The Economics of the "Non-Market Economy" Issue: Vietnam Catfish Case Study

By Adam McCarty and Carl Kalapesi
Mekong Economics Ltd.
mekongeconomics@hn.vnn.vn
www.mekongeconomics.com

Draft
January 29, 2003

Table of Contents

1. Introduction

> "…The criteria … give the respective administering authorities practically unlimited latitude in taking relevant decisions. As a matter of fact, the lack of definitions of such critical terms as "extent", "significant", "degree" or "freedom" can effectively guarantee that no country or even a separate industry will ever pass through such a bureaucratic exercise until and unless a *political* decision is taken to revoke NME [Non-market economy status]"[1]

A casual observer might think that determining whether an economy is "market" or "non-market" was an interesting question for economists. Actually, economic literature does not consider it an issue.[2] Particular markets may fail or be missing, but for whole economies it requires the concerted effort of central planning[3]. In all economies, some goods and service markets may be subject to monopoly, monopsony, or oligopoly control. But there seems little purpose in trying to measure some point at where a whole economy is "market" or "non-market". The concern for economists is whether and to what extent any given market should be regulated, taxed or subsidized.

So who does consider this an "issue", and why should it be for economists? The Governments of an increasing number of countries profess concern that whole economies with which they trade are not "market based", and therefore initiate research into the question. The professed criteria for coming to a conclusion are economic, although as the above quote suggests, the determining factor is primarily political. Decisions come before analysis. Given that it is a political process, the economic logic is invariably something of a facade. This should concern economists as it makes a sham of their science[4].

In this paper we consider the concept of a non-market economy from a broad economic perspective as well as from the more narrow definition related to anti-dumping. We also analyse the US Department of Commerce investigation of

---

[1] Polouektov (2002) p. 18-20

[2] Search ECONLIT for "non-market" references. Search Legal database and do a comparison

[3] Or to paraphrase Oscar Wilde: to lose one market is a misfortune; but to lose all markets requires careful planning.

[4] Edward Gresser has recently highlighted "neglect" by economists as a cause of present American tariff policy where, like the economics of dumping and non-market economies, "the tariff system has become an obscure, little-studied topic." [see Gresser, E. (2002) "Toughest on the Poor: America's Flawed Tariff System" in *Foreign Affairs*, November/December 2002. pp. 9-16]. Maybe economists, amongst others, have just given up the fight against shoddy economic arguments, and accept them as an unmovable and politically-driven aspect of the policy landscape. But such arguments undermine the economics profession itself, aside from the welfare losses of bad policies. Maybe the incentive structure of academic economist careers needs nudging towards more applied work (e.g. greater weight given to a short-list of applied policy journals)?

Vietnam as a case study to the economic methodology applies in "non-market" investigations. We take some indicators and compare them across a selection of countries. We then discuss how Vietnam can move towards satisfying the criteria as specified by such investigations, and more generally, how markets can be strengthened in Vietnam.

2. The Non-Market Economy Issue

> "GATT [General Agreement on Tariffs and Trade] was designed by market economies for market economies"[5]

The market/non-market economy distinction evolved during a time in which there was a clear divide between economies pursuing market-based economic and economies which were primarily centrally-planned. This distinction, subject to one or two exceptions, is no longer valid.

With the fall of the former Soviet Union, market reforms across Eastern Europe, the opening up and marketisation of China and of course Vietnam – the primacy of market-based economics is almost unchallenged. Of course that is not to suggest that all (or indeed any) economies worldwide are perfectly laissez-faire economies. What it does suggest is that market-based mechanisms, with all their imperfections, are subject to a few exceptions the most efficient way to allocate scarce resources in an economy.

The "non-market economies" concept has appeared in anti-dumping legislation since the 1970s. Antidumping is based on a comparison of costs and prices and value and therefore, given the difficulties in measuring reasonable values in centrally planned economies, such a distinction was appropriate. However today designating non-centrally planned countries as non-market economies allows the "application of different, less transparent, and potentially discriminatory practices in the determination of antidumping."[6]

In effect the term non-market economy has become a non-tariff barrier, facilitating selective restrictions on imports from low-cost economies into developed country markets.

[5] Polouektov, A. (2002)
[6] Wang (1996)

3. What is a market economy?

3.1 From a broad economic perspective

The US Department of State *Glossary of Trade* defines a "non-market economy" as:

> "A national economy in which the government seeks to determine economic activity largely through a mechanism of central planning, as in the former Soviet Union, in contrast to a market economy, which depends heavily upon market forces to allocate productive resources. In a nonmarket economy, production targets, prices, costs, investment allocations, raw materials, labor, international trade and most other economic aggregates are manipulated within a national economic plan drawn up by a central planning authority. Hence the public sector makes the major decisions affecting demand and supply within the national economy."[7]

It would be hard today, with the exception of perhaps North Korea, to find a single country in which the majority of decisions affecting demand and supply are controlled by the public sector and hence meet this definition of a non-market economy.

At one end of the spectrum we can place the ideal laissez faire economy and at the other the completely state-controlled economy. But given that all economies sit somewhere in between these two extremes where do we draw the line between market and non-market economies?

Professor Wang (1996) argues that it is "… the invasive control and planning of the government in the market place which distinguishes a market from a nonmarket economy. The key features in a nonmarket economy, as the term implies, are the absence of a market system under which prices are determined by market supply and demand and the failure of the level of production to correspond with market demands. In a nonmarket economy, the quintessential market decisions, such as production, supply, and price are determined centrally by the government"[8]

From a broad economic perspective the only sensible understanding of a non-market economy is that of a centrally planned economy. A market economy therefore being one that is not centrally planned. Today, however, the US Department of Commerce (DoC) and numerous other bodies (as shall be seen in Section 3.2 below) use a particularly narrow definition of a "non-market economy" that encompasses economies in which markets are the main mechanism for allocating resources.

[7] Blakeslee and Garcia (1999)
[8] Wang (1996)

3.2 From a narrow economic perspective[9]

Where markets clearly exist, how can an economy be labeled "non-market"? This must involve adopting a specified narrower definition of a "non-market economy" (NME). This, for example, is how the US Department of Commerce approaches the issue:

> "NME prices are not, as a general rule, meaningful measures of value because they do not sufficiently reflect demand conditions or the relative scarcity of resources used in production. The problem with NMEs is not one of distorted prices, *per se*, since few, if any, market economy prices are perfect measures of value, free of all distortions (e.g. taxes, subsidies, or other government regulatory measures). The problem, instead, is the price *generation* process in NMEs (i.e., the absence of the demand and supply elements that individually and collectively make a market-based price system work).
>
> The Department's evaluation of the statutory criteria does not require that countries be judged against a theoretical model or a perfectly competitive *laissez-faire* economy. Instead, the Department's determination is based on comparing the economic characteristics of the country in question to how other market economies operate, recognizing that market economies around the world have many different forms and features."[10]

Actually, the US DoC compares a *selection* of economic characteristics relating to six criteria for investigation. There is no justification for these criteria, nor any explanation of how each is weighted in coming to a decision. These methodological concerns are discussed later, for the moment we should focus on the definition outlined above.

The US DoC definition hinges on the conclusion that, "NME prices are not, as a general rule, meaningful measures of value…". This raises the question of "value", which has certainly been a concern of economists for some hundreds of years, and is a question that can only be answered by reference to a theoretical model, despite the DoC's assertion that they do not. In this instance, that model would appear to be competitively determined market prices in the absence of any distortions[11]. These would produce the ideal "meaningful values" that the DoC has in mind (which are not the same that theoretical perfect markets would produce). For real world purposes that is a reasonable interpretation of "values", the problem is the logical link to the "price generation process" in the DoC definition. That is a different issue. The process is one

---

[9] The statutory definition for a nonmarket economy appears in 19 U.S.C § 1677(18). This section, defines nonmarket economy as follows: [A]ny foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.]"

[10] US Department of Commerce (2002), "Antidumping Duty Investigation of Certain Frozen Fish Fillets from the Socialist Republic of Vietnam - Determination of Market Economy Status", A-552-801 Investigation Public Document

[11] That does not mean perfect markets, which is indeed just a theoretical construct. All markets are imperfect if only in that knowledge is never complete and the future unsure. That the US DoC interprets "perfect measures of value" as those generated by distortion-free markets suggests some theoretical confusion on the question of "value".

of competition: no competition, no process[12]. Some distortions reduce competition, but many just redirect resources without necessarily reducing competition in any market. The DoC definition, and indeed the whole subsequent analytical framework, fails to make this crucial distinction.

Consider, for example, a country where all goods and services are subject to a flat 10 percent value-added tax. Now, suddenly, only the motorbike industry gets an exclusion from having to pay that tax. If it is a competitive market, that will lead to a fall in motorbike prices and some increase in motorbike production, all other things being equal. Price has moved from the US DoC vision of "true value", yet it remains a competitive market with the same "price generation process" (but focused on a new equilibrium price). In other words, to show that an economy has many market distortions does not necessarily reveal whether its "market-based price system" is working or not.

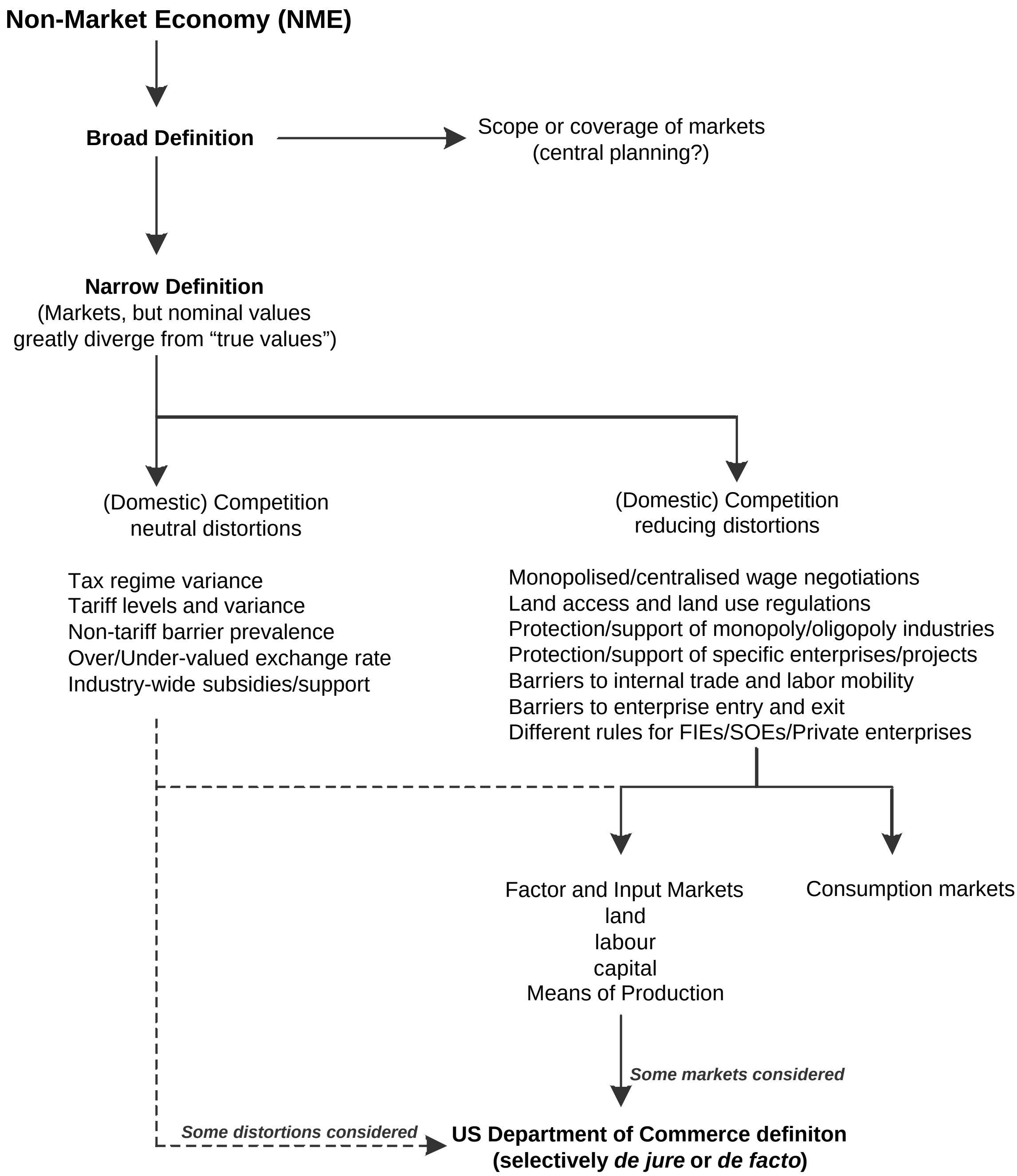
So is the narrow NME definition based on a concern that markets are not working (which "non-market" certainly implies), or that they work but values diverge greatly from the theoretical true values due to distortions? The six investigation criteria, discussed in Section 3.4, suggest that concern about markets and controls on competitive processes are the central concern. The US DoC NME definition is therefore better described as an economy where the Government excessively limits market-based competition. The issue becomes one about the degree of competition, and not whether markets exist, as such: more a CLME (competition-limited market economy)

But competition neutral distortions, like the motorbike example above, also cause nominal and "true values" to diverge. Thus, from the values perspective, the six US DoC criteria miss much that should be measured. Further, the US DoC criteria only focus on factor and intermediate goods markets (because that is the focus of anti-dumping concerns). The purpose of the investigation is to determine whether "market forces in the country are sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis" (US DoC 2002:7). The criteria reflect that purpose, but actually that purpose is only obliquely related to the question of whether the economy as a whole can be reasonably labeled "non-market". The issue is therefore the label. If the investigation was to determine "competition-limited factor markets" and countries label as such if they fail the evaluation, then the investigative methodology would be valid (if still unclear). As it stands, however, the methodology is far from adequate to reach any economy wide conclusion about "non-market" status, or even that nominal and "true" values greatly diverge.

Figure 1 illustrates the complex path to the US DoC definition. The definition clearly has little to do with any broad understanding of what a non-market economy may be. The DoC definition also excludes many distortions that cause nominal to diverge from "true" values in an economy, and by ignoring consumption markets a label that applies to the whole economy cannot be justified.

[12] "Competition" is presumably what the DoC had in mind when talking about "demand and supply elements".

Figure 1: Understanding the definitions of non-market economies



Measurement of the US Department of Commerce definition:

- Direct evaluation of factor and input market policies and regulations, and FIE access to all markets.
- No international price comparisons. No international benchmarking. No explicit weighting of criteria.

Box 1: What is a "distortion"?

A market distortion generally involves direct or indirect involvement by Government that results in a price change. More precisely, we can borrow the definition of Baldwin (1970) when he defined a non-tariff barrier to trade:

"..any measure (public or private) that causes internationally traded goods and services, or resources devoted to the production of those goods and services, to be allocated in such a way as to reduce potential real world income."

When we consider all distortions, then the goods and services can also include exclusively domestic goods and services, and therefore just remove "internationally" from Baldwin's definition.

3.3 The legal capture of economic analysis

The US DoC definition of a non-market economy, as discussed above, lacks detail and makes little economic sense. Further, when applied, the evaluation swings from *de jure* to *de facto* at will. Another concern is that the analysis becomes more a legal argument than an economic one. In the assessment of Vietnam's currency convertibility, for example, the DoC states that: "The extent of Vietnam's currency convertibility legs behind all recent NME graduation candidates" (US DoC 2002: 11). In other words, legal precedent replaces measurable economic criteria. Non-tariff measures such as the "non-market economy" concept now only make sense from a legal perspective based on precedent. From an economic perspective, it is hard to take the definition and related arguments seriously.

"Legal capture" has facilitated a conceptual drift in the definition of a non-market economy. Initially, it was clearly synonymous with centrally planned economies with all their attendant characteristics of price setting, rationing, and state enterprise "soft budgets". In such economies "prices did not matter" (access to rationed inputs and the ability to buy something with your money mattered), all prices were "too low" and official exchange rates were some fraction of the black market rates. Barter or some form of "managed trade" was common. It was this sort of economy that the US DoC had in mind when they dismissed countervailing duty petitions against non-market economies in 1984 on the grounds that the concept of subsidization has no meaning in an economy in which costs, prices, and profits are determined by central planning rather than market forces[13]. This position was upheld and explained by the Court of International Trade: "[G]overnment activity in a nonmarket economy cannot confer a subsidy because a subsidy, by definition, means an act which distorts the operation of a market." (in Wang 2002:3).

[13] *Carbon Steel Rod from Czechoslovakia*, 49 Fed. Reg. 19,370, 19,371 (Department of Commerce 1984) (final determination).

Of course centrally planned economies could and did subsidise favoured industries. This was done by giving them priority access to resources, not through financial measures. Financial favours only work where prices and money matter: in markets. This realization put the ball back in the US DoC's court, and demanded that they develop some sort of methodology to measure such subsidies. That is difficult, for "in a nonmarket economy in which all benefit inputs and financial decisions are made centrally, one would lack a clear benchmark for determining the level of specific subsidy." (Wang 2002:5). The search for a solution has led to the practice of using "surrogate country" (proxy) prices. The use of surrogate countries has its problems, but it is reasonable given the systematically meaningless prices of central planning. The problem is that somebody forgot that non-market economies were by definition centrally planned, or something very close to that. The present US Doc definition of a non-market economy more accurately describes the market imperfections of a typical developing country economy than it does a centrally planned economy. The non-market economy definition has surreptitiously moved from "centrally planned", to "in transition", to "highly distorted markets"[14].

The legal nature of the investigation also seems to allow for wild economic generalizing. For example, after listing the Vietnamese government exchange rate controls, the US DoC concludes: "Vietnam's FOREX administration is designed to avoid a precipitous slide in the value of the *dong*, such as was experienced by Vietnam's neighbours during the 1997 Asian crisis. The result is an exchange rate that is not responsive to the forces of supply and demand." (US DoC 2002: 10). This presumption that Vietnam's currency is presently highly overvalued is controversial, and unlikely to be true given the evident lack of a black market for dollars in Vietnam, but the point here is that it is an argument based only on the observation that neighbouring countries devalued since 1997[15].

[14] And after reading Section 6.1 below you may agree to add just "distorted markets".

[15] This is a particularly tenuous argument given that the other Asian countries had open capital accounts and Vietnam did not, and that the dong has devalued considerably vis-à-vis the US dollar since 1997. Further, according the to IMF (2002: 3), "external competitiveness remains broadly adequate as measured by CPI-based real effective exchange rates".

3.4 The existing "definitions"

> "The vagueness and inadequacy of the criteria suggest that the Department of Commerce may grant a market economy status to a country which does not have a market economy, while at the same time refusing to recognize a market economy even if it is one."[16]

The US DoC definition of a NME, as discussed above, is really one of a CLME, and even then the specified criteria narrow the focus to only some markets in a given economy. These criteria being:

1. The extent to which the currency of the foreign country is convertible into the currency of other countries;
2. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management;
3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country;
4. The extent of Government ownership or control of the means of production;
5. The extent of Government control over the allocation of resources and over the price and output decisions of enterprises;
6. Such other factors as the administering authority considers appropriate.

These six criteria are used to decide whether a country is a market economy for the purpose of determining whether price is a reasonable measure of value. However the six criteria tend to analyse an economy from a macro perspective,[17] and do not directly measure whether prices are a true indicator of value. The criteria do not directly consider whether, for example, "decisions regarding import and the import prices are made free of, or substantially free of, government control or intervention." (Wang, 1996)

The US is not the only country that conducts such an analysis. Many developed and developing nations classify other countries as "non-market" for the purposes of trade disputes, some according to a set of criteria, others based on the fact that another WTO member has classified them as non-market,[18] and others based on some unknown and non-transparent decision making process. Polouetov (2002) lists many countries that recognize the nonmarket economy classification. Table 1 below compares the criteria used by four legislative bodies in the USA, EC, Mexico and Malaysia in making decisions regarding the classification of economies as market or non-market

[16] Wang (1996)
[17] "An overview of the[US DoC] factors … suggests that because of their macroeconomic nature many of them would more appropriately belong to the IMF country reports, including those prepared in the framework of Article IV consultations, rather than in the WTO context." Polouetov (2002: 18)
[18] India

Table 1: Comparison of criteria for qualifying as a "market economy" country under some selected legislative systems

USA (G/ADP/N/1/USA/1) 10.04.1995	EC (Regulation No. 905/98) 27.04.1998	Mexico (G/ADP/N/1/MEX/1/Suppl.1) 31.01.2001	Malaysia (G/ADP/Q1/MYS/6) 11.01.2001
1. The extent to which the currency of the foreign country is convertible into the currency of other countries	Exchange rate conversions are carried out at the market rate	The currency of the foreign country under investigation must be generally convertible in the international currency Markets	No similar provision
2. The extent of government ownership or control of the means of production	D*ecisions of firms* regarding prices, costs and inputs, including of technology and labour, output, sales and investment, *are made* in response to market signals reflecting supply and demand, and *without significant State interference* in this regard, and costs of major inputs substantially reflect market values	D*ecisions* relating to prices, cost and supply of inputs, including raw materials, technology, production, sales and investment, in the sector of industry under investigation, *must be taken in response to market signals without any significant State interference*	The degree of private investment, in particular whether private companies hold the majority of shares and *whether government officials are on the board or in key management positions*
3. The extent of government control over The allocation of resources and over the price and output decisions of enterprises	Same as above	Same as above	Company control over sourcing of raw materials and inputs Freedom to determine export prices and export quantities
4. The extent to which wage rates in the foreign country are determined by free bargaining between labour and management	No similar provision	Salaries in the said foreign country must be established through free negotiation between workers and Employers	Freedom to hire and fire employees and to determine their salaries
5. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country	No similar provision	No similar provision	No similar provisión
6. No similar provision	Firms have one clear set of basic accounting records which are independently audited in line with international accounting standards and are applied for all purposes	The industry under investigation must have only one set of accounting records which it uses for all purposes and which is audited according to generally accepted accounting criteria	No similar provision

7. No similar provision	The production costs and financial situation of firms are not subject to significant distortions carried over from the former non-market economy system, in particular in relation to depreciation of assets, other write-offs and payment via compensation of debts	The production costs and financial situation of the sector or industry under investigation must not be distorted in relation to the depreciation of assets, bad debts, barter trade and debt compensation or other factors considered relevant	No similar provision
8. No similar provision	The firms concerned are subject to bankruptcy and property laws which guarantee legal certainty and stability for the operation of firms	No similar provision	No similar provision
9. Such other factors as the administering authority considers appropriate	No similar provision	No similar provision	No similar provisión

Source: Polouektov (2002)

Given the similarity between the various criteria in Table 1 and the US DoC recent determination concerning Vietnam, we will focus mainly on the US criteria. The EC (and Mexico), however, lay particular emphasis on accounting systems and financial reporting requirements, and we will first discuss them briefly. The EC also stresses the need for effective bankruptcy and foreclosure laws.

Accounting standards, including treatment of depreciation, asset valuations, and auditing processes, are essential for the true valuation of companies and production costs. They are crucial concerns for anti-dumping cases, and that is probably why the EC includes them, but they are less relevant for considering if markets are highly distorted. Markets can still be competitive with weak accounting and property rights regimes, but they will also be less efficient, with high transactions costs and tax evasion will be common. For “nonmarket” considerations, the US DoC is probably correct to ignore the company-level accounting issues and instead focus on industry-wide issues of market barriers to entry and exit, and where particular markets lack competition. Where competition is lacking, invariably rationing mechanisms emerge, say to decide who gets access to land or credit.

Vietnam would probably fail an EC evaluation of points 6 and 8 above, and possibly 7 also. Vietnam’s accounting standards still differ significantly from international norms, even after recent changes. The process of moving from rule-based to principles-based accounting takes much time and requires strong institutional structures (such as Professional Associations). More importantly, however, is the lack of public transparency and legal enforcement mechanisms. The Bankruptcy Law is recent, and foreclosure mostly not possible in Vietnam. Public transparency is a relatively new concept for Vietnam’s leaders and state enterprise managers[19].

[19] For an overview of internal/external governance structures in Vietnam, see:

Vietnam is a long way from some form of tripartite division of authority, and therefore from a reasonably independent Central Bank, Auditor General's Office, Judiciary, or Professional Associations. It will be decades before Vietnam's financial system and processes are as efficient as those in most developed countries (which also, of course, are far from ideal).

Consequently, most enterprises maintain several different sets of accounting records, and company and other taxes tend to be levied as negotiated fees. Corruption is common, and the legal system cannot provide objective enforcement of commercial contracts. These problems are real and serious. They waste resources, cause inequities, and increase the costs of doing business. Yet they have little relevance to the existence or competitiveness of markets. Prices can still reflect "true values" in such markets, but such values may be higher than otherwise because of higher transactions costs and risks.

3.5 The existing methodology (US DoC Vietnam example)

The definitions used for determining "non-market" economies, and related criteria, were discussed above. The method of analyzing these in practice reveals some further concerns.

The US DoC analysis for Vietnam, for example, swings arbitrarily from *de jure* (according to the law) to *de facto* (in reality). In the Vietnam study the assessment of the labour market reads:

> "The government retains *de jure* control over some wage levels which could affect free bargaining between employers and employees, having an ultimate effect on price formation. However, to the extent that legal control has not been consistently enforced, a *de facto* labor market has developed." (US DoC 2002:16).

When assessment is made of property rights, however, a strictly *de jure* attitude is adopted, which ignores the real nature of permanent "land use rights" and the open, easy and widespread trading of these in both urban and rural areas:

> "Households or individuals can only transfer land use rights if they move to other places to live or to take up production or take up business activities, change to other occupations or have no capacity to work … All land belongs to 'all the people' but is managed by the state. The government leases land and grants limited land-use rights to individuals and firms while the transfer and conversion of land-use rights are subject to government review and approval" (US DoC 2002: 28-29).

McCarty, A (2001) "Governance institutions and incentive structures in Vietnam" presented at *Building Institutional Capacity in Asia* (BICA) conference, Jakarta. http://www.riap.usyd.edu.au/bica/2001/confpaper.htm

Another concern is the lack of a clear understanding of what Vietnam should be compared to given the lack of pre-articulated and weighted indicators. So the US DoC looks at one point to "recent NME graduation candidates" (2002:11), at another to the defining features of transitional economies[20], but mostly to nothing at all. In the end, Vietnam is not compared to anything that could even nominally be considered an objective standard.

Box 2: Restrictions on land transfer and land use change in Vietnam

The recent US DoC study of Vietnam cites an article written by me[21] to support the notion that a "free land market" does not exist in Vietnam. It is certainly true that Vietnam's 1993 Land Law contains some restrictions on land use and land use right (LUR) transfer. Some of these are outlined in the cited article. In Vietnam, LURs are not free of legislative requirements and constraints; just as in the western world land ownership is not free of legislative requirements and constraints. In many cases the constraints on LURs are associated with land zoning for residential versus agricultural land, forestland versus cultivated land. These types of restrictions are common worldwide.

Research and observation support the fact that an active LUR market exists in rural Vietnam, and changes in land use are occurring. For example, in survey work conducted in conjunction with ACIAR Project ANRE 1/97/92 in 2001, we found that in around 100 surveyed households in four communes in Ha Tay province there was considerable evidence of leasing, exchange and sale of LURs between 1993 and 2001. In the four communes, the percentage of surveyed households who had or were engaged in renting-in land ranged from 10-32%; the percentage who had rented-out land ranged from 0-8%; the percentage of households who had exchanged land ranged from 0-38%; the percentage who had bought LURs ranged from 0-20%; and the percentage who had sold LURs ranged from 0-8%.

Land use change is also occurring as households seek approval to change the designated agricultural land use purpose, or in other cases, make changes outside the official "land use purpose" stated on the LUR certificate. Often these 'illegal' changes at the local level create pressure for official change at the higher level. In the survey work mentioned earlier, only a minority of the 400 households surveyed in four provinces perceived they faced restrictions in changing farming activities on their land. Five to 15% of households reported restrictions on some of their land for reasons ranging from land zoning, land type, and needing to "fit in" with village irrigation schedules or overall plans.

---

[20] "It should be noted, however, that corruption is a major problem in many other transition economies and some market economies." (US DoC 2002:42).

[21] Sally Marsh, The University of Sydney, December 17, 2002 (**smarsh@fpt.vn**) was referenced by the US DoC in their final determination on page 28/29. Box 2 was written by Sally Marsh for this research paper.

The survey did not cover urban areas, but anecdotal evidence for active and price-responsive land markets is overwhelming. In Hanoi alone, hundreds of real estate agents have started businesses in recent years.

The process of land reform in Vietnam is on going, and another revision to the Land Law is mooted for late 2002/early 2003. Considerable pressure is being exerted on the government in relation to the completion of allocation and registration of LURs, issues related to compensation, and the desirability of stable and long-term tenure. There is also on-going debate about the appropriate length of tenure, ceiling levels for land holdings, and the restrictions on the transfer and use of land. Less than 10 years have passed since the current Land Law was enacted, and the ongoing debate and process of continual reform suggests that Vietnam is well on the way to supporting and regulating a "land market" that is appropriately "free" within overall development and policy goals.

Sally Marsh

4. *Application across countries*

> "… [F]ar from all established "market-economy" countries would easily qualify under the requirements listed above [See Table 1]. Some of them would have difficulties in passing such tests on the grounds of national State-trading or price-control practices, while others, because of extensive social safety nets, would allegedly fail under the "freedom to fire and determine salaries" test, etc. The case of many developing countries would be even more embarrassing." (Polouetov 2002:20)

The six criteria of the US DoC are broad macroeconomic issues that encompass a wide array of economic indicators and measurable and comparable statistics. One of the recommendations to come from this papers is that a study be commissioned to compare Vietnam to all recent NME graduation candidates across all six criteria.

For the purposes of this paper we have done some basic comparisons, which start to show the economic confusion concerning the NME classification. Table 2 shows just a few economic indicators across a range of countries – including developed countries (France), developing countries (India, Bangladesh), formerly non-market economies (Kazakhstan, Russian Federation) and currently classified non-market economies (China, Vietnam). For the purposes of this paper we have classified the economic indicators under one of the six US DoC criteria.

Table 2: Comparative Data of Selected Countries

	NMEs		Recent ME		Market Economies		
	Vietnam	**China**	**Kazakh-stan**	**Russian Federation**	**India**	**Bangla-desh**	**France**
Criteria 1							
Official exchange rate to parallel exchange rate ratio	95	96	90	73	94	84	99
Criteria 3							
Foreign direct investment, net inflows (% of GDP)	4.14	0.03	1.53	0.11	0.06	0.59	0.02
Criteria 4							
Revenues from SOEs and government ownership of property (% of total revenues)	4	5	3	4	22	…	…
Criteria 5							
Government Expenditures (% of GDP)	24	18	25	35	31	14	49
Government Consumption (% of GDP)	6	14	17	16	13	5	23
Private Income (% of GDP)	70	78	15	22	…	…	…
Domestic credit to private sector (% of GDP)	35	125	13	12	29	25	…
Criteria 6							
Trade in goods (% of GDP)	96	44	78	60	20	32	47
Weighted Average Tariff Rate	19	15	10	11	29	21	2

Source: World Development Indicators 2000, ADB (2000), Heritage Foundation Index of Economic Freedom (2002)

Criteria 1

Despite the US DoC's claims that the exchange rate for the Vietnamese Dong is not responsive to the forces of supply and demand there is very little black market trade in Dong. The ratio of the Official Exchange rate with the Parallel Exchange rate gives an indicator of how far the official exchange rate is from what the free market determined rate might be. Using this indicator Vietnam performs better than Russia, Kazakhstan, India and Bangladesh – all "market economies" and all having assumed IMF Article VIII obligations.

Criteria 3

International investors must be confident in the functioning of markets before committing funds to a country. Thus inflows of FDI are one indicator of the confidence that investors have in the functioning of markets in a country. FDI inflows into Vietnam were over 4 percent of GDP in 1998 compared to less than .1 percent for India, China, Russia and France. Kazakhstan, despite its large oil industry, attracts FDI of only 1.5 percent of GDP.

Criteria 4
Government revenues from SOEs and government ownership of property in Vietnam are as low as Kazakhstan and Russia (both recently classified as “market economies” by the US) and much lower than in India.

Criteria 5
Vietnam’s Government consumption is around 6 percent of GDP, far smaller than that of India, China, Russia or Kazakshtan all of whose Government’s consume between 13 and 17 percent of GDP, and only a quarter of the French Government whose consumption measures over 23 percent of GDP.

Government expenditures as a percentage of GDP are lower in Vietnam than in France, Russia, India and Kazakhstan. Indeed Government expenditures in France are almost 50 percent of GDP and more than twice that of Vietnam. In France over half of all households have a member on the public payroll. Those workers get “early retirement (at 55 in many cases), virtually impregnable job-security, and generous pensions’.[22] Developed countries with high government expenditures are often referred to as countries with strong welfare systems, yet a developing or transition economies with much lower government expenditures can still be labeled “non-market economies”.

Private income is over 70 percent of GDP in Vietnam compared with just 15 percent and 22 percent for Kazakhstan and Russia respectively.

Perhaps most significantly domestic credit to the private sector in Vietnam is 35 percent higher than Bangladesh, India, Kazakhstan and Russia.

Criteria 6
In a centrally planned economy it may be possible for the Government to subsidize the exports of several industries but it is financially impossible to do so on a large scale. It is not possible that Vietnam’s export performance is grounded in subsidies. The only valid generalization is that Vietnam is exploiting its Comparative Advantage in labour-intensive exports through competitive markets. Indeed Vietnam maintains a very highly traded economy – the value of trade in goods alone is over 95 percent of GDP dwarfing even Kazakstan’s oil exports.

Whilst the average Weighted Tariff Barrier in Vietnam remains high compared to most developed countries, it is about the same as the average for least developed countries and better than many developing countries who have been considered “market economies” and are WTO members.

[22] *The Economist*, November 30th 2002, p.47.

5. The implications for Vietnam of non-market classification

5.1 The Narrow view: for bilateral trade and WTO Accession

The NME classification is directly relevant only to US anti-dumping investigations. In these, it leads to higher estimated “Vietnam” production costs and hence higher countervailing duties. An indirect consequence of the US DoC decision concerning Vietnam is that other bilateral trading partners will follow the US decision and treat Vietnam similarly in trade disputes. This is of little concern as most anti-dumping actions will come from the US or the EU.

It may be argued that the NME classification produces a negative impression about the Vietnamese economy in general. This is not an important factor. Those familiar with the NME definition and criteria appreciate that they are only vaguely related to the overall strength or existence of Vietnam’s markets. Those not familiar do not generally care, and look instead to the more comprehensive evaluations of country risk assessments by international organizations such as Moody’s.
The NME classification also has implications for WTO accession. A principle of WTO membership is that all member countries treat each other equally as most-favoured nations. The introduction of the non-market economy concept is, however, producing a second class of member. The non-market label empowers “market” economies in bilateral dumping disputes. It offers a convenient opaque tool for pandering to selective lobbying for protection, thereby avoiding the use of more blatant and measurable protectionist policies. Because of this, those countries utilizing this non-tariff barrier have tended to demand continuing the non-market status as a condition for accession to the WTO for transitional economies. The most prominent case is China, which accepted 15 years of US defined non-market economy status as part of the WTO accession deal. Other transitional economies are making similar deals, and Vietnam will probably also face the same problem.

Why did China agree to the 15-year deal instead of making the recommended policy reforms? Firstly, there is no guarantee that certain reforms will remove the NME classification. The US DoC is free to “move the goalposts”, and as in the case of Vietnam, exactly what reforms should be taken to become classified as a “market economy” are not specified. Secondly, there are good economic and social arguments for the careful sequencing of reforms, or indeed for rejecting some proposed reforms. The economic, social and political costs may outweigh the benefits. Thirdly, and most importantly, we need to appreciate the essentially political nature of the WTO/NME classification deal, which allows China MFN exporting to the US, but also allows for selective protection of US industries to slow structural adjustments and pander to the stronger domestic lobby groups.

The competitiveness of China in exporting to the USA can therefore be blunted in particular industries for the next 15 years, as required. The same thinking will apply to Vietnam. Clearly Vietnam must try to keep the WTO accession and its status as a non-market economy distinctly different issues, which in theory they are. In practice, this is unlikely to happen. The American authorities can insist on a link, and given the unclear requirements for WTO accession there is little scope to avoid the issue. Vietnam, however, must try. Options include exposing the unreasonable logic of the definition and analysis to a wide audience, seeking a re-evaluation by the US DoC in 2005, and lobbying through other countries for the issue to be addressed in the WTO.

The likely trend, however, is that Vietnam will remain on the US DoC list of non-market economies for many years, and that an increasing number of other countries will similarly classify Vietnam. Thus bilateral trade relations will be marked by an increasing number of complex and unfair anti-dumping cases, and to cope with these Vietnam needs to strengthen its legal and economic analysis capacities.

5.2 The Broad view: for growth, competitiveness and "catching up"

There are many justifications for governments distorting markets, but in all cases a justification is required. This is based on the belief that markets are the best mechanism to determine the allocation of resources in an economy. Competitive markets, it is argued, using prices as signals, lead to a balancing of supply and demand over time *better than any alternative system of allocating scarce resources*. Therefore, introducing distortions that move prices from their "true values" must involve arguments that the net welfare impact will be positive. That is, such price movement causes a definite negative impact by causing a shift from "true values", and so the positive impact must be shown to be greater[23]. There is no space for an explanation of such arguments, but the point to note is that for economists, "markets know best".

Under central planning it was argued that governments could plan the allocation of resources better than a series of apparently uncoordinated markets. The change towards believing in the "invisible" power of competitive markets is one of the most important aspects of the change in economic thinking in the move from central planning. Appendix One explains the change in economic thinking in more detail.

For economists, competition is the engine of growth, and government plays a leading role by setting the "rules of the game": the umpire. The government does not score the goals, yet the government is in charge, setting rules and handing out penalties. The Government must ensure that market competition is fair, open, and equal. Government also intervenes to account for market failures or imperfections, such as not valuing environmental damage properly. Some goods and services are clearly best left under central control (printing money, the army or police services), others may be natural monopolies (there is much argument about what these should be, but the postal service may be one example), and then government may intervene for social objectives, such as to redistribute income to war veterans.Therefore, if we want to strengthen markets in Vietnam, we need to look for distortions with weak economic arguments.

The few paragraphs above roughly outline the general role of government compared to markets in a "market economy". For Vietnam to become a stronger market

[23] Underlying this logic is the concept of opportunity cost. For example, introducing a 50% tariff may protect a domestic industry, causing it to grow and employ workers, but the "new" investment and those workers in that industry would have gone somewhere else if that tariff had not been increased (a loss), and consumers will be paying more for each unit of output (a loss).

economy, it needs to widen the scope of market activities (less direct government control of the allocation of resources for production), and to strengthen the competition in existing markets. Importantly, strengthening competition means allowing new private enterprises, foreign and Vietnamese, to easily enter and industry and to exit an industry. Letting the failures die (and thereby realize capital, land, and labor for something else) is just as important as letting new enterprises start up. It is the competitive process of "creative destruction", where new enterprises and industries grow while unprofitable enterprises and old industries die. Strong markets are flexible markets that let change happen. Charles Darwin observed something similar in evolutionary competition:

> "It is not the strongest species that thrive and survive,
> but those most able to change and adapt"[24]

The move from some form of central planning to a market economy has seen Vietnam start growing at the sort of "catch up" rates required for convergence with rich countries over the next 50 years. Doing that, however, requires GDP growth rates averaging over 6 percent per annum. Table 3 shows most of the few countries that have been able to achieve such rates (and some who came close) during 1990-98. Important contributing factors to their success have been policies that encouraged higher-than-global rates of domestic saving and investment, and an "opening up" to world trade and investment. There are exceptions on all points, but generally, developing countries have only achieved high and sustained development by becoming actively integrated into international competition and markets.

[24] *Check exact quote and reference*

Table 3: The high growth economies of the 1990s (ranked by GDP per capita)

	Ave. GDP growth rate, 1990-2001 (%)	HDI 2000 minus HDI 1990	Gross domestic investment (gross capital formation) as % GDP (2001)	Exports as % of GDP (1980)	Exports as % of GDP (2001)	Foreign direct investme[...] as % GD[...] (2000)
Ireland*	7.9	0.055	23(b)	59	80(a)	24
Singapore*	7.9(c)	0.067	31(b)	202	180 (b)	6
South Korea**	6.3	0.067	27	29	43	2
Argentina**	3.4	0.036	16(b)	10	11(b)	4
Chile**	6.1	0.049	23(b)	35	32(b)	5
Malaysia**	6.4	0.060	24	76	117	1
Thailand**	4.9	0.049	24	34	69	2
China	9.4	0.101	39	6	26	3
VIetnam	7.1	0.083	31	26	55	4
India	5.5	0.066	24	7	14	0
World average	2.5	n/a	22(d)	19	23(d)	3

(a) the 1998 value, (b) the 2000 value, (c) the Ave. growth 1990-2000 value, (d) the 1999 value

Sources: World Bank (2000), UNDP (2000).

*high income economy, ** Upper-middle income economy, *** Lower-middle income economy, and the remainder are low income economies (World Bank classifications).

From another perspective, we might also note that “non-market economies”, China and Vietnam, are two of the five fastest growing economies in the world, which would be a stunning empirical argument for central planning - if that was the definition of a “non-market economy”.

6. Recommendations to make Vietnam a stronger market economy

Growth is probably the central policy objective for Vietnam, but it is closely followed and linked to other objectives such as equity, stability, and sustainability. The mechanisms or tools to achieve these objectives include trade liberalization, competitive and price responsive markets, and an appropriate role for the state. The state sets the rules and ensures that markets are strong and competitive: that is where most of the growth comes from. The state also directly promotes growth by investing in public goods (e.g. roads) and the few natural monopolies (post office, printing money, railways), and by providing security and stability (police, army, judiciary). The state is also directly active in achieving the objectives of equity (income transfers, poverty alleviation programmes) and sustainability (environmental protection). In most countries, the state owns few commercial enterprises because when you own them you give them special treatment, and that means weaker market competition. Competition drives economic growth.

In Vietnam today there is an emerging consensus about where the economy should be heading. There is still strong debate about the appropriate role of the state or of the private sector, but the need for strong and competitive markets is generally accepted. That means Vietnamese markets linked to and competing in world markets. Now when we talk about “reform”, we usually mean some policy change to increase the choices and economic freedom of consumers and producers in Vietnam. This is what moving away from central planning is all about, and it implies reducing the responsibility of the state for economic activity. Consider, for example, the abolishing of hundreds of special business licenses under the Enterprise Law. Previously, a license was required to run a Real Estate business, and the state was responsible for checking that the person wanting to set up the business was qualified and had enough capital to invest. Now that responsibility has been moved onto the businessperson: “if you do not have enough capital or qualifications you will probably fail, but we will not stop you from trying anyway.” The hottest policy questions centre around “what responsibilities must remain with the state”? There are many, but under central planning too many.

People and businesses should be as free as possible to choose what to produce, where to work, and what to consume. Competition makes markets strong, and the price mechanism makes them efficient. This way of thinking means that changes to prices (taxes, subsidies, etc.), price controls, or quantity controls, all require special and strong justification because straight away they make markets less efficient. Economists always ask the reasons for policies that reduce competition or change prices or quantities. There are always reasons, but not always convincing ones. Sometimes the reasons are based on a “too responsible” role of the state (e.g. Real Estate licenses), or on a fear of competition, or fear of short-run negative consequences that may or may not be significant (e.g. capital flight from removing Surrender Requirements). In all cases, the reasons need careful examination to see if they are really excuses.

In this section, we firstly list the US DoC recommendations for Vietnam with which we agree. That is, we agree because these reforms are good for Vietnam and consistent with Vietnam’s economic reform strategy, not simply because they may lead to a removal of the US non-market classification. Then we discuss more generally how markets can be strengthened in Vietnam, including some further explanation of the links between policies and the responsibilities of the state in market economies. Finally, in Section 6.3, we outline some initial ideas about how Vietnam could tackle the US non-market economy status, and related anti-dumping problems, over the coming years.

6.1 According to US DoC criteria

The US DoC and related bilateral definitions of a non-market economy bear little relation to any reasonable countrywide definition of such a concept. Thus recommendations to make Vietnam a stronger market economy are discussed in the following section, while here we focus on changes that would justify a reclassification of Vietnam as a "market economy" according to the US DoC definition. Of course, given the political nature of this non-tariff barrier, and the subsequent lack of clarity in measuring the concept, listing what needs to be changed is a subjective and maybe futile exercise. Nevertheless, below are listed specific and viable policy changes that, if enacted, should at least lead to a review on the "non-market economy" status of Vietnam by the US DoC.

1. The extent to which the currency of the foreign country is convertible into the currency of other countries;

    - ✍ Lessen government control over the interbank (currency) market (reduce fees, more flexible bid price)
    - ✍ Assume IMF Article VIII obligations requiring full convertibility on the current account.
    - ✍ Remove tax on profit remittances abroad.
    - ✍ Remove restrictions on FOREX availability for certain imports.
    - ✍ Remove FOREX surrender requirement.

The academic assertions to rebut are that the dong is overvalued, and that "FOREX regime remains shielded from exogenous market forces." (US DoC 2002:11). A research paper should be commissioned that explicitly addresses these assertions and others noted below.

Note that the above recommendations repeat most of those by the US DoC. The authors of this paper are in agreement that these are desirable policy changes to strengthen markets in Vietnam (as well as to remove the NME classification). What is less clear is whether such changes should be made in 2003 or later. That question is discussed in the next section of this paper.

2. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management;

- ✍ Allow unsubsidized state-enterprises full autonomy to set wages above the minimum wage.

3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country[25];

- ✍ Remove all dual pricing relating to foreign-invested enterprises (FIEs), including land rental fees.
- ✍ Make employment regulations and processes the same for both domestic enterprises and FIEs.

The main US DoC criticism concerning these criteria is the limited scope for FDI activity in Vietnam: "Vietnam's regulatory framework does not evidence a willingness to allow FDI to flow throughout the economy." (US DoC 2002:22). This requires a research effort to show that most market economies do not allow this, and that Vietnam's restrictions on the scope and nature of FDI are not abnormal.

4. The extent of Government ownership or control of the means of production[26]

4.1 Privatisation

- ✍ Implement the impressive pro-privatisation legislation issued in 2002, and apply this to more of the larger capital-intensive state enterprises in industries without natural monopolies.

The problem with the US DoC analysis of this criteria is that they do not actually measure the *extent* of government ownership beyond the observations that, with the state sector accounting for 40% of GDP, 42% of industrial output and 10% of the labor force, "the SOE sector plays a significant role in the Vietnamese economy." (US DoC 2002:25). In Section 4 above, we showed that the extent of government ownership in Vietnam, both of the state sector overall and state-enterprises in particular, was not exceptional by international standards.

The US DoC criticism is therefore based on the facts that Vietnam plans to retain ownership of 700 state enterprises, majority shares in another 2,000, and that many of these are in areas that are not natural monopolies. Again, by international standards of comparison, these observations are not exceptional enough to warrant "non-market economy" status.

---

[25] This section begins with the extraordinary claim that FDI inflows to Vietnam "have been limited", despite now constituting 12% of GDP and 35% of industrial output.

[26] Although ostensibly looking at "the means of production", the US DoC analysis of this criteria looks at privatization across all industries, and at land ownership. The extent of government ownership of labor and capital are neglected. The words "the means of" should probably be dropped from this criteria, as they are in practice.

4.2 Land and land use rights

- ✍ Continue to strengthen land-use rights in Vietnam, and to simplify and reduce regulatory controls.

The US DoC, as noted above, take a strictly *de jure* interpretation of the land rights situation in Vietnam. In reality, land rights may arguably be too easily transferred, with a need for better documentation in rural areas (which is happening), and more transparent processes in urban areas. We might say it is “free” in the sense of “out of control”. Certainly the land use rights market has serious problems of tax evasion, corruption and injustice, but it is equally certain that it is an active market responding to the forces of supply and demand. A research paper is required to explain the present real situation in Vietnam, and what has changed since the return to household production on 1988[27].

5. The extent of Government control over the allocation of resources and over the price and output decisions of enterprises;

5.1 The extent of price liberalisation

- ✍ Remove all price controls on industrial goods (e.g. cement, steel, iron).
- ✍ Introduce Competition Law.

The discretionary price control of the Government Pricing Commission (GPC) is noted and somewhat exaggerated by the US DoC (2002:39). Such control is rarely effective and only applies to a few products outside of natural monopolies. Nevertheless, the Vietnamese government should remove these.

5.2 The status of commercial banking reform

- ✍ Establish independent auditing of the State-Owned Commercial Banks (SOCBs).
- ✍ Continue to regulate to encourage competition between SOCBs and between SOCBs and other financial intermediaries in Vietnam.

The US DoC conclusion that “Vietnam’s banking sector has not yet reached the level of development required to function as a true financial intermediary in [a] market economy” (2002:33) is, in our opinion, a valid conclusion. Financial sector reform remains a priority for Vietnam, as indeed it does in many developing countries.

[27] The US DoC observation that “the government is not initiating a land privatization program [in Vietnam]” (US DoC 2002:29) suggests a shallow appreciation of the complex, yet generally effective nature of land use rights in rural Vietnam.

5.3 The degree to which individuals and businesses can engage in entrepreneurial activities.

- ✍ Continue to "level the playing field" between private and state enterprises, particularly regarding access to finance and land-use rights.

The US DoC acknowledges the "burgeoning private sector" in Vietnam, while noting that "private business is still disadvantaged in the realms of finance, land-use rights, and red tape" (US DoC 2002:38). There is therefore no new criticism here, beyond those already noted above in 5.2 (banks) and 4.2 (land). The scope of SOE "crowding out" the private sector, which does exist in a few industries in Vietnam, is not discussed. In general, however, the private sector "economic engine of Vietnam" (US DoC 2002:38) is overwhelming any competitive advantages that SOEs may have.

6. Such other factors as the administering authority considers appropriate [trade liberalization, rule of law, corruption].

- ✍ Continue with AFTA trade liberalisation commitments, and later US BTA commitments.
- ✍ Continue efforts to establish "rule by law".
- ✍ Continue efforts to increase public transparency and reduce corruption.

The US DoC notes the corruption problems of Vietnam but then observes that "corruption is a major problem in many other transitional economies and some market economies" (2002:42). Which raises the question of what exactly is a problem generally unique to transitional economies? Many markets economies, and possibly most of those which are also developing economies, suffer from weak rule of law, weak financial systems, and politically directed lending and subsidies[28]. Many market economies also exhibit closed capital accounts, currency and exchange rate controls, specifically control FDI inflows, and run state-owned commercial enterprises.

This causal return to the broad definition of a non-market (i.e. transitional) economy towards the end of the US DoC analysis highlights the "conceptual drift" issue noted above, and opens up a whole list of questions that, from even a legal perspective, destroys the case.

[28] Production support subsidies to American farmers averaged US$20,000 per farmer in 2001 (The Economist, November 30th 2002, p.37).

Final comments on the US DoC Vietnam study:

In addition to the recommendations under each of the six criteria listed above, we also recommend that a study should be commissioned to compare Vietnam to all recent NME graduation candidates across all six criteria. This may strengthen the argument that, after enacting many of the above recommendations, Vietnam should be reclassified as a “market economy”.

If all the above policy changes were made, it is still likely that Vietnam would remain a “non-market economy”. This is, after all, a politically-driven legally-framed non-tariff barrier to trade. So is it worth it? The answer is “yes”. Firstly, because all the above policy reforms are advisable anyway, and they will help to strengthen markets and competition in Vietnam. Secondly, because when economics is used as a façade for political actions it should be exposed. And thirdly, because trade is win-win, and the quicker policy reforms are made in Vietnam and non-tariff barriers are removed in the United States, the quicker consumers in both countries will benefit.

6.2 According to economics

As discussed above, if we want to strengthen markets in Vietnam, we need to look for distortions with weak socio-economic arguments. In our opinion, these would include:

- Ongoing protection and subsidization of commercial (i.e. profit making) state enterprises where there is no argument for having a natural monopoly (“barriers to exit”).
- Some restrictions on labor mobility.
- Differences in the treatment of FIEs, state-enterprises, and private enterprises (e.g. dual pricing, taxation, access to capital, scope of permitted business activity, etc.): remove the “uneven playing field”.
- Restrictions on competition in the financial services sector.

Tax policies are another cause for concern. Vietnamese policy makers impose too many objectives on the one policy tool: collect revenues; protect some industries; promote some geographic areas; increase exports; reduce consumption goods imports; improve income distribution; discriminate against services; and provide special assistance to “strategic” industries or special projects. These policy objectives do not need to be, and most of them should not be pursued through tax policies. Other policy tools, such as government spending, can do the job alone. But because tax policies (tariffs, income taxes, VAT, special consumption tax, company tax, etc.) are given so many objectives, they become very complex, almost impossible to administer, and push prices away from “true values”. If we can make one strong call for strengthening markets in Vietnam, it is for a comprehensive simplification of the taxation regime, beginning with a strategic evaluation of what policy tools and best suited for which policy objectives.

In relation to the specific recommendations of section 6.1 above, we appreciate that some reforms are dependent on reform in other areas. Thus Surrender Requirements may be best phased out gradually to try and avoid capital flight. But then reasons for capital flight should also be addressed. Similarly, giving full wage setting autonomy to state commercial enterprises in competitive industries is desirable, but only so long as the state does not provide net subsidies to such enterprises or "bail out" when losses are made. In such cases, rapid wage increases can make these SOE "leaking buckets". In many cases, however, the arguments for delays are just "fear of competition". Leveling the playing field between SOEs, private enterprises, and FIEs, should move ahead rapidly, including removing dual prices, different taxes, and different permission and regulatory regimes. The most important area to increase competition is in commercial banking, but again this may have to be phased in line with the recapitalization of the SOCBs.

6.3 Action Plan concerning NME status and anti-dumping problems

Vietnam should consider establishing (and funding) an inter-Ministerial "Removing Trade Barriers Working Group" to design and implement strategies to combat the barriers to trade thrown up by bilateral trading partners. The overall purpose of the Group would be to make Vietnam a more proactive defender of free trade, and defend Vietnam against non-tariff barriers. The Group would be assigned responsibility for specific NTBs, such as the US NME status. Such a Group would be led by Ministry officials, but could also include academics and consultants, both foreign and Vietnamese. The Group would need a mix of diplomatic, economic, and legal skills, but also Public Relations expertise.

The recent support by a group of American Senators, led by John McCain, to drop the catfish anti-dumping case against Vietnam[29] underscores the public nature of policy debate in America and the need for Vietnam to use all opportunities and mechanisms to state its arguments. Vietnam has also received very favorable international press coverage on the catfish issue, including in *The Economist* and the *Far Eastern Economic Review*[30]. Such support is important, and maybe even essential if Vietnam is to win such "quasi-political games". Yet the support in this case came from no particular effort on the Vietnamese side. Yes, Vietnam has announced its position concerning the catfish investigation, but it did not contact John McCain, it did not draft and distribute articles, or push ideas onto journalists, or conduct a detailed research defence. The Vietnamese approach has been essentially passive and reactive – action after events. Too late.

There has been much less international coverage concerning Vietnam's nonmarket economy status, because the consequences are less obvious and the unfair nature of the barrier less clear. But the same reactive approach is evident on the part of Vietnam. This research report was commissioned after the US DoC announced its decision. The Vietnamese authorities chose not to present a defence to the US DoC during the investigation. Vietnam did not use the international press, academics, or

[29] REFERENCE REQUIRED HERE.
[30] REFERNCES REQUIRED HERE.

pursue any public relations ideas. Maybe the above judgments are too harsh, but it is true that there is much scope for Vietnam to become a more active and sophisticated defender of its trading interests.

In the case of the US NME Decision, a "Removing Trade Barriers Working Group" might seek agreement from the US DoC to review their classification of Vietnam in 2005. This would be on the basis of reforms likely to be implemented over the next two years. Vietnam could request this government-to-government, and also contact American politicians and others, formally or informally, to see how they might help. In the meantime, the pieces of research recommended above could be conducted:

- A paper to show that Vietnam's exchange rate is not greatly over-valued.
- A paper explaining the competitive land market in Vietnam;
- A paper comparing Vietnam to all recent US DoC "NME graduation candidates" across the six criteria.

The Working Group would also detail a Public Relations plan to highlight the unfair and outdated nature of this NTB. This paper, for example, can be cut and sent for publication in policy journals, or used for press articles. The Public Relations question is how to bring sustained attention to this issue. The Vietnamese Embassy in America would have an important role in implementing the plan. Other countries could be asked for their views, and maybe they could raise the question of "second class" WTO members. Other countries could be asked to declare that the NME concept is only relevant to centrally planned economies.

If the Trade Barriers Working Group existed now it may be assigned the defence of Vietnam's shrimp export industry, over which an anti-dumping case looms[31]. Now, in the early stages of such cases, is the time to plan and act. Vietnam should initiate its own high quality research into the industry and its market and price structures (in Vietnam and the USA). It should be contacting the other developing countries involved to hold a joint planning meeting in Hanoi. Legal expertise should be mobilized, and a Public Relations strategy formulated. It would be expensive, but a necessary investment to increase the probability of winning (which in most cases means having the charges dropped).

[31] REFERENCE NEEDED HERE!

7. Conclusion

This paper has surveyed the non-market economy concept as it has emerged as a non-tariff barrier to trade in recent years. The US Department of Commerce decision to declare Vietnam a non-market economy has prompted this study and provided a case study of the measurement methodology.

The definition of a non-market economy emerged in the 1980s from an understandable problem of measuring reasonable values in centrally planned economies. Over time, however, the definition has drifted from being synonymous with centrally planned economies, to transitional economies, to something like "economies with highly distorted markets". The present US DoC definition lacks precision, measurable criteria, and explicit weighting of variables. The six criteria the US DoC investigate are an *ad hoc* selection of distortions and markets. Further, the methodology of measurement, as revealed in the Vietnam study, shows a confusion of *de facto* and *de jure* considerations, and a reliance on legal precedents rather than cross-country economic criteria.

The conclusion that the non-market economy concept has evolved into a blatant tool for selective non-tariff protection is hard to avoid. This is a reality which Vietnam and other formerly planned economies must face, and one that the WTO seems disinclined to. The precedent of China's WTO accession and its non-market economy status has set the scene for Vietnam. Vietnam will probably follow a similar path, but not inevitably, and we have made recommendations about how to influence the process.

We have also outlined some general recommendations about how Vietnam can strengthen its already active and growth-producing market economy. These are much more important that the narrow non-market economy issue which, ultimately, will just provide protection to some markets in some bilateral trading partners. The impact of such protection is specific and negative for both countries, but overall will be marginal to trade growth and economic development. What matters is to integrate and compete, irrespective of the barriers thrown in the way.

8. References

Bernstam, M.S. and A. Rabushka (2002), "From Predation to Prosperity: Breaking up Enterprise Network Socialism in Russia", Hoover Institution Stanford University

Bernstam, M.S. and A. Rabushka (2002), "Market, Sharemarket and WTO", Hoover Institution Stanford University

Blakeslee, M.R. and C.A. Garcia (1999) "The Language of Trade" 3rd edition – US Department of State

Heritage Foundation Index of Economic Freedom (2002)

Horlick, G.N. and S. S. Shuman, (1993), Nonmarket Economy Trade and US Antidumping/Countervailing Duty Laws, 18 International Law 807, 836

IMF (2002) "Statement by Susan J. Adams, Senior Resident Representative, IMF" to *Consultative Group Meeting for Vietnam.* Hanoi, December 10-11.

ITC World Tr@de Net "Kick-off" Meeting Vilnius, Lithuania 20-21 November 2000

McMillan J and C. Woodruff (2002), *The Central Role of Enterpreneurs in Transition Economies*, Journal of Economic Perspectives, Vol 16, No. 3 pp 153-170

Polouektov, A. (2002), *'The Non-Market Economy' Issue in International Trade: In the Context of WTO Accessions*, United Nations Conference on Trade and Development

Qian, Y, (2000) "The Modern Market Economy and the Rule of Law", Persectives, Vol 1, No.5

The Economist (2002), "XXX", November 30th 2002

UNCTAD, UNCTAD Training Module on Anti-Dumping, Part 1

US Department of Commerce (2002), "Antidumping Duty Investigation of Certain Frozen Fish Fillets from the Socialist Republic of Vietnam - Determination of Market Economy Status", A-552-801 Investigation Public Document

Wang, S. (1996) US Trade Laws concerning nonmarket economics revisited for fairness and consistency, Emory International Law Review, Vol 10, No 2,

Watts, M. (?), "What is a Market Economy", http://usinfo.state.gov./products/pubs/market/homepage.htm

World Bank (2000), World Development Indicators

Appendix 1: The Transition of Vision

The force of ideas should never be underestimated. Donors use the quaint phrase "awareness raising" when they promote dialogue about Vietnamese Government policies they would like to change. Foreign business groups are, well, more business-like, and just present a shopping list of policy changes they would like, accompanied with sometimes-dubious arguments that these changes would be "best for Vietnam". Vietnamese organizations also present various arguments for policy changes, but their lobbying is internalised within the "consensus governance" system of Vietnam (McCarty: 2001). This interplay of interest groups is what politics is all about. But underlying it all, and constantly on the minds of policy makers is the question: "What is best for the economy of Vietnam"? Even if they choose otherwise, they, by definition, do so knowing that they have not chosen the "best" economic policy choice. And, all other things being equal, they will choose, or at least support, that "best" option.

All other things are rarely equal, however, and there are many reasons why policy makers might reject the first-best economic choice: concern for political stability or the income distribution and social consequences; the political need to pander to a narrow interest group; corruption; or just plain jealousy and the desire to damage a political opponent[32]. Nevertheless, the long-term direction of policy reforms is dictated by the collective vision about how a country gets rich. Ideas drive change. Table 1 lists many of the key economic concepts of central planning and compares them to the related concepts of market economics. Taken as a whole, this transformation in ideas constitutes a "paradigm shift" in economic policy thinking. It is arguably the most important aspect of the transition from plan to market.

The very concept of "transition" implies a middle stage, something between central planning and markets. In the realm of economic ideas, this means of period where both worldviews exist, with neither is totally dominant, and the ideas of both often thrown together in contradictory mixes. Newspaper articles provide many examples. On the one hand, self-sufficiency justifies pet projects, "unhealthy competition" is scorned, and government sectoral production targets are announced. On the other hand, the benefits of free trade and Vietnam's labour force are lauded, how to control monopolies is debated, and the impact of changes in world commodity prices is analysed.

How far has this transition of economic ideas progressed in Vietnam? That depends upon to whom you talk. Foreigners interact with a very biased sample of policy makers, which of course includes all those with English language skills[33]. It is easy to get an impression that the change in worldview is well advanced, and indeed most policy outcomes support this view. Vietnam, according to World Bank labels, is a "reforming country". Yet newspapers and policy documents reveal a deeper confusion, and nowhere is this more evident than in discussion of the private sector. It takes time, even generations.

---

[32] Such forces drive policy decisions in all countries. Real world policy processes are always complex and outcomes are not always logically consistent. An appreciation of such complexity helps to understand the recent policy "choices" of the USA regarding steel and catfish. Thus while the general thrust of reforms is directed by ideas and beliefs ("three steps forwards"), it is not always a smooth path ("one step backwards").

[33] And other languages, although clearly English is the language of international discourse, and certainly in economics.

Table A1: Transition as a change in worldview

Economic concepts underlying central planning	Economic concepts underlying competitive market economies	Policy making implications
"Leading role" of Government to directly allocate resources (land, labour, capital, goods & services). State sovereignty: extract agricultural surplus for industry.	"Leading role" of prices through competitive markets to allocate resources (relative prices as "signals" of value). Consumer sovereignty: all sectors treated equally.	Privatise most SOEs; divorce policy makers (e.g. Ministries) from owning assets (SOEs); regulate to ensure competitive markets (new "leading role").
Labour value of production (leads to bias towards material products, and sees services as "non-productive" sector)	Prices as signals for relative values of all goods and services.	Remove discrimination against service sector (e.g. still subject to higher rates of taxation).
Government responsible for all economic achievements and failures.	Government responsible for maximising the efficiency of markets (e.g. quality of information flows; ease of entry and exit; "internalise externalities", etc.).	Stop talking targets and start talking forecasts. Accept that Government not responsible for market outcomes/production.
Ongoing legacy of 19th Century intuitive logic that intermediary capital goods production somehow "leads development" ("Heavy Industries": steel, cement, etc.)	No particular industries warrant subsidisation. Let markets and comparative advantages decide growth areas.	Level playing field across types of goods and services production, as well as across forms of ownership of enterprises.
Growth achieved almost exclusively by accumulation (forced savings; obsession with static level of investment)	Growth primarily driven by the efficiency of resource allocations (dynamic "creative destruction"); flexible economy attracts investment.	Policies that hinder structural economic change slow growth.
No understanding of relative scarcities and opportunity costs (therefore output targets always "more of everything")	Scarce resources requiring tough choices, with opportunity costs the fundamental rationale for markets.	Need to overhaul public investment planning process.
Self sufficiency ("what we do not have today we should have tomorrow")	Comparative advantage and specialisation make most efficient use of resources ("let markets decide")	The self-sufficiency argument leads to wasteful use of scarce resources (typically in capital-intensive import-substituting projects)
International trade as fundamentally "unfair"	International trade as win-win through comparative advantages.	Unilateral trade liberalisation.
The correct forms of ownership of the means of production (collective/state) will by and of itself cause rapid development: search for "correct mix/balance".	Recommended forms of ownership dependent upon which is most efficient (welfare maximising) given circumstances.	Shift policy focus from concern about "who owns what" to "what is most efficient form"? (e.g. state for public goods).

Appendix 2: Definitions and explanations

Box 3: What are non-tariff barriers to trade?

"Non-tariff barriers (NTBs) are the scourge of any trade bloc which has committed itself to trade liberalisation. The eradication of these impediments is the next most pressing issue that ASEAN faces if AFTA is to become a truly effective trading area." (Economist Intelligence Unit, 1997, p.58)

A basic difficulty in identifying and analysing NTBs is that they are defined by what they are not. The OECD (1997, p.69) chose to define NTBs as "those border measures other than tariffs that may be used by countries, usually on a selective basis, to restrict imports" for one of their studies. Similarly, the UNCTAD Trade Analysis and Information System (TRAINS) database includes mainly only border measures[34]. This approach largely ignores export-related measures and internal measures (such as local content rules, subsidies, tax concessions, discriminatory government procurement and anti-competitive private practices). In fact, the border measures approach is adopted more for reasons of expediency than intellectual rigour. If the subject of investigation is NTBs (or NTMs), then whether they are border measures or otherwise should not be relevant.

The PECC study described NTBs as "any non-tariff instrument that interferes with trade, thereby distorting domestic production." (PECC 1995a, p.39). Baldwin (1970, quoted in Laird 1996, p.5), however, probably provides the most conceptually acceptable definition of a "non-tariff distortion" as **"any measure (public or private) that causes internationally traded goods and services, or resources devoted to the production of these goods and services, to be allocated in such a way as to reduce potential real world income."** The problem with adopting such a broad definition is in then developing a precise definition for analytical purposes. As Deardorff and Stern note: "In view of the vast array of formal and/or informal NTBs that may exist, there may not be a single analytical methodology capable of dealing completely with the entire spectrum of NTBs" (p.6).

NTBs should not be viewed as a synonym for NTMs, but rather as a sub-set of NTMs. All NTBs are also NTMs, but not all NTMs are NTBs. NTMs can include measures that promote exports, which are not "barriers" to trade at all. This more neutral sounding term is also preferred by governments to describe measures used to monitor imports for legitimate purposes (e.g. internationally recognised plant quarantine procedures). Further, for example, if quotas are non-binding (above what a non-quota market would import or export anyway), then it is difficult to characterise them as "barriers".

[34] See http://www.unicc.org/unctad/en/techcop/trad109.htm for information about TRAINS.

Box 4: Why do policy makers use NTBs?

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

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

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

Box 5: What would WTO membership mean for Vietnam's NTB regime?

Until recently, the WTO has approached the identification and removal of NTBs on a piecemeal basis. Specific elements connected with the simplification and harmonisation of trade procedures were found within the WTO legal framework as follows.

? GATT (1947) Articles V, VII, VIII, X
? Agreements on Customs Valuation
? Import Licensing
? Pre-shipment Inspection
? Rules of Origin
? Technical Barriers to Trade
? Agreement on the Application of Sanitary and Phytosanitary Measures
? Safeguards
? Anti-dumping
? Subsidies and countervailing measures[35]

[35] When anti-dumping and countervailing actions (AD/CVs) are OK if taken in strict accordance with corresponding provisions of the GATT they are seen as legitimate measures to counteract "unfair" foreign competition.

As the level of tariffs and use of quotas has been reduced attention has been switched to the use of less visible impediments to international trade – NTBs. This was apparent during the Uruguay Round when the following outcomes related to NTBs were achieved.

? NTBs on industrial products were reduced
? Definition of non-tariff protection measures were clarified
? Phasing-out multifibre agreement (textile and clothing sectors)
? Outlaw of new and elimination of current voluntary export restraints (or any similar measure affecting imports or exports such as orderly marketing arrangements, discriminatory import systems, consulting arrangements etc.)
? Agreement on Agriculture: all NTBs will be converted into their tariff equivalents (tariffication). Reduction in domestic support measures.

Only in 1997 at the Singapore Ministerial Conference did the WTO receive a mandate to take a more serious look at non-tariff barriers under the banner of “trade facilitation” in order to assess the scope of WTO rules in this area. An overall framework of WTO definitions, disciplines and rules is required if NTBs are to be tackled in an encompassing way. Trade facilitation being defined as “the simplification and harmonisation of international trade procedures” with trade procedures being the “activities, practices and formalities in collecting, presenting, communicating and processing data required for the movement of goods in international trade”.