Globalization and International Economic Integration

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Foreword

In April 1999 the Government requested UNDP assistance in the preparation of strategic policy-based research for Viet Nam's new Ten Year Socio-Economic Development Strategy 2001-2010. A Technical Assistance project agreement with MPI was signed in September 1999.

The Project subsequently undertook and synthesized policy-based research aimed at offering international perspectives in four key areas central to the new ten year socio-economic development strategy:

- The Role of the State and the Market
- International Economic and Financial Integration
- Rural Economic and Social Development
- Science, Technology and Industrial Development

In addition, the Project offered advice on the long term socio-economic objectives to 2010 and provided practical principles and recommendations for the coherent implementation of the proposed strategies.

The Project also organized a series of technical workshops on the draft research papers as well as two high level Round Table Consultations between senior officials from the Government and the donor community. The first of these Round Tables was held in June 2000 and focused on the various draft research papers and related recommendations. The second high level Round Table was organized in November 2000 with a focus on the Government's draft of the new ten year socio-economic strategy.

MPI has been the national executing agency responsible to the Government and UNDP for the achievement of the Project's objectives, and DSI – the Development Strategy Institute - has carried implementation responsibility. Throughout, the research and consultation process was directed jointly by DSI and UNDP. In addition, the Governments of Australia and Sweden, as well as UNIDO contributed financing as well as technical support for the Project.

In the course of the project, twelve research reports and two Round Table Proceedings Reports were produced jointly by international and local experts.

The foreign experts who participated in the Project included Bob Warner, Keith Bezanson, James Riedel, Lars Holmstrom, Rebecca Dahele, Scott Fritzen, Garry Smith, Frank Flatters, Mia Huyn, David Dapice, Borje Lunggren, Suiwah Leung and Ari Kokko.

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The research and consultation process benefited greatly from the guidance and substantive advice provided by Dr. Luu Bich Ho, President of DSI / National Project Director, Nguyen Van Vinh, National Project Manager, Bui Bich Hoa, Assistant to Project Management Board as well as by officials from UNDP Viet Nam including Robert Glofcheski, Vu Quoc Huy, Johan Fredriksson, Eliane Darbellay, Ernst van Koesveld, Michael Zuyderduyn and Klaus Greifenstein.

A listing of the reports produced by this unique initiative is provided below:

- The Role of the State and the Market in the Economy of Viet Nam
- Non-State Business Sector Development and Job Creation
- Globalization and International Economic Integration
- International Financial Integration
- Further Perspectives on the Challenges of Integration
- Agriculture and Rural Development
- Rural Development and Off Farm Employment
- A Rural Social Development Strategy
- Science, Technology and Industry Strategy for Viet Nam
- Strategic New Generic Technologies
- Choices and Opportunities
- The Synthesized Report of the Research Project

The views expressed in this research report do not necessarily reflect the official views or policies of MPI or UNDP.

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Abbreviations

AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AICO	ASEAN Industrial Corporation Scheme
APEC	Asia Pacific Economic Cooperation
CEPT	Common Effective preferential Tariff Scheme
CMEA	Council for Mutual Economic Assistance
EC	European Community
EPZ	Export processing zone
ESAF	Enhanced Structural Adjustment Facilities
FDI	Foreign direct investment
FTC	Foreign trade corporation
GATS	General Agreement on Trade Inservices
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross national product
IMF	International Monetary Fund
IPR	Intellectual Property Rights
MFN	Most favoured nation
MOT	Ministry of Trade
NTBs	non-tariff barriers
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
QR	Quantitative restriction
R&D	Research and development
SAC	Structural Adjustment Credit
SDS	Socioeconomic Development Strategy
SOE	State owned enterprise
SPS	Sanitary and Phytosanitary Standards
TNC	Trans-national corporation
TPRM	Trade Policy Review Mechanism
TRIMS	Trade Related Investment Measures
TRIPS	Trade Related Aspects of Intellectual Property
UNDP	United Nations Development Programmeme
VAT	Value added tax
WTO	World Trade Organization

Summary

THE GOVERNMENT OF VIET NAM is currently preparing a Socio-economic Development Strategy (SDS) to guide the country's development in the period 2001–2010. The key objectives for this strategy are:

- maintaining stability and sovereignty;
- achieving sustainable high economic growth rates; and
- achieving sustainable poverty reduction and equity.

These objectives are interlinked, but economic growth is central. Currently around 30 per cent of the economically active population is unemployed or underemployed, and each year 1.25 million people join the workforce. Despite significant progress on poverty reduction, some 29 million people live in poverty. Generating productive employment and income generation opportunities therefore must be at the forefront of the strategy, and this requires a growing economy.

> "Economic growth and increasing incomes are not the only ingredients for meeting the aspirations of the Vietnamese people over the next decade. But providing the other ingredients will not be possible unless the economy grows strongly".

Integration and ecmnomic development

Growth will depend heavily on maintaining high levels of savings and investment: but the kind of growth rate that Viet Nam needs in order to meet ambitious development targets will require that investment be accompanied by significant increases in productivity and efficiency. Open trade and investment policies will play a crucial role in ensuring efficiency and the search for productivity growth by:

- providing access to knowledge and technology to facilitate a process of catching up with other countries;
- subjecting foreign and local enterprises to competitive pressures to improve efficiency, while providing access to new inputs, intermediate products and production practices; and
- reducing risks through diversification of markets and sources of supply and locking in good economic management.

Productivity growth — very high in the early stages of *doi moi* — has been declining in the last few years. This is partly because much of the investment undertaken in the period — especially foreign investment — has been poorly directed, largely as a result of the

prevailing trade and investment policies. Maximizing the benefits of foreign investment requires open trade and policies that promote competition.

> "Viet Nam will not be able to achieve necessary growth targets without further trade and investment liberalization".

Risks

Much debate about integration in Viet Nam focuses on perceived risks — of social and economic disruption, of threats to equity and social justice, and of constraints imposed on national sovereignty — associated with integration and the growth it will bring.

There may be some disruption as enterprises adjust to increased international competition and to new opportunities. Growth will generate new opportunities for those displaced by change. However, because of rigidities in markets for land, labour and capital and the fledgling nature of many market institutions, adjustment to change may not be smooth. Addressing the risk of disruption will require continued efforts on all aspects of the ongoing transition programme, and developing appropriate social safety nets. Since the benefits from integration come from the reallocation of resources to higher productivity uses, it would be counterproductive to offset the effects of integration with policies that impede adjustment.

Growth resulting from deeper integration will inevitably be associated with growing income disparities. Without the prospect of earning higher incomes, Vietnamese people will be unlikely to take the personal risks and make the investments required to achieve the productivity increases that must underpin national economic growth. But, without growth, government revenues will remain stagnant, unable to support an expansion of social services and infrastructure facilities needed to improve human and physical capital and reduce poverty.

Integration will impact on the role of government in economic management, imposing constraints on the scope to use certain policy instruments. But, rather than a *surrender* of national sovereignty, this should be seen as an *exercise* of sovereignty, to strengthen the nation's capacity to determine its own future.

There can be significant risks if capital account liberalization precedes the development of appropriate mechanisms to supervise and regulate the financial system and generate adequate disciplines on credit decisions by lenders and borrowers. But these do not apply to liberalization of international trade and direct investment.

> "Integration and economic growth will bring change and involve risks. But the biggest risk is associated with not pursuing deeper integration, since low growth will jeopardise all of the nation's development objectives".

Viet Nam's integration efforts

Viet Nam's path towards integration with the world economy began with some of the earliest actions of *doi moi*, and great changes have been made in the country's trade and investment policies. Much of the extraordinary reversal in economic performance experienced in the early stages of *doi moi* is linked to these changes. Exports (and imports) now amount to over 35 per cent of gross domestic product (GDP) — showing how much progress has been made towards opening up the economy. However, there is widespread recognition that the integration process must be taken much further.

There are still significant barriers to international trade and investment, which are imposing significant costs as well as impeding future developments. Current protection policies are impacting severely on agriculture and the rural areas dependent on this sector — studies have estimated that that protection to the industrial sector depresses real farm incomes by over 10 per cent. Much recent foreign investment is highly dependent on protection and may generate little economic return to the community.

Current trade and protection policies are supporting inefficient import substitution activities in certain sectors of the economy. This automatically discourages investment in export oriented activities, and imposes significant direct and indirect costs on other parts of the economy.

The principal problems with Viet Nam's trade regime are:

- continued extensive use of non-tariff barriers (NTBs) which underpin uncompetitive investments in certain sectors and seriously distort production, consumption and investment decisions;
- a tariff and export tax regime which is highly dispersed, and is subject to frequent changes and inconsistent implementation;
- complex, non-transparent and obstructive trade and customs systems which are prone to high levels of corruption and revenue loss, and greatly increase costs of engaging in international trade;
- continued intervention in the foreign exchange market, which impedes market determination of the exchange rate and disadvantages exporters and other sources of foreign exchange; and
- complex and cumbersome policies affecting the establishment of foreign investment, and continued wide divergence in the legal, regulatory and tax treatment of foreign and domestic investment.

But perhaps the biggest problem lies in the continued tendency to provide protection and other forms of assistance on a selective basis to accommodate the lack of competitiveness of favoured activities and producers. This approach favours well placed state enterprises and foreign investors, and sends strong signals that the government will intervene to maintain the financial viability of large projects, even if they are economically unsustainable.

Viet Nam is currently placing considerable emphasis on bilateral, regional and multilateral agreements in the drive for deeper integration and the government has indicated that the principles and policies of the World Trade Organization (WTO) will guide future integration efforts. This is important, and these agreements can offer useful benefits.

Viet Nam's membership of ASEAN Free Trade Area (AFTA) imposes a timetable for tariff reduction and the phasing out of quantitative restrictions (QRs) and NTBs. Back loading of liberalization, however, has meant that there has been considerable delay in government and enterprise circles in recognizing the challenges and implications of AFTA commitments. The present apparent impasse in signing the trade agreement with the United States is imposing significant costs on the economy. This is not only because of the foregone opportunities that most favoured nation (MFN) access to the United States market would provide, but also because it sends negative signals about Vietnamese attitudes towards integration that are deterring investors and those considering doing business with Viet Nam.

> "Viet Nam has made great progress in developing a trade system consistent with a modern market oriented trading economies. But much more needs to be done, and this involves rethinking the overall approach to protection and industrial development".

Making the most of economic integration

The centrality of economic integration to Viet Nam's future development seems to be firmly embedded in strategic thinking. However, there is clearly uncertainty about how to build on past actions and move forward in a way which captures the benefits to be had from integration while limiting risks and possible disruption.

Some of this uncertainty reflects concern that Viet Nam's transition to an integrated market economy is a 'journey without maps'. It also reflects the fact that the next steps in the transition are much more complex and technically and institutionally demanding than in earlier stages of the reform. And, as in many other countries, a lot of this uncertainty is fed by groups in the community who see their economic interests threatened, and who resist change even though it is in the overall interests of the community. The situation is also complicated by the reasonable concern about the incomplete nature of market institutions, which could possibly lead to perverse outcomes from further liberalization.

The experience of other countries is that trade and investment liberalization can generate significant and sustained gains, provided it is associated with supporting macro and microeconomic policies. And adjustment problems have generally been much less than feared: the only real exception being the states of the Former Soviet Union, where the evidence suggests that the countries that have liberalized trade as part of their transition programme have done better than those who have not.

One clear message from the experience of other transition economies is that the benefits of integration are most likely to be maximized, and risks minimized, if integration is pursued as one part of the broader transition process and is accompanied by:

- implementing prudent fiscal and monetary policies and implementing a market-determined exchange rate system;
- fostering enterprise development and domestic competition;
- orienting trade and tax policies towards the incentives they create for decentralized decision making;
- continuing SOE reform;
- facilitating development of efficient markets for land labour and capital; and
- creating a legal framework that fosters and reduces costs of business transactions.

Beyond this a more specific strategy for integration is required. Two key principles should inform this strategy. First, the benefits of integration arise from having resources — capital, land and labour — respond to the incentives created by exposure to international prices, competition and market opportunities. Thus, it is counterproductive to take actions to shield local enterprises from the signals created by more open trade and investment policies. Second, investors — both foreign and domestic — are influenced primarily by their expectations of *future* policy. Thus credibility, consistency, transparency and coherence of policy is essential to ensure a positive rapid response to integration efforts. It is desirable to rely as much as possible on clearly established generally announced rules and timetables for reform.

"The integration strategy should address:

- the sequencing of further trade and investment reforms;
- adoption of complementary policies to secure the benefits and facilitate the structural adjustments that integration and growth will bring in their work;
- institutional changes needed to manage economic policies as integration proceeds; and
- the promotion of public awareness of, and support for, the changes involved with integration".

Sequencing of trade and investment reforms

The sequencing of trade and investment reforms and associated institution building will be strongly shaped by Viet Nam's decision to pursue accession to the WTO, and implementation of AFTA commitments.

Most of the changes that accession and compliance with the various agreements will require are consistent with what Viet Nam would want to do regardless of WTO (although the sequencing and timing might be approached differently). But besides preparing for these changes — and developing a sensible strategy for negotiating the remaining stages of accession — Viet Nam should:

- incorporate the guiding principles of WTO into domestic policy formulation as quickly as possible;
- formulate and adopt a strategy for tariff based protection, involving a programme for phasing out NTBs and moving towards a lower and more uniform and more stable tariff structure;
  - for some NTBs, the key is to develop appropriate, non-discriminatory forms of regulation to achieve non-protective objectives;
  - for others, the issue is to switch to tariff based protection as soon as possible to send clear signals to producers and investors that the level of protection is bounded;
- remove impediments to market determination of the exchange rate;
- adopt an appropriate policy and institutional regime to promote domestic competition — placing priority on review and reform of regulation, laws and administrative practices that impede competition; and
- moving towards a unified legal, regulatory and taxation treatment of domestic and foreign investment.

"The two most important priorities are to:

- establish a clear road map for replacing NTBs by tariffs and/or more appropriate forms of regulation, and implement it as quickly as technically possible;
- send a clear signal that the government will not longer accord protection to underwrite the financial viability of existing or new projects regardless of the economic costs".

Complementary policies to manage and facilitate adjustment

Complementary policies

The debate over integration in Viet Nam makes much of a need to provide enterprises in protected industries with time to adjust and to make new investments to be able to meet international competition. This is not a compelling argument, and suffers from the same flaws as the argument for infant industry protection: both ignore the costs imposed on the rest of the economy, and the difficulty of ever weaning enterprises off protection. However, there are reasons in Viet Nam for moving carefully on trade and investment liberalization:

- some trade controls are used primarily to achieve non-protective objectives, and will need to be replaced by other instruments;

- many current regulations and systems impede adjustment to change (for example, on land use and investment);
- the revenue system remains dependent on trade, and ongoing tax reforms are moving slowly to broaden the tax base;
- much state investment planning appears to assume that trade and investment policies will be adjusted to accommodate and validate investment decisions — planning processes will need to be changed to factor in the implications of changes in trade and investment policies;
- trade and investment liberalization has implications for, and is closely intertwined with, reforms of the SOE sector;
- ongoing efforts to develop a sound and competitive financial system will play a critical role in securing the benefits of liberalization.

For these reasons, liberalization will need to be accompanied by continued progress on other elements of the transition and renovation process.

> "Given linkages to other areas of policy and administrative reform, successful integration will be associated with profound changes in the role of the state in shaping the economy. It will contribute to the shift to state economic management through indirect means, relying on the incentives created by policies to influence decentralized — and increasingly private — production and investment decisions".

Facilitating adjustment

Implementation of the trade and investment liberalization strategy — and the growth it will bring — will generate pressures for structural adjustment. These adjustments will create some complex challenges for government policy. There will be intense pressure from vested interests for special treatment, and the social costs of adjustment in some areas of the country may be judged to be unacceptably high.

To address this challenge, the government will need to take actions to:

- develop mechanisms to assess requests for special treatment during the adjustment process, using criteria based on the overall national interest, and not sectoral, regional or personal interest;
- facilitate adjustment by removing impediments facing enterprises, industries and workers;
- develop social investment programmes to help people acquire the education and skills required by a modernizing economy; and
- support the development of appropriate social safety nets to address the needs of people lacking the capacity to take care of their own welfare regardless of the causes.

Institutional change

Many institutional changes will be called for by the integration process, especially to implement commitments made under the various agreements Viet Nam will enter into on accession to the WTO. But one important institutional change relates to processes and procedures for consideration and granting of protection and industry assistance. Viet Nam will need to develop mechanisms to evaluate requests for protection and other forms of assistance, and these mechanisms should embrace the principles of transparency and predictability, and explicitly recognise the trade-offs and costs involved in granting protection.

"Viet Nam needs a process for considering protection that

- incorporates an economywide perspective,
- embodies transparent processes and uses transparent instruments,
- allows public input,
- supports predictability by producing road maps to future reforms, and
- binds consideration of protection in all its forms to evaluation of what is in the national interest, and not just sectoral interests".

Promoting public awareness

Integration will continue to face resistance from interests that are directly benefiting from protection from competition. There may also be continued hesitation on the part of those who fear adverse effects on national sovereignty or that integration will promote the spread of social evils. The fundamental political problem is that those who are benefiting from current policies know how they benefit, while those who bear the cost are not aware of these costs. And people understandably fear the unknown. That is why public education and the dissemination of clear road maps for future policy change are so important.

"A key part of the integration strategy should be to provide people with information about the effects of current policies and of reforms — to help them understand what is involved and how they will benefit — and to provide them with opportunities to express their views and to influence policy making".

1. *Integration and Economic Development*

THE GOVERNMENT OF VIET NAM is currently preparing a Socioeconomic Development Strategy (SDS) for the years 2001–2010. The key national development objectives guiding this strategy are:

- maintaining stability and sovereignty;
- achieving sustainable high economic growth rates; and
- sustainable poverty reduction and equity.

This report addresses the question of the contribution which economic integration through liberalization of international trade and investment can, and should, make to the pursuit of these objectives. (A companion paper deals with the other key dimensions of integration — financial sector liberalization (Flatters 2000)). This report argues that achieving sustained economic growth, which, realistically is a precondition for making significant progress on the other objectives, will not be possible without decisive actions to further liberalize international trade and investment. There is a serious risk that as other countries in the region recover from the recent crisis, and as China forges ahead with its liberalization agenda, Viet Nam will be left behind. This will create serious problems of unmet expectations for the majority of the Vietnamese people, and jeopardise stability and the prospects of continuing to reduce poverty.

Globalization, trade and investment

The past decade has seen considerable attention devoted throughout the world to the processes of globalisation. The World Bank has pointed out that:

> …at the end of the 20th century, globalization has already demonstrated that economic decisions, wherever they are made in the world, must take international factors into account. While the movement of goods, services, ideas, and capital across national borders is not new, its acceleration in the last decade makes a qualitative break with the past. The world is not longer a collection of relatively autonomous neighbourhoods that are only marginally connected (by trade for example) and are generally immune to events in other neighbourhoods. Information and ideas can be accessed in all corners of the globe at the push of a button. The international economic order is evolving into a highly integrated and electronically networked system (World Bank 1999a).

The driving force behind globalization has been the expansion of trade in goods and services and with that the expansion of foreign direct investment (FDI). This expansion has been a response to changing technology, which is reducing the costs of international transport and communications, and facilitating the dispersion of related production and marketing activities throughout the world. Many countries — especially developing countries — have adopted policy stances to open their economies to FDI and trade. This has accompanied the internationalization of production networks, as large corporations have used scale economies, proprietary knowledge and management systems to take best possible advantage of the opportunities for locating stages of production and marketing across countries according to transport costs, markets and costs of production.

With large scope for further reductions in costs of transport and communications and technological catch up by developing countries, the economic and technical forces underpinning expansion of international trade and investment seem alive and well. This is despite some evidence of faltering in international forums associated with trade liberalization.

Most developing countries will continue to participate in these processes, as appreciation of the costs of persisting with policies of protection and excessive regulations of foreign investment shapes development strategies.

> For poorer countries especially, excessive protection shields local residents from a key transformative mechanism. Trade and investment can bring knowledge. Openness to trade does not just make it possible for consumers to consume at a lower cost suggested by standard models of trade; it also opens up new possibilities by forcing firms to innovate and by offering them new inputs and intermediate goods that embody new knowledge. Foreign direct investment can bring with it not just investment capital, but also secures human capital, new ways of organizing production and access to international marketing channels and 'knowledge networks' (Stiglitz 1999).

Recognizing the imperatives of participating in the processes, the government of Viet Nam has committed itself to achieving deeper integration with the regional and world economies. But there is still considerable debate about the questions of how integration should be pursued. This debate is concerned with issues such as the following.

- What should be the pace of liberalization? Should liberalization be delayed to provide time for existing enterprises to be restructured and made ready for international competition? Should liberalization be sequenced around the process of developing the institutions needed for a modern market economy?
- Should integration be pursued by entering into multilateral, regional, bilateral agreements, by unilateral liberalization or by a combination of these?
- What measures are needed to complement trade and investment liberalization to maximize the benefits and minimize the risks?

To a large degree, the process of answering these questions is linked to the process of assessing the nature of the risks and rewards from integration. Thus a strategy for integration should be based on assessment of where the gains from integration are likely to arise in Viet Nam, how integration will contribute to the country's development objectives, the adjustment that will consequent on further liberalization and exposure to world markets, and the changes in approaches to social and economic policy making that will be called for.

Viet Nam's development objectives

The imperative of economic growth and the need for jobs

Currently, around 10 million people accounting for 30 per cent of the economically active population of Viet Nam are unemployed or underemployed. Each year some 1.25 million people join the workforce. Despite significant inroads made into poverty, some 29 million people, or around 37 per cent of the population are estimated to live in poverty (based on an internationally comparable poverty line). Generating productive employment opportunities must be at the forefront of the Government's socioeconomic development objectives for the next decade. This will only be possible with a strategy that places high priority on continued economic growth.

Economic growth and increasing incomes are not the only ingredients for meeting the aspirations of the Vietnamese people over the next decade. But providing all of the other ingredients, and achieving socio-economic stability will not be possible unless the economy maintains strong growth.

The role of trade and investment

The growth targets for the SDS for the period 2000 to 2010 have not yet been specified. However, it is reasonable to expect that annual growth of 7 to 8 per cent, comparable to rates achieved in the 1990s will be the benchmark for the next ten years.

Replicating the growth performance of the first decade of *doi moi* will be a challenge, since the potential for strong productivity gains from the early reforms has been largely exploited. Attaining such growth targets for SDS will require accepting (and facilitating) significant changes in the structure of the economy (with associated social adjustments), because some sectors will grow more rapidly than others, and will need to draw resources from other uses to produce this growth. Increments to output from agriculture will be important, but it will be other sectors — industry and services — that will grow rapidly and so account for an increasing share of gross domestic product (GDP). These sectors will need to grow rapidly to absorb the labour that will be shed as agricultural productivity increases.

Meeting these growth targets will require an exceptional performance in mobilizing domestic and foreign savings, and in ensuring the efficiency of the investments made with these savings. It will also be conditional on major achievements in human capital enhancement to provide the workforce with the skills and health standards to meet the demands of a rapidly industrializing economy. And it will be predicated on success in meeting the infrastructural needs created by modernization.

A realistic strategy for sustained economic growth has to encompass a wide range of concerns. It must emphasise pushing forward with the transition to a market economy. Actions must be taken across a wide front, and these actions will be strongly interconnected, including:

- macroeconomic management, to create a stable and predictable environment for business decision-making;
- industry policies, — such as trade and investment policies and sectoral regulation — that shape the environment for decentralized decision making and the investment and production decisions of state and private enterprises;
- enterprise development, covering the regulatory environment for enterprise formation and development, and the process of SOE divestiture and reform;
- factor market policies, dealing with actions required to promote development of efficient markets for land, labour and capital;
- human resource development policies, to develop institutions capable of equipping people with the necessary skills;
- institutional development issues addressing the need to foster development of market institutions, strengthen the legal framework for business transactions, and to create a sound and competitive financial sector to mobilize savings and channel them into productive investments.

These actions may also need to be accompanied by measures to ensure an equitable distribution of the benefits of growth and to ameliorate, where appropriate, the social costs of adjustment to change.

Deeper economic integration, pursued through adoption of increasingly open trade and investment policies will be critical to achieving these growth objectives. While the contribution of integration to socio-economic development is complex, two key vehicles for prompting growth in a country such as Viet Nam are clear: catching up and promoting efficiency.

Catching up

The pursuit of economic growth in Viet Nam has been influenced by an extensive debate about the country's capacity to replicate the performance of neighbouring countries (and more recently, how to avoid the risks of financial instability that has beset some of these economies). Many commentators have tried to draw lessons for Viet Nam from the pre-crisis success of a number of East Asian economies — Hong Kong, Indonesia, the Republic of Korea, Malaysia, Singapore, Taiwan and Thailand.

Considerable caution is required in considering other countries policies as complete models for Viet Nam. However, the experience of these countries is evidence that countries at early stages of development are often able to grow relatively rapidly because they can borrow — or purchase — existing technology from developed countries. This contrasts to the situation of developed countries that are limited by the pace at which new technology can be developed.

This is sometimes referred to as the 'catch-up' factor. Eventually it is to be expected that as countries grow and come to adopt modern technology — that is, to 'catch up' — their rates of growth will slacken and growth rates will converge. But at this stage, and for the foreseeable future, countries like Viet Nam do have the ‘catch-up’ option available as a means of achieving rapid growth (Box 1.1). Indeed, if the so-called information technology revolution promises a new wave of rapid growth in developed countries Viet Nam should be able to also benefit from that wave. Thus, a useful way of thinking about a growth and development strategy for a country like Viet Nam is to ask what can be done to take advantage of the sources of growth, including ‘catch-up’, identified earlier.

Box 1.1 The scope for catching up

It is sometimes argued that countries like Viet Nam do not have the same opportunities for catching up through adoption of existing technologies as earlier industrializers like Japan, the Republic of Korea and Hong Kong. This is because the adoption of legislation to protect intellectual property rights (IPR) limits the scope for reverse engineering and outright copying of products developed in higher income economies. This may well be true, and complex IPR regimes may be unnecessarily burdensome for some developing countries to implement.

But this does not mean that developing countries are denied access to easily gained productivity improvements based on application of these technologies. Most long established technology is embodied in readily purchased capital equipment, and turnkey projects can provide access to quite complex manufacturing technologies. While IPR protection systems may require newly industrialising economies to pay for access to some standard technologies, they do not reduce the returns that can be made from applying them.

To utilise ‘catch-up’ requires ongoing foreign investment, educated people, open trade and domestic policies that foster competition. Foreign investment is needed as a vehicle for applying the new ‘catch up’ technology and for attracting the ‘know how’ that comes with foreign investment. Relevant education is required to apply it, and open trade is needed to allow new machines, techniques and ideas to come into Viet Nam and to allow exporters to take best possible advantage of those techniques. Domestic competition is required to make sure that firms have incentives to continually improve their operational and financial performance, and thus adopt the most appropriate technologies.

Productivity, efficiency and competitiveness

Efficiency is necessary to the achievement of Viet Nam’s development objectives because of the scarcity of investable resources. Meeting the sort of growth targets likely to be set in the SDS is likely to require achieving factor productivity targets comparable to the performance achieved in the early years of *doi moi*.

However, productivity in Viet Nam has grown rapidly from a low base. Reforms in agriculture — especially land use and pricing reforms — led to a dramatic increase in productivity in that sector. In addition, some of the productivity gains achieved in the past reflect use of excess capacity, prompted by the collapse of the Council for Mutual Economic Assistance (CMEA) trading system and the demands placed on local enterprises for basic inputs such as fertiliser, steel and chemicals. As Table 1.1 shows, the productivity growth rates achieved by Viet Nam during the early *doi moi* period have been obtained only rarely by other countries.

Table 1.1 also shows that productivity growth has faltered in recent years. In fact, productivity appears to have fallen in the period 1996 to 1999. This may be due in part to lags in implementation of some of the large investments initiated in those years. But it may also have occurred because of the inherent inefficiency of much of the investment occurring behind high levels of protection, an issue discussed in item 2.

Table 1.1 Growth accounting Selected countries

Country	*Period*	*GDP growth rate*	*Contribution to growth from*			*Productivity growth rate*
			Capital	*Labour*	*Productivity*	
		%	%	%	%	%
United States	1947-73	4.0	42.7	23.7	33.6	1.4
	1960-90	3.1	45.2	41.5	13.2	0.4
Germany	1950-73	6.6	40.6	2.8	56.6	3.7
	1960-90	3.2	58.7	-8.1	49.4	1.6
United Kingdom	1955-73	3.7	47.2	0.9	51.9	1.9
	1960-90	2.5	52.3	-4.2	52.2	1.3
Japan	1952-73	9.5	34.5	23.3	42.3	4.0
	1960-90	6.8	56.9	14.3	28.8	2.0
Hong Kong	1966-90	7.3	42.3	27.6	30.1	2.2
Singapore	1966-90	8.5	73.1	31.6	-4.7	-0.4
South Korea	1966-90	10.3	46.2	42.2	11.6	1.2
Taiwan	1966-90	9.1	40.5	39.8	19.8	1.8
Viet Nam	1987-95	7.4	42.8	22.1	33.9	2.5
	1987-99	7.8	58.1	22.5	18.7	1.4

Source: CIE (1999b) and author calculations.

Economic integration, and its corollary of reduced barriers to international trade, will be central to meeting the productivity objectives of SDS for a number of reasons. A key reason is related to the role that open trade policies can play as a means of ensuring competitiveness and efficiency of resource allocation, and of disciplining enterprise investment and production decisions (CIE 1999).

The integration processes that Viet Nam is currently pursuing involve changes across a range of policies, including trade liberalization, reducing impediments to foreign investment, harmonization of rules, regulations and standards and so on. At this stage, the most immediate effect on existing industries and enterprises will come from liberalizing international trade in goods and services. Some industries will prosper in the new environment being created by liberalization and expanded access to international markets, whereas other industries will face increasing pressures on the profitability and market share of component enterprises.

Enterprises in all sectors may have to adjust if they are to make the best of the changing environment, employing new products or production technologies, searching for new markets, adjusting labour forces and phasing out plant and equipment that is no longer profitable and undertaking new investments. But some of the greatest pressures will fall on enterprises in industries where current profitability depends on protection and other forms of assistance.

An industry that requires high levels of assistance from government to meet international competition in foreign or domestic markets cannot be considered to be competitive. Assistance to one industry always imposes costs on other sections of the economy. An industry cannot be considered competitive if its profitability depends on measures that disadvantage other parts of the economy. (A key example of this is that protection of import substitution automatically disadvantages exports).

Seen in this way, it is clear how open trade policies contribute to competitiveness: they create an environment that fosters the development of competitive activities. It is difficult to ensure that resources are shifting into competitive uses in an environment characterised by high levels of protection and insulation from international competition.

Open trade policies, with relatively low and uniform levels of protection or assistance are particularly important in maximizing the benefits of foreign investment. The international evidence suggests that the benefits are optimised when host countries have policies that promote competition and openness (Box 1.2). A recent summary of studies international experience of FDI concluded that:

> …appropriate trade and competition policies are probably essential to ensure that the benefits from foreign direct investment are maximised. Foreign TNCs that are protected by trade or entry barriers can afford to employ obsolete technologies and still generate significant profits, whereas TNCs facing national or international competition must continuously adjust their operations to changing conditions and prices (Kokko 1999).

Box 1.2 Foreign direct investment Drivers and impacts

Over the last decade or so, FDI flows have accelerated in response to four related features of globalization:

- changes in country policies to increase openness to FDI and international trade;
- evolving regional and global strategies by multinational corporations to locate interdependent facilities in various countries to exploit locational advantages;
- changing technology which is reducing the costs of international transport and communications, and facilitating integration of production and marketing activities throughout the world; and
- the growing complementarity between international trade and FDI: intra-firm trade between multi-

(Continued on next page)

(Continued Box 1.2)

national corporations now accounts for one third of world trade flows, and a further third is accounted for by exports by the corporations to non-affiliated enterprises.

Foreign investment has long played an important role in economic growth and development: foreign capital played a crucial part in the early stages of development of many of today's industrialised economies, including the United States, Canada and Australia. But as the processes of 'globalization' have accelerated in the last 15 years, foreign investment, and particularly FDI has become a key ingredient in the growth and competitiveness of developed and developing economies alike.

There is a strong correlation between growth and FDI in developing economies. The fastest growing developing countries and transition economies in Europe and Asian are the biggest recipients of FDI, and the data suggest that for emerging economies, a one percentage point increase in the share of FDI in GDP leads, all other things equal, to an additional 0.8 per cent increase in per capita income (Bergsman, Broadman and Drebentsov 1999).

FDI is a major vehicle for developing economies to 'catch up' with more advanced countries, since it provides access to foreign savings, technology, management skills and access to export markets. Attracting FDI has been a key element of Viet Nam's open door policy since the introduction of doi moi. However, a failure to recognize some of the factors driving FDI flows, and to build that recognition into the policy framework, has contributed to the decline in FDI commitments that started in late 1996. This decline has since been exacerbated by the effects of the regional financial and economic crisis.

Host countries have sought to attract FDI because of a range of perceived benefits. Direct benefits include the impact on:

- capital formation — FDI represented over 8 per cent of gross fixed capital formation in developing countries in the mid-1990s.
- employment — affiliates of transnational firms employed some 12 million people in developing countries in 1992;
- trade: there are a number of sectors where FDI has contributed to increasing exports as transnational corporations (TNCs) bring business contacts, marketing skills and product and process technology.

However, these direct effects may not always be significant. For example, foreign investment may crowd out local investment, so the impact on capital formation may be much less than capital flows indicate, and the impact on net exports may be quite small, since exports of transnational affiliates are often rely heavily on imports of raw materials and intermediates (the impact may be even less if host country policies encourage TNCs to invest in protected import substitution activities).

Perhaps the most important benefit sought from FDI relates to transfer of technology and improving productivity. The prospect that FDI will be associated with the transfer of technology to host countries is closely linked to the reasons why firms undertake FDI. A key reason why a firm might decide to establish production outside its home country and become a TNC:

> …is simply that foreign production is sometimes the most profitable way to exploit intangible proprietary assets — production or distribution technologies, unique organizational or management skills, trade marks, brand names or other firm specific sources of competitiveness (Kokko 1999).

But since the control of these intangible assets and technologies typically remains with the firm originating the investment, the impact of FDI on technology and productivity comes largely through the spillover or indirect effects on the host economy, which the TNC is unable to control or charge for. Indirect effects can be transmitted in many ways: local firms may copy technologies employed by

(Continued on next page)

(Continued Box 1.2)

TNCs, or those engaged in supplying TNCs may be exposed to efficient management techniques to meet customer requirements. And employees trained by TNCs acquire skills that they can retain and use elsewhere in the economy. Spillovers may also occur when local firms are forced to operate more efficiently to meet competition from TNC affiliates.

Studies of the technology transfer associated with FDI suggest that host country characteristics play a big role in determining the extent of benefits. The most important appear to be the educational background of the workforce and the level of technical skills, and a policy environment that promotes competition and openness. Fiscal incentives and specific policies requiring transfer to local partners appear to be less effective, because TNCs are often deterred from investing in countries that try to force unprofitable transfers, or they restrict technology imports to the minimum necessary to operate in the host country (Kokko op cit).

It can be particularly difficult for transition economies to attract the kinds of FDI that generate technology spillovers. A recent study of FDI in transition economies in the Former Soviet Union and in central and Eastern Europe showed that, contrary to the experience in other countries, it is firms with low rather than high research and development (R&D) outlays relative to sales that are more likely to invest in transition economies (Smarzynska 1999). The study showed that this is closely linked to weak IPR protection in many of the transition economies studied: weak IPR regimes were shown to have a negative impact on FDI flows and on the composition of FDI, encouraging investors to set up representative offices and distribution systems rather than production facilities.

Diversification and risk management

One additional reason for continued pursuit of economic integration is to help manage risks through diversification of markets and sources of supply. While there is considerable discussion in Viet Nam of the risks associated with integration (see discussion later in this item), it is important to recognize the contribution which open, non-discriminatory trade and investment policies make to spreading risk and reducing exposure to localized economic fluctuations.

Viet Nam has direct experience of the risks of excessive reliance on a limited group of trade and investment partners. The economy weathered the collapse of COMECON largely because *doi moi* reforms enabled traders to seek alternative partners, and opened up the economy to investment from a wide range of market economies.

Openness also affects the risks of borrowing on international markets. A recent paper (Stoeckel 1999) points out that because openness imposes external disciplines on economic management, it can have a beneficial effect on the costs of international borrowing. Credit rating agencies use openness as a criterion for rating countries' sovereign risk. The more open an economy, the lower its risk rating, and the lower the interest premium that has to be paid to borrow funds on the international market. Borrowing on better terms also lowers the domestic interest rate structure and stimulates domestic investment and growth.

Ongoing changes in the international financial architecture, prompted by reconsideration of the role of the international financial institutions in the light of recent crises, also place a higher premium on export revenues and open and transparent policies. If rescue packages for countries in crisis are less likely to be forthcoming, then sources of private capital will become more cautious and demand higher risk premiums for countries with weak financial governance and opaque trade, investment and exchange systems.

The practical significance of economic integration

As Viet Nam continues the transition to a market economy (under socialist orientation), the government will focus more on setting policies and laws that shape decentralized decision making by enterprises and households, rather than directly controlling outcomes. There are two immediate requirements for government with respect to integration. The first is to continue the process of changing laws and policies to enable greater access to international markets and foreign savings by enterprises. The second is to foster the development of institutions underpinning international trade and investment. This will involve further conforming of laws, policies and institutions to international practices, to facilitate contracting across national boundaries. It will also involve entering into more international agreements that jointly bind governments to particular codes of practice.

These trade agreements can help forge economic linkages between nations, and are sometimes perceived as being linked as much to objectives of international political and strategic objectives as to economic development. This perception is often exacerbated by the 'concessions' framework within which international trade and investment agreements are negotiated. Under this framework, reducing barriers to trade and investment is seen as a concession reluctantly granted, in return for similar concessions made by the other parties to the agreement. This distracts attention from the fact that it is the country that reduces the barriers that gets the big gains. Most of these gains can be achieved by actions taken to reduce barriers to trade and investment on a unilateral basis, independent of any agreements. Indeed, as is argued in item 2, the most significant actions taken by Viet Nam to further integration have been made outside of any trade agreements. And there is still great scope for actions to be made on a unilateral basis that will benefit the Vietnamese economy.

International agreements are useful, however, primarily because they establish a legal framework within which international trade and investment can be carried out. They may also be useful if they bolster the credibility of commitments to associated reforms. But it is important to remember that the big gains from integration come from letting international prices and international suppliers provide the benchmark against which local consumption and production decisions are made. International trade and investment agreements help economic development if they contribute towards this objective: their value lies in being a means to this end, rather than as an end in themselves.

Risks and rewards from deeper economic integration

Debates in Viet Nam about the scale and pace of liberalization of trade and investment is driven primarily by concerns about the costs and risks associated with further integration. The costs could include short term social and economic disruption as local enterprises have to adjust to increased international competition. Because of rigidities in markets for land, labour and capital, and the fledgling nature of many market institutions, adjustment to changes brought about by liberalization may not be smooth, even if economic growth creates new opportunities for those displaced by change. A related risk is that integration brings greater exposure to world business cycles and external shocks: with impediments to adjustment, the costs associated with negative external developments may be greater than in more developed market economies.

The link between open trade and investment policies — and the growth they bring — and structural adjustment underscores the need to accompany liberalization with continued efforts on other aspects of the economic transition programme, and to ensure that appropriate safety nets are in place. But the benefits from integration will come from the reallocation of resources to higher productivity uses and the improvements in productivity triggered by exposure to international competition. Therefore, it will be counterproductive to offset the effects of integration with policies that impede adjustment.

Policy makers in Viet Nam appear to be also considering a range of possible sociopolitical consequences of integration. These include some developments that could stem from the growth processes supported by integration, such as increasing income inequality and disparities in regional development. Such developments could add to the challenges of building a just, equitable, prosperous and civilized society. There is also a concern about the constraints that integration — especially participation in international agreements — may place on the scope of national policy making with respect to industrial policy, IPR and control of the operation of foreign entities. And there is also a set of concerns about the impact on current cultural and social values of greater exposure to external influences.

Integration will impact on the role of government in economic management. It will, for example, place constraints on the scope for the government to use certain policy instruments. But, rather than a *surrender* of national sovereignty, this should been seen as an *exercise* of sovereignty (Box 1.3). As discussed in item 2 and 3, integration is closely linked to the processes of transition to a market economy in formerly centrally planned economies. In this regard, integration will reinforce processes that require a change in the role of the state. Application of the principles of national treatment under various international agreements (requiring that, in certain areas, international firms, goods and services be accorded the same treatment as their national counterparts) will make it difficult to continue to favour state enterprises regarding regulation and access to resources. But, more importantly, integration will require an acceleration in the processes of shifting to indirect, policy based management of the economy in place of state determination of economic outcomes. In this regard, Viet Nam will be no different from all but a handful of socialist and formerly socialist economies (see item 3 for discussion of integration in transition economies).

These are all — to a greater or lesser degree — appropriate concerns that should shape the approach to integration. It is, however, important to place these concerns in context: and the appropriate context is to consider what may happen if Viet Nam does *not* pursue trade and investment liberalization.

Box 1.3 Integration and national sovereignty

One apparent reason for hesitation by Vietnamese policy makers in adopting a more rapid and comprehensive approach to trade and investment liberalization lies in concerns about the impact of integration on national sovereignty — at least as regards the exercise of instruments of economic management.

Integration can affect the scope that a government has to pursue economic policy objectives in a number of ways. One way is through international agreements, which may involve commitments on the use — or non-use — of particular policy instruments. Under bilateral, regional or multilateral integration agreements, governments may undertake commitments to limit the use of certain trade, taxation, subsidy or regulatory interventions, or to forego the independent use of certain policy instruments altogether. An extreme example of this is the European Monetary Union, under which certain members of the European Community (EC) have elected to forego an independent monetary policy (and hence exchange rate policy) through adoption of a common currency. This further cements the economic linkages between nations that have already chosen to eliminate inter-union border controls and to harmonise many regulatory controls on business.

Another way that integration may impose constraints on economic policy is that it exposes policy decisions to stronger market disciplines. By opening domestic markets to international investors and suppliers, and reducing barriers to domestic consumers, producers and investors operating in international markets, governments increase the avenues for economic agents to respond negatively and positively to policy settings. Open capital markets — as evidenced by the recent dislocations in East Asian — can allow declining investor confidence to translate rapidly into pressures on domestic asset prices and currency markets. There clearly are risks with financial liberalization that outpaces the development of appropriate regulatory and supervisory mechanisms, and of strong domestic disciplines that pressure managers of financial institutions and non-financial enterprises to take full account of the consequences of credit and investment decisions. But these are risks of poor policy and underdeveloped institutions, as much as risks of integration. It is just that open financial and capital markets mean that the consequences of poorly developed market institutions, weak cultures of corporate governance and inappropriate systems of regulation or supervision are transmitted more rapidly and dramatically than in a closed economy.

At the current stage in Viet Nam's transition to a market economy, it is clear that financial sector liberalization should be approached with considerable caution and a companion paper (Flatters 2000) addresses the issues involved in financial integration. However, the case for liberalization of trade and investment is much less affected by these concerns — if at all. The concern, however, that increasing trade and investment flows, and multilateral rules for trade and investment, may erode the capacity of governments to exercise national regulatory sovereignty is an issue affecting countries besides Viet Nam.

In a recent policy brief, the Organization for Economic Cooperation and Development (OECD) (1999) argued that: '…an agreement such as the WTO is essentially an exercise of national sovereignty rather than a surrender of it'. The OECD argued that trade and investment liberalization forms part of an overall strategy to strengthen a country's capacity to determine its own future by improving competitiveness and raising incomes, thus making the country less — rather than more — vulnerable to external shocks. Decisions to enter into agreements under arrangements such as the WTO are made precisely in order to gain the added security, stability and enhanced welfare that internationally agreed rules provide. It is important to remember that in joining the WTO — as in joining ASEAN — Viet Nam will be joining other countries that have all decided to surrender some freedom of manoeuvre in order to achieve the gains that voluntary acceptance of an external discipline can provide.

And, as discussed elsewhere in the paper, the policy principles embodied in the agreements associated with ASEAN and WTO are principles that countries worldwide want to embody in policy making regardless of international agreements. This is not to say, of course, that the sequencing and prioritising of issues to subject to agreements is necessarily what developing, transition economies might choose — this is an issue discussed later in this paper. However, these international agreements recognise the necessity for governments to impose regulations and controls in the national interest, and allow for exceptions from the rules that they establish.

It is most unlikely that Viet Nam could replicate past growth performances without a deepening of trade and investment liberalization. Without policies that involve further dismantling of impediments to exports, Viet Nam is unlikely to experience the growth of manufacturing and services that can support rapid job creation and continued income growth in agriculture. And without a continued flow of foreign investment — targeted at efficient rather than highly protected activities — it will be difficult to achieve the investment and productivity improvements needed for growth.

Without growth, the government's revenue will remain stagnant, unable to support an expansion of social services and infrastructure facilities needed to improve human and physical capital and in turn, the wellbeing of the Vietnamese people. Growth will inevitably be associated with growing income disparities. Without the prospect of earning higher incomes, Vietnamese people will be unlikely to take the risks and make the investment of time, energy and capital required to achieve the productivity increases that must underpin national economic growth. But, without growth, it will be impossible to maintain Viet Nam's recent impressive performance in reducing the extent and incidence of poverty. Further, the interests of the working class are more likely to be met in an economy that is rapidly generating new and better paid jobs. A stagnant economy is likely to pose much more of a threat to social stability than would be experienced in a growing economy. And it will be easier to meet objectives of national security from the basis of an expanding economy.

Growth will require, and inevitably bring change. Integration is largely about meeting the needs and aspirations of the Vietnamese people in the most efficient way. If the people do not want certain changes, they are surely able to choose not to adopt them. And if there is a divergence between national goals and some by-products of growth and integration, a modernizing economy should be able to find ways of addressing these divergences while still reaping the benefits of international trade and investment.

2. Viet Nam's Integration Efforts

Past and current approaches to integration

Economic integration is now receiving considerable attention in Viet Nam, mainly as a result of consideration of the implications of current and prospective international agreements, multilateral, regional and bilateral. However, Viet Nam has already taken great steps down the path towards economic integration since the early days of *doi moi* — the difference being that most of these steps were implemented on a unilateral basis, independently of any international agreement. In this regard, Viet Nam is similar to nearly all countries that have implemented far-reaching programmes to open up the economy for interactions with the rest of the world.

Changes in trade and foreign exchange policy, along with liberalization of controls on foreign investment, have been key features of the opening up of the Vietnamese economy since the introduction of *doi moi*.

These changes have involved actions on six main fronts:

- phasing out of foreign exchange controls and adoption of a more market oriented exchange rate policy, accompanying large scale restructuring of the financial system;
- relaxing of controls on entry into foreign trading activities;
- relaxing controls used to manage imports and exports;
- creating and amending a system of taxation of imports and exports, as part of a comprehensive change in the revenue raising system;
- joining regional and multilateral trading arrangements and establishing bilateral trade agreements; and
- developing a legal and regulatory framework to permit and encourage foreign investment.

Chart 2.1 summarizes the main actions taken with respect to trade, exchange and foreign investment since the introduction of *doi moi*.

As a result of these changes, the trade and investment regime — and Viet Nam's trade and overall economic performance — have undergone a significant transformation. According to some measures (such as the ratio of trade to GDP), Viet Nam appears to be a fairly open economy. As Table 2.1 shows, exports now account for over a third of GDP, and the ratio of imports to GDP is over 40 per cent. Foreign invested enterprises have, on average, accounted for over a quarter of gross investment since 1991, and now account for 10 per cent of GDP (20 per cent of manufacturing GDP) and around 20 per cent of total exports. Growth in exports accounted for over 40 per cent of the growth in GDP between 1990 and 1998. Enterprise participation in international trade has expanded significantly. The number of enterprises engaging in trade increased from less than 1,500 in 1994 to over 8,000 in 1999, and non-state enterprises now account for around 15 per cent of exports and imports (World Bank 1999b). (Foreign invested enterprises account for around 30 per cent of imports and exports, with state owned enterprises (SOEs) accounting for the balance).

Table 2.1 Trade and GDP: 1990–1998

	Unit	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Trade										
Exports	USD million	1 731	2 042	2 475	2 985	4 054	5 198	7 337	9 145	9 365
Imports	USD million	1 775	2 107	2 535	3 532	5 250	7 543	10 480	10 460	10 346
Share of GDP										
Exports	%	22.8	24.7	25.0	23.2	26.1	25.6	31.0	37.7	36.2
Imports	%	23.4	25.4	25.6	27.5	33.8	37.1	44.3	43.2	40.0

Source: CIE (1998), World Bank (1999a).

Despite the changes and the impressive growth in trade and investment that they have prompted, important features of the regime that preceded *doi moi* linger on, and, as Chart 2.1 shows, in recent years the direction of change has sometimes been to restrict rather than liberalize trade. An intricate framework of administrative and legislative barriers to trade is still in force. Current account payments — interest, profit repatriations, etc. — are still not free of restriction, and capital repatriation for foreign investors is not guaranteed. And more recently, surrender requirements were imposed on enterprises in receipt of foreign exchange inflows. Imports of key inputs and consumables — construction steel, cement, fertiliser, sugar, paper, glass and petroleum — are controlled according to administrative assessments of the balance between domestic demand and domestic supply. A similar balancing process is used in controlling exports of rice. Imports of consumer goods have been controlled by a range of administrative measures, including licencing, bans and foreign exchange restrictions.

The import tariff system provides high levels of protection to a range of local production, and is subject to frequent changes and inconsistent implementation. The trade off between revenue and protection objectives does not seem to have been fully resolved in tariff setting, and there are large variations in tariff rates and considerable volatility in rates over time. The tariff is unnecessarily complex, with many exemptions and end-use distinctions. While the average tariff rate is relatively low, the large and selective dispersion around this average means that protection accorded by the tariff can be very high (Table 2.2). The escalation of the tariff structure, with low rates for most inputs and high rates for outputs guarantees that protection is high for many goods.

Table 2.2 Viet Nam's import tariff: 1995–1999

Tariff rate	*1995*	*1996*	*1997*	*1998*	*1999*
0-10 per cent	62	65	64	62	na
10-20 per cent	20	13	13	11	na
20-40 per cent	14	17	17	18	na
Above 40 per cent	4	5	6	7	na
Total (all tariff lines)	100	100	100	100	100
Average rate	12.8	12.3	13.4	13.6	15.9
Maximum rate	200	60	100	60	60
Variation[a]	131	127	128	117	na
Memo item					
Number of rates	36	31	35	26	19

a. Standard deviation as a proportion of the average.

Source: Technical group of TLCV (1999).

Tariffs and quotas appear to be adjusted according to the 'needs' of established firms. In this way, protection is 'tailor made' with a view to meeting the requirements of local firms to maintain employment and output at the least possible cost to consumers. More fundamentally, some trade is still manipulated with a view to its effects on other aspects of economic and enterprise management. SOEs play a leading role in the economy, and remain important sources of resources and influence for central, provincial and local authorities and agencies. The interests of SOEs play a disproportionate role in the determination of trade policy, a situation facilitated by the continued close links between certain enterprises and policy making ministries. But at the same time it appears that trade policies are shaped with a view to controlling SOEs in the absence of full fiscal and financial disciplines, as well as to restraining competition and maintaining SOE revenues.

Export processing zones (EPZs), and more recently industrial zones, have played a role in addressing the problems caused by the unresolved status of commercial and industrial land tenure. The performance of these zones has been quite varied, with many recently established zones performing quite poorly (VCCI-Consulting 1999), and questions have been raised about the incentives faced by provincial and city administrations regarding decisions to create new zones.

Because the transition to a modern tax system is still underway, and fiscal relations between central and local authorities are being reconstructed, allocation of rents created by trade restriction is an important part of the process of government finance.

This assessment needs, of course, to be placed in context. One context is the trade regime of Viet Nam's neighbours and main trading partners. But it is also important to assess changes against Viet Nam's starting point at the beginning of *doi moi*.

It has been argued that Viet Nam's current regime is more restrictive than those of other countries in the region (see, for example, IMF 1998). Such cross-country comparisons are an important gauge of how well Viet Nam is doing relative to its neighbours. However, it is also important to look at what has been achieved over what time period in order to get an accurate picture.

In the mid-1990s some commentators were judging Viet Nam's trade regime to be quite open on the grounds that they could not identify legislated restrictions. In recent years the government has acted to codify practices in law and supported greatly increased transparency of the trade regime — and economic policy generally — so that laws, regulations and decrees are available quickly and in the English language. Moreover, various government ministries, including the Ministry of Trade (MOT) have facilitated various trade policy reports and studies documenting and analysing the regime. The MOT also completed the accession document for World Trade Organization (WTO) membership, which laid out the trade regime in great detail for all WTO members to examine. This transparency and analysis should provide the basis for reforming trade. But greater knowledge and awareness of trade barriers does not necessarily mean that there are more of them.

Only 10 years ago, as most trade activities were centrally determined, incentives, taxes and conditions for trade such as licences and quotas were largely irrelevant in shaping trade outcomes because individuals and firms had no capacity to respond to them.

Since then, the transition to a market economy with decentralized, commercially oriented decision making with respect to production, consumption and investment has been accompanied by the development of market-oriented trade and investment policies.

Property rights, enforceable contracts, access to information about markets — domestic and international — have developed so that individuals and firms have a greatly enhanced capacity, interest and willingness to engage in trade.

For most of Viet Nam's neighbours and trading partners, these conditions have existed for some time. It could be argued that the fact that conventional trade barriers as they are understood in a modern market economy now exist and are relevant as an indication of just how far Viet Nam has come in liberalizing trade from the ground up.

Recent reports (CIE 1998 and CIE 1999) have reviewed the content, pace and direction of Viet Nam's trade reforms. They concluded that:

- there has been considerable liberalization of trade and investment;
- this liberalization has been effective and most Vietnamese people are better off as a result; and
- while extended commitments, such as those made under ASEAN Free Trade Area (AFTA), accession to WTO and Asia-Pacific Economic Cooperation (APEC), and bilateral trade agreements still need to be met, they indicate a commitment to continued liberalization.

However, it is clear that the pace of reform slowed after 1997. As CIE's report on non-tariff barriers (NTBs) pointed out (CIE 1999), a much wider range of products has come under the reach of quantitative restriction on imports, and access to foreign exchange has become subject to a range of direct and indirect rationing devices, which has tended to erode the effects of changes in the foreign investment regime and liberalization of entry into international trade. The government has been discussing a three year programme to re-energise the trade reform process with the World Bank and the International Monetary Fund (IMF), to be supported by a structural adjustment credit (SAC) and the Fund's Enhanced Structural Adjustment Facilities (ESAF). It has also agreed to a long term programme to phase out selected NTBs as part of its arrangements with the government of Japan under the Miyazawa initiative. But considerable uncertainly remains about the government's willingness to commit to a more rapid pace of reform.

The slowdown in the pace of reform is important for three key reasons. One reason is that most other countries in the region are continuing to liberalize their trade and investment policies, perhaps leaving Viet Nam behind in the pursuit of the benefit of liberalization, and increasing their attractiveness as a destination for foreign investment. A second reason is that as the shift to decentralization of economic decision making accelerates, expectations of the *future* direction of policies have a big impact on investment and resource allocation decisions. When enterprises and potential investors see oscillations and backward steps in the direction of reform, it becomes more difficult for them to make decisions about the future. It also increases the sense that it may be more profitable to lobby for protection and concessions rather than plan on continued liberalization. This matters because of the third reason — the current trade regime is imposing significant costs on the economy. This issue is discussed further in the next section.

The costs of current policies

The most compelling reason for further trade and investment liberalization in Viet Nam lies in the *costs* being imposed on the economy by those barriers that still exist.

One dimension of the costs of current policies is their effect on exports. Rapid expansion of exports is a critical factor underpinning the government's development objectives. Despite its large population, Viet Nam's domestic market is small in terms of purchasing power — rapid output and employment growth can only come from enterprises targeting external markets. And to finance the imports of capital goods required to meet the country's investment targets, foreign exchange earnings will be required. Although Official Development Assistance (ODA) and FDI are expected to fund a big share of Viet Nam's investment these sources of foreign exchange may not grow commensurately with the country's investment needs.

The general thrust of the system of taxes and controls on trade is to favour import-substituting activities and production of non-traded goods and services over exporting activities. Some exports are directly disadvantaged by the continued use of export taxes and controls. But all exports are disadvantaged by the extensive system of import taxes and controls. These controls raise the price of imports and locally produced substitutes relative to all other goods and services and so reduce the real returns from exporting. Or, to put it another way, every USD spent on import substitution as a result of these controls is a USD taken away from export-oriented investment.

During 1998 and 1999, the situation has been exacerbated by the persistent over valuation of the VND. As Chart 2.2 shows, limited depreciation of the VND has not offset higher inflation in Viet Nam, so that the real exchange rate has appreciated since the early 1990s. Importantly, the real exchange rate has depreciated by only around 9 per cent since 1995 — this is in stark contrast with the significant real deprecations experienced by some of Viet Nam's ASEAN partners and significant competitors (Chart 2.2). The impact of overvaluation on exporters has been made worse by the continued application of surrender requirements which force exporters to trade their foreign exchange earnings at over-valued rates of exchange.

Together these controls favour import substitution and non-traded activities over production of exports. This does not mean that import substitution activities or investments in service sectors targeted at the domestic market should be discouraged. The old adage 'a USD saved is a USD earned' applies as much to economies as it does to households. Viet Nam should welcome efficient import substitution (that is, import substitution that is low cost and makes efficient use of the nation's resources and factors of production) as much as it welcomes efficient exporting.

The problem at the moment is that the general thrust of policies is to encourage *inefficient* import substitution.

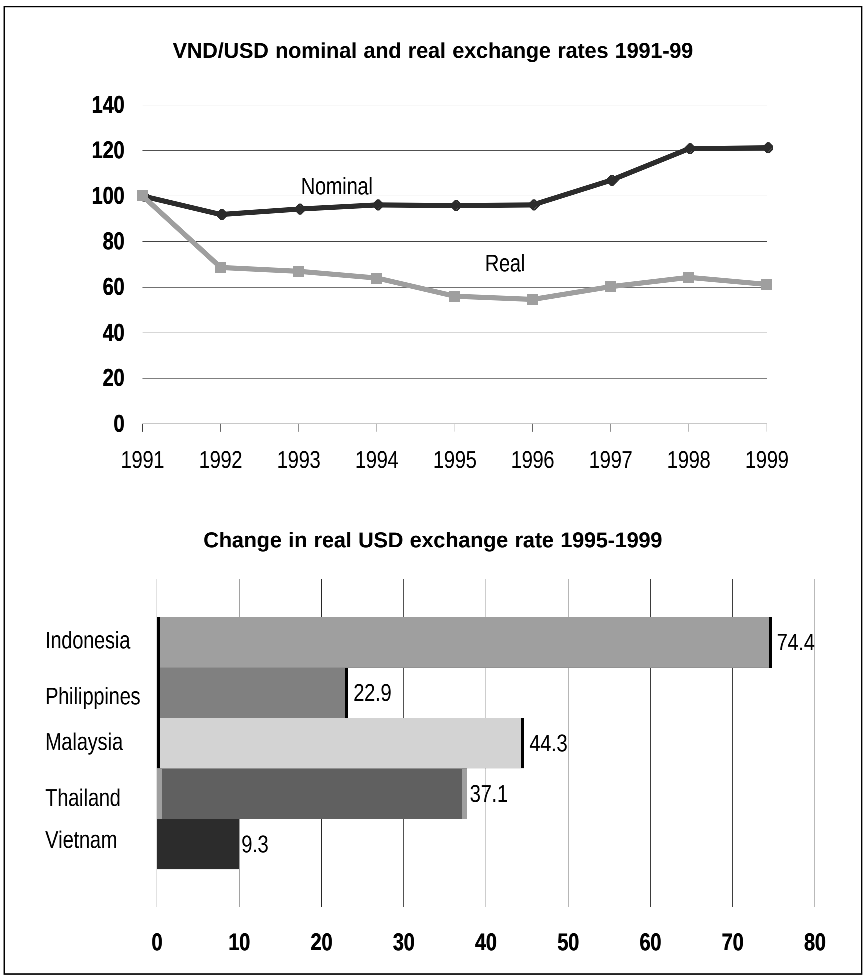
Recent studies of Viet Nam's trade and industry policies (Kokko and Zejan 1996, CIE 1998 and 1999, McCarty 1999) have explored how these policies appear to be being driven by a 'needs' based approach to protection. There are many examples where inputs are being tightly restricted to guarantee markets for local producers. There are also indications that new investments are being predicated on policies that aim at achieving self-sufficiency in key areas of the economy. As the CIE report of 1998 pointed out:

Certain themes seem to run through much of the discussion of trade and industrial development policy. They included the tendency to:

- regard imports as a necessary evil, rather than potential least cost sources of supply to meet the nation's demand for consumer and producer goods;

- approach industry plans in terms of self sufficiency — media reports of government strategy frequently present projections of local market needs and of local production capacity and focus on actions needed to close the gap; and
- expect that government policy will be adjusted to provide protection to industries according to their needs. As economic need and economic efficiency seldom go together, such a policy approach usually means discouraging economically efficient industries.

Chart 2.2 Recent exchange rate movements



Data source: IMF International Financial Statistics, various editions; IMF, World Economic Outlook, various editions.

As the report points out, if policy is to achieve economic growth through opening the economy to international trade, then it is logically inconsistent to seek self-sufficiency in any industry, let alone most existing and established industries. The gains from economic integration will come from allowing resources to flow into activities that do not need high levels of protection to meet international competition. Needs based trade and industry policies make it difficult for those industries that do not need protection to expand.

And fine tuning protection to maintain levels of production in existing industries is a sure way of preventing them from becoming competitive or economically efficient.

Some measures of the inefficiency of import substitution policies can be deduced from estimates of effective rates of protection according to different industries by current import policies.

A recent study of effective rates of protection in Viet Nam (CIE 1998) indicated that effective rates of protection vary greatly between sectors, and certain industries are being supported at very high economic cost. In some cases, quantitative restrictions (QRs) are significantly increasing protection available to local producers. Table 2.3 presents more recent estimates of effective rates, based on 1999 policies.

Table 2.3 Effective rates of protection by input–output industry 1999

Industry	*Effective rate of protection* %
1 Agriculture	17.0
2 Forestry	3.1
3 Fishing	43.3
4 Mining	-1.2
5 Fuels	14.5
6 Vegetable and fruit canning	100.4
7 Tea and coffee processing	90.1
8 Sugar[a]	107.0
9 Tobacco, alcohol and beverages	8301.7
10 Other foodstuffs	104.7
11 Textiles, carpets and rugs	131.7
12 Leather, footwear and bleaching	21.6
13 Wood processing and products	7.0
14 Paper and paper products	117.5
15 Petroleum and natural gas[b]	NA
16 Fertilisers and pesticides[a]	22.0
17 Chemical products	6.2
18 Pharmaceuticals	8.3
19 Soaps and detergents	162.7
20 Rubber and rubber products	160.0
21 Plastic and plastic products	185.2
22 Other chemical products	38.0
23 Ceramics, glass and porcelain	127.0
24 Cement	89.9
25 Other non-metallic minerals	2.6
26 Manufacture of ferrous metals	256.5
27 Manufacture of non ferrous metals	-5.1
28 Equipment and machinery[a]	32.0
29 Electrical and electronic products	65.3
30 Other metallic products	42.3
31 Other industry	62.7

a. Includes estimated effect of QRs on competing imports. b. The I-O table reports no domestic production by this industry.

Source: CIE (1999b).

An intuitive way of interpreting these results is to think of what they imply for the costs of saving foreign exchange by producing goods through these projects rather than importing them. In a project reliant on an effective rate of protection of 100 per cent, every USD 1.00 saved costs USD 2.00 in the services of local labour, capital and land used in the production process. On the other hand, in a project with an effective rate of –10 per cent, every USD 1.00 saved costs USD 0.90 in local resource use.

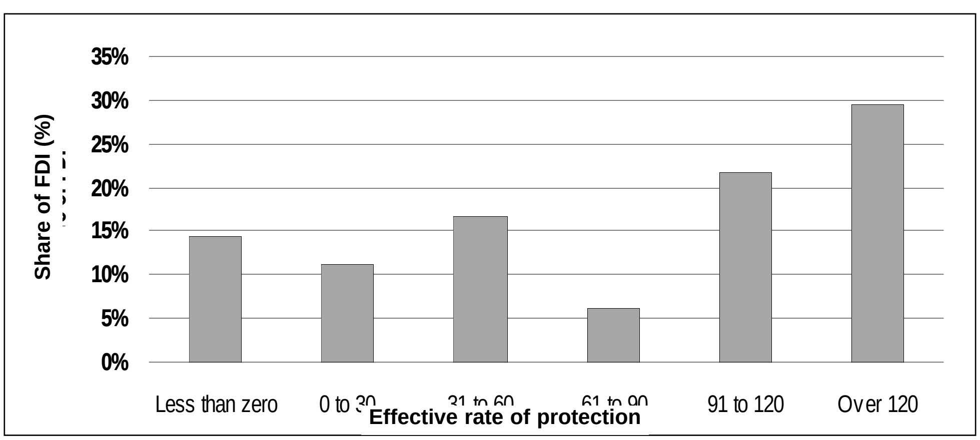
Misallocation of FDI

The study also showed that both domestic and foreign investment in Viet Nam is being directed toward sectors with relatively high levels of protection and not towards sectors that are viable with low levels of protection.

Chart 2.3 shows the distribution of the value of FDI projects according to the effective rate of protection of the sector to which each project is classified. (Projects involved in the production of non-traded goods and services have been excluded). Some 14 per cent of the value of FDI is in sectors with effective rate less than or equal to zero — most of which being oil or gas projects. However, around 50 per cent of investment is in sectors with effective rates of protection over 90 per cent, and a quarter is in sectors with effective rates over 120 per cent.

The high levels of FDI are resulting in rapid growth of industrial production capacity. However, to the extent that these investments are in activities made financially attractive by protection, the real long-term growth of industry could be impaired. And because much FDI is introduced through joint ventures with SOEs, this process is likely to be creating particularly strong interest groups that will make it difficult to reduce high protection in the future.

Chart 2.3 The relationship between FDI and effective rate of protection



Data source: CIE (1999b).

Impact on agriculture

A related dimension of the costs of current policies is the effect on agriculture and rural communities. Agriculture accounts for around a quarter of Viet Nam's GDP and over 60 per cent of employment, with over 80 per cent of the population living in rural areas.

Recent studies have examined the costs of industrial protection to the agriculture sector in Viet Nam. These costs arise because of the direct effects of protection on inputs used in agriculture, and also through the broader effects of protection throughout the economy.

- The current quota system affecting imports of fertiliser has, at times, allowed domestic prices to be some 70 per cent higher than the price of imports from Indonesia, and 40 per cent higher than the price of imports from Eastern Europe. This has been estimated to impose direct costs of around USD 38 million (around 0.2 per cent of GDP) (Goletti 1998). These costs are borne directly by farmers.
- A recent study (Nguyen 1999) has estimated that removal of all non-agricultural protection would lead to real farm income being over 10 per cent higher than it is in the presence of this protection. This study showed that in comparison, removal of direct trade restrictions affecting agriculture (primarily rice export quotas) could lead to an increase in real farm incomes of around 5 per cent. (This study also projected that total GDP would be higher by around 2.5 per cent if industrial protection were removed).

These indirect costs compound the effect of direct trade restrictions affecting agriculture, notably the system of rice export quotas and controls on imports of sugar. A study by the International Food Policy Research Institute estimated that the removal of rice export quotas would increase national income by some USD 225 million, or one per cent of GDP (IFPRI 1996). This would benefit the majority of the rural population. And a recent study of the impact of current sugar policies estimated that current restrictions on imports of sugar support very high cost and inefficient production of both sugar cane and sugar (Goletti and Rich 1998). The study showed that liberalization of sugar imports would:

- make sugar available at prices some 22 per cent lower than those prevailing in 1998; and
- increase the real income of the country by some USD 92 million each year, or around 0.4 per cent of GDP.

While the study estimated that sugar cane production would fall by around 11 per cent, it showed that trade liberalization would not destroy sugar cane production in the industry, but would generate incentives for reallocation of the structure of production.

NTBs — now the main problem

The feature of Viet Nam's current trade policies lying at the heart of the main costs being borne is the regime of administrative controls on trade, especially NTBs to imports. While there are difficulties and costs associated with Viet Nam's tariff system (see CIE 1998), it is industries protected by NTBs that are imposing the main costs on the economy. And it is willingness to use these barriers that has induced much of the misallocation of investment occurring in recent years.

Many kinds of NTBs are used in Viet Nam to pursue a wide range of objectives. Some reflect a continued concern to 'manage' or 'balance' demand and supply for goods that are considered to be of strategic importance for the economy. Others are designed to conserve the use of foreign exchange or to deter imports of goods considered to be of low priority, or to protect local producers. Some, for goods under specialized line management, are used to achieve a range of regulatory objectives. And yet others, especially where imports are outright banned, reflect concerns over public safety and public morals. In nearly all cases, however, the NTBs have the effect — whether intended or unintended — of protecting local production. During 1998 and 1999, the main NTBs in the first two categories were specified in two policy instruments, Decree 57/1998/ND–C which mainly covers goods in the first category, and Decision 254/1998/QD-TTg which mainly covered goods in the second category. Annex Tables A.1 and A.2 summarize the main elements of the NTB system.

NTBs are — generally — undesirable instruments to meet trade policy objectives. Reasons include:

- the use of NTBs disconnects an important signal to resource allocation — the price in international markets — which provides signals to investors, producers and consumers about Viet Nam's comparative advantage and the opportunity costs of producing (or not producing) goods locally;
- absence of transparency — because trade is subject to administrative controls, whether or not the import of a particular good is allowed is settled in a process that is both obscure and unpredictable. This increases the risks associated with trading and production decisions, and makes them vulnerable to lobbying and strategic manipulation by traders and producers;
- managing trade to achieve 'balances' within the economy — an explicit objective for key NTBs — is becoming close to impossible as the economy becomes more diverse and complicated;
- while a principal objective of many NTBs is to provide stability, the interventions in fact produce price and quantity instabilities in the market. This reflects the difficulties of managing trade administratively;
- the level of protection accorded by NTBs is not fixed, and rises to accommodate deteriorating competitiveness of local producers. Incentives to become efficient are thus muted at best;

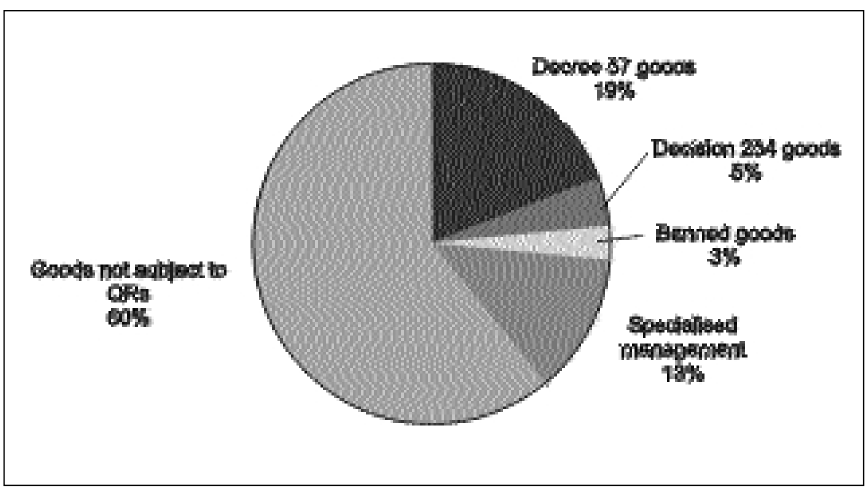
- the cost borne by other sectors on the economy also varies according to the competitiveness of local producers, increasing their uncertainty;
- current NTBs, which are often very selective within classes of product, can promote wasteful importation as users substitute less appropriate alternatives for the imports under control;
- allocation of rights to import goods subject to NTB confers access to economic rents — these rents are often dissipated and allocation methods do not ensure that the most efficient importers get access to rights; and
- NTBs are often complex to administer, adding to the burdens on customs and traders.

Chart 2.4 shows that approximately 40 per cent of imports are subject to administrative restrictions. These figures are based upon the structure of imports in 1996 but with 1999 import regulations.

Chart 2.5 shows the coverage of QRs under Decree 57 and Decision 254, in terms of goods production levels. Around 24 per cent of the production of goods is subject to protection from these QRs. In terms of total production (goods and services) coverage is about 15 per cent. Some 3 per cent of the work force is in sectors where QRs are in effect (it is difficult to determine how much employment is specifically dependent on QRs — in some sectors, there are activities which use the output of activities protected by QRs, or whose outputs have no linkage to the QR).

The above estimates only cover sectors directly affected by QRs. Because there are many intersectoral linkages in an economy with one sector buying and selling goods and services from many others, the indirect effects of QRs will be felt across all sectors.

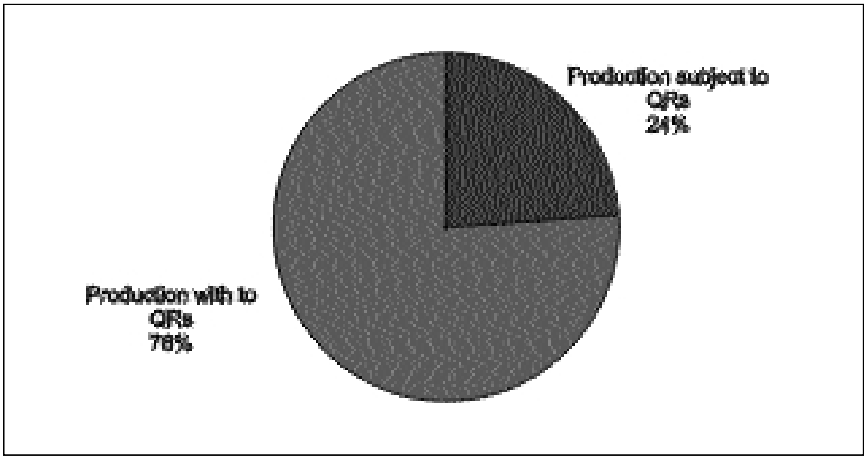
Chart 2.4 Import coverage of QRs



a. Banned goods include tobacco products only.

Source: GSO (1999), CIE (1999b).

Chart 2.5 Production coverage of QRs



Source: GSO (1999), CIE (1999b).

CIE's study of NTBs (CIE 1999) presents information on the potential impact of QRs on costs of production in the economy. Table 2.4 presents some indications of the costs incurred in different sectors of the economy because of current QRs on imports.

Table 2.4 Estimated cost savings from removal of QRs and associated protection

Industry	***Cost saving*** (%)
Agriculture	3.1
Construction	3.8
Food processing	6.4
Printing and publishing	2.2

Source: CIE (1999b).

For many of the industries whose outputs are covered by QRs, it is not the case that all producers need the blanket protection accorded by the restriction. Case studies of cement, steel and plastics presented in a recent report on NTBs (CIE 1999) show that technology, costs and competitiveness vary considerably across enterprises in these industries. They also show that the price differentials (between international and domestic prices) supported by these barriers are volatile and often quite small. Many industries protected by QRs are subject to constraints on pricing, market exploitation and investment that offset or blunt the incentives for expansion created by the protection. But at the same time these constraints raise production costs and give rise to inefficiencies. A policy approach that removed these constraints and the protection at the same time might see many enterprises in these industries competing quite well.

Corruption and high costs of conducting trade

An inevitable consequence of extensive regulations on trade and a complex tariff structure is strong incentives for smuggling and corruption. Customs clearance is slow, duty assessment is problematic and clearance runs the risk of being bogged down in dispute over arcane distinctions and extensive discretion exercised by officials. A tax stamp system introduced in 1998 to contain smuggling imposes considerable extra cost on legitimate trade transactions and adds to the administrative burden faced by an overstretched customs administration.

There are no reliable estimates of the extent of smuggling in Viet Nam, but there is no dispute that it is large. Long borders, high tariffs and taxes and extensive regulation of economic activity creates fertile grounds for smuggling. So too does the scope for officials charged with administering and interpreting controls to increase their incomes from side payments. When enterprise incomes are the main source of income for local administrations, some degree of official collaboration in evading central controls and taxes is also not surprising.

The extent of smuggling may have some important implications for the structure of protection. The incentives to smuggle are likely to be greater for high value, high duty, easily transportable final consumer goods than for lower value, lower duty, bulky producer goods. Smuggling is likely to erode protection for producers of consumer goods — but this may reduce the market for protected producer goods. Thus, the scope for widespread smuggling is likely to undermine efforts to apply high protection for producer and capital goods.

A recent report by the Bureau of the National Committee for ASEAN (Bureau of the National Committee for ASEAN 1998) reports on how raising tariffs on bicycles increased incentives for smuggling of low quality Chinese bicycles, displacing higher quality imports from other sources, without markedly increasing the market share of local products. The same report documents similar perverse outcomes for the short lived ban on imports of electric fans imposed in 1997.

One positive implication of the extent of smuggling is for revenue consequences of trade liberalization. As controls and taxes on trade are reduced, the incentive to smuggle will diminish and customs will have more time to devote to effective antismuggling activities. As more trade shifts into formal channels and as the risk–return calculus of smuggling alters, revenues will be positively affected.

The impact of current policies

The practical impact of current policies toward trade and investment is mixed — but there is a strong tendency to foster the development of inefficient capital intensive industries dependent on high levels of protection. These activities may make limited economic contribution to the nation in the future.

In the case of foreign investment, the thrust of policies has clearly favoured import substitution and service sector investments, and has created a climate in which investors have sought — and been granted — protection to make investments profitable.

The overall policy environment is difficult for foreign investors — a difficulty which investors and their local partners seek to have offset by guarantees of market share, taxation concessions, and shelter from competition — from domestic as well as international sources.

In the case of local investment, protection is often extended to support projects and sectoral development promoted by the government. Sugar and cement are two examples of protection following large scale state driven investment programmes. There is less — if any — evidence of protection being granted to sectors in which the local private sector predominates.

International integration agreements

A significant contemporary channel for Viet Nam's pursuit of economic integration is through entering into and implementing bilateral, regional and multilateral agreements. Viet Nam has been a member of AFTA since 1995, and of APEC since 1998. A number of bilateral trade and investment agreement have been signed — including with the European Union. An agreement with the United States has been negotiated, but is yet to be signed. Viet Nam has completed the 'transparency' phase of accession to the WTO, and is now entering into the market access negotiations with members of this organization.

Over the next decade, these agreements are likely to play a large role in shaping the nature and sequencing of Viet Nam's trade and liberalization policies. This has both positive and negative aspects.

On the one hand, these agreements can bring important benefits to Viet Nam. One set of studies (Fukase and Martin 1999a, 1999b) have estimated the gains to Viet Nam from implementation of liberalization commitments as part of AFTA, and of achieving most favoured nation (MFN) status with respect to trade with the United States (see Box 2.1).

Many commentators (for example Anderson 1998) have identified benefits which would accrue to Viet Nam from membership of WTO, beyond the gains to be achieved from unilateral liberalization. These include:

- greater and more secure market access for Viet Nam's exports because of the commitments to accord Viet Nam the same treatment with regard to market access and treatment of inward investment as all other members;
- availability of the WTO's dispute resolution mechanism;
- disciplines on domestic policy making to resist claims from special interest groups;

- assistance in strengthening and modernizing the regulation of trade and investment; and
- an opportunity to influence global approaches to multilateral trade and investment liberalization.

Box 2.1 The benefits of regional and bilateral trade agreements

Recent studies have tried to quantify the implications of Viet Nam's accession to AFTA and of being granted MFN treatment as part of a trade agreement with the United States. They show that the static welfare effects of implementing AFTA are very small, and may even be negative. The analyses estimate that real per capita expenditures would change by between –0.04 per cent and +0.4 per cent, depending on whether goods in the Sensitive and General Exception list are included (Fukase and Martin 1999a). This is because trade with AFTA partners is relatively small, and the initial effects of liberalization of these imports is also limited. In addition, the gains from trade creation are offset by the costs of trade diversion. And because Singapore is the dominant destination for Viet Nam's exports to ASEAN, there is little in the way of gains from market access, because Singapore's protection is already very low. In addition, Viet Nam may suffer substantial terms of trade losses from the export expansion association with AFTA liberalization.

A later study (Fukase and Winters 1999) has examined the scope for dynamic gains from ASEAN membership, from direct and indirect stimuli to higher growth. Three channels are considered: the impact of access to foreign knowledge on productivity growth; the impact on returns to physical and human capital on domestic and foreign investment; and the benefits of international commitments in locking in economic reforms. These channels may provide more rapid growth — but the result is not clear-cut. Viet Nam imports most capital and producer goods — which could be expected to embody foreign knowledge — from OECD and newly industrialized economics in East Asian — AFTA preference may divert these imports to ASEAN countries which are less renowned as locations of R&D and knowledge generation. Much ASEAN — and other source — FDI in Viet Nam appears to be responding to protection for import substitution activities, but AFTA tariff reduction may promote more in the way of investment based on vertical integration of production by foreign multinationals in the region. AFTA may be a useful 'training ground' for broader liberalization and help in moving down the path to market oriented reforms. But extending AFTA on an MFN basis would eliminate the risk of perverse diversion effects.

In contrast with the relatively small state benefits from AFTA liberalization, the studies suggest that the gains from gaining MFN status with the United States are rather larger — amounting to a 0.9 per cent increase in real expenditure per capita (Fukase and Martin 1999b). This is largely driven by a significant increase in clothing and textiles production.

However, the largest benefits derive from any support that membership gives to Viet Nam's ongoing pursuit of free trade and deregulation of the domestic economy. And there are potential downsides to pursuing integration solely through international agreements.

One downside is the impression that accession processes and international agreements give that the scope and pace of policy changes is being driven more by the interests of other countries than the domestic imperatives for economic development.

As noted earlier, this impression is reinforced by the 'concessions' approach to trade and investment liberalization that is part of many negotiation processes linked with the agreements. Under the 'concessions' approach, other countries ask Viet Nam to make policy changes on the ground of what might seem good for their economies, and not necessarily on the grounds of what might be good for Viet Nam. This creates a situation where it may appear logical for Viet Nam to defer doing things that are in the nation's best interest because doing them may seem to offer unnecessary concessions.

One further problem with trade agreements is their tendency to institutionalise mercantilism — the misleading idea that exports are the end objective of trade and imports are costs of trade. This has happened as attempts to make the notion of trade reform more politically acceptable have stressed the concept of reciprocity. It has been argued (Tumlir 1983) that this focus on mercantilism and reciprocity has created a serious flaw in the WTO (more precisely in the General Agreement on Tariffs and Trade (GATT)) — the flaw being a misstatement of the case for free trade. Tumlir argues that people accepted the argument that when every country protects its economy, all countries suffer. But instead of drawing the correct conclusion — that 'liberal (free) trade is the best policy for all countries', an alternative that 'liberal (free) trade is the best policy when all countries practice it' was put forward, which was ultimately corrupted to 'liberal (free) trade is a good policy *only* if all countries practice it'. It is the corrupted conclusion that underlies the 'concessions' approach described above.

Regional and bilateral agreements also run the risk of promoting trade diversion rather than trade creation: when tariffs on imports from one country or region displace lower cost supplies from the rest of the world. Viet Nam will not benefit if consumers switch to imports with higher foreign exchange costs just because the import tax is lower than on the cheaper goods. The studies mentioned in Box 2.1 show that under some scenarios, AFTA liberalization could reduce Viet Nam's national welfare and that the benefits are always much less than unilateral, non-discriminating liberalization.

WTO

The government has decided that the principles and practices associated with membership of the WTO should provide the basic framework for pursuing economic integration. What does this mean, and how will it affect Viet Nam's ongoing economic development process?

Accession to the WTO will mean that Viet Nam will join some 135 countries, which embrace the following principles:

- non-discrimination — that is, according all members of WTO the same, MFN status (with some exceptions regarding WTO compliant regional trading agreements), and not discriminating between domestic and foreign products, services or nationals;
- reducing barriers to trade, through processes of negotiation;
- increasing predictability of trade policies by binding commitments to opening markets and reducing barriers; and
- limiting use of non-tariff trade instruments.

Viet Nam will be required to prepare and negotiate three schedules of commitments that will be attached to the Protocol of Accession, relating to:

- tariffs (to be reduced and bound or subject to ceiling bindings) and other measures affecting trade in goods;
- market access, domestic support and export subsidies affecting agricultural trade (with bindings); and
- commitments on trade in services, consistent with the General Agreement on Trade in Services.

These schedules may specify phase-in periods and temporary maintenance of current practices. It is possible (in fact likely) that Viet Nam will be required to undertake commitments that are not currently required of existing members of WTO. Anderson (1998) suggests that Viet Nam may be required to sign on to the Government Procurement Agreement and enter into stronger commitments regarding state enterprises.

More specifically, accession to WTO is likely to require Viet Nam to undertake or commit to undertake some or all of the following policy changes:

- tariffication of many NTBs, especially import bans and quotas which are solely protective in intent;
- adopting more transparent procedures regarding import licencing (including licencing managed by specialized agencies);
- freeing up trade and foreign investment in services, over time, including granting national treatment to foreign service providers;
- strengthening and enforcing IPR;
- amending Trade Related Investment Measures (TRIMS) inconsistent with the Agreement on Trade Related Investment Measures reached during the Uruguay Round — this is likely to require extension of national treatment, and phasing out elements of foreign investment regulations conditional on export performance, import patterns or local content;
- reducing state support to state trading enterprises and other SOEs — this may require corporatisation or even privatisation of commercially oriented enterprises;
- notifying all trade and investment related policies to the WTO Secretariat, including measures adopted for balance of payments and quarantine purposes, and technical standards that differ from international standards;
- adopting a single door process for import licencing;
- identifying a single contact point to deal with queries about trade and investment policies;
- justifying quarantine restrictions on scientific, risk management grounds;
- adopting (or committing to adopt) the GATT Valuation Code; and
- agreeing to certain kinds of treatment by trading partners.

Ongoing membership of WTO will bring with it obligations to abide by the rules of the organisation, especially regarding processes for increasing protection and use of non-tariff mechanisms. Despite the broad principles of the organisation regarding reductions in barriers to trade and investment, the Articles of the organisation provide for imposition of temporary protection in specified circumstances. They also lay down some procedures to follow in cases where governments wish to take anti-dumping action or impose countervailing duties in situations of export or other forms of subsidy.

Table 2.5 lists the main agreements to which Viet Nam will become a party on accession to the WTO, and identifies some of the actions that will be required to prepare for and implement these agreements.

Table 2.5 WTO accession Institutional and policy implications

Item	***Implementation***	***Required actions***	***Comment***
General principles			
Most favoured nation	Accord all members the most favourable treatment accorded any trading partners	Review of bilateral trade agreements to ensure MFN consistency	Unnecessarily costly for Viet Nam to maintain multiple tariff regimes - best to harmonise normal and MFN rates
National treatment	Treat domestic and foreign products, services and nationals the same	Reform of discrimination taxation (for example tobacco, automobiles) Move to unified legislation, regulatory framework for foreign and domestic enterprises operating in Viet Nam	Complex issues with respect to investment and services need to be addressed
Limiting use of non-tariff trade instruments	Limited use of quotas, technical barriers to trade for protection except in special circumstances	Phase out QRs on import Reform specialised management of imports of certain commodities	Programmes laid out in Miyazawa SAC/ESAF framework Needs change in design and enforcement of standards
Reducing and binding import tariffs	Commit not to increase tariffs and to participate in future negotiations to reduce tariffs	Tariffication of NTBs Formulate strategy on tariff binding for access negotiation Develop long - term tariff structure	Limited value in trying to bind tariffs at rates in excess of current applied rates
Customs valuation	Adopt GATT customs valuation agreement, placing invoice value as primary base for value for duty	Phase out minimum price list, train customs in valuation procedures	Significant strengthening of customs systems and capabilities required

(Continued on next page)

(Continued Table 2.5)

Item	***Implementation***	***Required actions***	***Comment***
Agreement on technical barriers to trade	Refrain from using technical requirements to create barriers to trade and provide protection	Reform of specialised line management of imports. Upgrading of systems, procedures associated with design, recognition and enforcement of technical standards	Involves significant technical upgrading
Special agreements			
Agreement on sanitary and phytosanitary measures	Quarantine measures should be transparent and based purely on scientific considerations. Information bureaus required to meet needs of interested parties	Review and upgrading of quarantine system and capabilities	Long term technical improvement required
Agreement on import licencing procedures	Ensure licencing procedures are transparent, predictable, fair and do not create extra constraints on trade	Review and shorten list of goods under specialisation management. Make basis of restriction on importation of selected goods explicit. Reform procedures for enforcing standards to replace licencing system	
Agreement on subsidies and countervailing measures	Discourages and constrains use of subsides which may impact and distort trade. Allows members to impose measures to countervail effects of subsidies. Determines principles for imposing antidumping duties	Modification of certain export promotion measures and regional investment promotion. Review subsidies provided to state enterprises (concessional credit, debt write offs and debt rescheduling)	Special treatment for developing countries may limit changes Viet Nam required to make for accession. But SOE subsidies will be under scrutiny. Little value in Viet Nam developing complex antidumping and countervailing measures system.
Agreement on Trade Related Investment Measures (TRIMS)	Prohibits using measures inconsistent with national treatment and rules against use of QRs, including local content and trade balancing requirements, restrictions on access to foreign exchange for imports	Significant changes in foreign investment legal framework	Will require further development of market based management of foreign exchange

(Continued on next page)

(Continued Table 2.5)

Item	***Implementation***	***Required actions***	***Comment***
General agreement on Trade in Services (GATS)	Application of general principles of national and MFN treatment, mutual recognition, qualifications for supply of services, transparency of procedures. Also involves specific market access commitments	Changes to mechanisms for formulating and implementing laws and regulations impacting on services to meet transparency principle. Detailed analysis to develop strategy for market access commitments, to develop appropriate regulatory regimes	May require extensive and long - term process of developing appropriate framework for regulation of service sectors, especially when complex issues of competition, natural monopoly and private provision of infrastructure and other services are involved
Agreement on Government procurement	Application of MFN and national treatment principles to procurement by government bodies	Development of laws and regulation on bidding	Membership of WTO does not require accession to the agreement. But transition economies often pressured to join the agreement in WTO accession process
Provisions on state trading enterprises	Ensure arms length transactions with state trading enterprises and limitation of privileges accorded such enterprises	Elimination of de jure and de facto state enterprise monopolies in trade	Process of commercialisation of state enterprises will come under scrutiny in accession process
Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS)	Set minimum compulsory standards for intellectual property production	Small amendments to provisions of current legal basis for IPR protection. Strengthen mechanisms for enforcement of IPRs	Issue of enforcement of IPR laws will be raised at accession

Viet Nam has completed the transparency stage of WTO accession, and is now entering into the process of market access negotiations with existing members. These negotiations may be troublesome, as the delay in completing the trade agreement with the US indicates. The best way to approach these negotiations is from the basis of a fully developed and broadly agreed and understood strategy for trade and investment liberalization. This would avoid the problems of negotiating in a reactive mode, where it may seem that negotiating partners are shaping the agenda and proposed pace and content of reform. This is particularly important for a transition economy, because ensuring good outcomes from market access agreements may be contingent on putting in place appropriate institutional and regulatory arrangements (This issue is discussed in item 4). If such a strategy is not in place, then it may be desirable to slow down the negotiation process until it has been developed. But slowing down negotiations should not imply slowing down liberalization, because that would imply slowing down the benefits of more open trade and investment policies. Rather, Viet Nam should continue to implement on a unilateral basis those reforms that do not need to wait on complex institutional change.

AFTA

Another important vehicle for pursuit of integration is Viet Nam's participation in the regional cooperation initiatives of ASEAN. The key cooperation agreements are:

- AFTA
- ASEAN Investment Area (AIA)
- ASEAN Service Agreement
- ASEAN Customs 2020 Vision Statement

Membership of AFTA involves a commitment to reduce tariffs to a range of zero to 5 per cent on imports from ASEAN over a ten year period on a wide range of industrial and agricultural commodities under the Common Effective Preferential Tariff Scheme (CEPT) (see Box 2.2). It also involves commitments to eliminate NTBs on goods covered by the CEPT, and is linked to other areas of cooperation such as 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. The AIA involves agreements to move towards national treatment for ASEAN investors, liberalize flows of capital, skilled labour and professionals and technology, and removal of all sectoral restrictions on investment by ASEAN enterprises. The ASEAN Services Agreement involves commitments beyond those made under the WTO's GATS: essentially voluntary, binding limitations on market access and national treatment in seven priority areas.

The Customs 2020 Vision Statement lays out a basis for cooperation in strengthening customs services, promoting, among other things, adoption of a harmonised tariff nomenclature recommendations and the GATT valuation system, simplification of customs procedures and improvements in management.

Viet Nam's implementation to date

Preparing for, and implementing commitments under the various vehicles for ASEAN economic cooperation has had an important impact on domestic policy and thinking about integration. However, implementation has been on a sporadic and uncoordinated basis, reflecting a lack of a coherent and broadly accepted strategy for integration. A significant 'back loading' of commitments is occurring, and decisions which are inconsistent with both the letter and the principles of the agreements have been made.

Box 2.2. AFTA and the CEPT

Viet Nam became an official member of ASEAN on 28 July 1995. With that membership came the responsibility to participate in the AFTA, which member countries agreed to create in January 1992. The key element of AFTA is a commitment to reduce tariffs on intraregional trade under the Common Effective Preferential Tariff (CEPT).

Under the CEPT agreement (as modified by a Ministerial Declaration of December 1995), the members of AFTA entered into a commitment to reduce tariffs on intra-ASEAN trade to no more than 5 per cent by the year 2003 (later for new members such as Viet Nam (2006), Laos (2008) and Myanmar (2008)). The agreement lays out the broad mechanism for phasing tariffs down to the target, identifying four categories of products: fast track, normal track, unprocessed agricultural products and a temporary exclusion list. In addition, countries are allowed to identify a (supposedly limited) set of goods to be completely excluded from the tariff reduction exercise (the general exceptions list). This list is meant to only include products that comply with Article XX of the GATT, which allows measures to protect national security, public morals, human, animal or plant life and the protection of articles of historic, artistic or archaeological value.

For goods to be eligible for preferential treatment, they must have a minimum of 40 per cent ASEAN content, and be in the inclusion list — and same tariff category — in both exporting and importing countries.

The agreement requires that QRs on all products on the inclusion list be eliminated immediately following inclusion. All NTBs, including customs surcharges and technical restrictions (such as standards and regulations relating to product quality etc.) are to be phased out over a longer period, as AFTA work on harmonization of customs procedures and standards proceeds.

More specifically:

- Implementation of CEPT comments has been less than whole-hearted. The inclusion list, submitted at the Bangkok ASEAN summit in 1995, has been implemented on an incremental basis. No schedule for elimination of NTBs on items in the inclusion list has been submitted to the AFTA Council, let alone has concerted action taken to remove restrictions on goods included in the list.
- There has been little substantial liberalization to date. As at March 2000, some 4,230 out of a total of some 6,500 tariff lines had been formally included in the inclusion list. Most goods notified under the CEPT have, however, been ones that are not produced in Viet Nam, or which have general tariffs already equal to or less than 5 per cent. The temporary exclusion list covers most goods currently produced in Viet Nam and the general exception list includes a range of goods where Viet Nam has strong revenue and protection concerns, thus breaking the spirit of the CEPT (CIE 1998).
- Many decisions have been made which have increased barriers to trade, including the extension of coverage of NTBs in 1998, and the introduction of foreign exchange surrender requirements. Line ministries have requested adjustments to the committed tariff reduction schedule, and some of these requests have been accepted, primarily as a measure to protect foreign investment projects (Nguyen 1998).

- Viet Nam's initial offer under the ASEAN Services agreement has been limited in scope and depth (Bureau of the National Committee for ASEAN 1998).
- There are very profound changes required for Viet Nam to participate in the AIA, particularly with regard to national treatment, which would require, inter alia, not subjecting ASEAN investors to a separate Foreign Investment Law, offering them the same property rights as Vietnamese companies, creating a unified taxation regime and not requiring work permits to ASEAN nationals.

One very positive aspect of Viet Nam's implementation of AFTA commitments was the publication of an informal road map of CEPT reductions for items on the inclusion and temporary exclusion list, as part of a provision of public education and consultation. Table 2.6 summarises the path of tariff reduction for these classes of goods presented in the road map.

Table 2.6 CEPT road map Average tariff rates 1996 to 2006

Category	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
Inclusion list	7.0	6.8	5.8	5.6	4.7	3.9	3.8	2.8	2.6	2.5	2.3
Temporary exclusion list	19.9	19.9	19.9	19.9	19.8	19.6	19.4	17.5	13.4	8.9	3.9
Total	12.7	12.6	12.1	11.9	11.4	10.9	10.7	9.3	7.4	5.3	3.0

Source: CIE (1998).

The government has also been examining the competitiveness of local production, to identify sectors where AFTA tariff reductions may create pressures for adjustments (CIEM 1999). Products have been classified into three groups — those that are judged to be competitive, 'conditionally' competitive, and uncompetitive. This classification is being used as a guide to future investments, and also to determine the sequencing of inclusion of products in the CEPT tariff reduction process.

APEC

Viet Nam formally joined the APEC forum at the APEC Leaders meeting held in Kuala Lumpur on November 17-18, 1998. As a member of APEC, Viet Nam has undertaken to pursue the trade and investment liberalization objectives expressed in the Bogor Declaration, in which APEC leaders declared free and open trade and investment to be the objective by 2020 for developing economies and 2010 for industrial economies. In 1995 this commitment was restated in Osaka and in 1996 APEC leaders met in the Philippines to present action plans for achieving the free trade targets. While APEC commitments and obligations are not binding in the same way as CEPT or WTO commitments, membership is likely to provide another important set of pressures for reform.

All APEC members have made some progress in reducing barriers to trade. The action plans submitted by APEC members at the eighth ministerial meeting in Manila in 1996 show that average applied tariffs for all members in 1996 were below their 1989 levels. In addition to these tariff reductions, APEC members have unilaterally reduced or removed NTBs so that the incidence of these barriers affecting imports during the 1988–93 period fell from nine to five per cent for APEC as a whole (APEC 1996).
When Viet Nam joined APEC at the end of 1998, it submitted an Individual Action Plan, laying out actions to be taken to meet the Bogor Declaration objectives. The plan describes short, medium and long term actions dealing with tariffs, non-tariff measures, trade in services, investment, standards, customs procedures, IPR, competition policy, government procurement, deregulation, rules of origin, dispute settlement, mobility of business people, implementation of Uruguay Round outcomes, and information issues.

Future implications

Most of Viet Nam's commitments in the implementation of regional trading agreements (AFTA, AIA, ASEAN Industrial Corporation Scheme (AICO) and APEC) are based on the founding principles of the WTO although some commitments in regional pacts are at higher level than those in the WTO (such as the tariff reduction schedule in CEPT / AFTA). However the level of binding and enforcement in regional trading blocs is generally lower. Experience of the implementation of CEPT / AFTA in recent years (of Viet Nam and other member countries) shows that there is room for renegotiations of commitments in case the member countries face difficulties. Therefore, most pressure for Viet Nam to adjust the policies, legal frameworks and institutional arrangements will be from the implementation for accession to WTO.

In the last ten years, Viet Nam has done much to liberalize trade and investment — almost all of it on a unilateral basis with little reference to bilateral, regional and multilateral agreements. (In this regard, it is like most other countries that have implemented significant trade and investment reforms). A lot of emphasis is now being placed on participation in international agreements. These provide considerable opportunities to nurture further reform in Viet Nam and in other countries. But they also carry risks of diverting attention from the main game, which can be pursued on a unilateral basis.

Broadly speaking, the actions called for under participation in these agreements are thing that would be sensible for Viet Nam to do, even if they were not called for by articles of these agreements. And Viet Nam does not have to tie these actions to membership of these agreements. However, it is also clear that the agenda of organisations like the WTO does not always reflect the priorities or capabilities of countries like Viet Nam (this is discussed in the next chapter). This agenda is often driven by the interests of specific interest groups in developed and developing economies (as evidenced by the recent attempts to link trade to labour and environmental standards in the next round of WTO negotiations).

Moreover, the market access negotiations linked to accession to the WTO may lead to inappropriate sequencing of reforms, unless Viet Nam has a clear and broadly accepted domestic strategy for reform of trade policy, trade management, tariffs and investment and service sector regulation. It is in the nature of international institutions that there may be selectivity of priorities they pursue. However, as a recent report on integration said (CIE 199b):

> The key point here is that Viet Nam is unlikely to be able to influence these priorities by holding back on its own liberalization agenda. There may be scope for exerting influence by joining coalitions of countries pushing for greater action in areas of interest. But to refuse to liberalize Viet Nam's policies because other countries still restrict trade is to make the fundamental mistake of mercantilism, and to fall into the 'concessions' trap discussed above. It is true that the gains to Viet Nam from liberalization would be greater if all countries were to liberalize. But this does not mean that Viet Nam only gains if all countries liberalize. A small economy like Viet Nam will always be better of with a liberalized trade regime, regardless of what her trading partners do.

3. *International Experiences of Economic Integration*

SINCE THE SECOND WORLD WAR, many developed and developing countries have undertaken programmes of trade and investment policy liberalization. The individual and collective actions of these countries have facilitated the processes of globalisation and integration that have led to the recent rapid growth of international trade and investment flows.

The experience of countries that have undertaken these programmes can be useful in formulating Viet Nam's integration strategy for a number of reasons. One reason is to provide empirical evidence on the gains from liberalization, to help inform the domestic debate about reform. Another reason is to see how other countries have approached particular aspects of the liberalization process, to learn from successes and failures. The experience of two classes of country seem particularly relevant to Viet Nam — neighbouring market economies in Asia, and other transition economies in Asia and Europe. This chapter summarises some of the available information on liberalization experiences of these two groups.

The relationship between trade and investment policies and development

The relationship between trade liberalization, economic growth and development has been the subject of considerable analysis in recent years. An emerging consensus from this analysis is that countries which maintained open economies grow faster than countries with closed economies. Sachs and Warner examined the average growth of eight always open economies and forty always closed economies from 1966 to 1990. The open economies grew at rates of around 6 per cent while closed economies grew at about 2 per cent. Only during the oil price shock of the early 1970s did the growth rates converge and even then the open economies recovered much faster (Sachs and Warner 1995). Similar results have been found in cross-country studies by Dollar (1992), Ben-David (1993), and Edwards (1998). A recent study by Frankel and Romer showed that opening trade has a strong effect on productivity — estimating that a one percentage point increase in the ratio of trade to GDP is associated with a 2.04 per cent increase in labour augmenting productivity (Frankel and Romer 1999).

Several cross country studies and evaluations of the literature have stressed the importance of other policies besides open trade and investment (Papageorgiou, Michaely and Choksi 1990, Rodrik 1998).

Rodrik, for example, argues that openness must be complemented by appropriate domestic investment strategies and mechanism for resolving conflicts, especially those created by macroeconomic shocks and imbalances.

The issue of the role of open trade and investment policies has also received attention in assessments of the (pre crisis) success of a number of East Asian economies — Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, Singapore, Taiwan and Thailand. Much of the discussion of the performance of these economies centred on the issue of the role of government, but there is strong agreement that there was a common emphasis on export led growth based on competitive real exchange rates and a desire and ability to use foreign technology. But the successes of these countries in providing growth, development and poverty reduction was a attributable to a much broader range of complementary policies. A recent study published by the World Bank offers conclusions about policy organised around six themes (Stiglitz 1996). These themes are:

- policies that sustained a more equitable distribution of income — and that supported basic education for women as well as men — contributed to economic progress;
- as the East Asian economies grew and became more complex, governments had less need to assume an active role and, in any case, found it more difficult to manage production activities;
- governments played an active role in creating institutions and an institutional infrastructure that enabled markets to work more effectively;
- the accumulation of physical and human capital was encouraged by such things as provident funds, establishment of prudential regulations and policies that encouraged education and a receptivity to foreign investment;
- industries which would have a high payoff to R&D were identified by government; and
- governments intervened in capital market allocation.

Selected experiences of trade and industry policy reform

While the finer points on the links between openness and growth may not have been satisfactorily resolved, policy makers around the world are pursuing more open trade policies with firm conviction (and in most cases fairly compelling evidence) about the benefits of liberalization.

Asian market economies — East and South East Asian

Most East Asian economies have undertaken trade liberalization at some time.

- Indonesia has gone through a number of episodes of liberalization, one of the strongest and most sustained occurring between 1966 and 1971 in a period of severe economic crisis. The liberalization involved abolition of import licencing, elimination of price controls and relaxation of foreign exchange controls. In the ten years after this liberalization, exports increased seven fold — with non-traditional exports (other than oil and gas) growing very rapidly — investment 20 fold, and GDP growth shifted from an average of 2 per cent per annum to around 7 per cent (Stoeckel et al. 1997). In the mid 1980s Indonesia shifted from an inward to an outward looking development strategy, an undertook a programme of reducing the coverage of NTBs. The share of manufacturing production protected by NTBs fell from 68 per cent in 1986 to 31 per cent in 1992, and the share for agriculture fell from 54 per cent to 30 per cent (Dean, Desai and Riedel 1994). These changes were accompanied by more gradual tariff rationalisation. Indonesia undertook further liberalization in the 1990s, focussing mainly on tariff reductions and investment liberalization, and in the aftermath of the financial crisis, accelerated elimination of export controls and taxes, and moved to eliminate nearly all protective NTBs. Indonesia has generally accompanied AFTA tariff reductions with reductions in MFN tariffs, producing a low average margin of preferences.

- Korea undertook major liberalization programmes in 1965–1967, focusing on loosening QRs, and in 1978-1979, concentrating on tariff reduction. Exports rose rapidly after both periods of liberalization, from 4–40 per cent of gross national product (GNP) between 1964 and 1983. Continued tariff reductions during the 1980s brought the average tariff down from 24 per cent in 1983 to 10 per cent in 1992 (Dean, Desai and Riedel 1994).

- The Philippines has had four episodes of liberalization: 1960–1965, when comprehensive import controls were dismantled and the foreign exchange system was decontrolled; 1970–1974, when modest tariff rationalisation accompanied a devaluation; 1981–84 when a major elimination of quantitative restriction occurred along with substantial tariff reforms; and 1990 to the present, involving tariffication of quantitative restriction and major tariff reduction. Reforms have not been associated with the same improvement in economic performances as in other Asia economies, because of substantial reversals, of liberalization in intervening periods, incomplete liberalization of agricultural trade, continued domestic regulation and poor macroeconomic policies (Stoeckel et al. 1997).

- Singapore undertook major liberalization efforts in the period 1968–1973, as part of the push towards export orientation. This period was characterised by relatively stable prices, rapid growth in capital inflows and imports, rapidly growing labour productivity (averaging around 6 per cent per annum, and a rapid expansion of manufacturing.

- Thailand replaced an inward looking import substitution strategy with an export oriented approach to industrialisation in the 1980s. Trade and investment liberalization and domestic reform of key sectors has been central to this strategy. A major tariff reform initiated in 1982 was abandoned because of the impact on revenues. However, with a strengthening fiscal situation, tariff reform was restarted in the late 1980s. In the 1990s, a comprehensive tariff reform was begun, accompanied by a significant reduction in goods subject to import licencing.

A major study that covered liberalization episodes in most of these countries highlighted some important lessons (Papageorgiou, Michaely and Choksi 1991):

- Getting the macroeconomic variables right appears to be especially important. In some countries, such as the Philippines in the 1980s, liberalization was derailed by macroeconomic policy failure.

- Misreading the causes of an increase in the current account deficit can stall liberalization, as it did for the Republic of Korea in 1968 and 1990.
- When well managed, the short term costs of reform can be accommodated and adjustment is quicker than many have thought.
- Employment fears seem to be overstated. Liberalization can lead to job growth, as it did in manufacturing in the Philippines and Korea.
- Strong, fast and sustained reform seems to lead to higher economic growth. Liberalization leads to an outward orientation of the economy — most clearly seen in Korea.

The financial crisis in East Asian has been a significant setback for some of these economies, and has had a pronounced effect on global trade patterns. The sharp depreciations of the currencies in the region, coupled with a severe contraction in demand, have led to a large fall in imports in affected economies. While currency depreciations improved the competitiveness of exports, financial and corporate sector problems prevented the competitive gains from being rapidly translated into export growth. Nevertheless, the effect on trade balances has been significant, with the most severely affected economies recording large trade surpluses with the rest of the world.

One very telling feature of recent developments is that rather than resort to protectionist responses, most crisis affected countries have maintained or even accelerated programmes for trade and investment liberalization. As a result, significant additional trade liberalization has been achieved in East Asian during the past two years of the crisis. A recent IMF paper (IMF 1999) tracked past and prospective liberalization efforts in selected East Asian economies, and showed how many have continued liberalization of trade policies even during the crisis. The paper commented:

> Average tariffs were reduced from 20 per cent in 1990 to 10 per cent in 1998 in Indonesia: from 28 per cent in 1995 to 10 per cent in 1998 in the Philippines; and from 30 per cent in 1994 to 17 per cent in 1997 in Thailand and the coverage of NTBs has also been very substantially reduced. According to the IMF's index of trade restrictiveness, the Philippines moved from an index of 10 (the most restrictive) in 1985 to 5 in 1987, and would reach an index of 1 in 2000 with implementation of recently announced reforms. Indonesia moved from a 9 in 1985 to a 4 in 1998 and potentially to a 1 in 2000.

This continued commitment to open trade and investment policies is important, because there was a danger that policy makers might lose sight of the economic gains these countries had made from integration. In the period 1978–1996, real per capita output increased by between 4.7 and 5.2 per cent per annum in Indonesia, Malaysia, Singapore and Thailand (Sarel 1997). Over this period the number of people living in poverty in East Asian halved, as the proportion of the population fell from about 58 per cent to 21 per cent.

Equally, there are big gains to be made from further liberalization. A recent study of the effects of tariff reductions under APEC's Bogor agreement shows the substantial benefits that two of these economies, Indonesia and Thailand, may reap from implementation (Stoeckel et al. 1997). The study used a global model to estimate the gains from liberalization, and the main results were as follows.

- Further liberalization of trade by Thailand according to the Bogor Declaration is estimated to result in real GDP being nearly 3.3 per cent higher in 2020 than it would be without the liberalization. The bulk of the benefits would come from Thailand's own liberalization, rather than the effects of other APEC economies reforms. With liberalization, real consumption is projected to be up to 8 per cent higher than it would otherwise be in 2020, exports 25 per cent higher and employment higher at its peak in 2012.
- Indonesia's GDP could be nearly 6 per cent higher by 2020, real consumption 8 per cent higher, exports 12 per cent higher and employment close to 2 per cent higher.

Overall, the study estimated that for APEC as a whole, economic welfare as measured by real consumption could be 1.4 per cent higher than otherwise in 2020. ASEAN economies would benefit particularly, with real GDP some 3 per cent higher, exports over 10 per cent higher real consumption over 6 per cent higher by 2020. (These estimates are conservative, since they take no account of the productivity gains from liberalization or the gains from reducing NTBs).

The study demonstrated that removing barriers to foreign investment could greatly increase the benefits from liberalization. Removing barriers to investment to eliminate just one half of the differential in interest rates — a proxy for liberalising investment controls — between Asian members of APEC (except Japan) and the United States would double the gains to ASEAN's GDP from trade liberalization.

The other major risk in response to the crisis was of a failure to distinguish between the consequences of liberal trade and investment regimes, and poorly regulated exposure to volatile short term capital flows.

A recent examination of the lessons for Viet Nam from the experience of East Asian's newly-industrialised economies highlighted the differences between globalization of liquid capital and the other developments also captured under the term globalization: international trade; trade finances; long-term foreign equity investment; technology transfer; and the global transfer of useful information, knowledge and skills (UNDP 1999).

The report identified a range of lessons to learn from the crisis, including:

- effective macroeconomic management is a necessary but not a sufficient condition for sustainable development — policies impacting on the incentive structure and efficient markets are also critical;
- state-directed and state-influenced lending in commercial areas has heavy inefficiency costs which contribute to a build up of financial and structural imbalances, financial instability and crisis;

- government failure with respect to withholding essential information or enforcement of corporate transparency accountability and financial reporting can trigger financial crisis.
- The volatility of liquid global capital can destabilise developing countries if domestic financial markets are shallow and underdeveloped;
- inadequate prudential supervision of the financial sector can enable market failure in banking sectors;
- state socialization of private sector debt obligations unfairly passes the costs of bad investment decisions to the general population, including the poor;
- corruption, facilitated by a general lack of transparency contributes to the development of financially unsustainable investments;
- protectionist trade policies can quickly lead to balance of payment problems and lack of financial sustainability; and
- inequitable distribution of the costs and benefits of development can compromise social stability;
- excessive gradualism and postponement of needed reforms eventually leads to a build-up of dangerous structural and financial imbalances.

Transition economies

A number of countries in central and Eastern Europe and former members of the Soviet Union have undertaken major trade liberalization exercises as part of their programmes of transition toward market-oriented economic structures.

Most of these economies experienced sharp falls in economic activity in the early stages of the transition — and some are continuing to experience considerable economic distress. But many are recovering from the initial shocks associated with the end of central planning and the dissolution of former economic unions and agreements. The World Bank has argued that those economies that liberalized rapidly tended to experience faster recovery (World Bank 1996). However, the Bank recognised that it is difficult to separate out the effects of liberalization from those of other factors, including the initial point of departure, the overall transition strategy, the speed with which the institutional underpinnings of a market economy could be developed or reconstructed, and the success of stabilisation policies.

Where recovery has been more rapid, exports and the service sector have been the main engines of growth, facilitated in the latter case by adoption of open trade regimes (Table 3.1). Establishment of trade with the rest of the world has played an important part in helping economies recover from the collapse of trade within the CMEA and the Soviet Union, facilitating access to technology, raw materials and consumer goods, and to markets in which to earn foreign exchange to purchase these items.

The contrasting experience of Estonia and Ukraine provide some evidence on the link between open trade policies and trade performance. Estonia removed nearly all export barriers, eliminated all QRs, retained limited and low tariffs and made the currency convertible on the current account shortly after the collapse of the soviet bloc. Exports to Western Europe grew rapidly, as producers leapt over the quality barrier. Export growth accounted for 11 percentage points a year to GDP growth during 1992–94. In contrast, Ukraine retained many price and trade controls until the end of 1994. This included extensive state trading arrangements, controlled prices, export controls and a non-market exchange system. Exports fell and large trade deficits contributed to spiralling currency deprecation and economic instability.

Table 3.1 Trade policy and export performance Selected transition economies

	Trade policy		*Export performance*	
Country group	***State trading 1994***	***QRs 1994***	***Mfg exports to OECD 1994, share of GDP (Per cent)***	***Average annual contribution of export growth to GDP growth (Percentage points)***
Group 1[a]	Very small	No	24.5	3.0
Group 2[b]	Very small	No	18.1	3.7
Group 3[c]	Moderate	Yes	3.3	.5
Group 4[d]	Extensive	Yes	4.4	.3

a. Poland, Slovenia, Hungary, Croatia, FYR Macedonia, Czech Republic, Slovak Republic.

b. Estonia, Lithuania, Bulgaria, Latvia, Albania, Romania, Mongolia.

c Kyrgyz Republic, Russia, Moldova, Armenia, Georgia, Kazakhstan. d Uzbekistan, Ukraine, Belarus, Azerbaijan, Tajikistan, Turkmenistan.

Source: CIE (1999b).

Among the transition economies, China's approach to liberalization has been a strong influence on the directions adopted in Viet Nam. The institutional framework for production, trade and finance in Viet Nam at the beginning of *doi moi* closely resembled that of China a decade earlier, with trade largely conducted through specialised trade SOEs, and a banking system structured around 4 specialised state owned commercial banks. China's gradualist approach to reform (Table 3.1) appears to have been a model for Viet Nam's renovation process, and very similar problems have been experienced (especially with regard to the linkages between state enterprises and the banking system). However, both economies avoided the precipitous declines in trade and production experience by former members of the Soviet Union.

Box 3.1 China's liberalization experience

When China initiated economic reforms in 1978, international trade and investment played a minimal role in economic activity. Since China began to open up to the world economy, trade has grown from around 10 per cent of GDP (1975–79) to around 40 per cent of GDP (1998). Exports grew at an annual rate of nearly 16 per cent over the period from USD 9.8 billion in 1978 to USD 183 billion in 1998. Similarly, foreign capital flows grew rapidly, so that in 1996, China absorbed 40 per cent of the total flow of FDI to developing countries (McKibbin and Tang), and accounted for 10 per cent of international equity flows and 10 per cent of cross-border debt flows (World Bank 1997). By 1995, China was also the eighth largest supplier of capital to the world (although much of this investment went into Hong Kong).

China's reforms of trade have operated across three broad areas:

- gradual relaxation of the role of planning and increase in the role of market forces in trade;
- reduction in tariff and NTBs;
- reform of the exchange system; and

This has been accompanied by adoption of an 'open door' policy towards foreign investment and the creation of special economic zones.

At the onset of the reform process, international trade was monopolised by 12 specialised foreign trade corporations (FTCs). All foreign exchange receipts were surrendered, and all imports and exports were driven by plans. Restrictions on involvement in trade were progressively relaxed, as first provincial branches of FTCs were allowed to become independent entities and then provinces were allowed to create their own FTCs. Now thousands of state enterprises have direct trading rights, as do foreign financed enterprises — by 1997, 41 per cent of exports were accounted for by foreign financed enterprises, and a substantial proportion of the balance of China's exports was produced by non-state owned enterprises. Accompanying these changes, the share of exports and imports covered by plans was progressively reduced. In the first major trade reforms implemented in 1984-85, the coverage of the import plan was substantially reduced, and the share of exports covered by a mandatory plan fell to about 60 per cent of total exports (Cerra and Dayal-Gulati 1999). The coverage of the mandatory export plan was further reduced in 1988, and in 1991 the plan was abolished, along with fiscal export subsides. Mandatory import plans were eliminated in 1994, and licencing requirements and quotas for imports were reduced.

Although there has been significant relaxation of barriers to trade, China still imposes significant controls on imports and — to a much lesser extent — on exports, through systems of quotas, licencing and canalisation through state trading monopolies. The average tariff rate has fallen from 39.5 per cent in 1988 to 17.0 per cent in 1998. NTBs including QRs, state monopoly trading, designated trading import licencing and price tendering applied to over 30 per cent of imports in 1996 (World Bank 1997).

Foreign exchange reform played an important role in efforts to promote exports and to link domestic and international prices. Administration of foreign exchange was decentralized in the 1984-85 reforms, when local governments and enterprises were allowed to retain a share of their export earnings, in the form of rights to purchase foreign exchange at the official exchange rate. In 1986, foreign exchange adjustment centres were established, in which enterprises could trade foreign exchange at a depreciated rate, and trade foreign exchange retention rights. In 1994, the dual exchange system was unified, involving a depreciation of the official rate of around 50 per cent. In 1996, China's currency became fully convertible for current account transactions.

China's open door policy towards foreign investment began in 1979 with policies aimed at attracting FDI in natural resource development and export production. Special economic zones were progressively

(Continued on next page)

(Continued Box 3.1)

established, offering attractive conditions with respect to domestic and international trade, tax, labour regulations and land use rights. China experienced a 10 fold increase in FDI flows between 1991 and 1997 from USD 4 billion to USD 40 billion. However, the structure of incentives has encouraged round-tripping (capital originating in China being invested via Hong Kong to take advantage of tax breaks) and a strong emphasis on processing of imported inputs.

China has proposed to implement significant further liberalization of trade and investment in its accession offer to the WTO. If implemented, this would lead to a significant winding back of NTBs, eliminating almost all except those on food and certain other primary products.

China is strongly pursuing accession to the WTO which brings with it an accelerated approach to trade liberalization and opening up the domestic economy to foreign participation. The recently finalised trade agreement with the United States should pave the way to accession (Box 3.2).

Box 3.2 US-China bilateral WTO agreement

The recently concluded US-China bilateral WTO agreement covers all agricultural products, all industrial goods and all service areas. Key features of the agreement are as follows.

- China's industrial tariffs will phase from an average of 24.6 per cent (1997) to an overall average of 9.6 per cent by 2005. On selected products of interest to the US, tariffs will fall to 7.1 per cent by 2003 (wood, paper, chemicals, capital and medical equipment). On computers, semiconductors and on internet-related equipment, tariffs will fall to 0 per cent by 2005.
- Tariffs on agricultural products of high priority to the US (beef, grapes, wine, cheese, poultry and pork) the average tariff will fall from 31.5 per cent to 14.5 per cent by 2004.
- China will expand access in bulk agricultural commodities (corn, cotton, wheat, rice, barley, soya bean oil) through a tariff-rate quota system, which also allows trade between private parties.
- China will eliminate agricultural export subsidies.
- Import quotas will be phased out over a five year period.
- US firms will be granted rights to import and distribute goods inside China.
- China has agreed to eliminate most foreign equity restrictions in all major service sectors:
  - all restrictions on distribution services for most products will be phased out over three years;
  - all restrictions on service auxiliary for distribution will be phased out in three to four years; and
  - China will implement the regulatory principle embodied in the Basic Telecommunication Agreement, phase out all geographic restrictions for paging and value added telecommunications services, and allow foreign equity in telecommunication service.
- China will eliminate geographic restrictions and constraints on scope of activities undertaken by foreign insurance providers.

(Continued on next page)

(Continued Box 3.2)

- Full market access for foreign banks will be granted in five years, involving removal of restrictions on foreign currency business, and national treatment in designated areas.
- Minority foreign owner joint ventures will be allowed to engage in fund management on the same terms as Chinese firms.
- Foreign majority control will be allowed for many professional services (except practicing Chinese law).
- China will allow foreign participation in video, sound recording distribution and cinema ownership and operation.
- Foreign hotel operations will have unrestricted access to the Chinese market, with 100 per cent foreign ownership allowed three years after accession.
- China has agreed to implement the TRIMS agreement upon a accession and will:
  - eliminate trade and forex balancing requirements;
  - eliminate local content requirements; and
  - only impose laws on technology transfer that are WTO consistent.
- US will continue to treat China as a non-market economy for purposes of its antidumping and counter-veiling subsidies produced to 15 years after China's access to the WTO.
- China and the US have agreed to a special safeguard mechanism, allowing the US to apply safeguard measures using procedures that differ from WTO safeguard standards.

It is interesting that the Chinese authorities regard entry to the WTO as being fully consistent with the goal of establishing a socialist market economic system. The official Chinese newsagency, Xinhua, recently reported on a decision adopted at the Third Plenary Session of the 14th Chinese Communist Party Central Committee, which stated that 'setting up a socialist market economic system signifies enabling the market to play a role as a foundation in distributing natural resources under the state regulation and control' (BBC 2000). The decision stated that:

> China's accession to the WTO is conducive to conducting international trade with 135 WTO member states and conducting various forms of economic and trade cooperation and competition under the principles of the market economy. China's WTO entry is conducive to giving full scope to the active role of both the domestic and international markets in distribution of natural resources, integrating the domestic market and the huge world market into one, and giving full scope to the market's role as the foundation for distributing natural resources. All these are precisely our goal of setting up the socialist market economy (BBC, op cit).

Lessons from transition economies

Overall, seven key lessons emerge from the experience of transition economies (World Bank 1996). These are:

- consistent policies, combining liberalization of markets, trade and new business entry with reasonable price stability can achieve a great deal — even in countries lacking clear property rights and strong market institutions;
- differences between countries are very important both in setting the feasible range of policy choice and in determining the response to reforms;
- an efficient response to market processes requires clearly defined property rights — and this will eventually require widespread private ownership;
- major changes in social policies must complement the move to the market — to focus on relieving poverty, to cope with increased mobility;
- institutions that support markets arise both by design and from demand;
- sustaining the human capital base for economic growth requires considerable re-engineering of education and health delivery systems; and
- international integration can help lock in successful reform.

One strong message for transition economies such as Viet Nam is the need to pursue policy and administrative reform and institutional development across a wide front to maximise the benefits of trade liberalization. But an equally strong message is that a transition process is unlikely to lead to sustained economic growth unless accompanied by trade liberalization.

Adjusting to liberalization

Governments in developed as well as developing countries have sometimes expressed reluctance to implement trade liberalization because of concerns about the costs of adjusting to policy reforms and increased exposure to international competition.

The evidence suggests, however, that with the exception of the economies of the Former Soviet Union, the costs of adjustment to liberalization are small, especially when considered relative to the benefits. A review of some 50 studies of trade liberalization in developed and developing countries found that in developing countries, manufacturing employment usually increases (or the decline is very small) one year after liberalization. This was because (Matusz and Tarr 1999):

- developing countries typically have comparative advantage in labour intensive manufacturing, so trade liberalization should favour labour;
- there is usually a great deal of inter-industry shifts in activity after liberalization, which minimises the dislocation of factors of production;
- in many industries, normal turnover exceeds dislocation from trade liberalization so that downsizing where necessary can be accomplished without much forced employment;

- in economies where small and medium sized enterprises play a significant role, the typical dynamism of these enterprises means that there is a quick response to new opportunities.

Table 3.2 presents evidence on manufacturing employment during episodes of trade liberalization. The evidence seems to generally refute the hypothesis that liberalization leads to de-industrialisation. However, in transition economies, manufacturing employment has been seen to fall — sometimes precipitously — in periods of liberalization, although, as discussed above, countries liberalising trade as part of the transition have been less severely affected.

Table 3.2 Employment in manufacturing during episodes of trade liberalization

Episode	*Employment*		
	Year before liberalization	*Average for liberalization period*	*Year after liberalization*
	'000	'000	'000
Argentina (1967-70)	1 836	1 847	1 914
Argentina (1976-80)	1 863	2 099	2 132
Brazil (1965-73)	1 780	2 182	3 397
Chile (1974-81)	515	487	351
Korea (1978-79)	2 000	2 196	2 099
Peru (1979-80)	675	717	736
Philippines (1960-65)	1 456	1 647	1 825
Philippines (1970-74)	2 056	2 313	2 596
Singapore (1968-73)	61	139	210
Sri Lanka (1968-70)	74	08	97
Sri Lanka (1977-79)	112	134	155
Turkey (1970-73)	485	551	651

Source: Papageorgiou, Choksi, Michaely (1990).

Some of the studies reported by Matusz and Tarr also examined the fiscal impact of trade liberalization. They showed that in countries in which elimination of import quotas played a significant role, fiscal deficits and inflation was reduced, as tariff revenues increased. For those countries in which tariff reductions dominated, fiscal deposits and inflation were slightly higher after liberalization, but eventually shrank.

Matusz and Tarr also report the results of two studies of the impact of trade liberalization on poverty, an area where limited empirical analysis has been carried out. They argue that trade liberalization is likely to be associated with reduced poverty in the long run, because of the links to economic growth and through that to poverty reduction. They argue that in the short to medium term, liberalization will reduce the cost of the consumption basket of the poor, positively impacting on poverty. It may also increase wages and employment of the poor, who tend to be located in unprotected sectors. But they caution that even in the long run some poor may be made worse off. Trade and investment liberalization is not a universal panacea for all problems. The relevant caution is that more poor people will be made worse off if there is no liberalization.

EPZs

EPZs (along with industrial zones and high tech zones) have played a growing role since the 1960s in many developing countries' strategies for economic development. A recent evaluation of EPZs (Madani 1999) concluded that:

- under propitious circumstances and good management, EPZs generally achieve the two basic goals of increasing employment and increased foreign earnings. However, it is not always clear that the *net* foreign earnings are large enough to warrant the investments required to establish a zone;
- EPZ's are sensitive to the quality of national economic management;
- EPZ's can contribute to human resource development at the level of both previously unskilled workers and supervisory and managerial staff;
- EPZ's can have valuable catalytic and demonstration effects;
- creation of backward linkages depends largely on the existing industrial base of the country;
- some EPZ's have had negative environmental impacts; and
- the evidence on whether EPZ's facilitate or hinder more general liberalization is mixed — some are viewed as 'safety valves' which reduce pressure for more widespread reform, while others are viewed as models for further domestic reform.

The evaluation concludes that, overall, EPZ's have not proved to be 'engines of industrialisation and growth' as some proponents have anticipated. Their greatest contribution has been to job creation and income generation, and they may contribute to building human capital. This conclusion is supported by assessments provided in another paper prepared for the SDS (Bezanson, Oldham and Tran 2000), which argues that there has been

> …very little research on the return to investments in industrial zones and even less research that compares such returns to those from alternative approaches. Evidence from earlier experiences in Central America concluded that the manufacturing that did occur was almost entirely of the 'enclave industry' variety. It developed few, if any, linkages to the local economy; it was almost entirely at a low-cost labour variety; and no significant technological transfer or training occurred.

Generally speaking, EPZs and other zones are a second-best alternative to country wide liberalization, and may have limited value in countries that are implementing broad reforms.

Meeting the institutional challenges of integration

Membership of the WTO poses significant institutional challenges for transition and developing economies. Many of the new agreements reached during the Uruguay round place strong requirements on domestic policy, administrative and regulatory institutions. This in turn has meant that the accession process has become more demanding and time consuming.

For most transition economies, governments traditionally controlled trade through state trading enterprises, and had no need for institutions dealing with aspects of international trade in goods and services, such as IPR, standards, sanitary and phytosanitary controls and procurement (Michalopoulos 1998). However, WTO membership requires that policies and institutions dealing with these issues be brought into line with the provisions of the main agreements of the organization.

Meeting this requirement can be very costly to low income countries. A recent study examined how developing countries have addressed the challenge of implementation of certain obligations of membership of WTO, namely the GATT customs valuation agreement, the Agreement on Sanitary and Phytosanitary Standards (SPS) and the Agreement on Trade Related Aspects of Intellectual Property (TRIPS) (Finger and Schuler 1999). It made the following observations:

- Implementation of these agreements involves considerable investments in human and physical capital: these could cost more than the annual development budget in some low income countries.
- The content of the obligations imposed by the WTO take very little cognisance of the circumstances and reform needs of developing countries: they can be 'characterised as the advanced countries saying to the others, *Do it my way*!' (Finger and Schuler op cit).
- In many developing countries, there was little domestic ownership of the reforms, reflecting in part the limited capacity many low income countries have for full participation in WTO negotiations.
- Within the mercantilist framework within which trade negotiations are viewed, developing countries got very little in return in the market access parts of the Uruguay Round Agreement in exchange for their commitments on trade rules. (This is largely because the Agreements on Agriculture and Textiles and Clothing involved little in the way of immediate reductions in trade barriers by developed economies).

The evidence on accession to the WTO shows that it can be a time consuming and institutionally challenging exercise, especially for transition economies. As Michalopoulos (op cit) points out, there is a strong de facto requirement for acceding countries to operate as market economies, which goes beyond the US and EC practice of applying different, less transparent and potentially discriminatory with regard to antidumping and safeguards. Applicant countries are often expected to enter into stronger commitments under the various WTO agreements than existing members' undertakings. And while there are provisions to allow developing countries additional time to implement certain agreements, there is a tendency to regard to time taken in the accession process as sufficient additional time for new applicants.

At March 1998, the WTO was dealing with accession applications for 31 countries, 21 of which were transition economies. Michalopoulos estimates that it will take on average six years from the date of application for accession to be concluded for these economies.

One other issue that many transition economies have to address in accession concerns how liberal a trade and investment regime to commit to in the negotiation process. The key areas where these decisions need to be made relate to the level at which to bind tariffs, the support provided to agriculture and the range of commitments in the area of trade in services.

There is a tendency for some countries to approach these issues with a strategy aimed at committing to the least liberalization possible to ensure accession. The negotiation / concession framework of the accession process — and the general WTO approach to liberalization — are inclined to foster such an approach, since it is seen to provide countries with ‘bargaining chips’. However this is a very dangerous, and rather perverse approach. As one commentator has pointed out (Michalopoulos op cit):

> Individual countries, especially small transition economies, have little leverage in market access negotiations: hence the potential benefits they may be able to obtain from such a strategy may be very small. At the same time, maintaining protection through relatively high tariffs and protected agriculture and service sectors simply means that they impose costs to their own economies, by foregoing the benefits of a more liberal trade regime, which in the first instance accrue to the country itself. If, on the other hand, countries bind tariffs at levels higher than those applied and assume few commitments regarding agriculture and services, both of which are possible under WTO rules, they are subject to another risk: they create the opening for domestic interests to exert political pressure for additional protection in the future.

The experience of some Former Soviet Union countries has been that placing limited offers on the table during accession negotiations serves mainly to delay the process — accession Working Parties have been known to simply ask the country to submit a revised offer before serious negotiations occur (Michalopoulos op cit).

4. Making the Most of Economic Integration

THE IDEA THAT ECONOMIC INTEGRATION is central to Viet Nam's future development seems well-embedded in strategic thinking about the country. Enormous steps have been taken to break with the quasi-autarkic policies of the past, and a range of integration initiatives are being pursued. At the same time, there is evidence of considerable uncertainty about how to move forward and how to design the next steps in a way that makes the most of the benefits of integration but which limits risks and disruption.

Some of this uncertainty may reflect natural concerns about the unknown. Viet Nam's transition to an integrated market economy may have the appearance of being a 'journey without maps', warranting step-by-step movements. As in many other countries, a lot of the uncertainty is fed by groups in the community who see their economic interests threatened, and who resist change even if it may be in the overall interests of the community. And much of the uncertainty also stems from a concern that the scope and pace of policy change may be being driven more by the interests of other countries than by the domestic imperatives for economic development. And when, as sometimes appears to happen in international negotiations, other countries are urging Viet Nam to liberalize trade and investment while at the same time remaining quite attached to their own barriers, caution seems both natural and sensible.

This situation is complicated by the close intertwining of integration with the process of Viet Nam's transition to a market economy. It is reasonable to ask if the incomplete nature of market institutions (such as the legal underpinnings of economic contracts, effective prudential regulation of the banking system, well functioning factor markets) raises the risk of perverse outcomes from further liberalization. And it is reasonable to ask what kind of trade and investment policies are appropriate given that state enterprise and administrative reforms are still in progress.

The experiences of other transition and developing countries make it clear that in general, more is better than less and fast is better than slow. But they also show that progress on other aspects of the transition is important, and that emphasis should be placed on:

- maintaining prudent fiscal and monetary policy to create a stable macroeconomic environment conducive to efficient savings and investment decisions by domestic and foreign agents;
- fostering enterprise development in a competitive environment, using competition and financial disciplines to get state owned and private enterprises to operate efficiently;
- orienting trade and taxation policies with a view to the incentives they create for decentralized decisions, rather than administrative balancing of supply and demand;

- rationalising the SOE sector and overseeing, rather than dictating, investment and production decisions of enterprises that remain under state control, and setting up clear structures for the exercise of ownership rights over these enterprises and to encourage the pursuit of efficiency and financial viability;
- facilitating development of efficient markets for factors of production — land, labour and capital; and
- creating a legal framework that fosters and reduces costs of making business transactions, entering into and enforcing contracts, and spreading risks; simplifies processes of investment, market entry and enterprise development; and promotes competition and experimentation with new forms of transactions.

What does this mean for policy makers in Viet Nam? Because integration — and its linkages to sectoral development policies — is such a high profile and far reaching element of the transition process, a strategy which reflects Viet Nam's contemporary circumstances for pursuing integration needs to be developed and implemented. Such a strategy needs to address:

- the sequencing of trade and investment reforms;
- adoption of complementary policies to secure the benefits of integration and reduce the costs and to facilitate the structural adjustments that integration will bring in its wake;
- institutional changes needed to manage economic policy as integration proceeds — including changes to regulatory systems required by implementation of WTO agreements, changes in processes for policy formulation, and changes in state planning and investment processes; and
- ensuring public awareness of, and support for, the changes involved with integration.

An effective strategy would need to reflect an appreciation of why Viet Nam is pursuing integration and where the benefits will arise, and benefitting from past experience of reforms in Viet Nam and elsewhere.

Key principles to guide the strategy include:

- imports are the end purpose of trade, so integration is about accessing the world's best sources of goods, services and technology. This implies, among other things, that:
  - all trade and investment liberalization should be implemented on a non-preferential basis — MFN and national treatment are good for Viet Nam, and should be implemented as a widely as possible,
  - bilateral, regional and multilateral agreements are a means to an end, not an end in the themselves;
- actions to shield local production from international competition impose costs on the community, and shift the burden of adjustment elsewhere in the economy (and not onto the rest of the world);

- because taxes and restrictions on imports reduce the volume of trade they are also, in effect, taxes and restrictions on exports;
- industrial zones and EPZs are inferior methods for addressing deficiencies in government policies with respect to taxation, trade and investment controls and infrastructure;
- maximising the benefits of foreign investment depends on subjecting foreign invested firms to strong external and domestic competition;
- tax incentives generally have little impact on investment decisions, and usually generate little economic return for the country providing them;
- investors — both foreign and domestic — are influenced as much by their expectations of future policy as by current policies. Thus, credibility, consistency, transparency and coherence of policy are required to ensure as rapid response to integration efforts. It is desirable to rely as much as possible on clearly established, generally applicable rules and timetables for reform; and
- the benefits of integration arise from having resources — capital, land and labour — respond to the incentives created by exposure to international prices and market opportunities. So flexibility and responsiveness of factor markets is necessary to get the best from integration. And the evidence is that private enterprises are the most flexible vehicle for organising investment and production responses.

A final principle is to develop appropriate strategies to manage the risks of integration. Uncertainty about the implications of integration fosters a hesitant approach to change, which can be manipulated by vested interests threatened by reforms. Successful integration should therefore be accompanied by measures to address perceived risks. Table 4.1 presents suggestions for dealing with some of these.

Table 4.1 Managing the risks of integration

Perceived risk	***Comment***	***Risk management strategy***
Loss of national sovereignty	Integration should be viewed more as an exercise of national sovereignty than a surrender of sovereignty. Joining international agreements means joining many other countries that have judged that voluntary constraints on discriminatory policies are in the national interest	Improve national understanding of the nature of integration
Threat to socialist orientation and achievement of objectives of maintaining a just, equitable, prosperous and civilised society. Increased regional disparities and less equal income	China has indicated that joining WTO is fully consistent with achieving the goal of a socialist market economy system. The growth resulting from integration will generate increased revenues to fund social and infrastructure expenditures.	Develop modern instruments to meet equity objectives through public investment in health and education, fiscal transfers to aid the disadvantaged, while promoting the growth needed to general a government revenue base to fund such programmes

(Continued on next page)

(Continued Table 4.1)

Perceived risk	***Comment***	***Risk management strategy***
Limits on the scope to promote industrialisation and acquire technology	Protection and state subsidies seldom lead to sustainable and efficient industries. The main impediments to industrial development lie in the fledgling state of market institutions and market oriented instruments of state management	Accelerate public administration reforms and construction of a legal and institutional framework for an efficient market economy
Greater exposure to world business cycles and external shocks	Greater volatility may be a consequence of a more open economy, but it will be at higher - and more rapidly growing - income levels. The biggest risk lies with state enterprises that are insulated from pressures to adjust to changing circumstances and economic policies that try to defer necessary adjustments	Strengthen instruments of macroeconomic management - especially fiscal and monetary policy - and reduce domestic impediments to adjustment. Accelerate processes of SOE reform to increase financial disciplines faced by management and divest non-strategic enterprises
Inefficient and wasteful foreign investment displacing local enterprises	Viet Nam's protection policies have led to some very inefficient foreign investment projects going ahead which will generate limited returns to the community	Adopt a less accommodating approach to protection and incentives for foreign investments. Eliminate barriers to domestic and international competition in the markets supplied by foreign (and domestically) invested projects
High social costs of adjustment as protection and barriers for entry are reduced	Pressures for structural adjustment will be strong and may be concentrated in certain sectors and localities. Adjustment costs may be high because of rigidities in markets for land, labour and capital. But resisting changes may mean foregoing the benefits of integration	Press ahead with reforms in land, labour and capital markets to ease the reallocation of factors of production to new uses. Develop social safety nets to ameliorate unacceptable personal hardship
Loss of revenue due to tariff reductions	Tariff reduction alone may lead to lower import tax revenues. But eliminating NTBs and tariff exemptions, along with lower tariffs, will lead to increased value of dutiable imports	Accelerate refinement of the value added tax (VAT) to ensure that expanding sectors of the economy are captured in the tax net. Adopt a non-zero minimum import tariff and eliminate all tariff exemptions except those accorded to exports and mandated by international agreements

Sequencing of trade and investment reforms

As discussed in item 2, the government has made a fundamental decision that the principles and practices associated with membership of the WTO should provide the basic framework for pursuing integration. Despite some recent signs that WTO may be faltering as a vehicle for promoting multilateral trade and investment liberalization (Box 4.1), the principles that the organisation enshrines remain directly relevant for Viet Nam.

WTO accession (and implementation of AFTA commitments) will therefore shape much of the sequencing of trade and investment reforms and associated institution building over the next few years. As discussed in item 3, some of the changes involved in meeting requirements of WTO agreements will be costly, and it is not always clear that the priorities implicit in these agreements would be priorities for Viet Nam if it were pursuing trade and investment reform on a unilateral basis. (Although, in most if not all cases, the changes called for in the agreements are changes that Viet Nam would benefit from at some stage in the transition process).

Pending completion of the accession process, there are still many areas where Viet Nam can take action to maximise the gains from using WTO as the framework for integration. They include the following.

- Incorporating the guiding principles of WTO into domestic policy making as quickly and as comprehensively as possible.
- Formulating and adopting a strategy for tariff based protection.
- Adopting an appropriate policy and institutional regime to promote domestic competition: along with more open trade policies, this will help ensure that Viet Nam gets best value from foreign investment. Options for an appropriate approach to competition policy are discussed below.
- Adopting clear procedures for consideration and granting of protection and other assistance to industrial, agricultural and service sector activities that take full account of all the effects of such assistance. Some suggestions concerning institutions and processes for policy evaluation are presented below. These procedures should be based on a clearly enunciated approach to protection in the short to medium term.
- Reforming regulation of foreign investment.

Initiatives along these lines will help, but perhaps even more important is to develop and articulate a clear strategy for integration, together with the principles that will guide it, and publicizing this strategy widely. The strategy needs to present a road map of changes in policies and procedures and identify key institutional changes (such as, for example, developing new sanitary and phytosanitary procedures) and lay out a plan for putting these changes in place (including, where necessary, a plan for mobilizing technical assistance).

Box 4.1 Seattle and Bangkok

The WTO ministerial meeting held in Seattle late in 1999 was designed to forge an agreement on the agenda for a new trade liberalization round. Not only did the meeting fail to do this, but it also brought into sharp relief some of the fissures dividing participants in the WTO that will challenge the robustness of the WTO and its processes in the next few years.

Part of the momentum behind a new round came from the so-called 'built in agenda' that was the legacy of the Uruguay Round. Legal agreements reached at the end of that round committed members to negotiations on further liberalization of agricultural trade and trade in services, and aspects of the intellectual property rights (TRIPS) agreement. Certain groups of members pushed for a broadening of the agenda to sustain broader based liberalization or to put new items on the WTO agenda. No agreement was reached on these initiatives — nor, in fact, could the meeting agree on how to address the agricultural component of the built in agenda.

Some of the issues that divided member countries were as follows.

- The scope of a new round — the United States opposed the idea of a round broad enough to allow tradeoffs that would allow a package to develop that governments could sell domestically within the mercantilist framework embraced by the WTO. Many had argued that manufacturing should be included in the round, since there was considerable scope for gains for developing countries from further liberalization of manufacturing trade — particularly in textiles and clothing;
- Introduction of the 'new' trade agenda — labour and environmental standards — which were (rightly) seen by many developing (and some developed) countries as injecting a new basis for protectionism by the developed world.
- Review of existing agreements placing heavy institutionalised demands on developing countries and reform of the WTO agreement on antidumping (to place greater disciplines on the use of antidumping as a 'back door' protection device).

Despite the aura of disaster surround the meeting, there were, however, some interesting insights and outcomes for developing countries. One key insight is that the WTO is no longer (if it ever was) a vehicle for developed countries to force an agenda on developing countries — the fissures between developed countries were as strong or stronger than those between developed and developing economies. Developing countries were able collectively — and through coalitions with other countries — to resist outcomes that were not in their perceived interests.

This more effective cooperation among developing countries was echoed in the Bangkok meetings of UNCTAD 10, which provided a deeper understanding of the processes of globalisation and its risks and rewards. The meetings highlighted the scope for joint efforts by developing countries to grasp the opportunities and challenges created by globalisation and the importance that should be attached to persuading the developed world that trade is more important than aid in promoting development.

It is not at all clear how the members of WTO will restart the negotiations for a new round after the suspension of discussions announced at the end of the Seattle meetings, nor how developing countries like Viet Nam should position themselves in the next stages. For developing countries, there seem to be three broad options regarding continued processes of liberalization:

- proceed with sensible trade liberalization on a unilateral basis at a pace and in a form which is suited to individual countries and which is independent of what might happen in a new WTO round;
- hold off on major reform and maintain 'negotiating coin' until multilateral negotiations begin seriously; and
- devote efforts to influencing the agenda and direction of a new round, particularly with respect to labour standards, programmes in agriculture and textiles and clothing, and adoption of a comprehensive round which includes manufacturing.

(Continued on next page)

(Continued Box 4.1)

A sensible strategy would appear to involve a combination of the first and third options. There is little value in delaying domestic reforms pending inception of a new round — which may take years — because this only serves to delay the benefits of these reforms. And seeking to influence the agenda makes sense given the risk that bad decisions — such as the linkage of trade and labour standards — could impact negatively on both developed as well as developing countries.

The same broad approach seems sensible for Viet Nam in approaching the related issues of integration and WTO accession. Developments at Seattle mean that the feared 'raising of the hurdle' for new entrants has not occurred. While the external imperative for joining the WTO may have thus slackened, the internal imperative for trade and investment liberalization has not. The confusion in Seattle provides no grounds for delaying this liberalization.

Viet Nam will also need to develop, if it has not already done so, a strategy for accession negotiations, addressing, among other things, offers to be made, and the bottom line, with respect to key WTO agreements.

This strategy should take account of the experiences of other transition economies, and avoid falling into the 'concessions' trap discussed in item 2. This implies in particular that Viet Nam should:

- bind tariffs at, or as close as possible to, applied rates. This means that the process of tariffication of NTBs needs to be mapped out soon;
- assess the scope for offers under GATS that is based on an assessment of the speed at which appropriate institutional arrangements for regulation and management of key service sectors (for example, telecommunications, banking and finance) can be put in place (as opposed to on the basis of protecting local enterprises from international competition); and
- identify what changes will be required to avoid designation as a non-market economy by the US and the European Union for the purpose of applying bilateral safeguards and antidumping actions, which leads to the use of less transparent procedures and more severe actions than used in the case of market economies.

The overall phasing of integration

Two concerns are frequently raised about the pace of liberalization of trade and foreign investment regulation. The first is that many Vietnamese enterprises are perceived as weak and burdened by old technology, and would have difficulty competing in an open trade environment. The second is that the institutional underpinnings of a market economy are not fully developed, which may constrain and distort economic adjustment to liberalization.

Regarding the first concern, the first point which needs to be made is that the burden of supporting apparently weak industries is born by other industries in Viet Nam. Thus inhibiting adjustment which might involve contraction for some apparently weak industries necessarily inhibits the expansion of other industries. Simply delaying liberalization might shift the problem onto others or delay the resolution, but it will not resolve it. A second point is that without competitive pressures, enterprises are unlikely to become stronger and better managed. While social and political considerations may prompt special treatment of certain sectors, the choice of instrument to do this should be one which places the burden on the community at large and is targeted at the underlying problem.

Regarding the second concern, it is fair to say that Viet Nam is less well equipped with respect to market institutions than other economies, and fostering the development of these institutions is a matter of priority. However, it is not clear that delaying further trade and investment reforms will help institutional development. As pointed out in CIE (1999b):

> …the government has already done much to establish market oriented institutions. The speed at which these arrangements have become consolidated is partly driven by demand. If firms, including state owned firms, are to be required to operate in an administered, centrally directed framework they are less likely to see a need for market based institutions — private property, rules of contract, banking systems, financial markets and the like. However, if they operate in international markets where everyone they meet has access to these things they are likely to want them to be established at home. A perfect harmony between openness and institutional arrangements is never likely to exist. Even in the most developed economies, institutional arrangements for, say communications, banking and employment are constantly changing as communication, transport and international capital markets are changing. The lack of perfect institutional arrangements in these countries is a trigger to building better ones and not a basis for raising artificial barriers to the rest of the world.

A tariff strategy

Phasing out NTBs and replacing them with tariffs and/or regulatory systems that do not discriminate again imports except on health, safety or environment grounds (such as plant and animal quarantine systems) has been central to the liberalization programmes of most countries and will need to be a key element of an effective integration strategy in Viet Nam. This means that tariffs will become the central instrument for providing protection, and so a tariff strategy should be a prominent feature of the overall integration strategy.

There is strong theoretical and practical evidence suggesting that the medium term target should be a move toward a low and uniform tariff structure.

As Tarr (1998) has discussed in his review of tariff design for Russia, there is little economic justification for, and many dangers associated with, differentiated tariff protection to import substitution activities. The resource costs associated with protection are closely correlated with dispersion in tariff rates. While there are theoretical arguments in favour of differentiated tariffs as an optimal policy intervention (such as infant industry protection, monopsony power in world markets, strategic trade theory) the information requirements and political pressures involved pursuing these notions make them impractical even in developed countries with sophisticated information systems. And a cascading tariff (with higher rates on final goods than on intermediate and capital goods) is not needed to provide comparable levels of protection up and down the production chain. Where tariffs are used to raise revenue a uniform tariff is the most practical and efficient alternative. And a firm commitment to a uniform tariff regime may help reduce incentives for lobbying for protection. At the important — and often overlooked — level of tariff administration, a uniform tariff greatly simplifies customs administration, reduces compliance costs for traders (and so costs to consumers) and reduces pressures for corruption.

Low tariffs are to be preferred because of the impact of taxes on imports and export oriented activities — high tariffs act as a high taxes on exports. A low uniform tariff also reduces incentives for smuggling.

A sensible strategy for moving towards a lower and more uniform protection structure would include:

- replacing current protective NTBs with tariffs;
- reducing the maximum tariff rates over time (this process has already been started, with the maximum rate falling from over 100 per cent to 60 per cent (with some exceptions));
- if revenue requirements remain important, raising the minimum rate from zero to, say, 5 per cent; and
- eliminating tariff exemptions and concessions (except those applying to inputs into export production).

An important element of a tariff strategy would be to make CEPT tariff reductions applicable to imports from all countries. This would eliminate risks of trade diversion and greatly simplify tariff administration, eliminating the need for extensive efforts to enforce rules of origin requirements. The overall plan for CEPT (and thus MFN) tariff reduction should be pre-announced so that producers, traders and investors can plan their future activities with some certainty about the policies environment.

Competition policy for Viet Nam

Facilitating domestic competition will be a key ingredient for maximising the benefits of integration. Ensuring that foreign invested projects face domestic and international competition will help ensure that Viet Nam achieves the spillover effects that make foreign investment worthwhile. And ensuring that commercialised state enterprises face competition from new entrants will strengthen the state enterprise reform process. But most of all, an environment in which constraints on competition are minimised is the best insurance against unwarranted adjustment costs from integration, as small and medium non-state enterprises can operate dynamically to expand new opportunities and generate employment.

Many of the actions implemented under *doi moi* have had the effect of promoting or facilitating competition. However, there are still many constraints on competition, and some enterprises are able to exert monopoly or oligopoly power.

While the case for further actions to promote competition is (with occasional reservations) accepted amongst policy makers, the content and sequencing of such actions is still not resolved. A recent report (CIE and Vietbid 1999) has discussed the three main approaches that competition policy initiatives could adopt:

- regulation of structure and conduct through antimonopoly laws;
- review, testing and possible dismantling of barriers to entry and other regulations which might restrict competition — the competition review function; and
- regulation of network industries previously treated as natural monopolies, and where technological, institutional and regulatory change allow competitive service provision.

At this stage of Viet Nam's transition to a market economy, it would be advisable to move slowly on establishing an antimonopoly or competition agency and law. This is because:

- as with other transition economies, Viet Nam does not yet have the institutional foundations in place to implement so-called western models of competition policy;
- many policies in Viet Nam are deliberately designed to consolidate and create market power for certain SOEs and general corporations. This monopoly behaviour can be dismantled more directly by dismantling the policies that underpin it under existing laws and policies;
- antimonopoly laws can have the effect of reducing efficiency, the ultimate objective of promoting competition — they, can for example:
  - impede and raise costs of mergers needed to compete on international markets,
  - act as a vehicle for inefficient firms to harass potentially low cost competitors,
  - require the regulator to have unrealistic levels of information and appreciation of market developments;
- institutional foundations to effective competition are not well developed and are a higher priority for the attention of policy makers; and
- administration and enforcement demands considerable resources and sophisticated systems.

A far greater priority would be to embark upon a process of competition review of existing — and particularly new — regulations and laws, to identify and evaluate restrictions on competition they contain. Such a review process may help with identifying possible commitments under WTO agreements, and their effects on the economy. The pressures for liberalising competition in the accession process are likely to be selectively applied to suit existing member countries. As such, these pressures are not guaranteed to yield results which would be in Viet Nam's best interests (as was the case with China's agreement with the US described in item 3).

Viet Nam will also have to develop more sophisticated mechanisms for regulating utilities, if it is to take further advantage of the potential for foreign and non-state investment in the provision of such services (such as telecommunications, power and water supply). For many utilities, only a part of the service provision may be characterised by natural monopoly, and there is scope to increase efficiency of supply (and reduce burdens on the budget) by unbundling other services and allowing competitive supply. And where competition *within* a market is not possible, there is often scope to create competition *for* the market by allowing firms to compete for the right to supply under a long term contract. Such arrangements can create quite complex regulatory demands, however, since it often becomes necessary to regulate conditions of access and pricing, service and environmental standards and meeting social obligations.

Given that WTO accession is bound to involve requests from members for access into utility supply in Viet Nam, the need to develop appropriate regulatory arrangements is pressing. This is a complex challenge and will take time. Some steps down this path could include (CIE and Vietbid):

- introducing transparent reporting procedures for current operators which, among other things, clarify community service obligations (that is: non-commercial functions required of utilities for social and other reasons) and the success and costs of achieving them;
- requiring documented performance reports on such things as price, quality of services, breakdowns and installation;
- introducing competition in particular areas where competitive supply is feasible; and
- considering establishment of industry-specific regulatory agencies or of a general regulation and comparing the strengths and weaknesses of these approaches with self-regulation and transparency and review.

Formulating protection policy in an integrating economy

Up to now, Viet Nam has not developed an integrated approach to protection policy that can fully evaluate the costs and benefits of protection to specific activities, and that takes account of the implications of the various international agreements that are being entered into.

Setting protection policies is complicated in Viet Nam because, as a legacy of the central planning subsidy system, there remains a complex web of policy instruments that provide protection or interfere in international trade. At the same time, trade related measures are used to achieve a wide range of regulatory objectives that in more developed market economies are pursued using other, protection neutral, policy instruments.

As discussed above, membership of international agreements will provide further motivation for adopting an integrated approach to protection policy embracing principles of *predictability* and *transparency*. At the same time, there is a need to develop an approach that fully recognises the trade-offs and costs involved in providing protection to particular activities. This requires that the approach also adopt an economy-wide perspective to ensure that the effects of protection throughout the economy are properly taken into account.

Economy-wide perspective

The reason why protection policy should be formulated within an economywide perspective is that protection or assistance to one industry affects all other industries and activities throughout the economy. These effects are both direct and indirect (Box 4.2). Another reason why an economywide perspective is necessary is that many policies

Box 4.2 Direct and indirect effects

Direct effects occur through the impact on costs of users and purchasers of the output of the protected industry. Indirect effects occur through the impact on competition for resources and consumer spending. Increasing protection for an industry enables it to attract or retain more resources and factors of production than it could without the protection. These resources are necessarily taken away from other uses in the economy: these other uses are negatively affected by the protection. Exporting and unprotected import-substituting industries are strongly affected this way, because, facing international competition, they are usually unable to raise prices to offset the increase in their costs.

At the same time, because protection allows the industry to charge higher prices than would otherwise prevail, consumers of its output have less to spend on other products and services.

Through these mechanisms, protection for the steel industry, for example, impacts negatively on all other industries in the economy, not only those industries that directly use steel in production. This means that while protection may help maintain employment and income in the steel industry, it does so at the expense of employment and income in other industries.

have protective effects. In order to gauge the trade-offs involved in granting protection, it is necessary to take account of the impact of all measures which provide protection. An industry whose outputs are subject to low tariffs may still be highly protected if imports of competing products are subject to administrative controls.

An economy-wide approach is important to help decision makers, because it provides information about those people and industries that are indirectly affected by policies.

Transparency

The process of negotiating to join WTO gives the impression that the principle of transparency in trade policy is promoted for the benefit of member countries' trading partners. However, the more compelling reason for adopting transparent procedures for providing protection and using transparent instruments is the benefit provided to local producers, workers and consumers and the community at large.

Transparent process

Because protection does impose costs throughout the economy (many of which are hidden), the process of granting protection should allow all those potentially affected to evaluate the likely effect on them. This is particularly important given that the beneficiaries of protection are usually highly concentrated and able to organise themselves to influence policy. Those who bear the costs, in contrast, are spread throughout the economy and are less able to influence policy outcomes. At the same time, transparent procedures, especially if coupled with attempts to quantify the effects of protection, assist governments to make better decisions.

Transparent procedures would also help unravel the complexity of objectives and instruments that currently characterises trade and investment policy in Viet Nam. A process to carefully review the objectives and effects of measures impacting on trade and protection would help in developing better targeted and more effective policy measures.

It would be desirable to establish a more formal and transparent mechanism for deliberating on protection changes. This mechanism could require, for example, that some kind of protection review body report publicly to the government on the consequences of changes in protection for an industry before a change can be implemented (Box 4.3).

Box 4.3 A protection review mechanism for Viet Nam

A protection review body to Viet Nam could have a very formal structure, like the Industries Commission (now called the Productivity Commission) in Australia or the Tariff Commission in the Philippines. Or it could be a less formal grouping of officials and experts, like Team Tariff in Indonesia. The key would be to ensure that the terms of reference or mandate for the body require it to consider the economy wide consequences of protection, and the effects on all groups in the community, not just producers. Another key would be to require the body to conduct public inquiries into the matters referred to it, allowing all interested parties to make submissions, and leading to publication of its recommendations. In this way, the body would support transparency of the policy formulation process.

The body could also be required to undertake and publish annual reviews of trade and protection policies. The process of preparing a memorandum for the WTO, and answering questions, while time consuming, has been very useful to the government in developing a systematic characterisation of current trade related policies. When Viet Nam becomes a member of WTO, it will be become subject to the regular Trade Policy Review Mechanism (TPRM) process, under which the authorities and the WTO Secretariat prepare analyses of the country's trade policies for review by the WTO Council. There is a well established format for these reviews. The body could be required to prepare and annual review along the TPRM lines for public dissemination. The report would, among other things, describe all changes in tariffs and NTBs (including trade related subsidies), document all tariff concessions and import quota/licence allocations, and provide information on changes in customs procedures. It could also report on developments in bilateral, plurilateral and multilateral trading agreements, and perhaps over time present effective rate of protection estimates. This would provide an opportunity for a range of interests to comment on policies and the way they are formulated and implemented.

The body should not be restricted to consideration of border measures of protection, such as tariff and NTBs. Rather, its mandate should be broad enough for it to consider all forms of discriminating assistance to all sectors in the economy.

Transparent measures

The principle of transparency also applies to the type of instruments used to provide protection. This provides one of the important reasons for tariffication of NTBs. Non-tariff measures are often attractive to governments because they give the impression that they offer immediate control over outcomes. However, they usually have a range of unexpected effects, and provide an uncapped level of protection to the industry benefiting from the barrier. Many kinds of NTB insulate protected industries from international competition. While this may be thought to be beneficial by the participants in the industry, it means that there is no limit to the costs they can impose on the economy through inefficient use of resources. Tariffs, and other price related measures, maintain a clear link between international prices and domestic prices, and place a limit on the extent to which a protected industries costs and prices can get out of line with world prices.

Predictability

Predictability in protection policy is important for the domestic economy because all producers and consumers need to plan future behaviour. If protection is subject to frequent and arbitrary changes, planning becomes difficult, and enterprises and consumers must adapt their behaviour to the resulting uncertainty. This imposes costs, and reduces investment and growth in incomes and employment. It is preferable to give producers and consumers a clear road map of expected changes in protection, so that they can plan effectively. A clearly defined and announced policy provides enterprises important information about what activities will be viable in the longer term. This avoids wasting resources and effort which may have to be reversed in the longer term.

The publication of an informal road map for tariff reductions under the CEPT was an important step in this direction. But much uncertainty still surrounds protection policy in Viet Nam, in part because the processes and principles for granting protection remain non-transparent.

Dealing with protection issues in the short term

Pending setting up a formal transparency / protection review body, there is a need to establish a properly resourced inter-ministerial committee to evaluate proposals for changes in trade policies, and to integrate considerations of sectoral and trade policy in advice to the government.

One of the tasks of this committee should be to develop a programme for measurement of levels of protection accorded to different industries. It would be very useful to develop a more comprehensive analysis of effective rates of protection to inform policy making and to establish a set of benchmarks for considering requests for protection.

It is suggested that effective rates of protection be used to develop a classification of industries into three categories:

- highly protected;
- moderately protected; and
- lightly protected

When a request for protection is being considered, the approach should be that industries classified as highly protected would have to meet stringent criteria based on clearly defined benefit to the community as a whole, before additional protection is granted.

This benchmarking approach would be preferable to previous attempts to characterise industries as competitive, conditionally competitive and uncompetitive (CIEM 1999) because it allows use of a quantifiable indicator of competitiveness, rather than subjective assessments. It is consistent with a functional definition of competitiveness that is appropriate for evaluating existing activities (see Box 4.4).

Antidumping and countervailing duties

One particular area where requests for protection may become more frequent is where foreign producers are accused of 'dumping'. Provisions for anti-dumping and countervailing duties were made in the recent amendments to the Law on Export and Import duty. These amendments introduced provisions to apply surcharges against dumped and subsidizing goods.

Box 4.4 A definition of competitiveness

A useful definition of competitiveness for the purpose of deciding on government assistance to enterprises and industries is as follows:

An enterprise is competitive if it can be financially viable without protection or other forms of assistance from the state (such as subsidies on factors of production, preferential access to resources and so on). An industry or production process is also competitive if it meets this criterion.

The thrust of such a definition is that an industry that requires high levels of assistance from government to meet international competition in foreign or domestic markets cannot be considered to be competitive. Assistance to one industry always imposes costs on other sections of the economy. Therefore the definition captures the idea that an industry cannot be considered competitive if its profitability depends on measures that disadvantage other parts of the economy. (A key example of this is that protection of import substitution automatically disadvantages exports).

Of course, many government policies and interventions have the effect of improving the overall environment for the development of all industries. Many of the actions taken under doi moi, such as creating the legal framework for the establishment of enterprises and making contracts, reforming public administration, creating a modern tax system and increasing social sector and infrastructure investment are examples of such interventions. This contrasts with interventions that provide special treatment to particular sectors, which tend to support waste or inefficient use of economic resources, and effectively impose a tax on sectors not receiving special treatment.

Source: CIE (1999b).

GATT agreements condemn dumping. However, nothing in those agreements requires signatories to take action. Thus, the significance of the codes and articles on antidumping and on countervailing duties is not that they oblige a country to take certain actions against dumping and subsidies but rather that if action is taken it must conform to certain requirements as set out in Article VI and in the Agreement on Implementation of Article VI (otherwise known as the Antidumping Code of 1967 see Box 4.5).

Box 4.5 The GATT antidumping code

GATT Article VI and the Antidumping Code define dumping as occurring when 'products of one country are introduced into the commerce of another country at less than the normal value of the products'. However, dumping is condemned only 'if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry'.

There is thus an ambivalence in GATT rules on dumping which does not arise in most other areas of the GATT. That ambivalence reflects:

- the recognition that dumping is a source of cheaper imports, which normally benefits the importing economy;
- an awareness that antidumping action has the potential to be a means of protecting industries against legitimate world market competition; and
- the GATT code on antidumping consists mainly of procedural and other constraints designed to ensure that any reaction is justified and seen to be so.

There are essentially three hurdles which the WTO agreements place before a government contemplating antidumping action may do so. First, dumping — sales at less than 'normal value' — must be found to have taken place; second, a domestic industry must be shown to have suffered 'material injury'; and, third, that injury must be found to be attributable to dumping. To each of these hurdles is appended a myriad of definitions and criteria to do with the meaning of the key terms 'normal value', 'material injury' and the establishment of causality. Thus the machinery to assess claims of dumping is complicated, administratively expensive and necessarily reliant on information which is obscure and ill-defined, so that the findings from an antidumping inquiry are often very arbitrary.

How should Viet Nam deal with 'dumping'

Most antidumping procedures exclude any detailed consideration of the effects that dumping and antidumping measures can have on the broader community. Concern is focused solely on the effects to a particular industry. The larger question of whether the avoidance of industry specific injury might give rise to a greater injury to the economy as a whole is not considered. Article VI of the GATT and the Antidumping Code of 1967 make no provision for such an economywide perspective. This means that to encompass the economywide effects in dealing with claims of dumping there would need to be a broadening of criteria beyond that spelled out in GATT procedures.

Viet Nam could introduce these procedures in two different ways:

- by having a national interest provision in regulations to administer the antidumping legislation; or
- by having another agency which might range from an interdepartmental committee to a fully fledged independent commission which would assess claims for protection,

including claims based on the perception that goods are being dumped, on an economywide basis.

Reforming regulation of foreign investment

As discussed in item 2, accession to certain WTO agreements — especially TRIMS and GATS — will require significant changes in the treatment of foreign investment. The general requirement to provide for national treatment of foreign firms operating in Viet Nam will provide a stronger impetus for ongoing reforms aimed at creating a unified legal, regulatory and taxation framework for foreign investment.

The overall objectives for further reforms in foreign investment regulation should be to:

- replace current approval systems with a streamlined registration process with automatic approval for projects except in those areas explicitly restricted for foreign investment;
- relax controls over actions which are required for normal commercial operation and development of enterprises; and
- improve the overall legal and administrative environment for investment and doing business in Viet Nam, regardless of the origin of investment, thus reducing the need for complex and revenue sacrificing tax incentives.

Specific actions that will be useful in this regard include:

- amending the appropriate laws and regulations to allow foreign investment joint ventures to be incorporated under the company law — in particular allowing ventures to raise capital from the public and thereby increase the share of domestic equity;
- eliminate local content, trade and foreign exchange balancing requirements for investments in certain sectors;
- phase out the dual-pricing system that charges higher prices to foreign enterprise for services;
- establish explicit negative lists of areas from which foreign investment is excluded and discontinue the process of temporarily suspending licencing for selected industries and activities;
- phase out tax incentives that are not also provided to local enterprises, and unify corporate income tax rates for foreign and domestic enterprises;
- clarify laws on private participation in infrastructure;
- establish sectors that are automatically eligible for 100 per cent foreign ownership; and
- move towards unified treatment of foreign and domestic enterprises with respect to land use rights.

Further liberalization of foreign investment will go hand in hand with ongoing efforts to promote a legal and regulatory environment conducive for development of all enterprises regardless of ownership. It will also be linked to development of appropriate regulatory regimes for certain sectors — such as banking and finance and utilities such as telecommunications, water and power.

Complementary policies

The development and implementation of trade and investment policies is a continuing task, the conduct of which will inevitably be affected by social and political concerns. While much is made of the need to provide enterprises in protected industries with time to adjust and make new investments to be able to meet international competition in the future, this is perhaps the least compelling of the arguments. This is because it fails to take account of the interconnectedness in the economy, and the fact that high protection to selected industries is impeding the development of activities that are viable with low levels of protection.

Much of the argument in favour of delayed integration is similar to the argument for 'infant industry protection'. Except that in many cases, the industries and enterprises under consideration are not infants, but are based on long established enterprises whose inefficiency has become very apparent as preferential treatment and subsidies have been stripped away.

That said, there are sound reasons for proceeding carefully. Because of the complexity of the current system, it is still not clear what the current structure of protection is, and what alternative instruments may need to be deployed to replace trade restrictions used for non-protective purposes. Some controls on trade are in place to achieve regulatory objectives (such as health and safety, consumer protection, quarantine). Others are there as a means of controlling the use of state funds, in the absence of more effective means of financial control (especially of SOEs). Alternative measures will need to be put in place as these trade restrictions are phased out.

Equally important is that current regulations (for example, on land use and investment) impede adjustment to change. If it is difficult for businesses, especially small private businesses, to undertake new investments, mobilise finance and access factors of production, then the costs of adjustment to protection changes may be higher than necessary. The government's ongoing efforts to implement the elements of a market economy and to rationalise regulation will need to be accelerated to match the pace of integration.

At the same time, revenue issues remain an important concern. The introduction of a value added tax (VAT) should have taken pressure off import duties as the main source of indirect tax revenue. However, there are important questions about the structure and administration of the VAT that need to be resolved before the tax begins to play its full role. This may imply a need for a more cautious approach to tariff reductions. It is also going to be important to address in parallel the problems of administration of protection policies, as integration requires concerted efforts to develop a modern and effective customs system.

Further trade and investment liberalization will also be also affected by the interplay between central and local authorities in execution of regulatory and fiscal powers. These changes will need to go hand-in-hand with the ongoing administrative reforms.

Further reforms of the state enterprise sector will also need to be linked to deeper economic integration. This is for a number of reasons.

- Elements of any WTO agreement package are likely to accelerate the process of phasing out special treatment of SOEs, to achieve national treatment objectives, provisions dealing with state trading enterprises and accessible markets which are currently the sole preserve of state enterprises.
- Ensuring that the economy will be able to adjust rapidly to emerging challenges and opportunities will require a nimbler, more commercially oriented state enterprise sector, and less crowding out of the non-state sector in competition for resources.
- Phasing down high levels of protection and administrative controls on trade will impact heavily on state enterprises benefitting from these policies. Some enterprises will have to close down, and others divested or restructured. Mechanisms to facilitate such adjustments will need to be developed.

Similarly, ongoing efforts to develop a sound and competitive financial sector will play a critical role in securing the benefits of integration. The sector will itself be the subject of initiatives to increase access by foreign financial entities. But in addition, efforts to address ongoing problems in the banking system, and to inculcate appropriate credit assessment and lending practices will be needed if domestic savings are to be mobilised to finance the new investment opportunities created by trade and investment liberalization. Issues of financial sector liberalization for the SDS are discussed in the companion paper to this report (Flatters 2000).

Related to the need for strong reform of the financial sector is the need to re-energise movement towards a genuinely market-determined exchange rate system. Experiences throughout the world of trade and investment liberalization have demonstrated the powerful role which exchange rate flexibility can play in facilitating adjustment to removing trade controls. Allowing the exchange rate to depreciate in response to market pressures will enhance competitiveness of import-substituting and exporting activities, and help offset short run impacts of protection reductions.

Seen in the context of these linkages to other areas of policy and administrative reform, it is clear that successful integration will be associated with profound changes in the role of the state in shaping the economy. To maximise the benefits from trade and investment liberalization, state investment planning will increasingly have to take account of the implications of trade and protection policies. This will contrast with current practices where trade and protection policies are adjusted to accommodate and validate investment decisions. But, more profoundly, integration will contribute to the shift to state management of the economy through indirect means, relying on policies and the incentives they create to influence decentralized — and increasingly private — production and investment decisions. But this need not conflict with a desire to pursue underlying equity and distributional objectives of socialism. Rather, it will be associated with a shift to state provision and funding of social services and use of tax and fixed transfer system to achieve social objectives. (Options for addressing social policy issues in the context of the SDS are discussed in Fritzen 2000).

Facilitating adjustment

Trade and investment liberalization — and the growth they will facilitate — will bring in their wake pressures for structural adjustment. Some activities which are ill suited to Viet Nam's comparative advantage will come under pressure and may decline. But other activities — many of them new — will have opportunities to expand. Some enterprises will close down, as new ones are formed. The geographical distribution of economic activity will also change as industrialisation proceeds and people move out of agriculture.

These adjustments will create some complex challenges for government policy. There will be intense pressure from vested interests adversely affected by change to be granted special treatment. And the social costs of adjustment in some areas of the country may be judged to be unacceptably high.

The policy challenge for the government will be to find ways of defusing political pressures to defer reform or to resist the adjustment they promote, while responding to genuine hardships that may arise.

A strategy for addressing this challenge would need to operate on a number of fronts:

- building support for policy change by helping people understand what is involved and how they will benefit — and the costs of not proceeding with reform;
- developing mechanisms to assess requests for special treatment against criteria based on the overall national interest, not sectoral, regional or personal interest;
- facilitating adjustment by removing impediments facing workers, enterprises and industries to change what they do and how they do it;
- developing social investment programmes to help people acquire the education and skills required by a modernizing economy; and
- supporting the development of appropriate social safety nets to address the needs of people lacking the capacity to take care of their own welfare, regardless of the cause.

In Viet Nam — as in most other countries — the main resistance to integration will come from vested interests that are directly benefiting from protection from competition. There may also be hesitation on the part of those who fear adverse effects on national sovereignty or that integration will provide the spread of social evils. The fundamental political problem is that those who are benefiting from current policies know how they benefit, while those who are bearing the costs, through lost opportunities to improve their standards of living, are not really aware of the costs they bear. Moreover, for those who may lose from removing protection, the losses are likely to be large for them. Whereas the gains, though potentially large in total, are likely to be widespread so that beneficiaries have little motive to press for change.

So a key part of the integration strategy is to provide the second category of people with information about the effects of current policies and of reforms. Another part is to give them a forum where they can express their views and influence policy making.

This leads to the second plank of the strategy — developing mechanisms for assessing requests for special treatment. The protection review mechanism proposed earlier in the chapter would provide a way for disseminating public information about policies and their effects, and would allow all interested parties to make an input into the decision making process in a transparent and open way.

Facilitating adjustment would require addressing policy and institutional impediments that lock people and enterprises into declining activities and prevent them from moving into new fields of business and employment. It will also be important to ensure that the interests of disadvantaged people, or those with less direct influence on resource allocation issues, are taken into account. To this end, careful analysis of gender dimensions of adjustment will be very important.

A number of features of current labour market regulations constrain adjustment to changing circumstances. Enterprise specific social security and health insurance systems and entitlement systems deter people from moving between jobs. And residence controls stop people from moving to areas where employment opportunities are greater (CIE 1998). At the same time, there are still many impediments to enterprise formation linked to the business registration system, regulation of land and capital markets and controls on entry into specific sectors. These limit the ability of small and medium non-state enterprises to expand new opportunities and create new jobs.

Similarly, the vocational and technical training system needs to be revamped to help new entrants to the labour force — and existing workers — to gain new skills. Changes are needed to make the system more responsive to the demands of trainees and the skill needs they wish to address through, for example, creation of scholarship and voucher systems that allow workers to determine where government funding should be directed. Resources could be shifted out of current credit-based employment creation programmes and put into efforts to improve the framework for training and skill acquisition.

Finally, support for appropriate social safety nets would help address the needs of those who are unable to support themselves and their families. Experience in other countries has shown that specific adjustment assistance schemes seldom work well, so that creation of a broader based social security system is preferred.

An action programme for integration

Table 4.2 summarizes suggestions made in this report in a proposed action programme for further trade and investment liberalization. The programme must address both international and domestic dimensions of integration. On the international front, priority is given to pursuing unilateral liberalization regarding trade in goods, and continued reforms aimed at moving towards more equal — and liberal — treatment of domestic and foreign investors. Careful preparation is proposed to develop a strategy for implementing deeper integration initiatives required by WTO access, especially regarding trade in services and investment liberalization, given the efforts still required to develop market institutions and appropriate legal and regulatory frameworks for effective operation of services sectors.

The programme also identifies some key areas where complementary actions are required to ensure that the best outcomes from liberalization are achieved. However, progress across all fronts of the ongoing renovation process is desirable. The programmeme also identifies areas where actions may be required to facilitate adjustment and to address unacceptably harsh social consequences of adjustment to change.

Table 4.2 An action programme for further trade and investment liberalization

Programme objective	*Programme elements*		*Timeframes*
Proceed with unilateral actions to further liberalize trade in goods and foreign investment	Trade in goods	▪ Phase out NTBs, replacing with tariffs or non-discriminatory regulations	3-5 years
		▪ Develop target long term tariff structure - simple, relatively uniform - and time path to implement it (taking account of CEPT commitments)	1 year development 5 years implementation
		▪ Strengthen customs administration - valuation, compensation, procedural streamlining	5-10 years
		▪ Develop mechanisms for evaluation of protection issues, develop industry restructuring plans	1-2 years
	Investment	▪ Develop and implement programme for legislative reform aimed at phasing in national treatment	5 years
		▪ Phase in uniform tax and incentive treatment of foreign and domestic investment	5 years
		▪ Develop, where appropriate, sectoral regulatory regimes to replace direct investment controls (for example, telecom-munications, transport infrastructure, banking and finance)	5-10 years

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(Continued Table 4.2)

Programme objective	***Programme elements***		***Timeframes***
Continue implementation of commitments under existing international agreements and maintain effective participation	AFTA	Publish tariff reduction schedule for CEPT to 2006 (implementing reductions on MFN basis)	1 year
		Prepare and implement programmes for AIA and other agreements	Ongoing
	APEC	Update individual action plans	Ongoing
	US trade agreement	Sign and implement	Immediate
Formalise and implement strategies for WTO accession	Accession preparations	Complete assessment of legislative and institutional requirements of implementing most likely scenario of accession agreements	Ongoing
		Develop domestic consensus on pace, schedules and levels of market opening	Ongoing
		Prepare realistic negotiating strategy for accession negotiations	Immediate
	WTO activities	Actively participate as much as observer status allows in preparation for a new liberalization round	Ongoing
Develop complementary domestic reforms	Competition policy	Initiate process of regulatory review to identify and eliminate unwarranted legislative and administrative restrictions on competition	1-3 years
		Develop regulatory regimes for network industries (utilities)	2-5 years
	Business and factor market regulation	Streamline regulatory and legal systems governing business establishment and market entry	3 years
		Progress land and labour market reforms to facilitate reallocation to alternative employment opportunities	5 years
	Financial sector development	Restructure banking system	Ongoing
		Adopt modern methods of supervision and regulation	Ongoing
		Facilitate development of capital markets	Ongoing
		Develop legislative frameworks to support credit systems (for example, bankruptcy)	Ongoing
Facilitate adjustment	State enterprise reform	Complete equitisation, leasing and divestiture	Ongoing
		Commercialise enterprises remaining 100 per cent state owned	Ongoing

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(Continued Table 4.2)

Programme objective	**_Programme elements_**		**_Timeframes_**
		▪ Strengthen financial and fiscal disciplines on state enterprises	Ongoing
	Strengthening tax and fiscal policy and administration	▪ Refine design and administration of VAT	Ongoing
		▪ Strengthen public expenditure management systems to facilitate better implementation of social sector and human resource development programmes	Ongoing
		▪ Strengthen public investment in planning and maintaining mechanisms to take better account of implications of trade and investment liberalization	Ongoing
	Public administration reforms	▪ Develop and implement programmes to increase professionalism and efficiency of public administration and to reorient state administration to elements of a market economy	Ongoing
Facilitate adjustment	Public education and awareness	▪ Initiate programmes to improve public understanding at all levels of the implications and nature of integration	Ongoing
	Social investment programmes	▪ Strengthen and/or develop mechanisms for retraining, skill development, enterprise development, etc. for displaced workers and new entrants to the workforce to facilitate labour mobility, taking account of gender dimensions of change	Ongoing
	Social safety nets	▪ Develop short and longer term systems to provide social safety nets for those unable to support themselves, addressing gender differentiated needs	Ongoing

Annexes

NTBs in Viet Nam

NTBs REMAIN A PROMINENT feature on the landscape of trade policy in Viet Nam. QRs or targets, foreign exchange allocation and various administrative measures are applied to control, manage and limit the import of certain types of goods. Some NTBs are applied to pursue a multiplicity of objectives, and some are used because more efficient means of achieving non-protective regulatory objectives are not available. Table A.1 summarizes the various forms of NTB used in Viet Nam, and Table A.2 lists the goods subjective to QRs on imports as at 31 December 1999. The government has announced that some of these restrictions will be eliminated in 2000, and has committed to phase them all out under its agreement with the government of Japan under the Miyazawa initiative.

Table A.1 Non tariff barriers in Viet Nam

Type of non-tariff measure	***UNCTAD Classification number***	***Sectors applied to***	***Additional comments***	***Objective***
Customs surcharges	2100	▪ Imported petroleum, steel and iron, and fertiliser ▪ Exports of coffee, unprocessed cashew nuts and rubber	▪ Surcharges are often introduced for short periods with limited notice	▪ Ad hoc solutions to 'gaps' in protection. ▪ Revenue raising instruments ▪ To fund price stabilisation fund
Special sales taxes - the Luxury Tax	2310	▪ Tobacco products, beer, automobiles and golf courses	▪ Differential rates for imported and domestic sourced tobacco products ▪ Discretionary powers to exempt domestic producers from tax if firm is loss making	▪ Revenue collection ▪ Price stabilisation ▪ Protection of domestic industry (through exemptions and preferential treatment)
Value added Tax	2320	▪ Exemptions for imported inputs used for the production of exports and imports of capital goods not able to be produced in Viet Nam ▪ Reductions in VAT rates on charcoal, tractors and water pumps, certain chemicals and software.		
Decreed customs valuation - minimum import prices	2400/3110	▪ Various products		▪ Revenue protection
Anti-dumping and countervailing measures	3400/3500	▪ Open	▪ Uncertainties exist over how these measure might be implemented	▪ Protection from 'unfair' competition from overseas suppliers
Cash margin requirements	4120	▪ Consumer goods (no deferred letter of credit permitted) ▪ Certain other goods		▪ Management of short term international debt ▪ Protection of domestic industry ▪ Balance of payments concerns

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(Continued Table A.1)

Type of non-tariff measure	*UNCTAD Classification number*	*Sectors applied to*	*Additional comments*	*Objective*
Foreign exchange allocation restrictions	4310	▪ Limitations on access to foreign exchange for importation of consumer goods ▪ Foreign invested firms to balance their foreign currency requirements ▪ Priority access for infrastructure and import-substitution projects	▪ Latest import-export law required that importation of consumer goods be regulated by taxes and *payment modes of banks*	▪ Limit outflows of foreign currency
Surrender requirements	4400	▪ Open	▪ Firms required to surrender 80 per cent of foreign exchange immediately	▪ Foreign exchange market liquidity ▪ Limiting speculation against dong devaluation
Import licencing	6100	▪ Petroleum, fertilisers, motorcycles, automobiles, steel and iron, cement, sugar, paper, alcohol, glass	▪ Licences from the MOT are required to import goods which are 'regulated to balance the economy'	▪ Protection of trading rights for certain domestic firms
Goods subject to specialised management by line ministries	6100	▪ Chemicals, pharmaceuticals, cosmetics, aquaculture products, certain equipment for agriculture, printed and cinematic works, equipment related to labour safety, banking equipment, radio and telephone equipment	▪ Regulated by the Ministries of Industry, Agriculture and Rural Development, Culture, Public Health, Aquaculture and Labour, Invalids and Society plus the General Department of Posts and Telecommunications and State Bank of Viet Nam	▪ Protection of public health, occupational health and safety. ▪ Protection ▪ Quarantine ▪ Technical standards
Import quotas to balance the economy	6200	▪ Petroleum, fertilisers, motorcycles, automobiles (<12 seats), some types of steel and iron, cement, sugar, paper, alcohol, glass	▪ Outlined in Decree 57	▪ Protection of domestic industries ▪ Price stabilisation and surety of supply to domestic consumers ▪ Manage balance of trade

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(Continued Table A.1)

Type of non-tariff measure	***UNCTAD Classification number***	***Sectors applied to***	***Additional comments***	***Objective***
Temporary bans to balance trade	6200	▪ Electric fans, ceramics, plastic packaging, steel pipes and tubes, motor cycles components, Sodium Hydroxide, bicycles, vegetable oil, DOP products, 15-50 seat passenger vehicles, second hand ambulances, cars for carrying freight and passengers, clinker	▪ Outlined in Decision 254	▪ Balance of payments ▪ Protection of domestic industry
Export quotas	6200, 6600	▪ Rice, garments	▪ Garment exports to European Union, Canada, and Norway subject to restriction by export market	▪ Food security ▪ Allocation of rents from garment quotas
Prohibitions	6300	▪ Weapons, narcotics, immoral products, firecrackers, cigarettes, used consumer goods, used automotive parts		▪ Protection of cultural and social values ▪ Technical standards ▪ Protection of domestic industry
Allocation process for QRs	6700	▪ All sectors subjects QRs	▪ Process for allocating quotas to enterprises is not clear	▪ Distribution of rents arsing from QR ▪ Protection of favoured enterprises
Single or limited number of channels for imports	7100	▪ Food products, agricultural exports ▪ Petroleum, fertilisers, motorcycles, automobiles (<12 seats), some types of steel and iron, cement, sugar, paper, alcohol, glass	▪ Food Corporation of Viet Nam holds dominant position in food and agricultural products ▪ Line ministries and provincial authorities also dominant traders	▪ Distribution of rents ▪ "Ensuring quotas are satisfied"
Stamping (special customs formalities)	8310	▪ Televisions, bicycles, alcohol, tobacco, ceramic tiles, others	▪ Possible expansion planned	▪ Revenue protection ▪ Protection of domestic industry
Investment measures, export promotion and industrial policy	9100/9110/ 9120	▪ Various	▪ Discretionary tax exemptions and investment incentives such as soft bank loans, taxation schedules and exemptions and licencing controls	▪ Export promotion, industrial development

Source: CIE (1999a).

Table A.2 Goods subject to quantitative restriction As at 31 December 1999

Product	***HS code(s)***	***Scheduled tariff***
		%
Decree 57 - longer term management items		
Petroleum products		
Petrol	27100010	10
Diesel	27100020	60
Mazut	27100030	20
Aviation spirit	27100040	60
Kerosene	27100050	60
Naptha, reforade component and other preparations of petrol	27100060	60
Fertilisers		
Mineral or chemical fertilisers, nitrogenous	3102	0
Mineral or chemical fertilisers, phosphatic	3103	0
Mineral or chemical fertilisers, potassic	3104	0
Mineral chemical fertilisers containing 2 or 3 of the fertilising elements nitrogen, phosphorus, and potassium; other fertilisers; goods of this chapter in tablets or similar forms or in packages of a gross weight not exceeding 10 kg	3105	0
Two-wheel motor vehicles and their complete assembly components	8711	10/14/30/55/60
Vehicles		
Public transport type passenger motor vehicles of up to 24 seats	8702	60
Motor cars and other motor vehicles principally designed for the transport of persons	8 703	60
Motor vehicles for the transport of goods	8704	60
Chassis fitted with engines	870600	10/20/50
Steel and Iron		
Steel billet[a]	72070010	na
Flat-rolled products of iron or non-alloy steel, of a width of 600 mm or more, hot-rolled, not clad, plated or coated	720800	0
Flat-rolled products of iron or non-alloy steel, of a width of 600 mm or more, cold-rolled (cold-reduced), not clad, plated or coated	720900	0
Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, clad, plated or coated	7210	0/3/10/20
Flat-rolled products of iron or non-alloy steel, of a width of less than not clad, plated or coated	600 mm, 7211	0/3/5
Flat-rolled products of iron or non-alloy steel, of a width of less than clad, plated or coated	600mm, 721310	40
Steel for constructional purposes of circular cross-section measuring not exceeding 100mm in diameter, containning indentations, ribs, grooves	721310	40
Steel for construction purposes of rectangular (including square) cross-section not exceeding 20 in width	721320	0
Other	721390	10
Iron and steel for constructional purposes	721400	40

(Continued on next page)

(Continued Table A.2)

Product	***HS code(s)***	***Scheduled tariff*** %
Other bars and rods of iron or non-alloy steel	721500	40
Iron or non-alloy steel in sections of L,U,I,H T	721600	10/40
Wire of iron or non-alloy steel	721700	15
Wire net	7314	0/10/20
Iron and steel tubes, pipes and hollow profile	730431	0
Iron and steel tubes, pipes and hollow profile	730490	0
Iron and steel tubes, pipes and hollow profile	730630	0/5/20
Iron and steel tubes, pipes and hollow profile	730690	0/5/20
Cement		
White portland	252321	40
Other portland	252329	40
Aluminous cement	252330	40
Other hydraulic cement	252390	40
Raw sugar		
Cane sugar	170111	30
Beet sugar	170112	30
Refined sugar		
White sugar containing flavouring or colouring matter	170191	40
Other white sugar	170199	40
Writing and printing papers		
Newsprint	480100	20
Hand-made paper and paper board	480210	40
Other paper and paperboarda	480250	na
Other paper and paperboard	480260	40
Uncoated kraft and paperboard in rolls or sheets	4804	3/5/10/15/30
Other uncoated paper and paperboard	4805	10
Alcohol	2204	100
Construction glass		
Cast glass and rolled glass in sheets or profiles	7003	40
Drawn glass and blown glass in sheets	7004	40
Float glass and surface ground or polished, in sheets	7005	30
Glass used for construction, in sheets	7016	40
Decision 254 - temporary restrictions		
Civil electric fans	84145100	50
Ceramic and granite floor and wall tiles	6907	50
Ceramic consumer goods (including sanitary wares), glass and porcelain	6910	50
Plastic packaging	39231000	30
Liquid NaOH	28151200	15
Bicycles	87120020	50
Refined vegetable oil	15079010	40

(Continued on next page)

(Continued Table A.2)

Product	***HS code(s)***	***Scheduled tariff*** %
DOP plastic	38123010	5
Clinker	252310	20
Motor vehicles		
Incomplete two and three wheel motorbikes	8711	10/14/30/55/60
Various incomplete motors	84082000	5/10/15/30/40
Buses with less than 50 seats	8702	60
Used emergency vehicles	8703	0
Cars able to carry both freight and passengers	8703	60
Trucks of less that 5 tonnes	87042100	60
Steel		
Various 20-114 mm steel pipes, iron tubes	7303/73043191	1/15

a. No tariff required for this item.

Source: CIE (1999a).

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