scenario, however, reflects the relevant revenue loss since given the small loss there are many advantages Viet Nam can obtain if fulfilling AFTA obligation by 2003 rather than by 2006.

In the long run, many indicators show that this loss will be offset by other factors. The government budget loss will be reduced due to the positive results of the ongoing taxation reform programme. For some industries, the production costs will be reduced because of the tariff reduction on materials and other inputs of production, enhancing industry competitiveness. In addition, the tariff reductions will lower the prices of imports, raise savings and investment, and expand production of the private sector. Lowering tariffs also reduces the incentive for smuggling, so previously smuggled goods become legally imported with taxes paid. Moreover, the removal of non-tariff barriers and other quantitative restrictions under AFTA obligations has a positive impact on tariff revenue. Tariff revenue will increase when the commodities, which now are controlled by NTMs, are replaced by tariff equivalents.

Lan recommends several changes to the tariff policy.

First, Viet Nam should reduce the tariff lines from 18 to five main tariff lines (including zero per cent, five per cent, ten per cent, 20 per cent and 50 per cent).

Second, Viet Nam should unilaterally reduce tariff rates to zero-five per cent by 2003, rather than by 2006.

Third, Viet Nam should extend its AFTA concession on an MFN base. Since the gains are larger partly because of the greater extent of liberalization, partly because of broader liberalization lowers the costly trade diversion created by the initial discriminatory liberalization and also because of more efficient allocation of resources among Viet Nam's industries.

And Viet Nam should continue to use the excise tax and VAT as the main source of revenue instead of the tariff revenue. In particular, the replacement of non-tariff barriers (NTBs) by tariff barriers (tariffication) should be an option to raise the tariff revenue.

## 6.7 The Importance of Import Growth

Of all the various CEPT scenarios and economic factors analyzed, the most important determinant of the level of tariff revenue is the rate of growth of imports. To illustrate the point, first assume that there is a twenty per cent annual growth rate of imports during the period. Now consider the revenue impact of the following four CEPT scenarios:

No CEPT

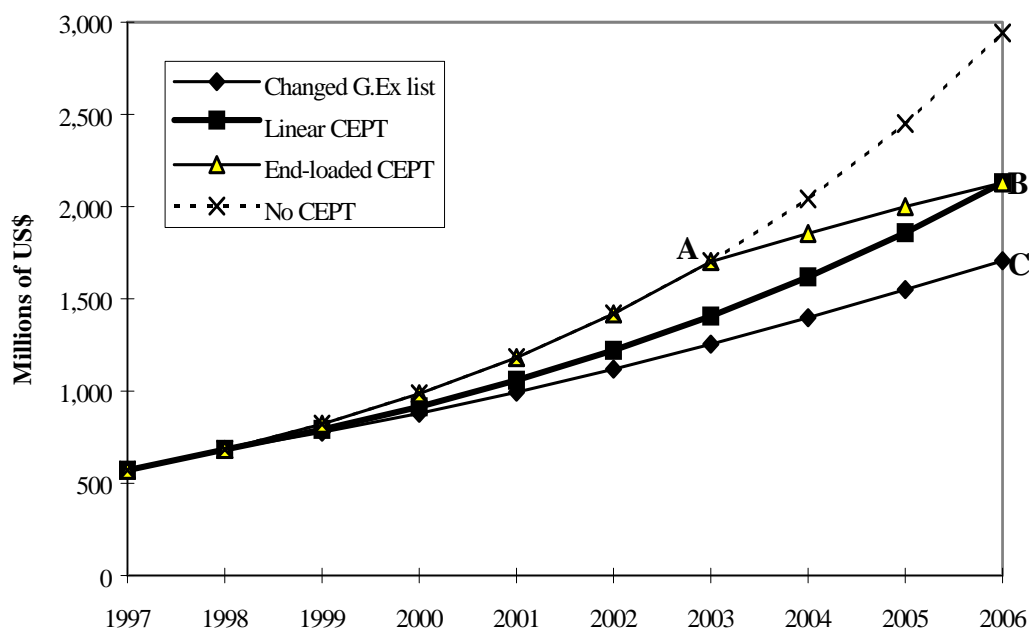
Linear tariff reduction

“End-loaded” tariff reduction

Revised General Exception List (GEL)

The results are shown in Figure 6.6.

**Figure 6.6: Twenty per cent import growth with four CEPT scenarios**



The main findings are:

- revenue will increase in all CEPT scenarios

- without joining CEPT causes revenues to rise to almost US\$3 billion by the year 2006

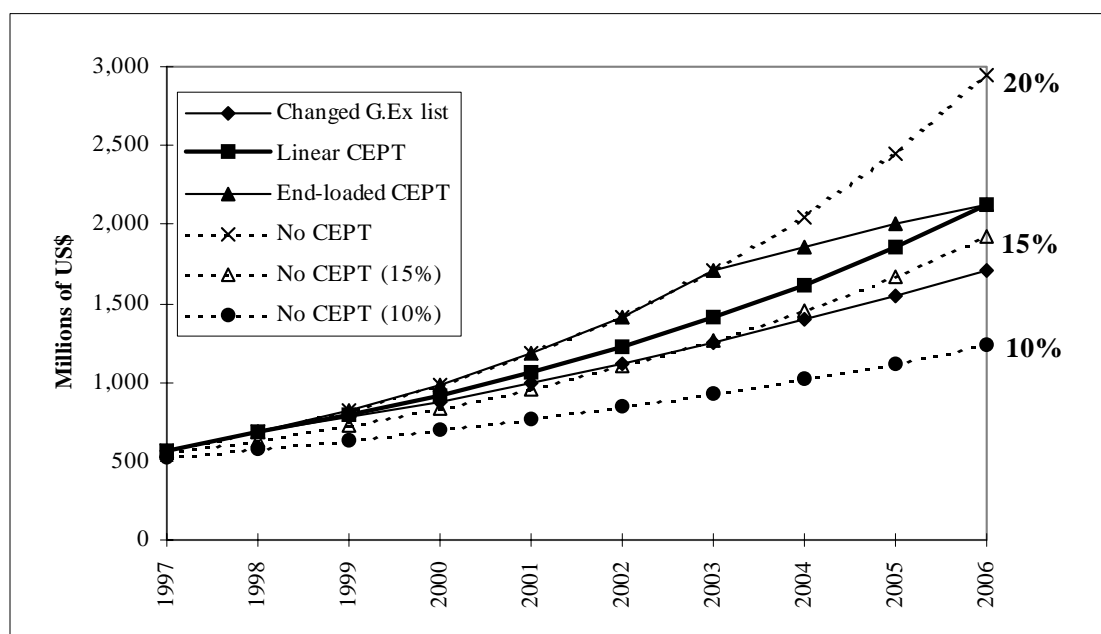
- the “end-loaded” scenario can delay revenue losses until 2003 (point “A”) by copying the “no CEPT” scenario. However, between 2003 and 2006 revenue will slow to the extent that the end revenue result will be equivalent to that of the linear reduction schedule (point “B”)

- a revised General Exceptions List (GEL) causes the greatest revenue losses

- an “end-loaded” scenario with a revised General Exception List (GEL) would see a fall in tariff revenues over the period 2003-2006 (equivalent to the line going from point “A” to point “C” on the graph in Figure 6.1).

The importance of import growth is seen when the four CEPT scenarios (with 20 per cent import growth) are compared to “No CEPT” scenarios with annual import growth rates of 10 and 15 per cent (see Figure 6.7).

**Figure 6.7: Different import growth scenarios**



Implementing a linear reduction CEPT (with 20 per cent import growth) earns more tariff revenue for Viet Nam than not joining AFTA with a 15 per cent import growth rate. Furthermore, it is estimated that tariff revenue losses caused by CEPT are equivalent to a change in annual ASEAN import growth rates of 3.4 per cent, i.e. a linear reduction CEPT scenario with 23.4 per cent annual import growth would have exactly the same tariff revenue impact as a “No CEPT” scenario with a 20 per cent import growth rate over the period. This implies that if CEPT trade liberalization causes additional ASEAN import growth of three per cent, then the revenue “loss” of AFTA membership will be insignificant.

Given that ASEAN imports make up about 26 per cent of total imports to Viet Nam, it is realistic to expect about a one per cent additional annual growth in imports from ASEAN due to CEPT (excluding trade diversion effects). The stimulus to import growth would be slightly more if the 2003 AFTA deadline was adopted. Even this modest addition to import growth would be important, and combined with the tariff exemptions and local content considerations (see Box 6.1) the total revenue “losses” could be halved.

The importance of import growth rates on revenue is clear. Any further analysis must also consider that joining CEPT will influence growth rates through trade diversion and trade creation.<sup>102</sup> Trade diversion can lead to a decline in overall revenues but can be avoided by carrying out tariff reductions on an MFN basis. Trade creation occurs through the stimulation of economic growth and is the primary reason why countries undertake trade liberalization. Reducing tariffs lowers costs for exporters and producers of non-traded goods and services. The extent of this fall in costs is determined by how many, and what type of, imported inputs are used. Import-substituting industries will lose from lower protection. Overall, however, industries and consumers benefit, demand and production are stimulated, and resources move into areas of national comparative advantage. Increased growth and exports lead to increased and sustainable levels of imports.

<sup>102</sup> Analysis of these “dynamic effects” requires detailed time series data and a reliable input-output table.

# Chapter 7 : ASEAN, AFTA and foreign direct investment

- Adam McCarty -

## 7.1 Introduction

Foreign direct investment (FDI) is of great importance for Viet Nam as the leading source of external funding for economic development and as a means of identifying and exploiting the international comparative advantage of the economy. Viet Nam has been able to benefit from the rapid rise in FDI flows due to its economic reforms and relatively liberal FDI laws. Over two-thirds of investments entering Viet Nam have been from developing Asian countries. However, Viet Nam's reform agenda remains unfinished. The regional investment environment is becoming increasingly competitive, and Viet Nam needs to continue to maintain the relevance and attractiveness of its FDI policies.

Foreign direct investment has its costs as well as benefits (see Box 7.1), but with a supportive and well-implemented regulatory environment, the net benefits are substantial.

### Box 7.1: Foreign investment can be a powerful tool for development.

Foreign investment can be a powerful force for development and growth in developing countries, but it can also disrupt the development process if not managed carefully. Over the past three decades foreign investment has generally been beneficial in East Asia, but in Latin America the results have been much more mixed. The potential benefits and dangers, as listed below, may apply more to foreign direct investment (FDI) or to foreign portfolio investment (FPI), depending on the circumstances.

#### Benefits of Foreign Investment:

- Additional resources available for productive investment
- Risk sharing with the rest of the world
- Greater external market discipline on macroeconomic policy
- Greater exploitation of comparative economic advantages (FDI)
- Enhanced access to technology, information, ideas and management skills (FDI)
- Broader access to export markets through foreign partners (FDI)
- Training and broader exposure for national staff (FDI)
- Greater liquidity to meet domestic financing needs (FPI)
- Broadening and deepening of national capital markets (FPI)
- Improvement of financial sector skills (FPI).

#### Dangers of Foreign Investment:

- Currency appreciation
- Reduced scope for independent macroeconomic policy actions
- Greater exposure to external shocks
- Demands for protection in local markets (FDI)

Some loss of control of foreign owned domestic industry (FDI)  
Disruption of national capital markets, asset inflation (FPI)  
Increased volatility in financial and exchange markets (FPI)  
High sterilization costs (FPI)

Obviously, countries can obtain these benefits or face these dangers with little or no foreign investment, but the risks are greater when levels of foreign investment are high. Astute policy can enhance the benefits, and the various dangers posed by foreign investment can be managed through clear policy direction and prudential regulations from the authorities.

*Source: World Bank (1996b)*

Government policies, particularly foreign investment regulations and trade policies, influence and distort the size and nature of FDI inflows. Recent trends to increase FDI controls by directing FDI into “priority areas” or by trying to “encourage” technology transfer are not efficient and generally do more harm than good in the long term. Similarly, maintaining significant differences between foreign and domestic investment regimes causes distortions and economic inefficiencies. Policies towards FDI should be consistent, clear and non-discriminatory, thereby allowing FDI to play a pivotal role in maximizing development. The government must focus on lowering transaction costs, improving information systems, clarifying regulations, and improving the implementation of regulations.

Viet Nam’s membership of ASEAN will affect foreign direct investment (FDI) flows coming into Viet Nam both indirectly and directly:

The indirect impact on FDI flows will occur as tariff and non-tariff trade barriers are removed as part of Viet Nam’s membership of the ASEAN Free Trade Area (AFTA), and from trade liberalization in general. The implications of AFTA for Viet Nam’s industrial sector do not seem to be appreciated in the general domain of policy debate in Viet Nam. Despite ongoing high protection and explicit support for import-substituting industrialization, Viet Nam has made a commitment to reduce tariffs to 5 per cent, and to remove all non-tariff barriers to trade, in all but a few sectors by the year 2006. The contradiction between the existing policy regime and future commitments cannot be ignored. Further delays in moving to meet these commitments only increases costs, and reduces the time for adjustment.

The direct impact will be through the harmonization of investment policies within the ASEAN Investment Area (AIA). The principle of “local treatment” for ASEAN investors is acknowledged as an objective by ASEAN, but detailed formulation and implementation rules are yet to be determined. How intra-ASEAN investment policies will develop therefore remains unclear and analysis of policy changes is necessarily speculative.

## **7.2 Foreign Direct Investment in Viet Nam**

Attracting foreign investment has been an integral part of the Vietnamese reform process since the late 1980s. It was in 1988, as the importance of FDI in the world economy was increasing, that Viet Nam introduced its first Foreign Investment Law. The law was generous and attractive by the standards of the time. However, the weak legal framework, the American

trade and investment embargo, and the lengthy process of approving foreign investment projects prevented a significant rise in commitments until the mid-1990s. The foreign investment law has been revised three times since 1988, and is now clearer and more detailed. However, administrative and other problems remain. Nevertheless, the law and its implementation have proved successful in attracting FDI to Viet Nam, particularly after 1994. It is very fortunate that Viet Nam was able to adjust its foreign investment policies to benefit from the East Asian foreign investment “boom” during the mid-1990s.

FDI commitments to Viet Nam totaled almost US\$27 billion from 1988 to April 1997 with a legal capital of approximately US\$11 billion (see Table 7.1).<sup>103</sup> Most of these commitments were made during 1995-97. Several large construction projects were approved during 1995-97, and this pushed up average project size to US\$20.5 million, compared to US\$13.3 million during 1988-94.

In measuring FDI, a number of adjustments should be made to Vietnamese FDI data to make it more reflective of the actual level of foreign direct investment entering Viet Nam. This is done by first deducting the Vietnamese share in joint ventures from the FDI commitment total. An additional 12 per cent is then deducted to take into account the overvaluation of the foreign contribution. This is a proxy estimate based on analysis from Chinese FDI data.<sup>104</sup> This produces a figure for “final adjusted commitments” of US\$17.9 billion to April 1997.

**Table 7.1: Value of FDI Commitments to Viet Nam**

|                                     | <i>1988-94</i> | <i>1995-97</i> <sup>105</sup> | <i>Total</i>  |
|-------------------------------------|----------------|-------------------------------|---------------|
| Number of projects                  | 869            | 748                           | 1,617         |
| Legal Capital                       | 5,203          | 5,843                         | 11,046        |
| <b>Commitments (US\$ millions)</b>  | <b>11,580</b>  | <b>15,327</b>                 | <b>26,907</b> |
| Weighted Vietnamese                 | 22.1           | 26.1                          | 24.4          |
| Joint-venture share (%)             |                |                               |               |
| Commitments (US\$ million)          | 9,017          | 11,331                        | 20,349        |
| Less Vietnamese Joint-venture share |                |                               |               |
| <b>Commitments (US\$ million)</b>   | <b>7,935</b>   | <b>9,972</b>                  | <b>17,907</b> |
| <b>Less over-valuation</b>          |                |                               |               |
| <b>(“final adjusted FDI”)</b>       |                |                               |               |

*Source:* Pacific R.I.M. (1997a)

<sup>103</sup> Detailed FDI data in Viet Nam is only available for “total commitments” and “legal capital”. Total commitments include all debt as well as the equity in projects with foreign investors, irrespective of whether the debt was raised and guaranteed domestically or overseas. The Vietnamese equity share of joint ventures, typically 30 per cent in the form of land, is also included. Legal capital is the “minimum investment required” by the joint venture. Recently, aggregate annual data on FDI “implemented capital” (disbursements) has become available.

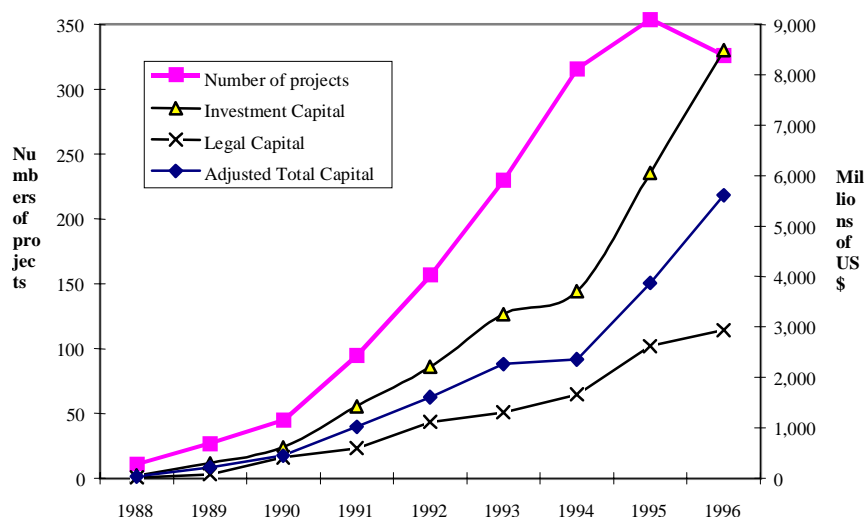
<sup>104</sup> Equipment and machinery imported through FDI projects is also generally over-valued. Inspection of five thousand shipments of machinery and equipment going to Chinese joint ventures between 1991-94 showed them to be overvalued by 22 per cent (World Bank, 1996b). As machinery and equipment were 70 per cent of the foreign contributions to joint ventures, this meant that their overall contribution was overstated by 12 per cent. Similar figures could be expected for Viet Nam.

<sup>105</sup> Data to end-April, 1997.

Figure 7.1 shows annual FDI data up to 1996. A sharp rise in commitments after 1994 is evident, although legal capital rose less rapidly. In 1996, the number of projects approved fell, but commitments still grew by 28 per cent due to two large construction projects. The trend in 1997 is a decline in both the number and volume of FDI commitments, which may be expected given that 1996 total commitments were about 36 per cent of GDP, which is relatively high for a country at Viet Nam's level of development.<sup>106</sup>

There has been a steady decline in the unweighted average Vietnamese share in projects (see Figure 7.2). The unweighted average declined because of the increasing number of 100 per cent FDI projects, which were 37 per cent of all projects approved during 1995-97, compared to 27 per cent during 1988-94. Nevertheless, the Vietnamese share of FDI commitments rose after 1992, and has remained above 25 per cent. This is due to the high shares of Vietnamese partners in the larger projects, and in particular in import-substituting industries, where market access and protection are negotiated for high ownership shares. This also caused the project weighted Vietnamese share of total commitments to rise during 1995-97, compared to 1988-94 (see table above).

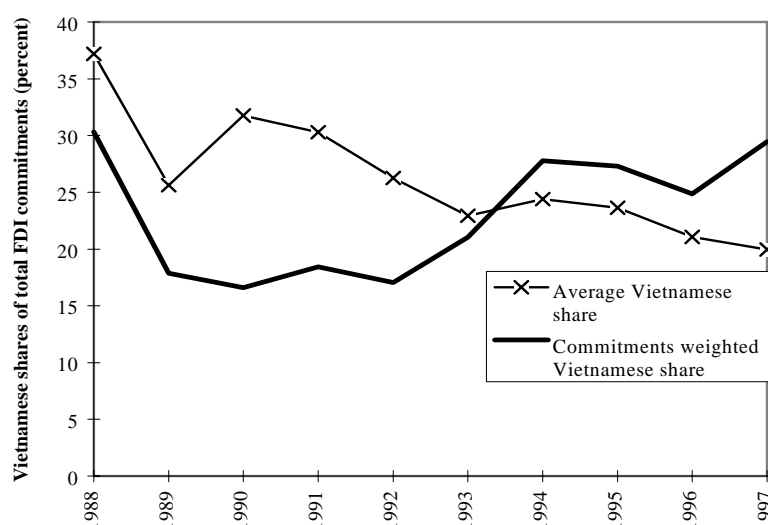
**Figure 7.1: Growth of total foreign direct investment, 1988-95**



Source: Pacific R.I.M. (1997a).

<sup>106</sup> Based on an estimated GDP of US\$23.5 billion in 1996 (UNDP, 1997). Adjusted commitments were 24 per cent of GDP, and legal capital was 12.5 per cent.

**Figure 7.2: Changing Vietnamese shares in FDI**



Source: Pacific R.I.M. (1997a).

Disbursements have typically lagged commitments. Vietnamese data on disbursements (see Table 7.2) show that 30 per cent of commitments made during 1988-96 were disbursed during that period. No official Vietnamese definition of disbursements is available, and it is unclear, for example, how the Vietnamese contribution to joint ventures is treated. Correlation of commitment and disbursement data for each economic sector indicated that industry and construction were “quick disbursing” sectors, while agriculture and forestry, hotels and tourism, and transport sector disbursements lagged commitments by at least one year.<sup>107</sup>

**Table 7.2: Distribution of FDI by Economic Sectors (US\$ millions)**

| FDI Commitments             | 1988-91 | 1992 | 1993  | 1994  | 1995   | 1996  | 1988-96 |
|-----------------------------|---------|------|-------|-------|--------|-------|---------|
| Industry                    | 823     | 973  | 1,191 | 1,636 | 1,374  | 2,322 | 8,319   |
| Oil and gas                 | 526     | 634  | 173   | 73    | (-193) | 52    | 1,265   |
| Agriculture and forestry    | 393     | 108  | 38    | 96    | 132    | 137   | 904     |
| Hotel and tourism           | 491     | 376  | 994   | 750   | 900    | 4,055 | 7,566   |
| Construction                | 88      | 14   | 416   | 284   | 803    | 798   | 2,403   |
| Transport and communication | 368     | 23   | 25    | 70    | 752    | 749   | 1,987   |
| Other                       | 296     | 162  | 133   | 934   | 2,400  | 384   | 4,309   |
| Industry                    | 150     | 218  | 342   | 435   | 491    | 747   | 2,383   |
| Oil and gas                 | 68      | 20   | 357   | 621   | 690    | 301   | 2,057   |
| Agriculture and forestry    | 54      | 17   | 44    | 56    | 76     | 50    | 297     |
| Hotel and tourism           | 143     | 100  | 131   | 191   | 420    | 446   | 1,431   |
| Construction                | 89      | 44   | 37    | 81    | 207    | 209   | 667     |
| Other                       | 70      | 23   | 30    | 46    | 31     | 257   | 457     |

Source: UNIDO (1997).

<sup>107</sup> The definition of these sectors differs from the Pacific R.I.M. database. It appears that “construction” in Table 7.2 refers mainly to manufacture of construction materials, and “hotel and tourism” includes substantial infrastructure construction activities.

Note: Sector definitions differ from Pacific R.I.M. database and are not strictly comparable.

Serious obstacles remain in legal provisions that give minority partners, often State enterprises or government entities, veto power in a joint venture. Several government agencies have to approve foreign investment projects. The approval process remains lengthy, arbitrary and tedious by regional standards. Laws governing the implementation of contractual agreements are still lacking. In this situation, the lack of an adequate dispute resolution mechanism is a serious problem. Local authorities have considerable power and their approval is as necessary as that of central agencies. Even then, disputes over problems such as site clearance for hotels have caused delays lasting years. Property rights continue to remain unclear.

An initial focus on petroleum and gas projects by the Vietnamese government has now been replaced by manufacturing and infrastructure projects. Investment in hotels and tourism has remained strong throughout the 1990s. At the sectoral branch level, commitments in construction and real estate dominate total commitments for the period to April 1997 (see Table 7.3). These are followed by large investments in both export-oriented and import substituting industries. Textiles, footwear, fishing, and agriculture are clearly export-oriented, while motor vehicle assembly is clearly an import substituting industry. However, for most sectoral branches their trade orientation remains unclear. Electronics and food industries, for example, can be import-substituting (beer production, television assembly) or export-oriented (assembly for re-export).

**Table 7.3: Sectoral direction of foreign investment commitments, 1988 - 1997.**

| Number of projects | Branch               | Investment Capital (US\$) | Vietnamese share of total capital | Legal Capital (US\$) |
|--------------------|----------------------|---------------------------|-----------------------------------|----------------------|
| 130                | Construction         | 7,103,369,694             | 27.4                              | 2,214,162,325        |
| 250                | Real estate          | 6,869,198,279             | 31.3                              | 2,791,898,059        |
| 152                | Food industry        | 2,342,749,506             | 24.6                              | 993,669,517          |
| 45                 | Oil and gas          | 1,397,057,301             | 3.8                               | 463,926,152          |
| 150                | Textiles             | 1,335,665,469             | 4.7                               | 598,646,418          |
| 46                 | Motor Vehicles       | 1,239,713,618             | 24.1                              | 494,861,445          |
| 13                 | Telecommunication    | 744,071,137               | 33.0                              | 712,955,618          |
| 51                 | Metallurgy           | 718,476,629               | 30.2                              | 270,873,349          |
| 82                 | Chemicals            | 595,257,267               | 19.7                              | 323,626,650          |
| 25                 | Electronics          | 493,690,441               | 23.5                              | 162,016,023          |
| 66                 | Agriculture          | 453,561,116               | 16.3                              | 198,497,835          |
| 36                 | Footwear production  | 376,914,610               | 3.5                               | 150,159,769          |
| 4                  | Electricity supply   | 340,280,000               | 3.4                               | 128,200,000          |
| 15                 | Glass                | 325,618,961               | 26.8                              | 130,989,873          |
| 36                 | Plastic articles     | 317,661,079               | 25.0                              | 125,628,579          |
| 50                 | Equipment/tools      | 239,005,900               | 11.3                              | 112,695,927          |
| 54                 | Transportation       | 210,383,264               | 39.4                              | 132,127,111          |
| 40                 | Electrical equipment | 205,442,846               | 25.8                              | 112,162,972          |
| 11                 | Banking and Finance  | 165,000,000               | 13.6                              | 165,000,000          |
| 25                 | Mining               | 139,545,410               | 22.5                              | 75,761,106           |
| 9                  | Ship building        | 139,380,040               | 29.4                              | 59,207,040           |
| 36                 | Fishing              | 114,808,970               | 19.1                              | 60,773,430           |
| 9                  | Forestry             | 112,680,920               | 23.3                              | 39,211,000           |

| Number of projects | Branch                | Investment Capital (US\$) | Vietnamese share of total capital | Legal Capital (US\$)  |
|--------------------|-----------------------|---------------------------|-----------------------------------|-----------------------|
| 11                 | Healthcare activities | 94,058,085                | 11.4                              | 40,841,921            |
| 19                 | Household appliances  | 82,725,835                | 6.2                               | 53,728,182            |
| 32                 | Wood                  | 53,501,259                | 22.1                              | 31,258,060            |
| 233                | All others            | 697,259,975               | 19.4                              | 403,508,819           |
| <b>1,630</b>       | <b>TOTAL</b>          | <b>26,907,077,611</b>     | <b>24.2</b>                       | <b>11,046,387,180</b> |

Source: Pacific R.I.M. (1997)

Much of the FDI entering Viet Nam is therefore going into the non-traded goods sector. An industry is categorized as being in the “traded goods” sector when its output is principally exported, or if foreign goods could be imported and substituted for domestically produced goods. This is not the case for construction, real estate and most services, which cannot be exported and where consumers must purchase the domestic products. This classification scheme is useful because only the traded goods sector will be directly affected by tariff and other trade policy changes.

The Vietnamese shares of total capital may be interpreted as rough indicators of the degree of import substitution in some industries (see Table 7.3). In export-oriented industries, such as textiles, or footwear, or in non-traded services such as healthcare and banking, the average Vietnamese shares are relatively low. This reflects the limited need for Vietnamese inputs beyond land and labour. Import substituting ventures, however, require protection from competition that is often at the price of a higher Vietnamese share of the project. If this is the case, the relatively high Vietnamese shares in the food industry and electronics suggest substantial import substitution rather than export-oriented FDI.

With respect to total FDI commitments since 1988, 52 per cent went into construction and real estate activities (see Table 7.4). When banking and finance, tourism, architecture, health care, and “other services” are included, the share of the non-traded goods sector becomes 53 per cent. Tariff reductions benefit the non-traded sector and export-oriented industries as the cost of imported inputs falls. Import-substituting industries suffer, however, from the increased international competition. In an economy where factors of production can move freely, this would cause land, labour and capital which had been used in import substituting industries to be increasingly used in the more efficient and, now, more profitable export-oriented and non-traded goods industries. Inflows of FDI would also be expected to follow this pattern.

**Table 7.4: Commitments to construction and real estate sectors, 1988-1997**

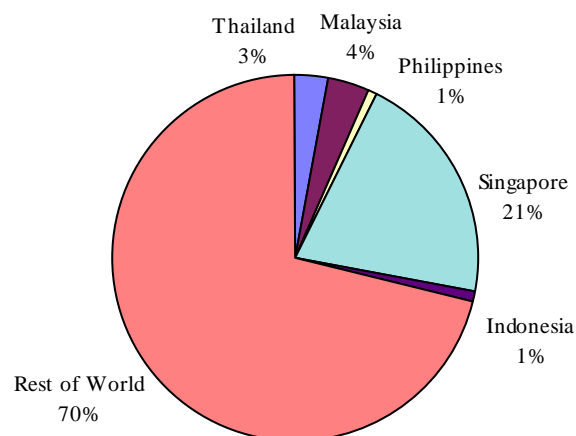
| Branch  | Investment Capital<br>(US\$ millions) | Percentage<br>of total |
|---|---------------------------------------|------------------------|
| <b>Construction:</b>  |                                       |                        |
| 1) Infrastructure   | 5,073                                 | 18.9                   |
| 2) Construction material production   | 1,963                                 | 7.3                    |
| <b>Real Estate:</b>   |                                       |                        |
| 1) Offices, apartment, house, commercial centre construction and related services | 4,538                                 | 16.9                   |
| 2) Hotel construction, renovation and management                                  | 1,786                                 | 6.6                    |
| 3) Rresort, entertainment centre construction and related services                | 545                                   | 2.0                    |
| All other FDI sectors   | 13,002                                | 48.3                   |
| <b>Total</b>  | <b>26,907</b>                         | <b>100.0</b>           |

Source: Pacific R.I.M. (1997a).

### 7.3 Foreign Direct Investment from ASEAN Countries

ASEAN FDI made up 30 per cent of total FDI commitments to Viet Nam during 1988-97 (see Figure 7.3). FDI legal capital is lower at 24 per cent of total FDI. This is largely due to FDI from Singapore having commitments significantly higher than legal capital.<sup>108</sup>

**Figure 7.3: ASEAN FDI commitments by country, 1988-97**



<sup>108</sup> Singapore has several large infrastructure projects that have relatively low legal capital levels.

The importance of ASEAN investment has changed little over the two periods, 1988-94 and 1995-97 (see Table 7.5). While the proportional number of ASEAN projects has remained constant at slightly less than one-quarter, the ASEAN share of total commitments has grown from 23 per cent to 33 per cent.<sup>109</sup>

**Table 7.5: Characteristics of ASEAN Investment**

|                              | ASEAN     |           | Rest of the World |           |
|------------------------------|-----------|-----------|-------------------|-----------|
|                              | 1988-1994 | 1995-1997 | 1988-1994         | 1995-1997 |
| Number of projects           | 160       | 145       | 709               | 603       |
| i) Joint ventures            | 118       | 96        | 456               | 346       |
| ii) 100% foreign-owned       | 30        | 44        | 202               | 233       |
| iii) Business cooperation.   | 12        | 5         | 51                | 0         |
| Average joint venture share  | 0.64      | 0.64      | 0.63              | 0.65      |
| Commitments (US\$ million)   | 2,708     | 5,029     | 8,871             | 10,298    |
| Legal capital (US\$ million) | 1,049     | 1,604     | 4,154             | 4,239     |

*Source:* Pacific R.I.M. (1997a)

The ASEAN share of legal capital has grown from 20 per cent during 1988-94, to 27 per cent during 1995-97. ASEAN investors appear to favour more joint ventures rather than 100 per cent foreign-owned investments compared to investors outside of the region. During 1995-97, 66 per cent of ASEAN country FDI projects were joint ventures, compared to 57 per cent from non-ASEAN countries.

ASEAN FDI has a similar sectoral focus compared with overall FDI (See Figure 7.4). Two thirds of ASEAN FDI commitments are in the non-traded goods sector (compared to 53 per cent for all FDI). Construction and real estate projects dominate the ASEAN portfolio to the extent that make up 3 per cent of FDI from all countries. The pattern is repeated when ASEAN projects are looked at on an individual basis (see Table 7.6). Construction projects dominate the portfolio with the two largest projects being infrastructure construction projects from Singapore. A number of real estate and food industry projects are also significant.

**Table 7.6: Largest ASEAN investments 1988-1997 (US\$ millions)**

| 2-Digit<br>HS Code | Branch | Country | Year | Legal Form | Investment<br>Capital | Legal<br>Capital | Foreign<br>Share |
|--------------------|--------|---------|------|------------|-----------------------|------------------|------------------|
|--------------------|--------|---------|------|------------|-----------------------|------------------|------------------|

<sup>109</sup> Commitment growth is largely due to a single US\$2.1 billion infrastructure project approved for the Ha Noi area in December, 1996 (with a legal capital of only US\$556 million).

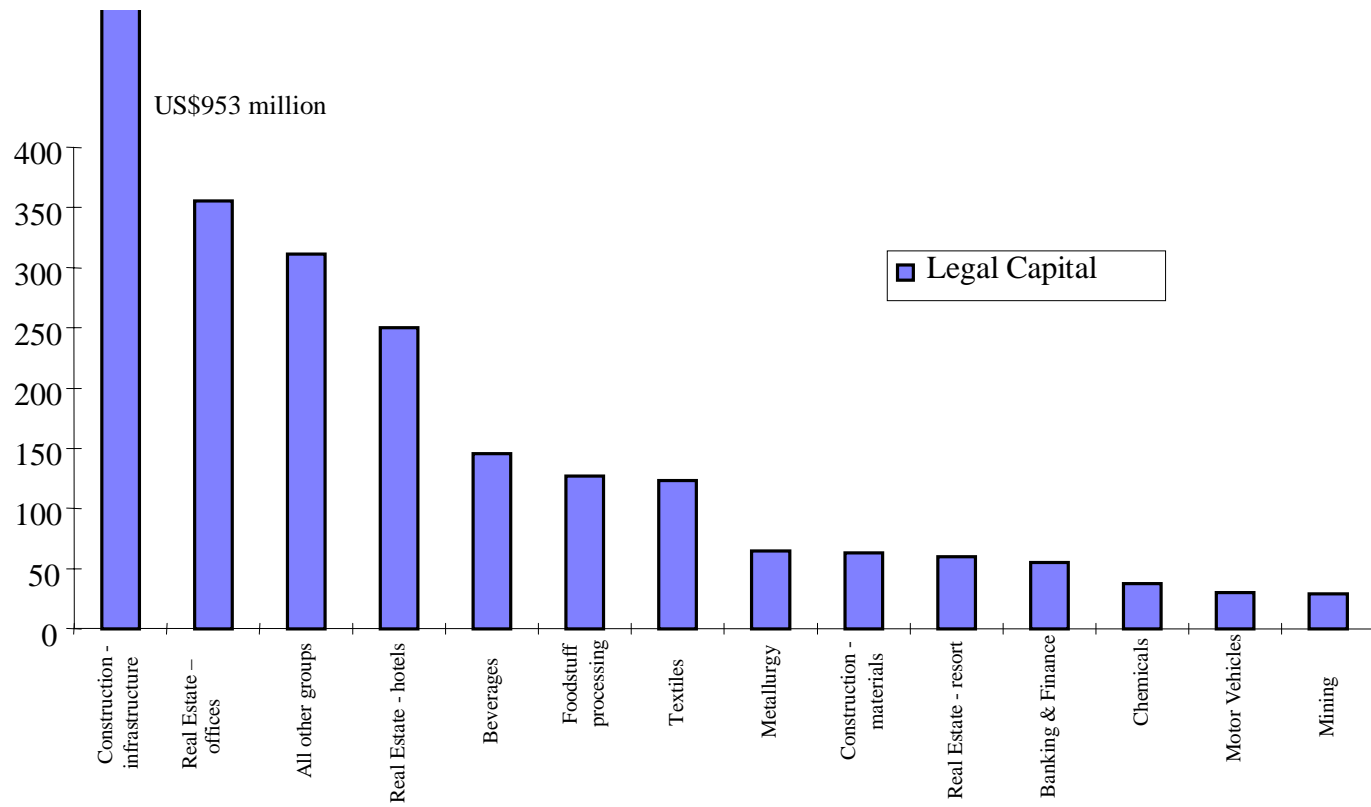
| 2-Digit<br>HS Code                      | Branch                        | Country | Year | Legal Form | Investment<br>Capital | Legal<br>Capital | Foreign<br>Share |
|---|-------------------------------|---------|------|------------|-----------------------|------------------|------------------|
| -                                       | Infrastructure (construction) | Sing.   | 1996 | JV         | 2,110                 | 556              | 0.70             |
| -                                       | Infrastructure (construction) | Sing.   | 1996 | 100%       | 637                   | 191              | 1.00             |
| HS-32                                   | Textile                       | Malay.  | 1993 | 100%       | 428                   | 121              | 1.00             |
| -                                       | Real Estate (offices)         | Sing.   | 1994 | JV         | 240                   | 72               | 0.70             |
| -                                       | Infrastructure (construction) | Thail.  | 1997 | JV         | 236                   | 70               | 0.60             |
| HS-22                                   | Food Industry (beverages)     | Sing.   | 1996 | JV         | 190                   | 60               | 0.55             |
| -                                       | Infrastructure (construction) | Sing.   | 1994 | JV         | 164                   | 49               | 0.70             |
| HS-20                                   | Food Industry (foodstuff)     | Sing.   | 1996 | JV         | 134                   | 40               | 0.73             |
| -                                       | Real Estate (hotel)           | Sing.   | 1994 | JV         | 51                    | 36               | 0.70             |
| HS-22                                   | Food Industry (beverages)     | Sing.   | 1991 | JV         | 93                    | 34               | 0.60             |
| -                                       | Real Estate (offices)         | Sing.   | 1996 | JV         | 85                    | 32               | 0.60             |
| HS-76                                   | Metallurgy                    | Sing.   | 1995 | 100%       | 105                   | 32               | 1.00             |
| -                                       | Real Estate (hotel)           | Phil.   | 1995 | JV         | 58                    | 31               | 0.70             |
| -                                       | Real Estate (hotel)           | Malay.  | 1993 | JV         | 44                    | 30               | 0.70             |
| HS-27                                   | Mining                        | Indo.   | 1991 | BC         | 27                    | 27               | 1.00             |
| -                                       | Real Estate (offices)         | Sing.   | 1994 | JV         | 45                    | 26               | 0.70             |
| HS-17                                   | Food Industry (foodstuff)     | Phil.   | 1995 | JV         | 60                    | 24               | 0.75             |
| HS-76                                   | Metallurgy                    | Sing.   | 1993 | JV         | 105                   | 23               | 0.70             |
| <b>Total for 18 largest projects:</b>   |                               |         |      |            | <b>4,475</b>          | <b>1,292</b>     |                  |
| Total for remaining 287 ASEAN projects: |                               |         |      |            | 3,262                 | 1,361            |                  |
| <b>Total ASEAN projects:</b>            |                               |         |      |            | <b>7,737</b>          | <b>2,653</b>     |                  |

Source: Pacific R.I.M. (1997a)

Note: JV = Joint Venture; 100% = 100% Foreign Owned; BC = Business Cooperation venture

## Figure 7.4: Focus of ASEAN Investment (1988-97)

(Millions US\$)



## 7.4 Analysis of the Impact of AFTA on FDI

As intra-ASEAN tariffs are reduced under the CEPT framework, FDI that previously used high tariff protection will face increased competition from ASEAN imports (to the extent that ASEAN countries can meet demand). All foreign investors, ASEAN or otherwise, will face adjustment problems if they are in protected import-substituting industries with tariffs falling. FDI in other industries, including export-oriented industries, will benefit from the resulting lower prices for imports. The extent to which AFTA will affect the size and scale of FDI flows to Viet Nam will depend on the following issues:

How closely is FDI related to levels of tariff protection?

In which CEPT Lists is the majority of FDI found?

How prevalent are import-substitution industries within sectors that receive FDI?

The methodology of this analysis requires some explanation. The FDI data for each project includes a brief description of the activity of the project. All 1,629 FDI projects were classified according to their most relevant two-digit HS (Harmonized System) tariff code classification.<sup>110</sup> Projects were classified according to the product they influenced. Thus, for instance, a cement factory project was neither “construction” nor “machinery”, rather it was “cement”. In many cases the product was unclear, or there were multiple products involved. Some informed judgments were necessary. Two major non-traded sectors “construction” and “services” were excluded from the analysis. The FDI data could then be compared with the nominal and trade-weighted tariffs, as well as the volume of imports from and tariff revenue from ASEAN trade.<sup>111</sup> In so doing, an indication of the relationship between the level of tariff protection and FDI in each commodity group becomes clearer (see Table 7.7).

The FDI of each product was then matched to a CEPT List. At the two-digit HS level, the matching of CEPT list classifications are only trade-weighted approximations i.e. they match the CEPT category that covers most of the trade under that two-digit line. For example, most beverages (HS-22) are found on the General Exceptions List, but not all (and therefore the average tariff will fall slightly under AFTA). By matching each product to a CEPT List, this enabled the average CEPT rate for 2006 for each FDI sector to be determined.<sup>112</sup> The HS classifications do not necessarily reveal whether or not the FDI is involved in import-substituting activities. For example, plastics (HS-39) and machinery (HS-84) are important HS-codes, but they include projects both for export and import substitution. A simple approximate approach to determine the relative share of FDI going into unprotected export-oriented industries and import-substitution is to extract only those HS codes which are clearly import-substituting or export-oriented. These are marked with an “M” or “X”, respectively (see Table 7.7).

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<sup>110</sup> The Pacific R.I.M. database does classify projects into about 40 groups, but as the “other” group was over 40 per cent of total commitments this classification scheme could not be satisfactorily used for the analysis.

<sup>111</sup> The trade-weighted tariff is derived from 1996 ASEAN import trade data only.

<sup>112</sup> See chapter on the revenue implications of AFTA for explanation on tariff reduction schedule for each CEPT List.

**Table 7.7: FDI and trade protection**

| HS code | HS description          | Number of FDI projects | FDI Investment Capital | FDI Legal Capital | CEPT List | Average tariff rates (1996) | Average CEPT rates (2006) | ASEAN imports (1996) | Nominal ASEAN Revenue | Trade-weighted |
|---------|-------------------------|------------------------|------------------------|-------------------|-----------|-----------------------------|---------------------------|----------------------|-----------------------|----------------|
| -       | Construction            | 339                    | 13,058,572,563         | 5,109,766,600     | -         | -                           | -                         | -                    | -                     | -              |
| 25      | Cement                  | 31                     | 1,615,489,841          | 538,659,688       | TEL       | 3.00                        | 2.47                      | 33,072,859           | 2,549,061             | 7.71           |
| 27      | Fuels                   | 51                     | 1,436,343,407          | 497,565,258       | GEL       | 3.41                        | 2.75                      | 970,910,870          | 218,966,083           | 22.55          |
| 87      | Vehicles                | 46                     | 1,241,713,618          | 495,281,445       | GEL       | 20.74                       | 9.92                      | 175,319,048          | 63,760,239            | 36.37          |
| -       | Services                | 185                    | 892,087,893            | 583,103,224       | -         | -                           | -                         | -                    | -                     | -              |
| 85      | Electrical machinery    | 74                     | 767,562,579            | 312,049,027       | TEL       | 11.00                       | 4.00                      | 191,338,342          | 20,473,885            | 10.70          |
| 22      | Beverages               | 39                     | 766,725,194            | 342,211,305       | GEL       | 64.12                       | 47.45                     | 6,614,257            | 4,263,400             | 64.46          |
| 32      | Tanning products        | 17                     | 549,083,188            | 187,153,598       | TEL       | 6.24                        | 2.97                      | 35,898,962           | 1,054,076             | 2.94           |
| 62      | Clothing                | 98                     | 539,601,468            | 278,771,927       | ?         | 47.06                       | 4.71                      | 36,392,104           | 18,196,052            | 50.00          |
| 73      | Articles of iron, steel | 50                     | 494,636,566            | 203,212,337       | IL        | 12.06                       | 3.37                      | 74,772,153           | 6,295,850             | 8.42           |
| 70      | Glass and glassware     | 23                     | 420,615,684            | 181,237,696       | TEL       | 21.53                       | 3.90                      | 13,204,613           | 3,625,722             | 27.46          |
| 64      | Footwear                | 38                     | 379,052,760            | 151,609,769       | IL        | 45.00                       | 5.00                      | 6,951,174            | 1,468,868             | 21.13          |
| 39      | Plastics                | 47                     | 374,920,123            | 153,711,095       | ?         | 11.67                       | 2.59                      | 114,822,409          | 5,501,445             | 4.79           |
| 38      | Misc. chemicals         | 16                     | 353,766,818            | 100,950,063       | IL        | 3.00                        | 1.49                      | 63,889,023           | 694,191               | 1.09           |
| 76      | Aluminium and articles  | 15                     | 323,801,327            | 104,148,327       | TEL       | 7.38                        | 3.15                      | 22,304,823           | 1,895,577             | 8.50           |
| 17      | Sugar                   | 11                     | 316,093,100            | 120,441,030       | TEL       | 21.75                       | 14.25                     | 17,191,743           | 3,431,357             | 19.96          |
| 21      | Misc. edible preps      | 4                      | 257,533,000            | 90,433,000        | TEL       | 34.58                       | 5.00                      | 36,316,633           | 14,206,870            | 39.12          |
| 20      | Preps. of vegetables    | 21                     | 236,964,007            | 88,975,663        | TEL       | 40.00                       | 5.00                      | 584,471              | 233,788               | 40.00          |
| 68      | Articles of stone etc   | 38                     | 214,757,730            | 117,538,941       | IL        | 11.76                       | 4.34                      | 6,112,477            | 877,780               | 14.36          |
| 4       | Dairy products          | 9                      | 183,224,035            | 86,641,000        | TEL       | 10.96                       | 5.61                      | 19,231,225           | 849,190               | 4.42           |
| 69      | Ceramic products        | 20                     | 175,801,712            | 74,238,079        | TEL       | 32.25                       | 4.71                      | 12,128,529           | 4,012,251             | 33.08          |
| 54      | Synthetic filaments     | 15                     | 135,823,653            | 77,011,007        | IL        | 15.67                       | 2.87                      | 26,051,036           | 711,355               | 2.73           |
| 30      | Pharmaceuticals         | 23                     | 133,041,959            | 56,477,100        | TEL       | 4.61                        | 2.06                      | 47,230,314           | 446,104               | 0.94           |
| 3       | Fish                    | 38                     | 118,572,370            | 64,640,330        | IL        | 16.07                       | 5.00                      | 4,828,839            | 356,842               | 7.39           |
| 40      | Rubber                  | 19                     | 118,173,003            | 65,551,597        | TEL       | 10.05                       | 4.75                      | 23,948,036           | 4,382,552             | 18.30          |
| 46      | Basketware              | 7                      | 113,146,920            | 37,377,000        | TEL       | 32.65                       | 5.00                      | 50,978               | 17,501                | 34.33          |
| 84      | Heaters, machinery      | 19                     | 108,561,917            | 52,081,517        | IL        | 2.88                        | 1.18                      | 312,556,828          | 16,968,016            | 5.43           |

| HS code | HS description        | Number of<br>FDI projects | FDI<br>Investment<br>Capital | FDI<br>Legal<br>Capital | CEPT<br>List | Average<br>tariff rates<br>(1996) | Average<br>CEPT rate<br>(2006) | ASEAN<br>imports<br>(1996) | Nominal<br>ASEAN<br>Revenue | Trade-<br>weighted |
|---------|-----------------------|---------------------------|------------------------------|-------------------------|--------------|-----------------------------------|--------------------------------|----------------------------|-----------------------------|--------------------|
| 2       | Meat                  | 7                         | 97,233,000                   | 40,856,300              | SL           | 8.33                              | 5.33                           | 196,862                    | 8,809                       | 4.47               |
| 23      | Food residues         | 16                        | 88,150,600                   | 42,940,399              | TEL          | 5.00                              | 5.00                           | 27,489,228                 | 1,374,461                   | 5.00               |
| 31      | Fertilizers           | 5                         | 84,972,000                   | 29,128,000              | TEL          | 5.70                              | 1.88                           | 92,324,704                 | 1,980                       | 0.00               |
| 19      | Preps of cereals etc. | 10                        | 77,872,077                   | 64,718,162              | TEL          | 34.20                             | 5.00                           | 12,042,288                 | 4,512,502                   | 37.47              |
| 33      | Essential oils        | 8                         | 76,152,470                   | 68,912,000              | TEL          | 28.84                             | 5.00                           | 15,125,766                 | 4,660,619                   | 30.81              |
| 9       | Coffee, tea etc       | 14                        | 73,869,180                   | 32,736,272              | ?            | 27.00                             | 5.00                           | 2,123,007                  | 763,161                     | 35.95              |
| 8       | Fruit, nuts           | 16                        | 71,500,008                   | 26,648,000              | TEL          | 25.00                             | 6.79                           | 176,959                    | 45,009                      | 25.43              |
| 10      | Cereals               | 5                         | 64,711,000                   | 26,847,000              | IL           | 5.12                              | 4.56                           | 20,818,188                 | 646,144                     | 3.10               |
| 71      | Precious metals       | 22                        | 57,356,231                   | 26,093,017              | TEL          | 11.19                             | 2.31                           | 22,197,099                 | 160,866                     | 0.72               |
| 15      | Fats & Oils           | 4                         | 53,198,611                   | 25,702,553              | TEL          | 12.17                             | 4.55                           | 54,499,781                 | 9,967,192                   | 18.29              |
| 51      | Wool                  | 5                         | 52,002,930                   | 33,808,000              | IL           | 16.66                             | 3.79                           | 2,169,886                  | 33,516                      | 1.54               |
| 90      | Optical, photographic | 11                        | 50,907,764                   | 26,627,200              | IL           | 2.47                              | 1.26                           | 35,619,547                 | 958,759                     | 2.69               |
| 34      | Soaps etc             | 4                         | 50,800,000                   | 42,310,000              | TEL          | 20.96                             | 4.75                           | 18,650,925                 | 3,451,763                   | 18.51              |
| 58      | Woven fabrics         | 4                         | 50,580,468                   | 15,540,000              | TEL          | 37.52                             | 5.00                           | 1,231,164                  | 492,101                     | 39.97              |
| 11      | Milled products       | 5                         | 45,521,054                   | 23,270,554              | TEL          | 12.52                             | 5.00                           | 18,201,982                 | 1,649,185                   | 9.06               |
| 28      | Inorganic chemicals   | 3                         | 42,850,600                   | 25,650,000              | IL           | 0.61                              | 0.61                           | 19,781,495                 | 117,975                     | 0.60               |
| 53      | Other natural fibres  | 5                         | 35,128,300                   | 14,761,300              | TEL          | 16.39                             | 3.82                           | 26,591                     | 10,636                      | 40.00              |
| 7       | Vegetables            | 15                        | 34,660,608                   | 23,120,008              | ?            | 17.29                             | 5.00                           | 99,005                     | 13,860                      | 14.00              |
| 47      | Wood pulp             | 15                        | 33,462,200                   | 25,693,381              | IL           | 1.00                              | 1.00                           | 5,825,640                  | 58,256                      | 1.00               |
| 16      | Meat, fish preps.     | 12                        | 33,458,670                   | 20,758,670              | TEL          | 37.00                             | 19.00                          | 498,511                    | 191,211                     | 38.36              |
| 44      | Wood products         | 21                        | 32,130,049                   | 17,366,760              | TEL          | 14.38                             | 4.14                           | 12,750,525                 | 955,794                     | 7.50               |
| 72      | Iron and steel        | 9                         | 29,910,706                   | 17,578,850              | IL           | 4.16                              | 1.16                           | 46,078,943                 | 2,208,800                   | 4.79               |
| 42      | Leather goods         | 18                        | 28,439,994                   | 13,899,135              | TEL          | 20.61                             | 3.67                           | 283,882                    | 85,248                      | 30.03              |
| 24      | Tobacco               | 3                         | 26,800,000                   | 23,477,000              | GEL          | 41.67                             | 11.67                          | 55,959,433                 | 15,309,237                  | 27.36              |
| 57      | Carpets               | 7                         | 26,625,631                   | 12,378,681              | ?            | 29.35                             | 5.00                           | 1,003,711                  | 350,101                     | 34.88              |
| 91      | Clocks, watches       | 2                         | 26,441,485                   | 14,441,485              | TEL          | 19.71                             | 4.00                           | 357,165                    | 83,664                      | 23.42              |
| 50      | Silk                  | 5                         | 26,437,432                   | 22,817,472              | IL           | 7.29                              | 3.00                           | 3,644,179                  | 12,014                      | 0.33               |
| 79      | Zinc                  | 6                         | 23,277,395                   | 8,380,700               | IL           | 1.57                              | 0.86                           | 3,191,152                  | 6,625                       | 0.21               |
| 94      | Furniture             | 14                        | 22,478,471                   | 13,739,682              | TEL          | 19.42                             | 5.00                           | 9,597,732                  | 2,736,032                   | 28.51              |
| 55      | Synthetic fibres      | 5                         | 20,622,006                   | 16,335,450              | TEL          | 18.64                             | 4.47                           | 22,411,399                 | 5,445,406                   | 24.30              |

| HS code       | HS description           | # FDI projects | FDI<br>Investment<br>Capital | FDI<br>Legal<br>Capital | CEPT<br>List | Average<br>Tariff rates<br>(1996) | Average<br>CEPT rate<br>(2006) | ASEAN<br>imports<br>(1996) | Nominal<br>ASEAN<br>Revenue | Trade-<br>weighted |
|---------------|--------------------------|----------------|------------------------------|-------------------------|--------------|-----------------------------------|--------------------------------|----------------------------|-----------------------------|--------------------|
| 95            | Toys, games              | 4              | 18,700,000                   | 14,500,000              | IL           | 14.74                             | 5.00                           | 2,032,077                  | 161,509                     | 7.95               |
| 74            | Copper and articles      | 1              | 18,570,000                   | 5,571,000               | IL           | 4.71                              | 1.32                           | 6,559,943                  | 65,148                      | 0.99               |
| 48            | Paper and paperboard     | 9              | 18,103,438                   | 8,325,000               | IL           | 20.03                             | 4.78                           | 38,484,719                 | 7,120,729                   | 18.50              |
| 1             | Live animals             | 4              | 17,617,822                   | 8,500,000               | SL           | 2.71                              | 2.71                           | 767,349                    | 9,861                       | 1.29               |
| 35            | Casein, starches         | 1              | 15,285,000                   | 5,000,000               | TEL          | 12.32                             | 4.38                           | 4,702,122                  | 844,377                     | 17.96              |
| 45            | Bamboo, rattan           | 10             | 10,791,800                   | 7,307,300               | IL           | 10.25                             | 4.00                           | 107,297                    | 12,256                      | 11.42              |
| 96            | Misc. manufact. articles | 3              | 8,349,280                    | 4,270,000               | TEL          | 29.40                             | 5.00                           | 15,792,981                 | 4,279,193                   | 27.10              |
| 12            | Oil seeds etc            | 6              | 7,281,720                    | 2,995,000               | TEL          | 8.14                              | 4.36                           | 2,542,872                  | 16,117                      | 0.63               |
| 41            | Hides, skins, leather    | 2              | 6,534,900                    | 4,334,900               | IL           | 5.16                              | 4.00                           | 1,668,380                  | 91,363                      | 5.48               |
| 49            | Books, printed matter    | 1              | 5,924,246                    | 5,924,246               | TEL          | 14.95                             | 3.54                           | 936,921                    | 91,175                      | 9.73               |
| 67            | Feathers, down           | 2              | 3,000,000                    | 3,000,000               | IL           | 30.00                             | 5.00                           | 0                          | 0                           |                    |
| 61            | Knitted fabrics          | 1              | 2,783,000                    | 1,080,000               | ?            | 39.04                             | 4.17                           | 361,902                    | 176,159                     | 48.68              |
| 56            | Twine, cordage           | 2              | 2,427,600                    | 2,000,000               | TEL          | 20.55                             | 5.00                           | 6,973,160                  | 1,184,784                   | 16.99              |
| 92            | Musical instruments      | 3              | 2,004,830                    | 1,306,080               | IL           | 2.00                              | 2.00                           | 1,204,679                  | 24,094                      | 2.00               |
| 6             | Live trees, plants       | 4              | 1,686,600                    | 1,000,000               | SL           | 13.13                             | 2.50                           | 307,380                    | 3,765                       | 1.22               |
| 93            | Arms, ammunition         | 1              | 1,200,000                    | 1,200,000               | GEL          | 10.05                             | 7.78                           | 361,178                    | 15,785                      | 4.37               |
| 82            | Tools, etc               | 2              | 1,100,000                    | 800,000                 | IL           | 15.45                             | 4.36                           | 2,855,901                  | 488,041                     | 17.09              |
| 83            | Misc. articles of metal  | 1              | 1,000,000                    | 1,000,000               | IL           | 21.67                             | 5.00                           | 8,388,275                  | 1,476,620                   | 17.60              |
| 18            | Cocoa                    | 1              | 700,000                      | 500,000                 | TEL          | 16.50                             | 5.00                           | 1,626,060                  | 650,673                     | 40.02              |
| 65            | Hats, headgear           | 1              | 600,000                      | 200,000                 | TEL          | 27.93                             | 5.00                           | 665,502                    | 188,410                     | 28.31              |
| 97            | Artwork & handicrafts    | 1              | 200,000                      | 200,000                 | GEL          | 4.67                              | 4.67                           | 0                          | 0                           |                    |
| <b>Totals</b> |                          | <b>1629</b>    | <b>26,907,077,611</b>        | <b>11,046,387,180</b>   |              | <b>17.53</b>                      | <b>5.08</b>                    | <b>2,852,437,193</b>       | <b>468,449,043</b>          | <b>17.19</b>       |

## 7.4.1 Summary of Findings

### FDI and Tariff Protection

Nominal trade-weighted tariffs are very high for many goods receiving FDI. Of the ten HS codes with the highest levels of FDI, six have trade-weighted tariffs of over 20 per cent.

### FDI, AFTA and Tariff Protection

AFTA will reduce protection for those products that are included on the CEPT Lists. The extent and speed at which protection is removed depends on which CEPT List the product is found. The CEPT Lists and FDI data from Table 7.7 have been sorted and the summary of results is displayed in Table 7.8.

**Table 7.8: FDI and the CEPT lists (US\$ millions)**

| CEPT             | Number of FDI projects | FDI Investment Capital | FDI Legal Capital | ASEAN trade (1996) | Nominal revenue | Average nominal tariffs (1996) |
|------------------|------------------------|------------------------|-------------------|--------------------|-----------------|--------------------------------|
| <i>Inclusion</i> | 307                    | 2,209                  | 1,001             | 694                | 41              | 5.9                            |
| <b>Temporary</b> | <b>460</b>             | <b>6,106</b>           | <b>2,441</b>      | <b>794</b>         | <b>100</b>      | <b>12.6</b>                    |
| <i>Exclusion</i> |                        |                        |                   |                    |                 |                                |
| <i>Sensitive</i> | 15                     | 117                    | 50,356            | 1                  | 0               | 1.8                            |
| <b>General</b>   | <b>141</b>             | <b>3,473</b>           | <b>1,360</b>      | <b>1,209</b>       | <b>302</b>      | <b>25.0</b>                    |
| <b>Exception</b> |                        |                        |                   |                    |                 |                                |
| Non-Traded       | 524                    | 13,951                 | 5,693             | 0                  | 0               | 0.0                            |
| Unclassified     | 182                    | 1,052                  | 502               | 155                | 25              | 16.2                           |
| <b>TOTALS</b>    | <b>1629</b>            | <b>26,907</b>          | <b>11,046</b>     | <b>2,852</b>       | <b>468</b>      | <b>16.4</b>                    |

Source: Pacific R.I.M. (1997a).

Key findings from the analysis are as follows

The largest proportion of FDI in the traded sector is used to manufacture products currently on the CEPT Temporary Exclusion List (TEL) (22% of total FDI) or General Exceptions List (GEL) (13% of total FDI).<sup>113</sup>

A number of products on the Temporary Exclusion List (TEL) have significant FDI and high trade-weighted tariffs (with relatively fewer products on the General Exceptions List (GEL) meeting the same criteria). Therefore, a significant level of FDI is going into industries with high tariff protection, but with AFTA commitments to reduce tariff levels by 2006. This suggests there could be a substantial change in the pattern of FDI inflows over the next decade together with a restructuring of Viet Nam's industrial sector.

<sup>113</sup> At the 2-digit HS level, the matching of CEPT list classifications are only trade-weighted approximations.

## FDI, AFTA, Tariff Protection and Import Substitution

To determine how FDI in those industries facing lower protection will be affected it is necessary to know the trade orientation of the industry. If the industries are already export-oriented, lower tariffs on ASEAN products, could imply lower costs leading to greater competitiveness and possible trade expansion. Import-substitution industries, however, will face increased competition from ASEAN imports, which will put into doubt their economic prospects, and future investment in these areas would be reduced. From the analysis, it was found that four of the five highest sector recipients of FDI (in the traded-goods sector) are producing clearly import-substituting goods – cement, vehicles, electrical machinery and beverages.<sup>114</sup> Data on these sectors are reproduced in see Table 7.9.

**Table 7.9: Four highest sector-recipients of FDI which are import-oriented**

| HS code                        | HS description       | FDI Investment Capital | CEPT List | ASEAN imports (1996) | Trade-weighted Tariff |
|--------------------------------|----------------------|------------------------|-----------|----------------------|-----------------------|
| 25                             | Cement               | 1,615,489,841          | TEL       | 33,072,859           | 7.71                  |
| 87                             | Vehicles             | 1,241,713,618          | GEL       | 175,319,048          | 36.37                 |
| 85                             | Electrical machinery | 767,562,579            | TEL       | 191,338,342          | 10.70                 |
| 22                             | Beverages            | 766,725,194            | GEL       | 6,614,257            | 64.46                 |
| <b>Percentage of total FDI</b> |                      | <b>33.9%</b>           |           |                      |                       |

Of particular interest are the vehicles and beverages markets. Both these sectors have high trade-weighted tariffs. Therefore cheaper ASEAN imports can be expected to enter the market once AFTA begins. Vehicles from ASEAN have approximately one quarter of the import market. As tariffs are reduced, ASEAN vehicles will gain a larger share of the import market (through trade diversion) while at the same time forcing locally based companies to become more competitive or loose their market share. A similar story can be told for the beverages industry (i.e. beer and soft drinks). Although, currently, both vehicles and beverages are on the CEPT General Exception List (as defined at 2 digit HS) it is doubtful whether they can remain there as the validity of their exclusion is questionable. The overall trade-orientation findings from Table 7.7 are summarised in Table 7.10.

<sup>114</sup> The fuel sector (HS-27) contains both Viet Nam's largest import and export items – refined petroleum products and crude petroleum respectively. Therefore, the orientation of the sector is difficult to classify.

**Table 7.10: Trade orientation of foreign investment**

| <b>Trade Orientation</b> | <b>Investment capital</b> | <b>Percentage of Investment</b> | <b>Legal capital</b> | <b>Percentage of Legal</b> |
|--------------------------|---------------------------|---------------------------------|----------------------|----------------------------|
| Non –Traded              | 13,950,660,456            | 51.8                            | 5,692,869,824        | 51.5                       |
| <b>Import</b>            | <b>4,707,584,332</b>      | <b>17.5</b>                     | <b>1,808,642,495</b> | <b>16.4</b>                |
| <b>Oriented “M”</b>      |                           |                                 |                      |                            |
| <b>Export</b>            | <b>1,704,482,789</b>      | <b>6.3</b>                      | <b>747,727,221</b>   | <b>6.8</b>                 |
| <b>Oriented “X”</b>      |                           |                                 |                      |                            |
| Other                    | 6,544,350,034             | 24.3                            | 2,797,147,640        | 25.3                       |
| Total                    | 26,907,077,611            | 100.0                           | 11,046,387,180       | 100.0                      |

Key findings from the summary table are as follows:

- FDI in clearly import-substituting industries (17.5%) is over double that going into clearly export-oriented industries (6.3% of total).
- The dominance of FDI in the two non-traded goods categories is evident (over 50%).

## **7.4.2 Conclusion from Findings**

At present, Viet Nam’s economy is structured to protect some of its larger import substituting industries and related foreign investments. The impact AFTA will have on FDI and the industrial structure of Viet Nam will depend on how Viet Nam approaches its AFTA commitments. There are two main issues – the timing of the tariff reductions and the fate of Viet Nam’s General Exception List. Viet Nam can delay any tariff reform until 2003 and still abide by the CEPT agreement. It can therefore avoid substantive industrial restructuring and maintain its import-substituting regime until this date. With respect to Viet Nam’s GEL List, it is likely that it will need to be revised resulting in many additional FDI-recipient sectors being affected directly by AFTA. In summary, AFTA can be expected to cause fundamental changes in the structure of FDI inflows and of the Vietnamese industrial sector. It is important that Viet Nam prepares for this eventuality sooner rather than later. The first step would be to inform all those industries based in Viet Nam of the impending tariff reductions as a result of AFTA so that they have more time to prepare for this eventuality.

## **7.5 An ASEAN Investment Area**

In November 1996 at the ASEAN Economic Ministers meeting (AEM) an agreement was reached on the need for the establishment of an ASEAN Investment Area (AIA), which would harmonise the investment regimes of ASEAN countries. This would create a more competitive “investment bloc” rivaling that of China and India. The AIA was created primarily in an attempt to arrest ASEAN’s declining Asian share of FDI.

A preliminary draft framework AIA agreement was completed in October 1997 and the final framework agreement ratified at the 30th AEM Meeting in December 1998. The two main objectives of the AIA agreement are as follows:

- 1) to establish a competitive ASEAN Investment Area (AIA) with a more liberal and transparent investment environment among Member States by 1 January 2010, in order to:
  - substantially increase the flow of investments into ASEAN from both ASEAN and non-ASEAN sources;
  - jointly promote ASEAN as the most attractive investment area;
  - strengthen and increase the competitiveness of ASEAN's economic sectors;
  - progressively reduce or eliminate investment regulations and conditions which may impede investment flows and the operation of investment projects in ASEAN
- 2) to ensure that the realization of the above objectives would contribute towards the free flow of investments by 2020.

The main features of the AIA Agreement are:

- a coordinated ASEAN investment cooperation programme that will generate increased investments from ASEAN and non-ASEAN sources;
- national treatment to be extended to ASEAN investors by 2010, with any exceptions to be agreed upon by member countries, and to all investors by 2020
- the business sector having a large role in cooperation on investment related activities in ASEAN
- a freer flow of capital, skilled labour and professionals, and technology among Member States
- all industries to be open to ASEAN investors by 2010 and to all investors by 2020

Once the AIA has been ratified, each member country will be asked to submit an action plan outlining the timeframe for its implementation. This, however, is to be achieved, unlike AFTA, through a consensus approach that shies away from compulsive elements. Individual ASEAN countries will be free to accept or reject any aspects of the AIA.

The stated objectives of the AIA are impressive, but to achieve them in any substantive form is going to require strong commitments to FDI-related institutional reforms across all ASEAN member countries (see Table 7.11 for current FDI impediments in the region). Foreign investment policies are the product of domestic political economies and are highly sensitive. The same, however, may be said of trade policies, although foreign investment policies are less transparent than trade policies, and for many countries there is no sense of reciprocity. That is, countries like Viet Nam do not invest overseas, and hence do not see any immediate "in kind" benefit from commitments to regional investment liberalization.

**Table 7.11: Impediments to FDI in Six East Asian Countries**

| <i>Areas of concern</i>                           | <i>China</i>   | <i>Indonesia</i>   | <i>Malaysia</i>   | <i>Philippines</i>  | <i>Thailand</i>   | <i>Viet Nam</i>  |
|---|--|--|---|---|---|--|
| <b>Barriers to entry</b>                          | General negative clause. Certain sectors (services and others) are closed.                                       | General negative clause. Certain sub-sectors are closed.   | No negative clause. Mass media are closed.  | No negative clause. Certain sectors (services and others) are closed. | No general negative clause. Certain sectors (services and others) are closed.   | No negative clause. No sectors are closed.   |
| <b>Full foreign ownership requirements</b>        | Full ownership allowed under restricted conditions, such as those relating to technology level and export ratio. | Full ownership allowed for firms that export all output, firms with more than \$50 million of investment, and other designated locations. Obligation for localization.   | Full ownership allowed for firms that export more than 80% of output in large projects or more than 50% of output in other specific projects.   | Full ownership allowed in designated sectors.                         | Full ownership allowed in firms that export more than 80% of output and in designated sectors/locations. Obligation for localization.                 | Full ownership discouraged in sectors dominated by state enterprises.                  |
| <b>Local content and performance requirements</b> | Local content required on a case-by-case basis. Export requirement a condition.                                  | Certain import of raw materials and intermediate goods restricted to firms that export more than 65% of output. Export requirement a condition for investing in certain sectors and for obtaining incentives and exemption of import restrictions. | Local content required in certain sectors and for tax incentives and export credits. Export requirement a condition for issuing a certain share of foreign equity and for obtaining incentives. | Export requirement a condition for obtaining incentives.              | Local content required in certain sectors. Export requirement a condition for issuing a certain share of foreign equity and for obtaining incentives. | No local content requirement. Export requirement a condition for obtaining incentives. |
| <b>Transfer of profits and convertibility</b>     | Restrictions apply. Foreign exchange balancing is required.  | No restrictions.   | No restrictions.  | No restrictions.  | No restrictions.  | Restrictions apply. Foreign exchange balancing is required.                            |

Note: This table does not necessarily reflect recent changes.

Source: Japan Institute for Overseas Investment (1993).

Finally, tariff reform is driven by other international agreements such as APEC and the World Trade Organisation (WTO). An ASEAN tariff reform agenda that lagged behind WTO commitments would be irrelevant. There is no similar impetus for liberalization of foreign investment regimes. The introduction of the new ASEAN members further complicates the picture. The investment regimes of these countries are generally protectionist. If AIA initiatives are to be introduced unilaterally, then the pace of reform will be determined by the slowest member country. It is unlikely that these countries are going to agree to a foreign investment regime like Thailand's or Malaysia's for many years.

## **7.6 Viet Nam and the ASEAN Investment Area**

Viet Nam is likely to have particular difficulties with respect to the implementation of the AIA. Aside from political commitment, there are many practical problems that will stop AIA becoming effective in Viet Nam for many years. National treatment for ASEAN investors would imply that ASEAN investors would be treated in every way the same as domestic investors (with some exceptions). That would mean, amongst other things, that ASEAN direct investments would:

- not be subject to a specific Foreign Investment Law;
- have the same property rights as Vietnamese companies;
- face the same taxation regime;
- not require work permits.

Additionally, during the transition process towards the AIA, three investment regimes would be required: one for domestic investors, one for ASEAN investors, and a third for other foreign investors. This could be expected to be highly inefficient and difficult to enforce. Also, since capital is highly mobile, "rules of origin" will be much harder to apply than in the case of AFTA. If a company is registered in Indonesia, and the funds are transferred from Indonesia, is that enough for the investment to be classified as ASEAN?

In the draft AIA Agreement there is to be a two-staged liberalization process i.e. national treatment to ASEAN investors (2010) followed by non-ASEAN investors (2020). It is argued that this will allow ASEAN countries to prepare for global competition on a more controlled basis. It is, however, yet to be determined what is the most appropriate definition for an "ASEAN investor" for the purposes of the agreement. Two options that have been mentioned by ASEAN, both of which are not without their problems, are:

- each ASEAN Member Country would determine their own definition of an ASEAN investor;
- a common ASEAN investor definition would be used which requires a minimum level of 30 per cent ASEAN national equity ownership.

The most immediate benefit for Viet Nam from the AIA will be the process itself. Viet Nam has much to share and learn from exchanging experiences about FDI with other ASEAN countries. Small details concerning FDI policies, from visa processing to information collecting and sharing, can be discussed and analyzed. Participation in the AIA process will stimulate debate about FDI policies in Viet Nam, just as participation in AFTA is stimulating debate about trade policies.

The major objective of the AIA is to harmonize the investment regimes between ASEAN countries. This, as such, is not a particularly meaningful objective as the ASEAN economies differ so markedly. The objective should be to determine optimal FDI policies for each country, given constraints and political considerations. Harmonization occurs when there is clear agreement that the benefits will flow to all. Exchange of views and experiences will be important in this process, but the process must ensure that it reaches decision-makers in Viet Nam for change to occur.

### **7.6.1 Should Viet Nam embrace the concept of an AIA?**

It was noted earlier that investment liberalization would be a one-way affair for Viet Nam as it is only a recipient of foreign investment. This, however, misses the point. Viet Nam is a developing economy in urgent need of foreign investment. In that context, the present investment regime remains too restrictive, and further liberalization should be pursued irrespective of ASEAN. National treatment is economically efficient, but politically untenable for the immediate future. Any form of ASEAN “preferential treatment” should be approached with caution as it introduces distortions and monitoring problems. But ASEAN “preferential treatment” should not be rejected outright. Viet Nam’s main regional competitor for foreign investment is China. Viet Nam’s capacity to attract labour-intensive foreign investment is largely due to its economic attractiveness relative to China. Some Taiwanese and South Korean firms view Viet Nam as an alternative to China and spread their FDI portfolio risks by investing in both countries. “Preferential treatment” arrangements for ASEAN investors can ensure that Viet Nam gets a larger share of Singapore and Malaysian FDI than does China. Yet if Viet Nam is prepared to offer some special conditions for ASEAN investors, then why not for all foreign investors? Why have three investment regimes instead of two?

Another reason to shun “preferential treatment” arrangements is to avoid creating opportunities for the manipulation of policy by special interest groups. Selecting countries and industries for special treatment invites political and bureaucratic interference and economic inefficiencies. The AIA would add one more to the already extensive list of growth triangles and other regional cooperation mechanisms in Asia. These cooperation ventures are often motivated by a desire to attract foreign investment. Competition for foreign investment has, however, become intense. Countries and regional groups compete with each other for investment, often overlapping.<sup>115</sup> The negative aspects of these arrangements are:

New regional initiatives draw attention and resources from others.

Favouring one region over another can lead to unproductive bidding between countries and growth triangles in the form of tax and other concessions offered to potential investors.

Governments need to be careful to assess the expected national costs and benefits of any new infrastructure expenditures and fiscal incentives to ensure these will enhance national welfare. This is a difficult task, but much less so if only one policy regime is adopted towards all foreign investors across all industries.

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<sup>115</sup> Thailand, for example, is involved in a growth triangle initiative in the north, the Greater Mekong Growth Area, and the Indonesia-Malaysia-Thailand Growth Triangle.

Therefore, it is recommended Viet Nam should not be side tracked by the AIA. In short:

Viet Nam should continue to focus on developing a single investment regime for all foreign investors, and to make that regime attractive for investors and still beneficial for Viet Nam

National treatment for all foreign investment should be an explicit long-term policy objective.

## Chapter 8 : AFTA and service sector liberalization

- Carolina S. Guina -

### 8.1 Introduction

The growth in services trade has been increasing faster than merchandise trade over the last decade. Over the period 1980-93, the growth of traded services was nearly eight per cent, compared with five per cent for merchandise. The share of services in global trade increased from 15 per cent in 1980 to over 22 per cent in 1993. The importance of the services sector in world trade was affirmed with the inclusion of this sector under a new set of disciplines in the recently concluded Uruguay Round of Multilateral Trade Negotiations (General Agreement on Trade in Services (GATS)).

The growth in international services transactions is driven by several factors. Rapid economic development in many countries has increased consumption for goods for which services provide a number of important intermediate inputs. The increase in foreign investments has also shifted some of the demand for services from the investor's home country to the host country. On the supply side, advances in transport and information technology have increased the range of services that can be traded.

#### Box 8.1: Understanding the Concept of Service Trade

The novelty of trade in services requires some explanation of key concepts. The defining feature of services is that producers and consumers must interact for the service to be rendered. A tourist must have to be physically present in the country of destination to avail itself of tourism services. This is not the case with goods production.

Under the GATS, four modes of services supply are used:

**cross-border supply:** through cross-border flows in which the neither the supplier nor the producer moves physically, relying instead upon an intermediate service such as telecommunications;

**consumption abroad:** through the movement of a consumer to a supplier's economy;

**commercial presence:** through the movement of a commercial organisation to the consumer's economy;

**presence of natural person:** through the movement of an individual supplier to the consumer's economy.

The World Bank and UNCTAD (1994) have identified two major categories of impediments to trade in services: market access and national treatment. Impediments relating to market access involve those that regulate the entry of foreign service-providers to the host economy. Impediments relating to national treatment are those that determine whether the regulatory treatment received by the foreign service-provider is consistent with the treatment received by the domestic producer.

*Source:* APEC (1995).

In ASEAN, the services sector plays a significant role, contributing between 39 and 63 per cent to the national output of member countries in 1996. This was higher than the respective industry contribution for some countries (see Table 8.1). As a percentage of total trade, services account for between 15 per cent and 25 per cent within ASEAN in 1993.

**Table 8.1: Share of Service and Industrial Sectors in GDP (1996)**

|             | Services (%) | Industry (%) |
|-------------|--------------|--------------|
| Indonesia   | 42           | 43           |
| Malaysia    | 41           | 47           |
| Philippines | 43           | 36           |
| Singapore   | 63           | 37           |
| Thailand    | 47           | 43           |
| Viet Nam    | 39           | 39           |

Source: ADB (1997).

## 8.2 ASEAN Services in Viet Nam

There is already a significant presence of ASEAN suppliers in the services sector in Viet Nam (see Table 8.2).<sup>116</sup> In the two principal services sectors — construction and real estate, ASEAN suppliers have a substantial market share. In banking and finance, advertising, and aviation services sectors ASEAN providers are relatively active. Among the ASEAN investors, the most prominent in Viet Nam are Singapore and Thailand.

**Table 8.2: ASEAN Foreign Direct Investment in the Services Sector in 1995.**

| <i>Services Sectors</i>  | Total Foreign Investment Capital (US\$000) | Indonesia (%) | Malaysia (%) | Philippines (%) | Singapore (%) | Thailand (%) | Total ASEAN FDI as percentage of Total FDI |
|--------------------------|--|---------------|--------------|-----------------|---------------|--------------|--|
| <i>Real estate:</i>      |  |               |              |                 |               |              |  |
| - hotel construction     | 1,833.83                                   |               | 4.6          | 4.1             | 14.8          | 6.4          | 29.9                                       |
| - resort                 | 545.48                                     |               | 1.4          |                 | 9.4           | 6.2          | 17.0                                       |
| <i>Construction:</i>     |  |               |              |                 |               |              |  |
| - infrastructure         | 5,128.41                                   |               | 1.8          |                 | 42.4          | 5.8          | 50.0                                       |
| - materials              | 67.85                                      |               |              |                 | 4.9           | 8.8          | 13.6                                       |
| <i>Computer services</i> | 15.72                                      |               |              |                 | 5.6           | 1.7          | 7.3  |
| <i>Transportation:</i>   |  |               |              |                 |               |              |  |
| - maritime               | 40.48                                      | 5.1           |              |                 | 4.7           |              | 9.8  |

<sup>116</sup> For services FDI of non-ASEAN countries see End Table.

| <i>Services Sectors</i>        | <b>Total Foreign Investment Capital (US\$000)</b> | Indonesia (%) | Malaysia (%) | Philippines (%) | Singapore (%) | Thailand (%) | Total ASEAN FDI as percentage of Total FDI |
|--------------------------------|---|---------------|--------------|-----------------|---------------|--------------|--|
| - <i>aviation</i>              | <b>15.62</b>                                      | 1.0           |              |                 | 90.7          |              | <b>91.7</b>                                |
| - <i>other</i>                 | <b>146.50</b>                                     | 3.7           |              |                 |               |              | <b>3.7</b>                                 |
| <i>Banking and finance</i>     | <b>165.0</b>                                      | 6.1           | 9.1          |                 |               | 18.1         | <b>33.3</b>                                |
| <i>Tourist</i>                 | <b>19.3</b>                                       |               | 6.8          |                 |               | 11.3         | <b>18.1</b>                                |
| <i>Telecommunications</i>      | <b>366.6</b>                                      |               | 0.5          |                 | 1.2           |              | <b>1.7</b>                                 |
| <i>Business :</i>              |   |               |              |                 |               |              |  |
| - <i>advertising</i>           | <b>7.0</b>  |               |              |                 |               | 24.4         | <b>24.4</b>                                |
| - <i>consultancy and audit</i> | <b>9.7</b>  |               |              |                 | 6.3           | 10.5         | <b>16.5</b>                                |
| - <i>other</i>                 | <b>32.5</b>                                       |               | 9.0          |                 | 3.8           |              | <b>12.8</b>                                |

Source: Viet Nam Investment Review Database.

The significant presence of ASEAN investors in a number of services sectors in Viet Nam indicate the strong potential for enhancing services trade through liberalization of market access in these sectors. The significant services component of ASEAN FDI (two thirds of all ASEAN FDI in Viet Nam is in the services sector) reinforces the complementary that exists between FDI and trade in services. As FDI increases, the transactions involving the provision of cross-border services (such as communications and information services) as well as the movement of skilled personnel will also expand.

### 8.3 ASEAN Cooperation in Services

ASEAN cooperation in services was preceded by the participation of ASEAN member countries in the General Agreement on Trade in Services (GATS) under the WTO. The sectors where ASEAN countries are participating under the GATS are:

- business services
- tourism
- finance
- transport
- telecommunications

Participation in these sectors involved commitments to grant market access on a MFN basis and national treatment to services providers to both ASEAN and non-ASEAN signatories. Thus, the benefits of ASEAN accession to GATS are already being enjoyed by its members

under the WTO framework. Under the ASEAN Framework Agreement on Services of 1995, ASEAN member countries agreed to make commitments beyond those that they committed to under the GATS (GATS-Plus). Consistent with the GATS, the ASEAN Framework Agreement on Services signed at the end of 1995 enjoins member countries to adhere to the MFN and transparency principles. Seven priority areas have been identified under the Agreement. These are:

- tourism
- air transport
- business services
- construction sector
- financial services
- telecommunications
- maritime transport

Participation in the Services Agreement requires member countries to signify, for each sector on which they are participating, the limitations on market access (LMA), and the limitations on national treatment (LNT) for each of the four modes of supply.<sup>117</sup> For each limitation, member countries may commit to bind or not bind (unbound) their existing regimes. Indications of bound commitments is equivalent to a standstill provision; indications of unbound commitments means that specific commitments are still subject to any regulations/requirements that may be imposed by the country on that service sector or mode of supply. A country could also indicate that there are no conditions or qualifications made on the offer.

The schedule of commitments submitted under the Services Agreement is in two parts: horizontal and vertical or sectoral commitments. Horizontal commitments refer to commitments that apply to all sectors and subsectors included in the schedule while vertical commitments apply only to the sectors. Examples of horizontal commitments are those related to foreign equity participation, entry and exit restrictions, and foreign currency restrictions. Since the offers must be GATS-Plus, they must be improvements over the ASEAN Member Countries' existing GATS commitments or involve the addition of a new sub-sector that was not previously committed under the GATS. For Viet Nam, as a non-WTO member, its offers under the agreement must be no less favourable than its existing regime and more favourable than those accorded to non-ASEAN countries.<sup>118</sup> Initial indicative offers were put forward by member countries in early 1997 covering five of the priority areas: air transport (three countries), business services (one country), maritime transport (four countries), telecommunications (one country), and tourism (seven countries). These offers involved commitments in all four modes of service supply (see Table 8.2).

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<sup>117</sup> The four modes of services supply are: cross-border supply; consumption abroad; commercial presence; movement of natural persons (see Box 8.1).

<sup>118</sup> With regard to new members - Laos and Myanmar, and prospectively Cambodia, ASEAN agreed to some minimum preconditions for their accession to the Framework Agreement. These minimum conditions include: i.) adherence to basic obligations in the services sector such as the MFN treatment and transparency; and ii.) binding their existing services regime whenever possible. Once the new members accede to the Services Agreement, they cannot be excluded from enjoying the concessions contained in the initial package of commitments that have been negotiated by the ASEAN6 and Viet Nam.

**Table 8.3: Sectors Covered by Initial Offers under the ASEAN Services Agreement**

| Countries   | Sectors  |
|-------------|--|
| Brunei      | Maritime Transport, Air Transport, Tourism       |
| Indonesia   | Maritime Transport, Telecommunication, Tourism   |
| Malaysia    | Air Transport, Maritime Transport, Tourism       |
| Philippines | Business Professional Services, Tourism          |
| Singapore   | Air Transportation, Tourism                      |
| Thailand    | Maritime Transport, Tourism and Related Services |
| Viet Nam    | Telecommunications, Tourism                      |

Source: ASEAN Secretariat (1995-7b)

The October 1997 ASEAN Economic Ministers meeting endorsed the initial package. The date of implementation of these initial offers was 31 March 1998, and of the final package on services liberalization in these seven sectors was 31 December 1998 (covering a “certain” (yet to be specified) percentage level of their sub-sectors). The initial offers are GATS-Plus. However, in terms of quality/depth, most of the offers tabled are only binding of existing regimes and the preferentially for ASEAN is questionable. It should also be noted that while new sub-sectors are offered, these do not cover a substantial part of the whole sub-sector.

In order to accelerate the liberalization in services, a new approach/modality in the ASEAN negotiation is to be adopted. Guidelines for the new approach have been prepared (Informal ASEAN Economic Ministers meeting), with the aim of the new liberalization guidelines being to have free flow (i.e. national treatment and no barriers to market access) of all services by 2020 with a fast track for selected sectors for 2010. Negotiations will be made on a sectoral or sub-sectoral approach with cross-sectoral negotiations on a bilateral basis if necessary.

## 8.4 Viet Nam and ASEAN Services Commitments

Under its initial offer for the Agreement, Viet Nam is participating in the telecommunications and tourism sectors. The specific activities covered by its offer are listed in Table 8.4.

**Table 8.4: Viet Nam’s Initial Services Offer (1997)**

| Sector              | Activities   |
|---------------------|--|
| Telecommunications: | Electronic voice mail service<br>Electronic data interchange<br>Telegraph services |
| Tourism:            | International hotel operations   |

This offer is rather limited in scope and depth. For its horizontal offers in a limited number of sectors, Viet Nam is maintaining its present policies with respect to foreign investments (Mode 3 - commercial supply) and limitations on national treatment (Mode 4 - presence of natural persons).

Although the Services Agreement does not aim for uniformity across ASEAN, transparency rules provide Viet Nam the opportunity to gauge the relative openness or restrictiveness of a sector in ASEAN member countries and therefore the opportunity to calibrate its market opening moves. For instance, although equity participation in tourism is set at not less than 30 per cent in Viet Nam, Malaysia and Brunei Darussalam, it is only in Viet Nam where foreign investors are required to enter into joint venture partnerships. Thus, although Viet Nam could participate in a sector under the Services Agreement, the benefits may not be fully realized if the sector remains restricted.

If Viet Nam were to continue pursuing an incremental approach to the liberalization of investment laws, the Services agreement can provide the opportunity to target key sectors and open them initially to ASEAN prior to a wider scope of liberalization measures. In most areas, including those for the horizontal schedules, Viet Nam's offers were unbound, meaning that existing limitations on market access and national treatment could be subject to any regulation/requirement that could be imposed. An example of this could be cited for the tourism sector. Viet Nam initially indicated that the presence of a natural person (Mode 4) in international hotel operations is allowed for high skills and management levels, subject to the specific needs to each hotel, and subject to the issuance of a labour permit.

During the negotiations, the Philippines made an offer to liberalize this limitation to allow other categories of personnel (including general manager, food and beverages manager, sales and marketing manager, specialist operations, musicians and congress organizers). In its latest revised offer, Viet Nam's commitment under this mode (Mode 4) was unbound.

Existing limitations on sectors/subsectors covered under the initial package could be improved to at least a level comparable with some ASEAN states. There is also scope for covering a wider range of sectors in subsequent package of offers. Possible areas to consider include business services and financial services since there is already considerable ASEAN presence in these sectors. Expanding sectoral/subsectoral coverage can create opportunities for hastening market-opening measures through the mechanisms of horizontal commitments. For instance, limitations on commercial presence through joint ventures can be reduced (or eliminated) for as many sectors/subsectors that are included in a package of offers. This could contribute significantly, albeit incrementally, to investment liberalisation without requiring comprehensive changes in investment legislation.

In the absence of quantitative measures of commitments made under the Service Agreement, and the highly voluntary nature of offers, there will always be a tendency to take the minimum position in a given round of offers. This is more probably true in the case of Viet Nam to whom the GATS Plus criteria does not apply. Given this situation, efforts must be made therefore, at the very least, to respond favourably to requests made by other countries. The one fundamental services concession that could gain considerable mileage for Viet Nam is the relaxation of visa restrictions for ASEAN nationals. Viet Nam's participation in the Services Agreement has given this issue a greater sense of urgency. Viet Nam should take serious steps to address this issue as soon as possible, not only for practical considerations, but also as a gesture of goodwill to ASEAN.

### 8.4.1 The way forward

The foregoing observations suggest that Viet Nam has not taken full advantage of ASEAN mechanisms to push for market-opening reforms and strengthen the services sector in Viet Nam. Compared with AFTA, the Services Agreement offers more flexibility and does not aim for uniformity of goals (e.g., levels and timing of tariff reductions as in the case of AFTA). Participation in services sectors are made by choice (within a set of mutually agreed priorities) and the only major criteria for judging the offer is that it should be an improvement over existing regimes. This flexibility may actually work to Viet Nam's disadvantage. It is crucial for Viet Nam's international competitiveness that Viet Nam has an efficient services sector. Without a competitive services sector, Viet Nam's export-oriented industries will be at a distinct cost disadvantage.

As a next step, Viet Nam should consider binding her existing regimes in sectors where it is participating so as to prevent any possibility of a reversal in policy. The ASEAN Services Agreement, like GATS, is essentially a standstill agreement. As such, the schedules under these agreements can be seen to reflect the extent of market access and national treatment commitments; by inference, those that are not included remain closed. Thus, it could happen that Viet Nam could pursue liberalization policies in a given sector but remain unbound in these sectors if no commitments are offered as means of protecting domestic interests. In the short term, Viet Nam more closely should review other services sectors/subsectors for which it could provide better market access and non-discriminatory treatment especially to ASEAN suppliers with the context of its ASEAN membership.

### 8.4.2 The wider reform agenda

By the nature of the ASEAN Services Agreement coverage, participation in the agreement provides Viet Nam with a mechanism to push for more reforms in the areas of foreign investment legislation, foreign exchange regulations, and movements of natural persons. These are bound to have fundamental and far-reaching impact on other economic transactions. For example, Viet Nam could use the ASEAN Services Agreement to push for visa free entry of ASEAN nationals initially to promote tourism, and eventually to remove entry restrictions for purposes of other services providers. It could also push for the elimination of restrictions on joint ventures and foreign exchange controls, which have served as disincentives to many foreign investors. Under its present offer in the telecommunications sector, foreign investor participation is allowed only in the under a business cooperation contract (BBC) with a state-owned enterprise (SOE).<sup>119</sup> It is interesting to note that initially the offer allowed BBCs to take place with any Vietnamese operator, but following revisions the offer became more restrictive.

Two important developments have put more pressure on Viet Nam's services agenda. First was the establishment of an ASEAN Investment Area (AIA), signed in 1998. The key element in the AIA framework agreement is the granting of national treatment, initially to ASEAN investors by the year 2010, and subsequently to all investors by the year 2020.<sup>120</sup> The second

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<sup>119</sup> Under Viet Nam's Foreign Investment Law, a business cooperation contract is signed by two parties engaged in investment activities without forming a legal entity.

<sup>120</sup> There will be some coverage overlap for the ASEAN Services Agreement and the ASEAN Investment Area. For example, services supplied through mode of commercial presence (through the movement of a commercial organisation to the consumer's economy) would be covered by both agreements.

was the new approach/modality towards the ASEAN Services Agreement with the aim to establish an ASEAN free trade area in services by the year 2020. The proposal is an alternative to the current approach that is considered by many ASEAN countries to be too slow and unable to generate substantial offers over existing regimes. Viet Nam has to consider the requirements under these initiatives. The slower the pace of domestic reform, the more difficult it will be for Viet Nam to comply with international commitments.

In the long-term, broadening Viet Nam's participation in the ASEAN Services Agreement would help pave the way for her accession to the WTO which would require meaningful and substantial commitments. In this regard, Viet Nam may have to think carefully and anticipate her negotiating stance in the process of accession by way of phasing her commitments in ASEAN in order to establish a negotiating leeway under the GATS. On a final note, the paucity of statistics in services poses a serious limitation for better-informed decisions on the sector. Viet Nam should take steps to improve the manner of collecting data on the services sector to conform to international conventions and definitions.



**Table 8.5: Share of Foreign Direct Investment of non-ASEAN countries in the Services Sector in 1995.**

| <i>Services Sectors</i>    | Total Foreign<br>Investment Capital<br>(US\$000) | Hong Kong<br>% | Taiwan<br>% | Korea<br>% | Japan<br>% | U.S.A<br>% | Europe<br>% | Australia<br>% | Other<br>% | Multi-Country<br>% |
|----------------------------|--|----------------|-------------|------------|------------|------------|-------------|----------------|------------|--------------------|
| <i>Real estate:</i>        |  |                |             |            |            |            |             |                |            |                    |
| - hotel construction       | <b>1,834</b>                                     | 31             | 4           | 5          | 9          |            | 8           |                | 123        |                    |
| - resort                   | <b>545</b>                                       | 21             | 48          |            | 2          | 4          |             |                | 10         |                    |
| <i>Construction:</i>       |  |                |             |            |            |            |             |                |            |                    |
| - infrastructure           | <b>5,128</b>                                     | 21             | 7           | 3          | 2          |            |             |                | 4          | 13                 |
| - materials                | <b>68</b>  | 20             | 5           |            | 9          | 24         | 5           |                | 4          | 10                 |
| <i>Computer services</i>   | <b>16</b>  | 6              | 6           | 39         | 4          | 35         | 3           |                |            |                    |
| <i>Transportation:</i>     |  |                |             |            |            |            |             |                |            |                    |
| - maritime                 | <b>40</b>  | 1              |             |            | 45         |            | 5           |                | 40         |                    |
| - aviation                 | <b>16</b>  |                |             |            | 7          |            | 1           |                |            |                    |
| - other                    | <b>147</b>                                       | 22             |             | 4          | 26         |            | 9           | 14             | 21         |                    |
| <i>Banking and finance</i> | <b>165</b>                                       |                | 9           | 12         |            |            | 36          | 9              |            |                    |
| <i>Tourist</i>             | <b>19</b>  |                |             | 35         |            | 7          | 1           |                | 37         | 2                  |
| <i>Telecommunications</i>  | <b>367</b>                                       |                |             | 15         | 2          |            |             | 82             |            |                    |
| <i>Business:</i>           |  |                |             |            |            |            |             |                |            |                    |
| - advertising              | <b>7</b>   |                |             | 55         | 21         |            |             |                |            |                    |
| - consultancy and audit    | <b>10</b>  |                |             |            | 6          | 24         | 6           | 5              |            | 3                  |
| - other                    | <b>32</b>  | 39             |             |            | 2          | 8          | 15          |                | 29         | 39                 |

Source: Pacific R.I.M. (1997a).



# **Chapter 9 : Customs reform under AFTA**

**- Jim Williams -**

## **9.1 Introduction**

“As the globalisation of trade advances, the dependence in business on the fast moving of goods becomes more and more vital. Trade needs simple formalities through fast and transparent customs services.” (WACO)

In recent years, over 75 per cent of the world's customs services have undergone major reform. Viet Nam's customs service, the General Department of Customs (GDC), urgently requires reform if Viet Nam is to benefit from the increasing importance of international trade in the world economy. Without greater reform, the GDC will become totally overburdened and many of the reforms elsewhere in the economy will not be fully utilized.

The main issue facing the GDC in implementing reform is its outdated customs laws that do not provide sufficient clarity or appropriate powers for a rapidly changing economic environment. Matters are made more difficult by the bureaucratic complexity of Viet Nam's administration, with multiple government agencies involved in matters related to the import and export of goods. This creates difficulties, both for the GDC and traders, in understanding or reaching agreement on a wide range of tariff and non-tariff barrier issues. Additionally, the spectre of corruption within the GDC is troubling, both in its direct affect upon the proper administration of the customs laws and in the image that it portrays to the business community and general public. Whatever the true level of corrupt activity, the issue must be resolved, since there is a public perception that corruption is widespread within the GDC.

In addition to the corruption accompanying “legitimate” trade, the high tariffs that are imposed on international trade, encourage the development of very high levels of informal trade. The existence of smuggled goods has been recognized for many years but shows every sign of increasing rather than diminishing. This is reinforced by the most recent public pronouncements of the government on the need to act decisively against the smuggling. Whilst interdiction and investigation will continue to be needed in this area, much also needs to be done through tariff reductions and procedural reform to encourage many of those involved in the black economy to move profitably to legitimate trade.

## **9.2 Viet Nam's Customs Service: The State of Play**

The current state of play of the GDC, as outlined in this section, is based on discussions with those who have direct dealings with the Vietnamese customs service, that is, trading companies, diplomatic missions and non-government organisation (NGO) representatives. Their general perception is that the law, procedures and bureaucracy the GDC is encumbered with are inconsistent with the country's intention of active participation in the world economy. The customs border has fiscal and administrative obstacles intended to obstruct rather than assist the movement of goods. Furthermore, the problems created by this approach lend themselves to the development and prolongation of corrupt practices.

The customs border is the primary point of contact for the outside world. Currently, it does not present a good image of the country nor reflect Viet Nam's economic potential to those considering opportunities for trade and investment. The principle areas of concern relating to the present system of customs control in Viet Nam are lack of clarity in the law or conformity with international best practice, differing interpretations of law and procedure throughout the country and pervasive corruption with respect to decision making and informal payments ("speed" or "tea" money) insisted upon before an official will process a perfectly legitimate transaction. Other principle areas of concern are disproportionate attention given to minor errors or inconsistencies in customs documents which have no material bearing on the legitimacy of the transaction or revenue, the use of the reference price system as a method of valuation the freight clearance process which requires excessive and repetitive checking of documents together with a policy on physical examination which covers close to 100% of consignments as well as absence of dialogue between the GDC and the trading community.

All of these issues need to be addressed quickly if legitimate international trade and the revenue it generates is to increase substantially in Viet Nam. These issues are further examined below under the broad headings of law, freight clearance, corruption, and communication.

### **9.2.1 Law**

Viet Nam's current customs law was promulgated in 1990. Since then it has undergone a number of amendments dealing with specific problems as they have arisen. However, this body of law requires major revision and extension to deal with the globalization of international trade and the changes that have taken place in the way commerce is conducted. Whilst the need for reform of the legislation was recognized in 1994, the revised customs law has now reached its eleventh draft, with little prospect of becoming law in the immediate future. The areas of difficulty need to be quickly identified and resolved. If necessary, further advice on issues of international practice should be garnered from regional or WCO experts to speed up the process of drafting effective legislation.<sup>121</sup>

The importance of the new law to the effective development of Viet Nam's economy should be made clear to legislators, with the process of enactment of the law given priority in the legislative process.

Once the revised customs law is enacted it is essential that nationally agreed guidelines on the application of the law are published and implemented at every customs office in the country. Both training and national introduction of internal and independent external appeal process would facilitate and safeguard the integrity of the implementation process.

Provision should be made in the law to allow for the application of control measures based on selectivity through the use of risk assessment. Powers should also be provided for customs to undertake post import/export audits by reviewing normal business records and systems of traders. These provisions, coupled with legislation to allow for the use of information technology in all areas of customs activity, are urgently required.

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<sup>121</sup> The issues requiring most attention were clearly set out the government, by the IMF, in 1994.

Training in the process of selecting documents, goods and businesses for examination, management checks or audit, by the use of risk assessment techniques, should be provided to all levels of staff. Senior management, in particular, needs to understand that the use of random selection techniques, in a very small number of cases, is essential to the integrity of the process and provides an excellent opportunity to identify new areas of fraudulent activity.

Publication of the law, guidelines for its application, administrative procedures, and appeals should be undertaken swiftly with regular updating and wide distribution. To assist this process, the provision of “help desks” at the main customs offices is highly desirable.

## **9.2.2 Freight Clearance**

Once the legal basis is clarified, the clearance of freight would be greatly facilitated by the introduction of a range of administrative measures aimed at improving compliance, maximizing revenue yield, speeding clearance, increasing efficiency, and reducing corruption. Specific actions should include the introduction of a Single Administrative Document (SAD) for all customs transactions, self-assessment by the declarant or his agent of tariff classification, value and duty, the GATT valuation agreement (GVA), and improved computerization of the clearance process including the opportunity for direct trader input of data. In addition, these actions should introduce an examination of documents and goods on the basis of risk, a physical examination of goods, on a very small risk assessed basis, a system of guarantees or deposits to provide security for duty where deferred payment or temporary admission is permitted, a review of all forms of transit, and verification and control of declarations, primarily through post importation/exportation audit of traders’ commercial records and IT systems.

The introduction of these measures would ensure that the responsibility for the accurate provision of data and duty assessment rests with the declarant. This would remove from customs an area of largely unproductive work. Adopting the approach to customs control would reduce delays at the frontier, improve revenue yield, and increase the chances of detecting serious fraud. It would also greatly improve the GDC’s relationship with the trading community, improving compliance and leading to more open lines of communication regarding those involved in the contraband trade.

Whilst acknowledging the concern that is expressed in the GDC over the potential for under-valuation if a system other than reference pricing is used, Viet Nam's wish for WTO membership and commitments to AFTA make change inevitable. Reference pricing is not popular in the business community, as it discourages good trading practices in terms of legitimate discounting and competitive pricing. The increasing diversity of goods being traded means that reference pricing, on a national basis, has difficulty in keeping up with reality, which can lead to local negotiations that offer undesirable opportunities for corruption.

As long as Viet Nam's ad valorem duty rates remain at very high levels, there will always be an incentive for importers to understate values at importation. Until the GATT system is properly applied, it is not possible to make a credible estimate of the level of valuation fraud. However, the introduction of the GATT valuation system should not be further delayed on the grounds that it is open to abuse. Prior to the introduction of the GATT valuation system, substantial training in its use should be provided to all customs officials involved in the system, while seminars explaining the process should be delivered to the trading community.

In addition, the training and deployment of post import/export control teams should be undertaken at the earliest opportunity. They should be especially encouraged to look at valuation matters when conducting their audits.

If it is found that valuation fraud does take place at an unacceptably high level, and the control measures proposed do not appear to contain it, then consideration could be given to the use of pre-shipment inspection certificates. This system would require the importer to have their goods examined and sealed, prior to shipment, by one of a number of approved independent organizations. The pre-shipment inspection (PSI) companies would issue a certificate confirming the quantity, quality and value of the goods shipped, and then seal the container. The certificate and sealed container, when presented to customs could be accepted without further examination. PSI could offer an increase in net revenue for the state and speedier frontier clearance for the importer.

Whilst PSI is an attractive method of applying the GATT valuation agreement at minimum risk to the state, it should be regarded as a short-term technique, intended to allow time for the restructuring of the customs service to allow it to control valuation issues with confidence. In the long term, it will be the lowering of excessively high tariff rates that is likely to have the biggest impact upon reducing valuation fraud.

In addition to valuation reforms, the process of clearance should be streamlined to include self-assessment of duties and taxes. Once this process is linked to the examination of documents and goods on a risk-assessed basis, improvements in the quality of the processing can be introduced, whilst reducing the number of stages through which the declaration has to pass. With the exception of goods requiring special handling for reasons of safety, for example, explosives or radioactive materials, all goods requiring examination should be dealt with at specially designated facilities within a port or clearance point. These facilities should be secure and provide covered facilities for unloading, sorting, examining and reloading cargoes. The isolation of examination facilities from the premises of importers, together with the rotation of staff, will also reduce the risk of corruption at the point of examination. This, together with selected cargo requiring examination on the basis of risk, and the provision of good quality examination equipment, including x-rays, fibrescopes, dogs, and narcotic testing kits, should substantially increase the percentage of occasions in which contraband is found during physical examinations.

Once there has been reform in the processing of declarations and the examination of cargo, there is no reason why, in the majority of cases, duty payment should not continue to be deferred, if it is felt that this is in the interests of increasing trade. However, it is essential that any duty deferment regime makes provisions for the security of the duty through a system of guarantees or deposit payments. In any case, where duty is not protected by such a scheme, payment should be required before the release of the goods from customs control. The release of goods, without payment or security, is an invitation for systematic late payment and fraud, which adds substantially to the costs of revenue collection. If this system continued after the introduction of VAT, the potential loss of revenue would increase dramatically.

During the review of the freight clearance process, the imminent introduction of VAT should be addressed. It is poor practice to have more than one agency involved in the clearance of import or export cargo for fiscal purposes. Customs should deal with all import/export formalities in relation to VAT. Amongst the issues requiring urgent attention is the introduction of a Single Administrative Document (SAD), which allows for declarations,

including VAT, and can provide evidence of both import or export for the trader. The information extracted from the SAD will enable taxation officials to better monitor data. In addition to the SAD, a unique taxpayer number, which is used in all transactions between a trader and the taxation authorities or customs, is essential if accurate information is to be passed between the departments on VAT matters. Both the collection and dissemination of information relating to the import/export of goods subject to VAT controls would be greatly improved by the computerization of all freight clearance.

### **9.2.3 Corruption**

Corrupt activities take place in all law enforcement, fiscal and business environments throughout the world. Sound systems of management, audit, investigation, training, and public education are required to detect and deter all aspects of corruption. This is particularly important when the corruption detracts from the ability of a government to effectively control its own resources. Low-level corruption, in the form of small payments to officials for the performance of their official duties (“speed” or “tea” money) is often condoned or excused on the basis that the officials concerned are poorly paid and overworked. This view is unacceptable as it encourages higher levels of corruption and reinforces a pervading culture of corruption.

Issues such as poor pay and conditions of service for public officials, which are at the root of much low-level corruption, must be addressed in Viet Nam if progress is to be made in the fight against corruption. While it will be difficult to raise wages significantly, ways of achieving improvements in conditions should be urgently sought. The provision of bonuses, linked to increases in revenue collection or speed of clearance, as well as rewards directly related to the seizure of contraband and penalties imposed on smugglers, should be explored. In addition, officially charging fees (at fixed and published level of prices) for some customs activities, with the money received being directed to the improvement of pay and working conditions for staff, should be considered. The fees would need to avoid classification as a customs tax but could prove a valuable short-term anti-corruption initiative. Furthermore, a vigorous education campaign targeting customs officials and the general public on the problems created for society by endemic corruption should be undertaken.

Serious corruption in the core fiscal and law enforcement activities of the government has serious implications for good governance, the rule of law, and international reputation. This is particularly the case where, one of the agencies involved in corrupt practices on a routine basis is customs, who are the primary point of contact for many businesses, particularly foreign ones<sup>122</sup>. Whilst specific anti-corruption measures are necessary, good management practices, internal audit regimes, and transparency in administration process can all contribute to the deterrence of corrupt actions. The positive image that will come from a better perception of the GDC, by both the public and business community, will also improve the self-esteem and morale of the service.

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<sup>122</sup> Hong Kong and Singapore offer excellent examples of the application of improved conditions of service, strong public education campaigns and effective enforcement of the criminal laws in a well structured, sustained, campaign against corruption. Such are the high sums of money available for corruption in some areas of commercial activity that even countries with low levels of corrupt activity, vigilance at all levels of management is essential.

## 9.2.4 Communication

All aspects of customs activity and associated issues, such as corruption, will be more easily dealt with if communication within the GDC, with other areas of government, and most importantly, with the public, are significantly improved. It is important for customs officials to understand that efficiency can be improved significantly through communication and the provision of information. The areas of activity where confidentiality and secrecy are essential are, when viewed objectively, minimal and relate primarily to a small group of issues relating to commercial confidentiality, criminal investigation, and state security. The bulk of customs processes and systems can be streamlined through discussion with those in the trading and business community who are affected by their operation.<sup>123</sup>

The concept of working with the business community and undertaking change through consultation has been a difficult one to accept for many customs administrations worldwide. However, the importance is emphasized by both the WCO and the WTO. Good results, both in improved administration and in the fight against smuggling, have been achieved by this partnership in a wide range of countries. If GDC was to follow the road of consultation and discussion, by working with the Viet Nam Chamber of Commerce and Industry (VCCI), professional associations at the national level, and user groups in ports, there is good chance that these results could be replicated.

## 9.3 Customs reform and ASEAN

The customs service of Viet Nam needs to implement a number of steps to facilitate Viet Nam's integration into ASEAN. Currently, each ASEAN member country operates its own customs regime, with little in the way of common practices or documentation.<sup>124</sup> However, ASEAN has made substantial advances in indicating the direction in which they wish to cooperate and harmonise ASEAN customs activities. These issues are set out in a series of agreements with the overriding customs principles of:

“Consistency, Simplicity, Transparency, Appeals, Efficiency and Mutual Assistance”.

These principles, together with the ASEAN Customs Vision 2020 Statement, offer an excellent platform from which Viet Nam can develop a customs reform programme. In addition to the general customs principles, specific agreements on tariff harmonization and valuation are already in place as part of the ASEAN Free Trade Area (AFTA). By gradually changing its procedures towards worldwide “best practice” in customs matters, and by participating in the formation of common customs procedures for ASEAN, Viet Nam will be in a better position to ensure that its customs reform process is smooth.

The indication that ASEAN wished to achieve harmonization of customs procedures and attain a high level of customs cooperation between members was most clearly set out in the Vision Statement issued by the Heads of ASEAN Customs Services in May 1997:

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<sup>123</sup> Good examples of this approach to customs planning and operational implementation can be found in the ASEAN countries of Singapore, Malaysia and Thailand.

<sup>124</sup> Unlike the European Union (EU) or the North American Free Trade Area (NAFTA) which have common customs procedures and documentation.

“ASEAN Customs Partnerships for World Class Standards and Excellence in efficiency, professionalism and service, and uniformity through harmonised procedures, to promote trade and investment and to protect the health and well-being of the ASEAN community.” (*ASEAN Customs Vision 2020 Statement*)

The Vision Statement sets a target date of 2020 for the completion of its tasks and encompasses most areas of customs activity.

The active participation of the GDC in the drafting and implementation of AFTA (customs component) and the ASEAN Vision Statement are essential. Active involvement in the discussions will ensure that the GDC has some control over the formulation of conditions, and have a fuller understanding of the difficulties and benefits involved.

None of the activities outlined in the Vision Statement conflict with Viet Nam's wider responsibilities and commitment to APEC and WTO membership. Neither do the items requiring review or development hinder the ability of the GDC to pursue a programme of law enforcement in relation to revenue smuggling and the trade in prohibited or restricted items, which is regarded as essential to safeguard the morality and integrity of the state. In fact the introduction of these measures will assist the GDC in their fight against corruption. Improved performance and success will bring a greater sense of achievement and pride to the GDC by removing the taint of corruption. Increased efficiency will also support the arguments for improved pay and conditions of service, which further contribute to the elimination of excuses for the continuation of corrupt practices.

## **9.4 The ASEAN Customs Vision 2020 Statement**

ASEAN Customs Vision 2020 Statement consists of fifteen individual programmes. In this review, the order of the individual programmes has been changed to reflect more accurately the potential benefits for Viet Nam in reforming the customs service from the top-down. Strategic issues have been given prominence since many of the details relating to individual procedures will follow on from the proposed amendment of the customs law and an agreement on ASEAN “best practices”. The customs programmes are ordered as follows: Strategic Planning and Management, Transparency Enhancement, Partnership with the Business Community, Mutual Assistance, Technical Assistance Programme to ASEAN Customs Administrations, Training and Human Resource Development, Cargo Processing, Valuation, Audit, Tariff Classification, Rules of Origin, Procedures for Goods in Transit and Temporary Admission, Automation, and Enforcement.

### **9.4.1 Strategic Planning and Management**

Like the majority of customs services around the world, the GDC is facing a massive increase in cross border trafficking of many types. Accompanying this are demands for both a liberalization of customs procedures and improved effectiveness. To succeed in achieving reform, it is necessary to have commitment and vision at all levels of the service, together with focused leadership. This can only be achieved through dialogue and understanding of the issues, with solutions linked to a clear, long term strategic plan, covering three to five years, supported by annual planning linking all levels of the organisation. To ensure continuation, an annual review should be published which reports progress and strategy updates.

It is important that any consideration of strategy and long-term planning remains focused on Viet Nam's commitments to ASEAN, APEC and the WTO. As a blueprint for achieving the necessary procedural changes, the WACO Kyoto Convention (and recent IMF recommendations) should be considered. Parallel consideration of the International Customs Guidelines prepared by the Commission on International Trade and Investment of the International Chamber of Commerce (ICC), may be helpful. These external commentaries offer suggestions and comments drawn from the experiences of customs organisations and their clients.

For most customs services, one of the most difficult concepts to manage is the need to balance their role as an effective law enforcement agency with the need to offer a "service" for the majority of their clients who wish to undertake import-export transactions legitimately and swiftly. The transition to a "service" industry is not an easy one to achieve or to convey to staff at all levels. Much can be done to alter this perception through the strategic development of "service" policies, which portray the organisation as protecting society against a range of social evils as well as supporting international trade. The situation is conveyed well in the following comment by a WCO member:

"Service...that one word underscores our values, service to the Government as a collector and enforcer, and service to business and individuals in terms of meeting their expectations. Our aim is to get a good fit between the two types of service" (WACO)

The strategic thinking must look well beyond the present problems and take into account the probable improvements to Viet Nam's trade and tourist activities over the next three to five years, as well as giving thought to the lifespan of the ASEAN Customs Vision Statement up to the year 2020. The substantial expansion in all areas of cross-border activity will require dialogue with government and trade interests on an ongoing basis.

#### **9.4.1.1 WCO Diagnostic Study**

One way of narrowing and clarifying the thinking of senior management whilst developing a basic planning document is through the use of the World Customs Organisation (WCO) Diagnostic Study. This approach requires bringing together, for a period of several days, all the senior managers of the organisation so that they can review, with the assistance of a small number of facilitators from the WCO, the activities of the GDC. The discussions would take into account all the influences and stakeholders impinging upon GDC and produce a strategic plan for the future development of the organisation. Open and frank discussion of existing problems and potential solutions is essential to achieving success. This process, in varying formats, has been undertaken successfully by several customs services with good results in the implementation of substantial institutional change.

Following the Diagnostic Study, the publishing of its findings should be made available to all levels of management. This should be followed by a review of annual plans and strategies so as to ensure uniformity with the nationally agreed strategy.

It is important to emphasize that whilst support and facilitators can be provided to the participants by the WCO, the success of the activity is heavily dependent upon the active participation of the most senior levels of management. The process normally takes place in the country concerned, but given the importance of being able to concentrate on the diagnostic activity, it is desirable to have a venue away from the normal place of work of the participants. The procedure can often be substantially enhanced by ensuring the study is run on a residential basis, allowing for the discussion to be enhanced through informal contact and discussion in the evenings.

The senior management of GDC gives immediate consideration to undertaking a Diagnostic Study of their service facilitated by the WCO, within the next six months. To accomplish this aim, the following steps should be taken: consulting the WCO on the viability of the timeframe for a Diagnostic Study, agreeing to the principle that all the senior management team will participate in the study and structure diary and activity planning accordingly, identifying a suitable location for the study and preparing costings, presenting the plan for the study and timetable together with costings to potential funding organizations, and encouraging the WCO to consider the inclusion of members of ASEAN Customs Services in the facilitation team. Furthermore, once agreement on the study has been reached, an internal announcement concerning the rationale of the process to all staff should be made. Recommendations on Customs reform or good practice already submitted to Viet Nam by the IMF should be included in the study. And a press statement should be issued and a press conference should be held to explain the fundamental review of the GDC through the undertaking of a Diagnostic Study and to invite the business sector and the general public to contribute comments and papers for consideration during the process. Finally, a team should be established to administer the study and liaise with all those involved, to ensure that the study can start on time. This team would act as a focal point for all comments from staff and the public. These comments should be compiled and referred to during the study. The team would undertake the post study publication of findings and plans. It could also act as a monitoring organisation for the implementation of the strategic and annual plans arising from the study, with direct reporting to the senior management of GDC.

## **9.4.2 Transparency Enhancement**

### **Clarity of Information**

A key feature of the ASEAN Customs Vision is the need for member states to develop greater transparency in their customs organizations and operations. For all customs services, the movement to greater transparency is a difficult mix of balancing the requirements of openness and public accountability with the needs of commercial, personnel and state confidentiality. It is therefore necessary for each customs service to develop their own approach to creating greater transparency. Given the confidence transparency instills in the international business community and civil society in general, it is an area that should be accorded special consideration during the strategic planning activities.

It will be particularly important that decision makers at all levels understand that appeals and the overturning of their decisions is just part of the normal process of administration from which all parties learn more about the proper interpretation of the law. The association of appeal with personal loss of face and the subsequent search for opportunities to even the score will have to be taken out of the system if it is to operate to everyone's advantage. This issue is particularly important when trying to encourage the use of the system by the trading community, who will be concerned that they will be disadvantaged in some other part of the organisation if they take advantage of an appeals process.<sup>125</sup>

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<sup>125</sup> During informal discussions, members of the business community in Ha Noi repeatedly expressed an interest in the establishment of a transparent appeals procedure, however, the fear of retaliation against their trade was seen as a distinct problem.

The publishing of all laws, regulations and procedures, in very clear and accessible documents for the use of all staff and the trading community, is a vital step on the road to full transparency. In addition, the development of guidelines on the common procedures to be followed at all customs points in the implementation of the law must be undertaken and the documents widely distributed.

In addition to printed matter, the provision of inquiry desks at all major customs points including regional centres and headquarters, is important. These will allow for, and encourage, questions from travelers and traders about customs-related procedures, which will again improve the accuracy and speed of activity of freight processing. It will also assist in changing the approach of customs towards their clients.

## Media Interaction

An area in which the GDC is already demonstrating a good level of understanding and participation, capable of enhancing transparency, is that of media activity. A willingness to respond quickly and effectively to press and media inquiries will contribute substantially to the development of a culture of openness within the organisation. Being prepared to comment honestly on difficulties as well as highlighting successes improves public confidence in the organisation.<sup>126</sup> Similarly, ready acceptance that mistakes have been made, with full apologies in appropriate cases, also greatly enhances the public image and credibility of the service, adding further to the perception of transparency.

## Corruption

One of the primary aims of transparency is to strengthen the economic environment needed for the operation of legitimate international trade in Viet Nam. The successful implementation of these changes will also impact heavily on those who profit from the abuse of customs regulations and those who participate in contraband trade. As indicated by media and official reports, the large-scale smuggling of goods, customs evasion, excise and internal taxes, strongly suggests that corruption exists within customs and the law enforcement administration, and that it needs further attention. Levels of pay and conditions of service for customs officials must be considered against the temptations of very high levels of profit available in most areas of contraband trafficking.

Within the GDC, the anti-corruption action should be reinforced by the publication and circulation of the World Customs Organisation (WCO) Arusha Declaration on Integrity, the ASEAN Customs Code of Conduct, and the UN Code of Conduct for Public Officials. Such an approach should be accompanied by the continued public commitment by the Prime Minister to fight corruption within the government, wherever it may occur.

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<sup>126</sup> A good example of this approach was provided recently by the Director General of Customs when, in addition to highlighting a substantial success in countering smuggling, he accepted that corruption represented a problem to the service and commented on his plans for dealing with it.

The establishment of an anti-corruption enforcement unit should be encouraged, with both the public and government officials being encouraged to contact the unit with information relating to corrupt acts.<sup>127</sup>

In considering the problem of corrupt customs officials, the government should keep in mind that any action to eradicate the problem has to be seen to be fair and effective. This means that at the senior governmental level, support for action must continue regardless of the political connections or position in society of those identified as being involved in corrupt acts. It cannot be assumed that all those involved in major smuggling or corruption will be minor market traders or junior officials.

It is important that the government publicly should state that transparency in the operation of the GDC is both a national and ASEAN objective. And the redrafting of the customs law should take fully into account the need for transparency and provides for rather than inhibits its progress. Furthermore, discussions should be held with members of the trading community and professional bodies on their perception of the transparency needs of the GDC. A further public announcement by the GDC and the government of their commitment to fighting corruption should include public acceptance of the WCO Arusha Declaration and the ASEAN Customs Code of Conduct with a commitment to their principles, commitment by the government to a substantial reduction in smuggling through the introduction of pro-active risk-based enforcement measures and a review by the government of the salary levels and structures of the customs with particular emphasis on encouraging integrity. High profile monitoring of the anti-corruption measures should be undertaken at the highest level in the GDC by the government.

### **9.4.3 Partnership with the Business Community**

As well as being a measure to be addressed within the ASEAN Customs Vision statement, the development of a partnership with the business community is an area that has been successfully explored by many of the worlds' customs services to the advantage of all. Given the historical divide between customs and their clients, it has been difficult for many services to come to terms with the idea of cooperation and consultation instead of direction and imposition, in dealing with trade matters. However, it has been recognized that consultation with the business community during the early stages of reform, has led to the introduction of laws and procedures which have improved the flow of goods and lifted administrative burdens from business, while still providing for effective enforcement. Equally, there has been recognition within the international trading and transport industries that pro-active cooperation with customs services in fighting smuggling and other fraudulent activity benefits legitimate trade, assists in the protection of society, and strengthens the development of good governance. This is reinforced by the trade consultation activities of the WCO and its encouragement of members to conclude memorandum of understanding (MOU) talks with the trading community to enhance the opportunities for dialogue.

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<sup>127</sup> An example of an internationally respected, pro-active anti-corruption organisation, is provided by the Independent Commission Against Corruption (ICAC) in Hong Kong. One of ICAC's strengths is that not only does it prosecute corruption but it also undertakes substantial public awareness and education programmes aimed at the reduction of public acceptance of corruption as the normal method of conducting government administration. The success of ICAC in Hong Kong has been substantial and tolerance of corruption by society at large is much reduced as is its prevalence in business or the administration.

The development of trust and good communications with the business community takes time and resources from all concerned. It cannot be simply one-way traffic. The provision of facilities and information from the trading community on smuggling matters must be matched by opportunities for improved clearance times and simplified procedures for those who provide the cooperation and abide by the law. Furthermore the provision of information cannot be used as a shield for inefficiencies, inaccuracies, or disdain for the law on the part of business. At a national level, discussions with trade and professional bodies should initially be aimed at building a framework for the further discussion of issues involving amendments to laws or procedures that are of national significance.

Similar forums should be constructed at the regional level. These will provide an opportunity for dialogue between those more directly involved in procedural issues and bottlenecks. At a port level, regular meetings with representatives of all users and control authorities can yield good results in terms of increased cooperation, improved clearance times, and better overall understanding of each other's problems.

Compliance with customs laws will also be enhanced through increased communication and transparency, particularly where that encompasses simplification and clarification of law and procedure.

GDC's preparedness to be directly accountable for their actions at all levels will enhance their standing in the eyes of the business community. If linked to a clear and fair system of appeal, including an external independent option for appropriate cases, this should remove many of the concerns of the business community relating to the personalizing of administrative decisions. An appeals procedure that is accepted as independent and fair by all concerned is in itself a valuable method of improving the partnership with business.

It is recommended to establish a national forum at which relevant members of the business community, trade associations and professional bodies meet with senior officials of the GDC to discuss issues of mutual concern. Memorandum of understanding (MOU) with individual organizations regarding areas of cooperation and facilitation should be developed. And regularly reviewing the structure, operation and continued appropriateness of the discussion forum and MOUs, amending and updating should be carried out where necessary. Furthermore, a structure for regular meetings between business and professional interest groups and senior GDC regional managers to respond to matters of a local concern, while also identifying issues requiring national consideration should be created. And the creation of port user groups representing all interested parties to allow for discussions on issues of mutual concern with a view to improving the overall performance of the port should be encouraged. Regional and local advice centres where the public and business can receive help on their dealings with customs, as well as accessible, fair and independent appeals procedures should be established.

#### **9.4.4 Mutual Assistance**

The GDC is already committed to and familiar with the concepts of mutual assistance between customs services, through its membership of the WCO and participation in its activities, including the Regional Intelligence Liaison Office (RILO) computer network. For mutual assistance to be effective, there must be goodwill on all sides and adequate legal provision within the national law for the exchange of information, including data held on computers, and the attendance of official witnesses at proceedings in other states.

Enhanced trade within the region will increase the need for cooperation on the routine verification of certificates of origin, valuation, and other procedural matters, including customs debt enforcement. In the short term, it is likely that the majority of GDC activity in this area will be in the form of requests to other member states for assistance, particularly in the area of enforcement. Given the extent of its land borders, the already substantial level of smuggling (through commercial shipping channels and coastline activity), the benefits that can accrue from mutual assistance in this type of work are substantial.

In the fight against narcotic drugs trade, mutual assistance with ASEAN partners is essential. While good cooperation has already been achieved in this area, continued pressure must be maintained if the ASEAN goal of achieving a region free from narcotic trafficking by 2020 is to be achieved.

It is essential that the revision of the customs law should be ensure to take into account the need for mutual assistance between customs services, and provides for the legal exchange of information between administrations, including that held on computers. And the legal provision for the attendance of members of the GDC as witnesses in the courts of other member states should be reviewed. Furthermore, the adequacy of legal and practical arrangements for joint activities against smuggling and fraud should be considered. And structured liaison between enforcement units at regional and point of entry levels should be encouraged. Finally, bilateral mutual assistance agreements supported by a legal framework with countries outside ASEAN who have substantial trade with Viet Nam should be developed.

## **9.4.5 International Customs Forums**

In keeping with Viet Nam's commitments to ASEAN and the WCO, together with the wish for further involvement with the WTO and APEC, the GDC needs to continue to fully participate in international customs forums. The benefits to the GDC in terms of shared experience and opportunity to influence the harmonization of procedures, outweighs the direct costs of participation. There will also be the opportunity, especially within ASEAN, to actively influence policy decisions that will affect the regions' approach to customs procedures and practice.

Considering the level of smuggling activity currently affecting Viet Nam and the limited successes achieved through interdiction, this is an area in which Viet Nam could contribute more of their experience and methodologies for the benefit of other services. It is of particular importance that GDC stays abreast of the developments being undertaken within the WCO for the updating of the Kyoto Convention, which provides guidance to customs services and businesses on best practice for import and export procedures. As Viet Nam is in the process of amending its customs law, being aware of and influencing changes to Kyoto are of considerable importance.

### **Internet**

Viet Nam could improve its links with the WCO and other customs services by establishing access to the Internet and establishing its own web page. The WCO has its own web pages both for public consumption and those controlled by password, accessible only to member customs services. The Internet provides a very rapid and cheap method of obtaining up-to-

date information from the WCO. Additionally, many customs services now have their own web pages that provide information on the service, copies of legislation or other documentation, press releases, and in some cases, the ability to download forms for completion. As well as customs services, information from organizations such as the WTO, World Bank, EU, UN, NAFTA and ASEAN, together with many commercial operations of interest to customs such as the PSI (pre-shipment inspection) companies, all have extensive web sites that allow rapid access to documents and reports.

The general acceptance of the internet as a means of acquiring knowledge and transmitting information within the international business community would provide the opportunity for informing companies of the laws, procedures and services offered by the GDC well before the companies commenced trading in Viet Nam. It would also allow those already trading in the country to update their information regularly and be made more easily aware of addresses and contact names for additional advice or information.

It is recommended that active involvement with the WCO, paying particular attention to the current discussions on the Kyoto Convention reforms, should continue, and an internet connection within the GDC and a web site for the GDC providing information on customs laws, procedures, advice centres and contact points be established.

#### **9.4.6 Technical Assistance Programme to ASEAN Customs Administrations**

One of the principle early benefits of the ASEAN customs harmonization process for the GDC is the opportunity to participate in Technical Assistance Programmes. A first step to achieving the best value from these programmes would be a comprehensive needs-analysis conducted by a team from the GDC, the ASEAN Secretariat, and one of the more developed ASEAN customs services. In parallel with the needs analysis, the team could undertake detailed work on identifying sources of appropriate assistance within ASEAN, as well as options for funding the activity.

An area in which the GDC could take the lead would be to propose the development of a programme within ASEAN for the exchange of staff at various levels within the customs services, for periods of work or study within other member states customs administrations.<sup>128</sup> While much work would be required to establish the boundaries and funding of such a scheme, the potential assistance it would provide for ASEAN customs harmonization through improved understanding of problems across a broad band of experience, would be substantial.

A joint GDC/ASEAN team to provide a detailed needs/sources/funding analysis of the GDC requirement for technical assistance from within ASEAN should be established. And ways in which GDC could deliver technical assistance within ASEAN should be quickly identified. Furthermore, it should take the lead in proposing the development of an exchange scheme within ASEAN customs services similar in scope to that operated by the EU.

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<sup>128</sup> This would parallel the scheme operate by the EU for the exchange of customs officials initially within its borders but now extended to the countries of eastern Europe which has been very successful in spreading best practice, cooperation and cross-cultural understanding within the participating states.

### **9.4.7 Training and Human Resource Development**

As with the ASEAN Technical Assistance Programme, training and human resource development requires a needs analysis to be undertaken to ascertain the most cost-effective way of ensuring that the GDC benefits fully from its ASEAN opportunities. Training in the management and application of change, the use of risk management techniques, tariff harmonization, the GATT valuation system, and post import-export control (PIEC) procedures would need to be addressed quickly. Further technical and management training can be scheduled in keeping with the results of the needs-analysis and the availability of training resources and funding.

The proposal, as set out in the previous section, for the development within ASEAN of a scheme to allow the exchange of officers between customs services for periods of operational experience, as well as study or training, should be considered. It would be of particular advantage to the GDC to receive practical experience concerning commercially related customs activities and risk-based management techniques, while allowing GDC to reciprocate in areas such as anti-smuggling.

Within the strategic planning and management of change, consideration needs to be given to the development of the GDC's human resources. Aspects of human resources that should be reviewed include the setting of targets and the introduction of structured performance reviews on a regular basis. In all areas of activity, the encouragement of innovation and risk management strategies should be encouraged. Linked to the structured training programmes, career development paths should be available for all staff.

An open and fair appointment system will also enhance GDC's commitment to integrity, which is essential for the long-term effectiveness and acceptance of change. Three of the primary attributes within any suitability criteria for customs officials are integrity, adaptability, and initiative. Technical training can always be provided and assimilated but these primary attributes cannot be taught. As new methods of working may prove difficult, even for those who appear initially to have the right attributes, a probationary period of six months service following training, should be considered.

It is necessary to undertake a training-needs analysis. Priority areas of training associated with ASEAN commitments needs to be identified. And source training to meet needs and priorities should be implemented. In addition, to plan funding for the training and to establish a training implementation plan and timetable taking into account operational needs should be done. It is essential to review human resource needs taking particular note of the implications of ASEAN commitments. And it should be ensured that a target setting and structured review process is implemented and understood by all officials. Furthermore, it should propose within ASEAN the development of a scheme for the exchange of officers to obtain operational and cross-cultural experience.

### **9.4.8 Cargo Processing**

The demand for the development of common cargo processing procedures envisaged in the ASEAN Customs Vision document is likely to increase rapidly once AFTA comes closer to reality. The lack of common procedures or an ASEAN customs code makes it important that GDC take great care in the development of their own systems to ensure that they take into

account the progress being made in this direction at various ASEAN customs meetings. The current lack of a common approach to cargo processing, does however, offer GDC the opportunity to strongly influence the ultimate shape of the ASEAN process, instead of having to adapt to an existing code. An improved Kyoto Convention is likely to become the world standard approved by the WTO and applied in one form or another by most of the worlds' customs services. Similarly, the study of the development of the customs codes of the EU, NAFTA and the CIS may give consideration to the adoption of relevant procedures by ASEAN. Again, this is an area in which GDC could actively encourage debate.

What is sought by business, both within ASEAN and elsewhere, are customs systems which are easy to understand, fair and consistent in their application, minimal in their demands (especially at the frontier), quick in operation through the use of electronic systems, and have the ability to utilize direct trade input techniques and international data standards.

Furthermore, the use of guarantees or deposits, which allow a deferred duty payment scheme to operate, are understood and accepted by the international business community. The present system of deferment, without any security being taken for the duty, and which allows companies to delay payment beyond the statutory periods, or default on payment and disappear, requires urgent reform.

Within the context of basic customs procedures, international business is familiar with and supports the use of Single Administrative Documents (SADs) for clearance purposes. SAD's are a single declaration document used for all customs transactions regardless of whether they relate to import, export or transit. Coding systems are used to identify the nature of each transaction, such as home use, warehousing or temporary importation/exportation under a special regime. Other matters such as licensing, quotas, VAT and excise payments can all be coded together with statistical information in a standard format on the SAD. The SAD also provides for self-assessment of import duty and taxes, together with the provision of areas for recording customs activity or authorizations.

The best known SADs are those of the EU, which have been adopted as a standard by many states outside of Europe who wish to computerize their systems.<sup>129</sup> It is apparent that GDC favours the adoption of the EU SAD by ASEAN, as do some other ASEAN members, but technical difficulties, particularly over the number of digits that can be accommodated within certain areas of the form, have delayed progress. Given the probability that the EU SAD or a form closely based upon it will ultimately be adopted by ASEAN, it would seem appropriate for Viet Nam to adopt the use of the EU SAD at the earliest opportunity. That decision would facilitate computerization, introduce self-assessment, and speed up the processing of all customs transactions. Such an approach would be welcomed by business and provide a lead to other ASEAN nations. In the event that the chosen ASEAN SAD was based on the EU SAD, adaptation would not be difficult for Viet Nam.

In addition to simplification in the processing of documents, one of the critical issues to which the GDC is going to have to give considerable attention is their approach to physical examination of cargo. The present system appears to rely heavily on physical examination with rates approaching 100 per cent. However, errors or contraband found during routine examination do not appear to justify this effort. The delay and inconvenience caused to legitimate trade by this approach is considerable. The introduction of risk-based selection

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<sup>129</sup> Russia and the CIS have a similar SAD to the EU.

techniques linked to good intelligence and post import-export activity, is important in achieving an overall improvement in cargo processing.

As the computerized clearance of cargo will continue to be a principle feature of developments within ASEAN and world trade, it is important that the GDC reviews its activities in this area. However, before committing very high levels of resources to IT for cargo clearance, it is essential that fundamental matters of customs law and procedures are addressed first.

## Risk Management

Like many transitional economies, Viet Nam continues to rely on very high levels of routine physical control over passengers and cargo entering its territory, both for the levying of import taxes and for the control of prohibited or restricted goods. These controls are burdensome to the innocent traveler and legitimate businesses engaged in import-export trade, and do not justify their existence in terms of the successful suppression of smuggling. They are also expensive to maintain and tend to encourage a low quality of application because of their routine and repetitive nature. Customs officials, encouraged to use initiative and intelligence in the application of selective controls, are likely to apply them to a much higher standard and with more success. Smugglers are also discouraged by the proper use of risk assessment techniques, despite the apparent opportunity for unchallenged passage through the controls. They are aware that active intelligence measures are being taken to detect them, and if stopped the chance that their contraband will be discovered during an examination conducted by a well-motivated and trained officer is much higher. This process, when linked to effective management and internal audit, ensures that the opportunities for evasion through corruption are also significantly reduced.

The argument for selective control applies equally to passengers and freight. Computerized systems, such as ASYCUDA++, can be designed to provide the ideal opportunity for the application of well-directed physical and paper controls on freight through the use of a selectivity module. This module does not remove the decision-making responsibilities from the GDC, but simply allows them to apply both their risk testing and specific controls more accurately.

A manual adaptation of this system, whilst slower to operate than a computerized system, will still give a significant improvement in speed and effectiveness as compared to 100 per cent documentary and physical examination. The basis of the information used for selection purposes should be determined by risk identified through intelligence activity, examples of which include commodity, destination/origin, importer/exporter, carrier, value, and a combination of factors and upon the needs of specific control programmes such as licensing, valuation, quotas, verification, and penalty recovery.

Computer and manual selectivity systems should be constructed to generate a small percentage of “random” selections in any category of examination on a scale, pre-set by the GDC, which should be used to test the accuracy and effectiveness of the other modes of selection. Random selections are an important part of the intelligence process as they often identify new methodologies of smuggling. They are also both a deterrent and a tool in the detection of corruption. Upon the basis of the criteria for selection entered by customs intelligence teams, the selectivity programme should identify consignments which meet varying criteria and direct them to one of three options: a yellow channel for examination of

paper work associated with the movement of the good, a red channel for full physical examination in addition to scrutiny of the supporting paperwork and, a blue channel which allows for immediate release but routes the papers to the post import export control team (PIEC) for examination of supporting commercial records at the premises of the company, after the release of the goods has taken place.

The remaining majority of goods requires no physical intervention and should be immediately released once the required duties or taxes have been secured (the green channel).

It is recommended to introduce selective examination of documents and goods based on risk-assessment principles and to adopt the EU SAD immediately for all customs freight declarations. A green channel or fast-track clearance facility for ASEAN goods should be activated. In addition, it is essential to implement the procedures of the Kyoto Convention as the basis for all freight processing. Security or guarantee for the payment of duty before release of goods qualifying for deferred duty payment should be required.

#### **9.4.9 Valuation**

As Viet Nam is committed to the introduction of the GATT valuation methodology an important aspect of customs control is the identification of inaccurate or suspicious value declarations. Provision needs to be made within the clearance system, both manual and electronic, for the setting of parameters to identify cargoes with declared values outside specific limits and select them for detailed examination. Development of such a system should allow for its linking to intelligence databases including any dealing specifically with valuation data available from commercial sources together with information obtained from the post import-export control (PIEC) team activities. Increased liaison with other customs services and making full use of facilities offered by membership of the WCO, in order to verify suspect invoices, are also necessary.

GATT valuation system should be introduced immediately. It is also recommended to verify declared values by post import audit and mutual assistance and to review level of valuation fraud on the basis of audit findings. And appropriate remedial measures should be considered if valuation fraud reaches unacceptable levels.

#### **9.4.10 Audit**

##### **Commercial Operations**

A substantial contribution to improved quality and speed of customs clearance at the frontier can be achieved by the development of Post Import Export Control (PIEC) teams undertaking the audit of traders transactional systems after the movement of goods has taken place.

Through these visits to commercial and retail premises, the PIEC teams can verify import-export declarations by examining the normal trading records of companies and identify contraband stocks and potential smuggling organizations. The teams can improve links with the business community and acquire information of further use for intelligence teams. They can also undertake the selective examination of importers' and exporters' records and accounts, at a variable period, after the transaction has taken place. In addition, additional

revenue can be raised through the identification of fraud and genuine errors in declarations. These teams can contribute to the flow of information through which risk assessment can be improved, and suspected smuggling activities targeted by the intelligence teams. They can verify declared values. The opportunity to look beyond the documents presented at the frontier for clearance purposes, by examining the whole structure of a company through its normal trading records, will be of substantial benefit in determining the accuracy of value declarations. Furthermore they can ensure smuggling through the use of false invoices more difficult and less economic for the importer.

## Retail Control

Additional action in cooperation with the local authorities, particularly at the retail level, to undertake checks on the provenance of high-risk revenue goods, such as tobacco products, alcohol, electronic goods and bicycles, would be valuable. It would be particularly beneficial in the development of information for risk analysis and management purposes. Regular visits to markets and retailers by the PIEC Team may identify contraband, along with links in the supply chain.

Given the high levels of smuggling of alcohol and tobacco in Viet Nam, consideration should be given to the restricting of sales of these items to outlets that have been specially licenced for the purpose. The potential loss of the licence and their subsequent inability to trade legally in such goods, if they are found to be dealing in contraband, would be a power incentive to trade lawfully. The reduction in the number of legal outlets would make enforcement easier. The setting of a realistic licence fee would discourage casual traders, pay for the administration of the scheme, and raise revenue.

This type of control measure is best linked to a well conducted publicity campaign aimed at discouraging smuggling, which should offer opportunities and incentives for the provision of high quality information relating to those engaged in large-scale illegal importation. This scheme could also serve as a valuable intelligence tool. The cost of the scheme could be financed from the additional revenue raised, the sale of non-prohibited contraband seized or penalties imposed on offenders.

## Internal Audit

All GDC systems, whether financial or not, should be audited on a risk assessed timetable. Basic auditing of the adequacy and performance of procedures and financial regularity should be included in all line management activities. These management controls should be supplemented by a nationally planned and directed programme of in-depth auditing, by an internal audit unit working independently of any operational area, and reporting directly to the head of GDC. The staff of this unit should be trained in financial and systems audit work to internationally recognized professional standards. The internal audit unit should publish an annual report of findings drawing particular attention both to areas of weakness and best practice.

## External Audit

The GDC as a whole should be subject to regular systematic audits by an external auditing agency of the government. These audits should be based on systems examinations and seek to identify best practice, as well as inefficiency or malfeasance. In its approach to all auditing

procedures, GDC should take into consideration any proposals made by ASEAN in the context of the development of the Customs Vision Statement.

It will be essential that the law on post import and export control should be reviewed and the law should be amended when necessary. A post import/export control team (PIECT) to undertake audit activities at business premises should be established and trained. In addition, examination of high-risk stock and records at retail and market premises using PIECT, and where appropriate, local authorities should be conducted. It is also essential to review the legal and practical consequences of a publicized telephone system for obtaining information on contraband consignments. And a licensing scheme needs to be considered for retailers of goods carrying high levels of duty, which are regularly smuggled on a commercial scale.

#### **9.4.11 Tariff Classification**

Viet Nam is committed to the acceptance of the ASEAN Harmonized Tariff Nomenclature (AHTN), which is to follow the eight-digit code of the WCO's harmonized system. This should represent little difficulty for Viet Nam, whose current code is based on the HS and runs to eight digits. Given that the GDC are already experienced in the use of present HS-based tariff, the AHTN should not present any operational problems.

It would be worth considering the adoption of a system used in a number of customs administrations whereby a small number of customs officials representing the head office, regional offices, and the main points of cargo processing, are given enhanced training in tariff classification activities. If adopted, these individuals could then form the nucleus of well-publicized help desks, which would provide advice and assistance to both colleagues and the trading companies. Provision should also be made for the company to obtain binding classification decisions in advance of importation, by submitting samples of goods for examination. The classification process should be supported by access to laboratory or other specialist testing facilities for advice on complex items.

The ASEAN Harmonized Tariff Nomenclature (AHTN) in 1998 is recommended to finalize and implement. Key staff should be trained in HS classification procedures in order to undertake help desk duties. In addition, it is necessary to adopt and publicize a system for binding classification procedures for use by importers/exporters prior to their transactions taking place.

#### **9.4.12 Rules of Origin**

In any area that involves special treatment for goods based on their origin, the rules surrounding qualification for that treatment are of great importance for customs. In the case of AFTA, the rules are clearly set out and in broad terms require, in the case of manufactured goods, 40 per cent of the value of the goods to be represented by activity undertaken within ASEAN. For raw material and agricultural products the rule is generally 100 per cent ASEAN origin. The system is controlled through the provision of Certificates of Origin (known as Form D) to exporters, by designated authorities, within the country of origin. The certificate of origin provides details of the qualifying goods based on information supplied by the exporter to the certifying authority. This information is subject to verification, both by the

issuing authority and at the request of the authorities in the importing state, normally customs. The investigation of certificates of origin is time consuming, and a lengthy period is allowed for action by the exporting state, which is acceptable for routine verifications but not satisfactory where inquiries are taking place into suspected fraud. Without a certificate of origin, ASEAN goods will not qualify for AFTA preferential tariff rates. It is therefore important that steps are taken to ensure that Vietnamese importers and exporters are made aware of this requirement and the procedures involved. In conjunction with such publicity, initiative training in origin procedures should be given both to GDC help desk staff and to those dealing with ASEAN trade.

It will be worth establishing a system, well publicized to staff, for the routine verification of a small percentage of all non-suspect certificates of origin. To ensure a good liaison with other ASEAN members and overall monitoring of the procedure, a central point should be established for the processing of all requests for verification. Consideration should also be given to discussing with other ASEAN members the establishment of a fast-track verification system for those cases where fraud, involving certificates of origin, is suspected. In cases where there is a problem over the adequacy of the evidence of origin, but fraud is not suspected, a provision should be made for the release of the goods. This could be made against the payment of duty on deposit or the provision of a suitable guarantee for the payment of the full rate of duty, within a predetermined period, in which evidence of origin is produced.

It is necessary to establish an enhanced training programme for staff operating help desks or dealing with high levels of ASEAN traffic. It is recommended to publicize the verification process within the GDC and operate a centralized system for processing and monitoring all requests. It is necessary to discuss with the other ASEAN members the establishment of a fast track verification procedure for cases where fraud is suspected. In addition, the legal and procedural arrangements necessary for the provision of a system should be considered which allows for the securing of duty on a temporary basis where initial evidence of origin is inadequate.

### **9.4.13 Procedures for Goods in Transit and Temporary Admission**

At present, there is no common procedure for transit within the ASEAN region. While this presents difficulties for Viet Nam on deciding in which way to develop its system, it also provides an excellent opportunity to influence the ultimate structure of the ASEAN system. Viet Nam has two forms of transit across its territory, internal and external. Each of these represents differing problems and risks. However, the basic concepts of evaluating the risk, securing any potential duty, and monitoring the traffic share common aspects. The enforcement and verification procedures for the transit of popular high duty goods such as tobacco, alcohol or consumer electronics, should clearly be different to those carried out for duty free or specialized industrial cargo. However, the basic principle of securing any duty liability through a guarantee system is relevant to all goods. The level of the guarantee must be at least equal to that of the duty revenue at risk. In all cases, guarantees should only be accepted from banks, insurance companies, or other financial institutions that are either internationally recognized or specifically approved for the purpose by the government.

The monitoring of transit movements by controlling the declarations, designating the route and time to be taken, and ensuring the effective sealing of the consignment, should remove

the necessity to escort or convoy transit goods. Physical inspections of transit goods should be limited to cases of suspicion and a very small percentage of random checks to test the risks inherent in the system. An effective system enabling the transit import points to receive certified copies of the original declaration from the export point should be established, as well as prompt notification to the appropriate organisation of the discharge of the guarantee. The entire system of declaring and monitoring transits is made much easier where a computerized clearance system is in operation.

It will be worth reviewing and revising all transit procedures and to ensure adequate provision is made for a system of guarantees covering all forms of transit. A computerized monitoring system for transit utilizing current technology and software should be designed and implemented. It is also recommended to ensure that adequate provision is made for transit in future specifications for computerization of the freight clearance system, and revisions are taken into account during drafting of new customs law.

#### **9.4.14 Automation**

Given the growth potential of Viet Nam as a trading nation, the computerization of many aspects of the activities of the GDC is a high priority. The need for harmonization with ASEAN on customs matters adds to the urgency of the issue. Computerization should incorporate freight clearance, accounting, management information, asset management, personnel management, enforcement, communications, and public relations.

There is virtually no area of customs activity that will not be enhanced by a well-constructed computerization programme. It is also essential that legal, procedural, and management reform drive the process of computerization, which should be recognized as an important support mechanism for a sound administration. Attempts to promote procedural change from within a computerization project often fail or lead to resistance to reform from operational staff. Despite the necessity to ensure that computerization is seen as an ingredient of reform, and not its primary activity, good IT systems have a strong role to play in the modernization of all customs services. Information technology will speed clearance, ensure that finances are brought to account quickly and fully, track debt, enhance audit procedures, support enforcement action, especially intelligence activity, provide management information, inhibit and track many types of corruption; and allow for greater efficiency in all areas of activity.

Given the experience of several ASEAN members in the customs computerization field, it would be prudent for GDC to undertake a close study of at least two of these countries, for example, Singapore and the Philippines. While undertaking such a study, the GDC should be clear on its own needs, and question and test the strengths of the systems they view against those needs and their own experiences. In parallel, it is essential that the legal aspects of data management, storage and transfer are fully reviewed.

Computerization of areas such as freight clearance will bring benefits in terms of enhanced revenue yield and greater trade efficiency, with direct benefits to the national economy. A programme of appropriate research and IT implementation should be one of the primary pieces of strategy emerging from a consideration of policy during any WCO Diagnostic Study by the GDC.

It should ensure that IT policy and strategy is fully considered during any Diagnostic Study. A team of operational and IT specialists to study ASEAN Customs IT systems should be

created. It is necessary to include comprehensive coverage of IT issues in the draft customs law. Furthermore, discussions should be initiated with the trading community on direct trader input issues.

#### **9.4.15 Enforcement**

The GDC already has a structured approach to enforcement, illustrated by its responses to smuggling. While duty reductions under AFTA may reduce some smuggling, major contraband operations are likely to remain a problem for the GDC for some years to come. The legal revisions currently taking place are clearly a necessary step to ensure that the GDC has the powers to effectively pursue all offences relating to importation and exportation, without the necessity to pass them to other agencies for action. However, the necessity for the continued maintenance of good working relationships and, on occasions, joint operations with other law enforcement agencies, should not be neglected.

Administrative boundaries, which hinder a rapid flow of information or swift operational deployment, may make bureaucratic sense, but only serve to assist criminals who have no such constraints. In parallel with administrative reform, a review of intelligence activities and co-ordination in respect to fraud and smuggling would be of benefit, particularly if it was conducted in such a way as to take into account of international best practice.

Deeper involvement with ASEAN offers the opportunity for exchange of information and personnel within the region, which could greatly assist the enforcement effort.

# CONCLUSION

Integration to regional or world groups is a complex and difficult process if you start with a complex trade regime. There is no doubt that Viet Nam, like other transitional economies and most other developing countries, has a complex trade regime. The bureaucratic legacy of central planning compounds the normal problems of weak administrative capacity in poor developing countries.

And while the challenge is large, the way forward remains rather unclear in Viet Nam. A desire to integrate and join the world trading community clashes with old ideas about “self-sufficiency” and the desirability of protection. Viet Nam seems to want to join trade liberalization clubs, but then views actually liberalizing as the membership fee. Liberalization as competition results: “I win if you liberalize more”. It makes no economic sense, but then nor do many policy outcomes.

Economists, sometimes ridiculed for their inability to agree, are almost universally in agreement that, in all but exceptional circumstances, trade liberalization is a win-win welfare result for all countries involved in trade. This conclusion is based on strong theoretical arguments about gains from trade and comparative advantage. It is also based on the global experience of recent decades. Countries with a ruling consensus for trade liberalization (which does not preclude entrenched protection for some powerful interest groups), try to encourage other countries to share their vision. That encouragement is sometimes viewed with caution and suspicion, particularly if trade is viewed as some sort of competition rather than a series of mutually beneficial exchanges by independent parties. In Viet Nam there are internal forces leaning in both directions.

This book is an argument for continued trade liberalization in Viet Nam. The argument is based not on theory, but on the experience of other countries in ASEAN (chapter 3), and on the detailed analysis of the impact of liberalization on government revenues (chapter 4), foreign direct investment (chapter 5), and service sector liberalization (chapter 6). In all cases it is clear that AFTA has had only a marginal impact to date, but that impact should be much greater over the next decade (assuming commitments are achieved).

The impact on government revenues will be much less than is generally presumed, particularly if the dynamic effects of trade liberalization are considered. Revenue, however, will decline, and this underscores the need for Viet Nam to continue developing more efficient and less distorting taxes in the future, such as the VAT tax introduced in 1999. The impact of ASEAN and AFTA on foreign direct investment is likely to be marginal. Rules of origin for FDI are not even developed, and are unlikely to be effective in practice. The ASEAN Investment Area will be a subject of much talk and little action for many more years. Liberalization in services is, however, more exciting. Services in general were greatly neglected under central planning, when attention focused on “material products” as the only things of “value”. Viet Nam’s service sector remains underdeveloped compared to many other poor countries. Liberalization and the stimulus of competition in this area is a priority.

Chapter nine showed the nature of the challenge for reform of Viet Nam’s Customs service. There is much that needs to be done, including harmonizing the tariff nomenclature and

adopting international valuation methodologies. While these involve complex technical tasks, they also involve political and institutional change that is difficult to enforce. The Customs service has recently participated in a diagnosis of its whole system, guided by the World Customs Organisation, and funded through a UNDP project. Reforms are gathering momentum and commitment to international agreements is sincere, but such processes of fundamental change in institutions are difficult in all countries, not just Viet Nam.

We may conclude that the economic impact of AFTA on Viet Nam has been modest. It may be much greater as the 2006 deadline approaches, but as other countries waver and backstep - Malaysian cars for example - the ability of Viet Nam to meet all of its commitments on time must weaken. It will be a testing time for those Vietnamese leaders committed to ASEAN and trade liberalization. Against them will be many strong interest groups reluctant to give up benefits and calling for more “infant” protection from “unfair competition”. The policy outcome remains unclear.

On the other hand, ASEAN and AFTA have been and remain very important avenues for promoting trade liberalization in Viet Nam. AFTA has proved a “testing ground” for the ability of Viet Nam to meet international commitments, and it is clear that they are taken seriously and efforts to meet them are sincere. ASEAN is important because Viet Nam does feel to be a full and equal member of the group, which will be much less the case when Viet Nam joins the WTO. The ASEAN group has a unity of purpose, mostly derived from common strategic concerns, but this spills over into a desire to meet the economic commitments of being a member.

But it will take time. The trade reform challenge for Viet Nam is daunting. It will take decades. Not because of training needs or technical assistance requirements, but because the consensus for free trade still remains weak in Viet Nam. Strong and meaningful trade liberalization can only come from within a country, and this is particularly true for Viet Nam where the suspicion about foreign influences runs deep. Joining AFTA has helped to stimulate that debate within Viet Nam, and in the long run that may be the most important outcome from membership.

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## **Appendix 1: List of interviews**

### **a) Government Authorities**

1. Ministry of Trade (MoT)  
24 September  
Mr. Pham The Dung, Vice-Director, Import-Export Department  
with another officer from the Import-Export Department
2. Ministry of Science, Technology and Environment (MOSTE)  
25 September  
Mr. Vinh, General Department of Quality Control.
3. Ministry of Health (MoH)  
21 September  
Ms. Minh and Mr. Ky, Pharmaceutical Controls Department.
4. Ministry of Agriculture and Rural Development (MARD)  
23 September  
Nguyen Thi Hong, Planning and Management Department, and others from the  
Science, Technology and Product Quality Department.
5. General Department of Customs (GDC)  
22 September  
Dr. Vu Ngoc Anh, Deputy Director of Customs Control & Supervision  
Mr. Ngo Minh Tuan Deputy Chief of Multilateral Cooperation Bureau
6. State Bank of Viet Nam (SBV)  
22 September  
Mr. Nguyen Quang Huy, Deputy Director, External Relations Dept.  
and 2 more Officers from the International Relations Department.

### **b) Non-Government interviews**

#### **i) State Corporations:**

7. Viet Nam National Tobacco Corporation (VINATABA)  
4 September 1998  
Mr. Le Viet Duoc, Deputy General Director
8. Union Of Ha Noi Bicycle And Motorcycle Factories (LIXEHA)  
8 September  
Mr. Le Thuoc, President of Vinacycle and General Director of Lixeha.  
Mr. Nguyen Cong Hau, Chief Accountant.  
Mr. Le Anh Tuan, Manager of Motorcycle & Furniture Trading Dept.

9. Viet Nam Paper Corporation (VINAPIMEX)  
4 September  
Mr. Doan Manh Phuc, Deputy Director General.
10. Viet Nam National Cement Corporation (VINACEMEX)  
4 September  
Mr. Dao Duy Nhan, CEO of Vietnam Cement Import Export Company,  
and one Officer of Planning Department of Viet Nam Cement Corporation.
11. Union of Pharmaceutical Enterprises  
10 September
12. Viet Nam Chemicals Corporation (VINACHEM)  
10 September  
Mr. Nguyen Van Duc, Import-Export Director.
13. Viet Nam Sugar Corporation No.1  
15 September  
Mr. Tran Van Son, Director, Commercial, Trading and Service Centre
14. Viet Nam National Textile Corporation (VINATEX)  
8 September  
Hoang Ve Dung, Director of Import-Export Department.
15. Viet Nam National Leather and Footwear Corporation (LEAPRODEXIM)  
25 September  
Mr Do Thanh Hong, Deputy Director General.
16. Viet Nam National Sundries Import-Export Corporation  
Mr. Cao Van Thuy, Manager of Import-Export Department

**ii) Trading companies and production enterprises**

17. Viet Nam Medical Products Import-Export Co. No.1 (VIMEDIMEX, HA NOI)  
11 September  
Mr. Vu Quang Duong
18. Viet Nam Chemicals Import & Export Corporation (VINACHIMEX)  
10 September  
Mr. Do Manh Duc, Director of Planning Department.
19. Viet Nam National Construction and Engineering Corporation (CONSTREXIM)  
4 September  
Madame Tran Ha Thu, Director of Import Department.
20. Viet Nam National Construction and Engineering Corporation (CONSTREXIM)  
18 November  
Madame Tran Ha Thu, Director of Import Department.

21. Starlight Electronics Co. Ltd. (SEL)  
8 September
22. Dong Da Electronic Co. (VIETRONICS Dong Da)  
8 September  
Mr. Nguyen Van Quyet, Manager of Import-Export Department.
23. Hai Ha Confectionery Company (HAIHACO)  
15 September  
Mr. Nguyen Manh Tuan, Commercial Executive
24. Garment Co. No.10 (GARCO)  
17 September  
Le Huu Hai, Sales Executive, Planning Department.
25. Viet Nam Import-Export and Trade Service Co.
26. Mangharams (HK) Ltd., Ha Noi Representative Office (Garment buyers)  
15 September  
Ngo Phuong Anh, Manager

### **iii) Commercial banks and others**

27. VIETCOMBANK  
17 November  
Nguyen Thu Ha, Deputy Executive Director, Operations Center.  
Tran Phuong Mai, Deputy Director, Import Payment Department.
28. Industrial & Commercial Bank of Viet Nam (INCOMBANK)  
17 November  
Nguyen Van Khien,  
Pham Van Anh, Expert of Credit Department,  
Tran Thi Kim Yen, Deputy Director, International Payment Department.
29. Viet Nam Chamber of Commerce and Industry (VCCI)  
16 November  
Mr. Nguyen Gia Hao, Director General, Business Consultancy Department
30. Viet Nam Chamber of Commerce and Industry (VCCI)  
17 November  
Mr. Hoang Anh Dung, Officer of International Relation Department
31. Ray Mallon  
Economic Consultant  
UNDP-CIEM State Enterprise Reform Project

## **Appendix 2: List of border taxes and charges**

### **Para-Tariff Measures (2000)**

#### Customs surcharges (2100)

#### Additional taxes and charges (2200)

- tax on foreign exchange transactions (2210)
- stamp tax (2220)
- import license fee (2230)
- consular invoice fee (2240)
- statistical tax (2250)
- tax on transport facilities (2260)
- taxes and charges for sensitive product categories (2270)
- other (2280)

#### Internal taxes and charges levied on imports (2300) [not included ASEAN]

- general sales tax (2310)
- excise tax (2320)
- taxes and charges for sensitive product categories (2370)

#### Decreed customs valuations (2400)

### **Price Control Measures (3000)**

#### Administrative pricing (3100)

- minimum import prices (3110)

#### Voluntary export price restraint (3200)

#### Variable charges (3300)

- variable levies (3310)
- variable components (3320)
- compensatory elements (3330)
- flexible import fees (3340)
- other (3390)

#### Anti-dumping measures (3400)

- anti-dumping investigations (3410)
- anti-dumping duties (3420)
- price undertakings (3430)

#### Countervailing measures (3500)

- countervailing investigations (3510)
- countervailing duties (3520)
- price undertakings (3530)

### **Finance Measures (4000)**

#### Advance payment requirements (4100)

- advance import deposit (4110)
- cash margin requirement (4120)
- advance payment of customs duties (4130)
- refundable deposits for sensitive product categories (4170)
- regulations concerning terms of payments for imports [see 4500]
- transfer delays, queuing [see 4600]

Multiple exchange rates (4200) [not included ASEAN]  
Restrictive official foreign exchange allocation (4300) [not included ASEAN]  
    prohibition of foreign exchange allocation (4310)  
    bank authorisation (4320)  
Regulations concerning terms of payments for imports (4500)  
Transfer delays, queuing (4600)

**Automatic Licensing Measures (5000)** [not included ASEAN]

Automatic License (5100)  
Import Monitoring (5200)  
    retrospective surveillance (5210)  
    prior surveillance (5220)  
    prior surveillance for sensitive product categories (5230)  
Surrender Requirement (5700)

**Quantity Control Measures (6000)** [not included ASEAN]

Non-automatic licensing (6100)  
    license with no specific ex-ante criteria (6110)  
    license for selected purchaser (6120)  
    license for specified use (6130)  
        linked with export trade (6131)  
        for purpose other than exports (6132)  
    license linked with local production (6140)  
        purchase of local goods (6141)  
        local content requirement (6142)  
        barter or counter trade (6143)  
    license linked with non-official foreign exchange (6150)  
        external foreign exchange (6151)  
        importers own foreign exchange (6152)  
    license combined with or replaced by special import authorisation (6160)  
    prior authorisation for sensitive product categories (6170)

Quotas (6200)  
    global quotas (6210)  
        unallocated (6211)  
        allocated to exporting components (6212)  
    bilateral quotas (6220)  
    seasonal quotas (6230)  
    quotas linked with export performance (6240)  
    quotas linked with purchase of local goods (6250)  
    quotas linked with local supply and demand (6260)  
    quotas for sensitive product categories (6270)

Prohibitions (6300)  
    total prohibitions (6310)  
    suspension of issuance of licenses (6320)  
    seasonal prohibition (6330)  
    temporary prohibition (6340)  
    import diversification (6350)

- prohibition on the basis of origin (embargo) (6360)
- prohibition for sensitive product categories (6370)

Export Restraints Arrangements (6600)

- voluntary export restraint arrangements (6610)
- orderly marketing arrangements (6620)
- multi-fibre arrangement (6630)
  - quota agreement (6631)
  - consultation agreement (6632)
  - administrative cooperation agreement (6633)
- export restraint arrangements on textiles outside MFA (6640)
  - quota agreement (6641)
  - consultation agreement (6642)
  - administrative cooperation agreement (6643)

Enterprise-specific Restrictions (6700)

- selective approval of importers (6710)
- enterprise-specific quota (6720)

**Monopolistic Measures (7000)**

Single channel for imports (7100)

- state trading administration (7110)
- sole importing agency (7120)

Compulsory national services (7200)

- compulsory national insurance (7210)
- compulsory national transport (7220)

**Technical Measures (8000)**

Technical Regulations (8100)

- product characteristics requirements (8110)
- marking requirements (8120)
- labelling requirements (8130)
- packaging requirements (8140)
- testing, inspection and quarantine requirements (8150)

Pre-shipment Inspection (8200)

Customs formalities (8300)

- Special formalities (8310)
- Customs efficiency (8320)
- Corruption (8350)