CHAPTER 7. OPENNESS, INCOME DISTRIBUTION AND POVERTY

7.1. Trade, Income Distribution and Poverty

Since 1986 Vietnam has experienced a transition from a centrally planned economy to a market-oriented one. These reforms were associated with a comprehensive economic reform package to open the economy to the world with domestic structural reforms and macro-economic stabilising measures. Outcomes of this reform package in terms of poverty reduction at the aggregate level are so remarkable that Vietnam quickly rose be become one of the best performers in regards to growth and development. On the other hand, with increased opportunity from a private sector also comes increased income inequality. Economic reforms brought significant inequality compared to Vietnam’s past situation, but Vietnam’s overall inequality is relatively small compared to other countries in East Asia (Krongkaew 2003).

Direct analysis of Vietnam’s experience with international trade is so far it has been good for the poor. While overall income continues to increase, the gains are being undermined as income distribution becomes more polarized. Within the analysis of trade and poverty, we cannot exclude the simultaneous domestic market reforms that also occurred. While trade will be a continuous challenge to Vietnam’s competitiveness, the gains from liberalizing the domestic private sector will only have one-time gains. As highlighted in Chapter 5, trade policy and the economic reforms have not had a consistent and equitable impact on poverty and income distribution. By and large, richer and more developed regions have greater advances in reducing overall poverty, while also experiencing an increase in income disparity.

This section discusses the impacts of trade policy on poverty and income distribution by identifying direct linkages. Major transmission channels of trade openness to poverty reduction and income distribution are from overall economic growth, and its impact on employment, productivity and income. The Stolper-Samuelson theorem substantiates that a country abundant in unskilled labour that opens to international trade would benefit from a comparative advantage labour-intensive industries, and consequently would experience an increase in employment levels. International trade would also reduce the prices of import-competing goods, thus improving real income and an unambiguous growth in welfare.
An indirect benefit from international trade is an increase to budget revenues from export earnings, which can be channeled into poverty-reducing activities, education, health and other social investments. The negative effects of trade liberalization are the reductions in sustainable employment in sectors with government protection. Seldom can these industries compete in a global market and are therefore edged out of business by cheaper and higher quality exports. To counter this effect Vietnam should create the incentives to expanding labour-intensive activities and establishing worker retraining programs for laid-off workers. By promoting labor flexibility the impact of trade on employment will be transitory.

The effect of tariff and non-tariff barriers

In comparison with other developing countries, Vietnam’s average nominal tariff rate is not very high. Before 2001 the variation of tariff rates across sectors was relatively large, and tariff rates were subject to frequent changes. This system protected key industries, but by changing other protective measures industries were unable to become accustomed to support and market distortions. It was argued that Non-Tariff Barriers (NTBs) are more complicated, less transparent and also subject to frequent changed, thus undermining forward planning. Marked improvements have occurred since the adoption of a systematic trade regime from 2001-2005.

This pattern of protection had profound impacts on poverty from changes in household consumption pattern and producers’ income. Tariff levy have increased government budget revenues. Tariffs and NTBs have had a favorable impact on producers of competing with exports, but an adverse effect for producers that need key imported inputs that must pay higher than world market prices for locally produced and sometimes inferior substitutes. For those industries that faced tariffs on both inputs and outputs, the net impact would be determined by the overall effective rate of protection, with the higher rate implying higher protection. As shown in Figure 21, industries producing consumer goods enjoyed a high level of protection via tariff and NTBs, at the same time agricultural and mining industries did not receive such benefits. While some 84% of the poor in Vietnam worked in agriculture throughout the 1990s, this pattern of protection clearly resulted in net decrease in welfare for the poor in terms of employment and income. In addition, industries enjoying protection were mostly heavy industry and import-substitution schemes, which tended to employ a disproportionately low share of unskilled labour. These factors among other contributed to deterioration of income distribution and greater inequality in Vietnam during the 1990s.

Figure 21: The structure of effective protection by sector in 1996

With respect to consumers, a high level of protection for consumer goods pushed up domestic prices higher than the world prices. This made consumers, including the poor, net losers from the relative reduction in purchasing power and a net real income decrease.

For example, by imposing NTBs on fertilizer the domestic price of fertilizer increased to a level higher than the world market price. As a key input, agricultural products were in turn forced to increase in price. In this case, the consumers of agricultural products would lose real income, while the net-benefit for agricultural producers was unchanged. Increased production costs were simply pushed onto the consumer. In worst case scenarios, as consumption of agricultural products drops from higher prices, a poor farmers’ real income is reduced.

Impacts of export policy

In addition to tariff and NTB policy, the Government has made undeniable efforts to expand exports by both export penetration to new markets and diversification of exportable commodities. Major policies to encourage exports included loosening requirements for business entities to engage in export activities, providing various incentives for exporters, and adopting measures to mitigate biased effects from tariffs and NTBs. As discussed in Chapter 3, these policies have helped expand export activities in recent years. However, it is rather difficult to measure how much the poor gain from this expansion.

In the early 1990s the trade liberalization resulted in export expansion for products in the agriculture sector first, where most of the poor and low-income people worked. The reforms opened the economy to the world, raised the relative prices of agricultural
products -- to both agricultural inputs and other non-agricultural prices -- and improved efficiency. The majority of the poor in Vietnam are rural and net sellers of agricultural products. They benefited substantially from this increase in market size. Favorable agricultural terms of trade at the time Vietnam opened up the economy further reinforced these gains. Between 1992 and 1998, the nominal price of Vietnam’s rice exports increased on average by 9.2% per year (Pham Lan Huong et al 2003). Estimates attribute almost half of this increase from a realignment of the exchange rate, a fifth due to an increase in the international price of rice and the remainder from improved marketing efficiency and quality (Poverty Working Group 1999).

Agricultural export earnings increased by 14.3% per annum over 1990-98, more than fourfold from USD 1 billion in 1990 to USD 4.3 billion in 2000 (General Statistical Office 2000, SRV 2002). Consequently, rural agricultural income grew by over 60% between 1993 and 1998. By expanding the production of exports, a large proportion of farmers in Vietnam escaped poverty during the 1990s.

Textiles, garments and footwear have been the industries that benefited most from more open trade. It is important to note that although their exports soared job creation in this sector was rather low. In 2000, the employment growth in textiles and garments industry was only 5.6%. The indirect linkage impact occurs from the improved income of workers in exporting industries, who in turn consume more agricultural products or expanded consumption in other low-skilled personal services. Although employment creation was not so great in this sector, export growth still facilitated a shift in labour from agriculture to manufacturing and eased under-employment in rural areas.

The primary negative effect of a more open economy is increased vulnerability to external, exogenous shocks. For instance, the poor suffered income losses during 1998-2002, when the world price of major agricultural commodities fell. Export quotas on some commodities (rice, garments and textiles, wood processing products) have been imposed due to various reasons (food security concerns, requirement by importing markets, environmental protection). As Vietnam is a relatively small country, export quotas reducing producer income. On the other hand, quotas distort domestic prices compared to the world prices with an ambiguous effect on consumers. If the poor are net sellers, as it is often the case with rice, they would lose from decreased net volume. However, it should be understood that although more openness creates new challenges, this impact is far outweighs the volatility, inefficiency, and productivity loss from autarky.

7.2. FDI, income distribution and poverty
7.2.1. The link between FDI and poverty

FDI influences poverty through direct and indirect ways. The direct impact can be expected from new employment opportunities in FDI funded projects. The indirect impact is an increase in economic growth this net reduction on poverty. Spillover effects and technology transfers from FDI to the host country is another key gain. Also, FDI contributes to government tax revenues and may facilitate government programs on poverty reduction. Furthermore, the investment of host government on infrastructure to attract FDI flow may benefit the poor.

For the direct impact it is noted that workers employed in FDI related enterprises just share 0.99% of total labor force. Furthermore, employment conditions are not pro-poor and require some education and moderate level of skill. Only a small portion of FDI flows into agriculture (5-6%), but there are indirect employment gains from backward and forward linkage. Enterprises that import inputs rather than buy domestically limit the development of backward linked industries. However, as Graph 1 below shows, for 1996-2000 FDI did not have any impact on poverty at the 10% rate\(^{\text{11}}\).

*Figure 22: FDI, domestic investment, growth and poverty from 1990-2002*

\[\text{Source: Adapted from MPI and GSO}\]

The table 65 shows that workers’ monthly wages at foreign enterprises are higher than at any domestic firms in all considered time periods.

*Table 63. An average monthly wage by sectors of ownership.*

## Table 6.2:

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Whole economy</td>
<td>355.47</td>
<td>600.85</td>
</tr>
<tr>
<td>SOEs</td>
<td>394.95</td>
<td>734.55</td>
</tr>
<tr>
<td>Cooperatives</td>
<td>157.17</td>
<td>248.25</td>
</tr>
<tr>
<td>Private</td>
<td>236.08</td>
<td>748.89</td>
</tr>
<tr>
<td>Wholly foreign-owned</td>
<td>979.57</td>
<td>982.05</td>
</tr>
<tr>
<td>Joint venture</td>
<td>555.86</td>
<td>795.71</td>
</tr>
</tbody>
</table>


Regarding indirect employment that results from FDI, there is not clear statistical evidence. FDI enterprises may have had a positive effect in terms of increasing competition and creating a more challenging business climate that requires constant innovation. However, in Vietnam this effect has not been adequately studied. The witnessed economic growth indicates a level of capital formation. The gains in capital accumulation can ease investment constraints from a lower saving rate, an incentive to investment. Furthermore through backward and forward linkages, FDI can induce both government and private investment and boost economic growth. However this effect has thus far been ambiguous in Vietnam (see graph 1).

Although there are inconsistencies in the macroeconomic data, FDI inflow shows a significant contribution to overall investment of Vietnam. In the period from 1996 to 2000, FDI sector was 24% total development investment. On average, FDI sector accounts for 8.6% of GDP and was 14% of GDP in 2002 – a relatively high rate for a developing countries. This capital flow significantly helps to establish, expand, and modernize targeted sectors of the economy, such as oil, electronics, motorbike, chemistry, fertilizer, textile, agro-product process. FDI also strengthen the international competitiveness of the good. In addition, for 1996-2000 the growth of FDI funded firms was 2.5 times higher than overall growth. FDI has a significant role in boosting exports. The growth of exports from firms funded with FDI reached 65% per year from 1991-2000 and accounted for 25% total export of the country. It likely that FDI is one factor determines the economic growth and then indirectly reduces poverty in Vietnam.
Table 64. Cumulative FDI inflow by industry (Unit: %)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of projects</th>
<th>Registered Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Industry</td>
<td>50.76</td>
<td>38.47</td>
</tr>
<tr>
<td>Services</td>
<td>17.98</td>
<td>34.90</td>
</tr>
<tr>
<td>Construction</td>
<td>10.84</td>
<td>12.60</td>
</tr>
<tr>
<td>Transport</td>
<td>5.63</td>
<td>9.40</td>
</tr>
<tr>
<td>Agriculture</td>
<td>14.79</td>
<td>5.5</td>
</tr>
</tbody>
</table>

*Source: The Ministry of Planning and Investment*
From an investment portfolio perspective, FDI is not necessarily a component of pro-poor growth. The table above shows that FDI in agriculture, about 90% of the Poor’s employment, obtain only 5.5% of total registered foreign capital. In addition FDI into agriculture tends to reduce at 41.1%/year. In 1991 FDI to agriculture was US$ 63 million, accounting for 28.3% of the total FDI flows for that year. In 1999, FDI to agriculture fell to US$4.77millions and 0.32% respectively of total. By 2002 the total share of FDI rose to 6.3%. FDI inflow shows it severely unequal among regions in Vietnam with concentrations in urban, less poor areas. Cumulative FDI inflow from 1988 to 1999 by region (as presented in Chapter 3) reveals that South East and Red river delta attracted almost 83% of all FDI capital to Vietnam. These areas attributed by economically activeness and less poverty compare to others. According to the Law on Budget, FDI enterprises have to pay taxes on personal income, enterprise income, natural resources use, import, export and on repatriated profit; these gains contribute to state poverty reduction projects. This contribution increases over time and at an annual rate of 13%. Regarding to the role of FDI on income inequality it is noted that economic growth and FDI inflow to Vietnam occurs simultaneously with a slight increase on the GINI coefficient-an indicator of income inequality. The impact may be explained by the fact
that almost all FDI enterprises provide jobs for workers with moderate to high skills hat exclude the poor. This net effect creates an overall increase in inequality.

Figure 23: Gini coefficient and FDI

Source: GSO and MPI

7.3. Trade, FDI and the informal sector

7.3.1. Trade and informal sector

Trade liberalization creates changes in the informal labor market. In some countries, there exists a relation between these two factors, in others, there does not. In Vietnam, a labor market has not taken shape and functioned in accordance to market rules. Furthermore, the relation between trade liberalization and the informal sector has also not been studied. However, trade liberalization by means of informal trade activities may be a peculiar feature of Vietnam. Vietnam has actively expanded opportunities for border trade activities, which have in turn responded with great economic benefits for border provinces.

Vietnam’s long border with several neighboring countries creates a situation that has resulted in significant amount of informal trade activities. At times this rate can even exceed official trade figures. Generally, Vietnam exports agricultural, forestry, aquatic and sea products, and raw materials, while China exports production materials, equipment and consumer’s goods. Since 2001, the key categories of goods exported to Laos from Vietnam via border gate economic zones are: equipment, materials, chemicals (including construction materials, commercial power, petroleum, pharmaceutical products, road construction equipment, stationary), consumer’s goods (including sweets, detergents, sugar, salt, cigarettes, rain coats, silk, furniture), and sea products. The main imports from Laos to Vietnam via border gate economic zones have been: agricultural,
forestry products (logs, rattan etc.), equipment and parts (bikes and motorbikes, metal waste products), consumer’s goods (dried bamboo roots, cakes, sesame). The key export items from Vietnam to Cambodia via border gate economic zones are: material, fuel, equipment (including petroleum, construction materials, soil powder, processed wood, fertilizer, raw silk, machinery, mechanical tools), consumer’s goods (including rice, salt, food, read-made garments, plastic articles, footwear, dried noodle, ceramics, detergent), agricultural products (fruit, garlic, cabbages)

The turnover of imports and exports at the border gate economic zones in 1999 was USD 757.574 million, 308 million in export value and 321.325 million imports. The trade deficit at border gate economic zones mirrors the national current account.

In 1999, the total import – export value at border gate economic zones accounted for 50–60% of the total import-export turnover between Vietnam and China. In particular, the absolute value of imports and exports was USD 1,777 million from 1998 to 2000 and USD 2,827 million for the 2001-2003 period (a 59 % increase). With the open trade for the border provinces of Vietnam and Chinese, the economic and trade relation between the two countries has increased at an incredible pace. The import-export turnover via border gate economic zones still accounts for a large share of total turnover between Vietnam and China.

Table 65. Imports exports via border gate economic zones

(Exports/Imports, USD million)

<table>
<thead>
<tr>
<th>Item</th>
<th>Unit</th>
<th>1997-1998</th>
<th>1999</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import export turnover</td>
<td>USD</td>
<td>610.252</td>
<td>439.058</td>
<td>1,501.815</td>
<td>1,258.360</td>
<td>915.101</td>
</tr>
<tr>
<td>Export</td>
<td>USD</td>
<td>339.227</td>
<td>204.448</td>
<td>945.472</td>
<td>702.467</td>
<td>420.644</td>
</tr>
<tr>
<td>Import</td>
<td>USD</td>
<td>271.025</td>
<td>234.618</td>
<td>556.342</td>
<td>555.892</td>
<td>494.457</td>
</tr>
</tbody>
</table>

Source: Reports on operation of border gate economic zones by 17 provinces

It can be generally seen that the import-export turnover at border gate economic zones still accounts for a major part of the total import export turnover between Vietnam and Laos (80-90% of the total turnover in 1999). However, the absolute value is small with a sharp decline during the 2001 – 2003 period. The import-export turnover via Vietnam –
Cambodia border gates in 1999 accounted for 70-80% of the total trade turnover between Vietnam and Cambodia. The total value of imports and exports during 2001 – 2003 was approximately USD 766.43 million.

7.3.2. Foreign Direct Investment and the informal sector

FDI and the informal sector have not been studied since the enforcement of the FDI law. Regarding foreign investment in Vietnam, there is one peculiar feature that relates to the informal sector. That is the issue of informal investment with unnamed investors or third parties.

“Informal” investment in Vietnam mainly falls in two groups: investment by overseas Vietnamese and investment by foreign investors via local Vietnamese. Investment by overseas Vietnamese strongly was an issue prior to 1996 in part because of remittances. In addition, there was significant foreign investment via local Vietnamese in the southern provinces. By 1996, there had been 600 to 700 Chinese, Taiwanese projects with a total investment capital of about USD 1 billion.

Informal investment or unnamed investment can be made in several ways:

(1) relatives or friends to buy and register buildings,

(2) relatives or friends make the investment and the real investor is not directly involved in management of the investment,

(3) relatives or friends set up enterprises; the real investor participates as a technical expert or manager,

(4) direct investment in relatives’ or friends’ enterprises,

(5) credit goods from abroad,

(6) Vietnamese wife to make all interments,

(7) relatives or friends to buy raw materials, sea products and send abroad for processing.

By 1999, the first three forms were the most common ones -- with about 10% of overseas Vietnamese have bought buildings via relatives.

There were a number of reasons for informal investment prior to 2000. (1), there was no legal framework for overseas Vietnamese to make investments. The encouragement policy for investment by overseas Vietnamese was enacted in 1995 with the Law on
Domestic Investment Encouragement. In addition. And it wasn’t until 1993 that Land Law allowed renting, but not allocating, land to overseas Vietnamese. Prior to 1993, overseas Vietnamese had almost no rights to land and buildings. (2) There are shortcomings related to procedures for overseas Vietnamese. There were price differences between renting land as domestic and overseas Vietnamese investors. Overseas Vietnamese had to use short-term visas which needed frequent extension; this was also an obstacle against overseas Vietnamese who wanted to work permanently in Vietnam. (3) Constraints on investment sometimes made overseas Vietnamese not eligible for formal investment, such as: (i) capital not enough for formal investment, (ii) capital enough for formal investment but business capability not sufficient, (iii) not frequently present in Vietnam, and (iv) not willing to be known with the investment.

7.4. The impact of policies for increasing openness

7.4.1 Open door policy

Figure 24: Relationship between import-export and economic growth (%)

![Graph showing relationship between import-export and economic growth (%)](image)

Source: Statistical Year Book 2002

Vietnam has basically performed the policy “to diversify markets and economic relations, actively participate and establish standings in new markets, and develop new relations”. One of the targets of economic policy reform in the last decade is to help the economy of Vietnam integrate in the regional and global economy. For the past decade, Vietnam has built such promising economic structure that encourages production and export and has an open perspective on international trade.

Vietnam has trade relations with more than 200 countries and territorial regions. During 6 years (1996-2002), 60 new trade agreements were signed with foreign countries. During the last two and a half years, nearly 20 new markets were found, 12 bilateral trade agreements and economic – trade frame agreement have been signed. Perhaps the most
significant being the Vietnam – US trade agreement, which is an important step in gain access to the largest market in the world (2001); Trade agreement and 2 frame agreement (2002); one trade agreement (2003). At present, Vietnam is, completing 9 trade agreements (including one trade agreement to be re-singed). By 2003 September, Vietnam had entered into trade agreement with 84 countries and obtained most favored nation status with 81 countries and territorial regions, successfully organized 6 meetings of the Working Group on participation of Vietnam in the WTO.

Vietnam has also been active in the world economic integration process, expanded bilateral and multilateral economic relations, developed investment relations with nearly 70 countries and territorial regions, normalize relations with international financial and monetary institutions (such as IMF, WB, ADB, ASEAN, AFTA, co-founded ASEM, participated in APEC_, become an observer of the WTO and is now negotiating to become a WTO member. Vietnam has also signed a frame agreement on economic cooperation with EU and a bilateral trade agreement with the US in accordance with WTO regulations.

The import-export growth rate from 1991 to 2000 was 18.4%, which was 2.6 times as high as the GDP growth rate. The export growth rate has also relatively high from a steady increase in processed products for export (8% in 1991 to 31.4% in 2002). The export growth is rooted mainly in easy to capture resources that do not need much investment or FDI. It is also associated with agricultural and rural products such as rice, coffee, aquatic products, garments and textile, crude oil, electronics.

With implementation of AFTA commitments, import taxes on 6000 items are to be cut to being lower or equal to 20% in 2003, 0-5% in 2006 and 0% in 2015. Vietnam removed some quantitative non-tariff barriers in 2003 and in the period 2003-2006 all non-tariff barriers are committed to be removed completely; this incremental adjustments of the tariff and custom system to harmonize with ASEAN commitments. For the bilateral trade agreement with USA, the import taxes are committed to be lowered from 35% to 26% for 244 items imported from USA over the next 3 to 6 years, specifically removing the protective tariffs for domestically produced goods. In 1997, there were 11 industries that were supported by the State for import substitution; there were also 3 industries oriented for export. by 2002, the one-year export growth rate of Vietnam was 5.1%, while import growth rate was 10.8%.

7.5. Role of financial liberalization

7.5.1. Financial liberalization procedure
Vietnam clearly recognizes that a weak financial market will not be able to attract both domestic and foreign capital to serve the industrialization and modernization process of the nation. Since the 6 Party Congress (1986), especially the VII Party Congress (1991), Vietnam has undergone a comprehensive reform of the economic mechanism from a centralized and planned nature to a market orientation. One of the critical achievements of the reform is that the financial and monetary systems have been fundamentally reformed. This is the prerequisite for transacting, exchanging, buying and selling capital in a free way mandatory for market economy. These reforms are building the ultimate foundation for a financial market.

7.5.1.1. International integration of the monetary market of Vietnam

According to the agreements and principles of GATS, Vietnam has made advances to meeting basic requirements and has thus far allowed only limited capital mobility. Currently, Vietnam allows modest participation of foreign banks’ branches and joint venture banks. Before 2002, there had been 6 State commercial banks (including the bank for the poor and the bank for housing development in the Mekong River Delta), 47 joint stock commercial banks, 8 finance leasing companies and 959 people’s credit funds that cover the whole country. In addition, Vietnam, has 31 branches of 26 different foreign banks, such as ANZ, Citibank, Standard Charter Bank, ABN-Amro and 4 joint venture banks. Compared to the pre-reform period, Vietnam’s capital market is making progress moves toward liberalized capital flows, but with the underlying shakiness of the system progress has been very incremental. Vietnam’s financial market still lacks several key reforms to have full accordance with GATS.

(1) Licenses for branches of foreign banks. In legal terms, it is possible for banks and credit agencies with foreign capital to function on a large scale and in wide range of business lines. However, foreign credit agencies cannot automatically participate in banking activities. Licenses are issued on a case by case basis depending on the development needs of the economy and financial market of Vietnam.

Branches of foreign banks, joint venture banks and credit agencies with foreign capital can carry out banking activities subject to their specific license. Vietnam government still reserves the right to issue or not issue license for a specific foreign bank. Another issue related to issuing licenses is the investment form. Only 3 investment forms are allowed in the banking sector: (i) branches of foreign banks, (ii) joint venture banks, and (iii) non-

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banking credit agencies (including finance leasing joint venture companies, 10% foreign capital finance companies and other non-banking credit agencies). Thus, foreign enterprises are not allowed to establish 100% foreign owned banks. This is policy violates GATS stipulations, where enterprises are free to select their investment form, independent of regulations of issuing authorities (Article XVII, GATS). Domestically, this regulation limits the availability of capital and tightens money in an already tight money market.

(2) Supply of new services. This seems to be out of reach of the regulations of Vietnam. A legislative principle of Vietnam is to recognize businesses within specified legal limits. This principle is adopted in a fairly consistent way, especially with ordinary businesses. But for banking, new services are rather sensitive. With scientific and technical developments, financial and banking services become more and more varied with different ways of providing existing and new services. Another barrier against the market access of foreign bank branches are limits subordinate agents and transaction locations. Foreign banks are allowed to set up branches in provinces, centrally-managed cities but are not allowed to set-up subordinates to those branches. Foreign banks are not allowed to set up representative offices in places where their branches already exist. Except for branch offices, foreign bank branches are not allowed to set up transaction points in whatever form. According to this regulation, such things as foreign currency exchange desks, ATMs of the branches can only be put at the branch office. The denial to or the lack of regulations on services new to Vietnam is an impediment to the growth of the financial market in Vietnam.

(3) Mobilization of deposits from all economic sectors. Mobilizing deposits is the critical action by a bank. However, to foreign credit agencies, especially with foreign bank branches, there are strict limitations in lending and required reserve rations. Foreign bank branches are not allowed to hold the savings of residents in any form. For foreign bank branches, there are additional limitation to non-termed deposits in VND by Vietnamese individuals and organizations. This limitation is a rate of 25% of capital amount provided must come from the home mother-banks. Regarding mortgages and guarantees for loans, according to the Land Law, foreign bank branches and joint venture banks are not allowed to take mortgages in land use rights. They are just allowed to offer guarantees for foreign economic organizations in bidding for projects in Vietnam and give loans to them to conduct the projects if they win. Whereas, according to the Law on Foreign Investment revisions in July 2000, this limit is somewhat relaxed; enterprises with foreign capital are allowed to mortgage properties attached to land and land use rights to borrow loans from credit agencies with approval to function in Vietnam. Credit
agencies allowed to function in Vietnam include foreign bank branches and joint venture banks.

In conclusion, the openness of the financial market in Vietnam highlights the transitional nature of the economy with the moderated participation of foreign banks in credit and banking activities. In practice, the foreign bank branches are restricted in many ways, but it is also obvious that their market share continues to increase, while some domestic banks are still swimming in inefficiency. Thus, it can be said that the financial market of Vietnam is not yet a part of the international capital market.

7.5.1.2. International integration of the foreign exchange market of Vietnam

Regarding foreign exchange control, there are still some restrictions to current transactions, specifically the regulations on foreign exchange collection and tax rates on profit remittances by foreign enterprises to their home countries. Regulations on foreign exchange collection were lifted in 2003. Before that, domestic enterprises had to transfer all foreign exchange gained from current revenues. When the enterprise needed foreign exchange, they had to buy it from the bank at prevailing rates. If the enterprise was not subject to foreign exchange collection (e.g. enterprises in export processing zones), it had to take care of its own foreign exchange balance. At present, with the foreign exchange rate increasing everyday, foreign exchange collection must be a burden for enterprises with revenues in foreign currencies, and limits their use of foreign currencies. It is a similar case with remittances of profit by foreign firms. The tax rate of 3 – 7% is a burden for enterprises with foreign capital. Another barrier is that some transactions are not recognized. When dealing with foreign exchange control, the Government has not allowed enterprises of all sectors to open bank accounts overseas. This can limit the overseas demand for services, such as for outsourcing IT projects.

Regarding the supply of foreign exchange services, at present, domestic banks offer two types of service, spot transactions and forward transactions. Swap transactions began being offered in July 2001. According to the Vietnam – US trade agreement, Vietnam's commitment is to offer a full national treatment status to foreign banks in their swap and forward transactions will begin three years from the effective date of the agreement. However, there are no commitments on futures and options—leading to significant shortcomings in foreign exchange transactions. The result is a low turnover of foreign exchange transactions.

7.5.1.3. International integration of Vietnam 's stock market
In legal terms, international bonds include government bonds, bonds issued by State commercial banks, and bonds issued by State owned enterprises. In other words, just three entities are allowed to participate in the international stock market by way of issuing bonds in international markets: the Ministry of Finance, State commercial banks, and State owned enterprises. Domestic stock companies can participate in international stock markets under the form of joint ventures or setting up 100% Vietnamese capital companies abroad, however they most abide by foreign exchange restriction mentioned above.

The State Treasury does issue international bonds to attract foreign capital. This is a step forward in advancing the development of the financial market and the international integration process. However, Vietnamese organizations and individuals are still not able to participate in international markets. Vietnamese joint stock companies are not eligible to be quoted in foreign stock market; Vietnamese stock companies are not financially capable, lacking technology and the experience required to do business in international stock markets.

Regarding participation of foreign investors, in legal terms, foreign investors have been allowed to participate in the stock market since 1994. At present, the stock market of Vietnam is fairly open for foreign investors. Foreign organizations and individuals can participate in almost all activities of the Vietnam stock market. Overseas Vietnamese (with or without Vietnamese nationality), foreign investment companies, foreign enterprises, foreign companies, foreign groups, foreign individuals are allowed by buy bonds from joint stock commercial banks and joint stock finance companies. In addition, foreign economic organizations and foreign individuals are allowed to buy shares from equitised State owned enterprises, joint stock companies and other enterprises that are allowed to issue stocks and convert into joint stock companies. Joint venture banks, foreign bank branches, finance joint venture companies, 100% foreign capital finance companies are also allowed to function as an agent in issuing stocks for joint stock companies. In addition, foreign organizations are allowed to buy stocks quoted in the stock market and are allowed to go in joint ventures with Vietnamese firms to do business in the stock market of Vietnam. Finally, foreign organizations and individuals legally working and living in Vietnam are allowed to buy Government bonds and render services as the issuing or buying agent of Government bonds.

Legislation in Vietnam with regard to foreign participation in the stock market is still inconsistent, incomplete and asynchronous. This has caused many difficulties in practice. Organizations and individuals are allowed to hold a maximum of 20% of the total number of stocks issued by an organization; but on the other hand, the total value of stocks sold to
foreign investors must not exceed 30% of the registered capital of the issuing organization and the total stocks held by foreign investors must not exceed 30%.

Since 1993, foreign organizations and individuals have officially participated in the stock market of Vietnam, but this activity is limited to the role of investor’s not stock traders. These constraints have limited foreign participation to a very select few. By June 30 2003, there were only 35 foreign investors buying 6.18% and selling 1.27% of the total transaction value. Without a transparent accounting and trading system; the stock market of Vietnam does not attract significant interest. There are only a small number of quoted stocks and the joint stock companies are small and not very profitable. While portfolio diversification will drive some investment into the Vietnamese market to match return-risk positions, these investments will reach significant levels under current conditions.

Total indirect investment in Vietnamese enterprises (functioning in accordance to the Law on Enterprises) is estimated to be about USD 10 million. Most of foreign indirect investors are small investment funds that have been previous experience operating in Vietnam. At present, just 6 of them are still operating with a total capital amount of USD 241 million. Six investment funds pulled their capital with a total withdrawn value of USD 250 million out of a total invested capital of USD 390 million.

The representative offices of the two multi-national stock groups – Normura and Daiwa – closed after 4 – 5 years in operation in Vietnam. There are several funds that began operations in 2001 with an average capital amount of USD 5 – 10 million each, which is 4 times smaller than starting firms during 1991 – 1997 period. These funds want to mobilize capital from abroad but are having difficulty attracting attention from major institutional investors. Individual investors are just investing in quoted stocks. Very few strategic, long-term foreign investors buy assets or equity in Vietnamese enterprises.

A big concern now is that equitisation of all types of enterprises is being promoted. More than 1500 enterprises have been equitised, in which more than 200 are eligible listing. In the next 3 years, 2000 enterprises more will be equitised. The rate of indirect over direct invested capital in Vietnam is 1.19% (2002) which is low compared to the 10 to 50% average in the region.

Furthermore, the State limitations of foreign investment in 35 business lines or sectors impedes investment in 4 ways. (1)After selling shares to foreign investors in accordance to current regulations, Vietnamese enterprises may need to expand to new business lines which are not prohibited (by the Law on Enterprises), but those may be business lines that foreign investors are not allowed to own. This is not clear at the moment and this lack of transparency is added risk for foreign investors. (2) Some Vietnamese enterprises
engage in a variety business lines and in several sectors, including sub-business lines which are not allowed to have shares sold to foreign investors. This excludes those enterprises from using any foreign capital. (3) Foreign investors are not interested in investing in Vietnamese enterprises as they are afraid that Vietnamese enterprises may either break the current legislation or be restricted to just a number of certain business lines. Uncertainty about following the law or future unpredictable changes add unnecessary risk to already risky investments. (4) The limit of business lines does not inspire a competitive domestic investment environment compared with regional countries and other countries in the world. Without competitive pressures, protected sectors will fall behind the international standards and norms.

There needs to be proactive measures to attract foreign investment in Vietnamese enterprises. Vietnamese firms need access to foreign capital, technology, management knowledge, and overall international best practices. There should be mechanisms which allow Vietnamese enterprises to do what is not prohibited or limited by laws. The range of businesses that allow foreign ownership of equity should be widened. Policies and regulations should be clear to make foreign investors feel secured. Instead of building a list of business lines where foreign investment is allowed, just build a list of business lines where foreign investment is not allowed. For those business lines that are not in such list, private enterprises, equitised enterprises should be allowed to sell stocks to foreign investors.

7.5.2. The financial policy measures in Vietnam

Vietnam is only at a stage of initial engagement with international financial market. A first step is to reform the tax system to create a nondiscriminatory, simplified system for filing. The continual evolution of the international financial system and integration of advanced and emerging markets have left Vietnam behind, there is a strong need to send direct signals to the international community of Vietnam’s sincere interest in joining. Vietnam will need to make significant changes to its capital control regime to meet the new BASEL II standards. Of course with liberalizations of the capital account, the current account and trade will need to open more to increase the business efficiency of enterprise creation. Vietnam will need to manage this system and ensure not just open trade, but fair trade for its citizens.

Second, the government will need to adjust and amend the fiscal budget so that is both balanced (to stabilize growth) and accords with international nation income accounting standards. To accomplish this task, subsidizes from state budget to SOEs will need to be cancelled. The primary issue is to create a legal environment that stimulates the building of financial institutions including insurance, accounting, investment funds, and non-
banking financial institutions. To accomplish these goals, the government has to build and complete the legal framework for each kind of financial institution, clearer define the role of state sector in the economy, and re-organize SOEs to enhance the competitiveness of those enterprises. Thirdly, the development of service market, including those of insurance, accounting, auditing and tax advising is an important requirement for Vietnam to move to a more open and transparent society.

These factors will create the initial conditions for attracting of investment resources. These constraints have caused a boom in insurance services that developed with promulgation of Insurance Law. The Vietnamese insurance market has become very active as a means for individuals to mobilize portions of their savings. Foreign owned insurance companies currently are, and will become more so, a strong player in Vietnam’s insurance sector as regulations follow the road map of international commitments, such as ASEAN and Vietnam. Currently, the market share of foreign invested enterprises is 39%. Moreover, there has been marked improvement in accounting and auditing service. The Accounting Law and the introduction of internationally standardized accounting and auditing standards have improved the improved the standards of these services in Vietnam. However, there are still significant gains that need to be made to manage increased inflows of international investment.

Vietnam is improving the investment environment by targeting reforms in the legal framework, policies to liberalize foreign investment, increased transparency and increase adoption of international best practices. In March 2003, the Government of Vietnam issued the Decree on revision, a supplement to various articles of the Decree on expanding attraction to foreign investment. This new decree reforms several shortcomings of the markets and simplified administrative procedures. The Government then issued a Decree that allows certain enterprises with foreign investment to be converted to joint stock companies. Import – export taxes are also being reduced. Since July 1, 2004, the Ordinance on personal income was enacted, according to which reduces taxes for the highest tax bracket. In addition, a number of other pieces of legislation related to foreign investment were also revised and completed (revised Land Law, Trade Law, revised Labour Code, Construction Law, Aquaculture…), creating a better legal framework for attracting foreign investment. The Prime Minister has also issued a

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decision to open the rate of capital contributions and the purchase of shares by foreign investors in Vietnamese enterprises from 20% to 30%.

Although a lot of improvements have been made in the field of foreign investment, there are still insufficiencies that need to be reformed. There are still some key business sectors that require hi-technology and foreign capital, but they are still not allowed to solicit foreign investment. The current list of businesses where foreign investment is allowed does not include those that require big amounts of capital such as power/water plant construction, steel production etc. However, in reality, some enterprises with foreign invested capital have been allowed to be set up and operate in Vietnam in those areas.

At present, the Government is promoting the equitisation of big State owned incorporations, including those in the power sector, metallurgy, mechanics, chemistry, fertilizer, cement, aviation, sea-transport, telecommunication, banking, and insurance. Those policies will create a new environment for attracting foreign investment.

7.6. Case study on the impact of openness on income distribution and poverty

The family of Mr. Truong Van Tuong in Hai Ninh commune, Quang Ninh district, Quang Binh province has 6 members in which 3 are of working age. The family’s major business is fishing and sea-food processing. They have only 300m² of land, 2 small boats for fishing and 1 fish drying machine. In the past, this family was classified as a poor household because of dependants and lack of production equipment. Their main income source was from fishing, but they did not have boat with diesel engine so that they can go off-sea for fishing.

Since the economic renovation has started, Mr Truong has been able to borrow money from formal credit sources. He borrowed VND2millions to buy an engine for his fishing boat. His income from fishing has grown to VND10millions/year and VND1.5millions/year from pig husbandry. The family’s skills in drying fish grew into a cooperative with 4 neighbors to create a small fish drying factory. This is very profitable business with a short business circle. The products almost are exported and recently, income from this business reached VND5 million/month.

The market provided the escape from poverty escape for this family. First, the opening of the economy provided the opportunity for accessing the export market. In the past, dried was not sold, only raw fish. There was a limited demand for Dried fish and only in the
remote markets of the mountainous regions. As the family gained access to the export market, the family was able to convert previous survival skills into. The open market also brought the incentives and pressure to improve fish drying technique to meet quality requirements for export and cheaper engine equip for production.

7.7. National strategy for maximizing the equitable distributional impact of trade and FDI

7.7.1. Nondiscrimination for all ownership

The government of Vietnam has a long-term strategy for a single legal framework for all types of enterprise without discriminating either private or state or foreign enterprises. The short-term strategy is to remove discriminatory taxes, credit provisions, land accessibility, wage regulation, and investment opportunities.

Currently strong reform are occurring to lower investment costs and eliminate dual-price mechanisms. Since early 2004, airfare for domestic routes has been the same for both Vietnamese and foreigners. By the end of 2005, a single power price level will apply for both domestic and foreign enterprises. Other charges, such as in telecommunication tariffs, have been reduced to be equal average levels for the region. Land reserves have been actively arranged to support investors in their search for investment sites. Additional support has also been institutionalized for investors in site clearance and compensation. One-door policy has been adopted in dealing with investment procedures to lower transaction and information costs. Investors, after having their investment license receive additional assistance during the project implementation phase.

Development of a bilateral legal framework on foreign investment continues in line with the committed phasing of international integration. Vietnam has so far entered into 47 bilateral agreements on investment encouragement and protection, including the Vietnam – US trade agreement and the agreement with Japan on liberalization, encouragement and protection of investment. Multilateral legal frameworks on investment have been strengthened and expanded. Examples of these are negotiations (round 8) on joining in WTO, Protocol on revision of the Frame Agreement on comprehensive cooperation between ASEAN – China, similar agreements with Japan, India, Action Programme on liberalization and promotion of investment within APEC, and ASEM. In round 8 of negotiations on joining in the WTO, Vietnam is intending to initiate implementing all WTO agreements including the agreement on commerce-related investment measures. In a new offer to open service markets, Vietnam will gradually give way to foreign investors
to get access the 10/11 service groups as classified by WTO. This is a great effort by the Government of Vietnam considering the low level of the national economy and limited competitiveness of domestic enterprises.

In the process of improving the investment environment, Vietnam is carrying out the action program of the Vietnam – Japan joint initiatives comprised of 44 groups of basic solutions. The solutions are focused on building up and implementing investment policies, completing legal frameworks on foreign investment, strengthening capacity of government bodies, improving investment procedures, and developing socio-economic infrastructures. Vietnam and Singapore are also implementing joint initiatives on strengthening cooperation to attract investment from third countries. One of the important issues of the initiatives is the application of a quick approval mechanism for important projects.

Key solutions in this process so far:

(1) Actively build up and complete transparent, equitable and predictable legal environment for foreign business,

(2) Ensure an open and fair business environment with the Law on Investment and Law on Enterprises applicable to enterprises of all economic sectors and key elements,

(3) Adjust sector and regional planning to make sure discrimination between domestic and foreign investment is eliminated,

(4) Create favorable conditions for more involvement of foreign investment in production processes,

(5) Gradually open the service market in accordance to bilateral and multilateral international commitments,

(6) Continue to diversify the forms of investment, including regulations on management of and incentives for investment funds in Vietnam,

(7) Pilot the model of mother–and-son companies and model of buyouts and incorporation of foreign investment,

(8) Continue to accelerate the reduction in investment costs and prices,

(9) Increase business efficiency of enterprises with foreign invested capital,
Publicize the roadmap of abolition of differences in prices and charges of goods and services for domestic and foreign users, heading for the target of complete abolition of the dual price system in 2005.

Strengthen the efficiency of State management on foreign investment.

Continue to improve investment procedures: expanding investment projects, carrying out issuance of investment licenses in line with the road of implementation of international commitments.

7.7.2. Publicizing the export and quota

7.7.2.1. Export

As part of the economic transition the government is changing from a strategy of import substitution to export promotion. This process involves an explicit move from protective barriers and subsidies and to incentives for export. Still influenced by the remnants of the centrally planned economy and its strong protection policies, export subsidies are still directly paid to producers. Thus far export subsidies have been ineffective in raising competitiveness and a burden on the fiscal budget.

The previous inflexible planning of foreign trade, which reflected an unreasonable import export composition, was abolished in 1986 with the 6 Party Congress. The overall planning system for trade has improved. The old inflexible export planning system has been replaced by a non-centralized and market-based regime. The over aggressive export control system of the past is nearly gone as the Government has decentralized trade activities and implemented policies on foreign exchange rates, where exports are equally treated.

The most important change has been an extension of the rights to export. As already mentioned, the control over exports was loosened, even for critical goods and no absolute exclusive rights to export are reserved for the State. Producers of goods for export are exempted from paying revenue tax, and if profits are used for investment in the production of goods for export, their profit tax will be reduced. Producers of goods that can substitute imported goods will be considered for revenue tax and profit tax reductions. Since 1998, additional incentives are available for exporters. Exporters with foreign invested capital are allowed to export goods that are not specifically listed on their license and domestic exporters are allowed to export directly without having to apply for an export license.
The reform of prices and foreign exchange allocation has been an important factor related to the growth of exports in the recent years. Before the reforms, exchange rates were fixed by the State in a way that the Vietnamese dong was over-valued, in order to support importation of goods with high capital requirements and beyond domestic capacity. In late 1980s, the situation started to change. The dual exchange rate system was replaced by a single rate system where the rate is based on an inter-bank basis. The regulations on foreign exchange collection were loosened as were controls on foreign exchange reserves.

The policies on foreign exchange have undergone three phases of change:

(1) from 1988 to 1992, control of foreign exchange rates was loosened to bring market forces to assist in setting the rate,

(2) from 1992 to 1999, foreign exchange rates were set and kept almost fixed to keep control over inflation, stabilize the financial and monetary market, and attract foreign investment,

(3) 2000 – present, there have been active adjustments to deal with crisis and avoid the case where the Vietnam dong is too highly valued.

Such exchange rate policies have had positive impacts on trade, especially regarding exports. The Vietnamese exchange rate is becoming closer aligned with market values; however, this is far from a float and distortions are inevitable with any managed peg.

In the past, Golden Box Support was used to support agricultural products through the Price Stabilizing Fund -- renamed as Export Supporting Fund. The total support for the 1996 to 1998 period was VND 1,644.84 billion. The support was mainly for rice, sugar, pork, cotton, livestock and pineapples. According to the WTO, this support is small and not necessary against existing WTO regulations.

One area of trade that will undergo dramatic change is import regulation. The following discusses some distortions that result from import controls.

(1) Import duties The Law on Import and Export Duty of Vietnam was issued on January 1, 1988. From its initiation, protection targeted imports in competition with State owned enterprises. Import tariffs caused a negative impact on exporting activities as exporters had to use imported intermediate materials, which were even more expensive than those in international markets.
Non-tariff barriers. These barriers include quotas, import restrictions, professional control, non-automatic issuance of license, foreign exchange control.

The Government of Vietnam has enacted positive policies to make sure exporters can get access to capital at low interest rates, but this policy is not consistent for all exporters. Private exporters still find it very difficult to get access to credit due to procedures and security. State owned banks, still are the main source of credit, and only accept land use rights and Treasury bonds as securities. Letters of Credit, which are widely acceptable as securities in most of the world, are not accepted in Vietnam. For Vietnam, it is probably right that lending working capital is the weakest point in the current policies for enhancing export. Exporters sometimes have forego opportunities as they cannot get required credit in a timely manner. Export supporting funds are not working as well they should be; on the contrary, they can even create obstacles against exportation -- from charging direct fees on exporters. Furthermore, while support for exports is rendered on a selective basis, the selection criteria are not transparent. This has caused rent-seeking, misconduct and corruption during the selection process. Moreover, this fund is restricted to supplying long-term capital for exporters.

At present, exporters in Vietnam are exempted from VAT (which has been in place since January 1 1999 with 4 tax lines ranging from 0% to 20%), and special consumption tax (which has been in place since 1990 with 10 tax lines ranging from 15% to 100%), making a difference in the export price. The profit from export production (including tax deductions) will depend on export volume and whether the production is carried out in an industrial zone or export processing zone. It seems that all tax incentives, except for VATs, are based on unclear and qualitative criteria. This has led to the so-called negotiated tax, which means the tax rate the exporter pays depends on how well the exporter negotiates and on the relations with tax authorities. From this process, an exclusive right is created for the tax authorities, who can freely determine tax rates. This is very unfavorable for new and small enterprises without the leverage for negotiations. Furthermore, this also creates a risky environment for enterprises as they cannot estimate their tax obligation. Despite great efforts in making the tax structure reasonable and removing quantitative limits, taxes and tariffs in Vietnam are still high and not consistent. Quantitative limits, either public or implied, are the main barriers on the flow of export. It is obvious that the export encouraging mechanism is distorting export incentives and reducing export growth.

The average tariff level in Vietnam is not high, but there is significant deviation from the mean. This causes ERP to be very high for processing industries and much lower for agricultural production. A lot of processing industries in Vietnam are not globally competitive. Protectionism has also distorted the structure of resources, especially
investment capital. In reality, a big proportion of both domestic and foreign investment has been diverted to highly protected industries. As compared with other countries, the rate of effective protection of Vietnam is 116%, which is much higher than that of South Korea during its initial stage of export-oriented industrialization (27% for manufacturing industry).

There must be adjustments to existing trade policies to overcome these shortcomings -- improving the role of export in the national economic growth and international economic integration. As far as net impacts from export encouragement are concerned, an equal playing field between import taxes and export subsidies would mean zero import taxes and export subsidies. Identical interventions will not be the best for trade policies, as it is always less optimal than intervention. Any and all interventions, by definition, increase costs.

Free trade cannot be applied immediately. There needs to be other options to ease the transition in the economy caused by foreign markets, and an initial policy of increasing export subsidies while reducing import taxes on intermediate inputs for export, will be a good change. This will increase the effective protection of exports, cause a reduction in revenues as a result of reduced import taxes, and increase costs from tax returns and tax exemptions. The common trend in trade liberalization requires that developing countries (such as Vietnam) reduce and gradually remove tariffs and quantitative restrictions, while synchronizing the tax system. The only strategy for Vietnam to compete with international export markets is to simplify the taxes and lower tax rates. Transition into a unified tax system is an effective way to reduce losses from wrong allocation of resources, fight corruption by tax collectors, and reduce rent-seeking an inefficiency by customs officials.

Vietnam has made some advances in reforming the taxes and non-tax instruments, such as: prohibition, suspension of quotas, sub-charges, minimum basic price for calculating taxes. These instruments will be eliminated to comply with international trade agreements have been reached. Therefore, it is necessary to seek for new instruments that are compatible with international standards to ensure fair trade.

Absolute taxes on unit of goods do not affect formal trade, but impact trade activities in border areas where goods are imported at very low prices. By adopting this kind of tax, it is possible to give up calculating taxes based on a minimum price and fight trade fraud where the value falsely reported. This tax is suitable for agricultural and some industrial products, which are often imported at too low a price, especially regarding second-hand items.
It is necessary to adopt anti-devaluation taxes to ensure a safe business environment for exporters in Vietnam. Environmental protection taxes should be imposed to compensate for environmental losses or limit second hand consumption goods imports. This is also an option in cases where it is impossible to increase taxes without affecting home made goods.

7.7.2.2 Quotas

Vietnam has done a great deal in cutting down taxes and tariffs since joining in AFTA in 1996. During the integration in the regional economy, Vietnam has committed to reduce taxes and tariffs on 5,505 goods items. The new tax rates of 80% only applies to 0 – 5% of all goods and more than 5% for the other 20%. With the official effect of the Vietnam – US trade agreement, Vietnam committed to reduce import tariffs for 244 import goods items during 3 – 6 years. The tariffs will be reduced on average from 35% to 26% (80% of the imported items are agricultural products). Also under this commitment, Vietnam is also giving up import tariffs in relation to the rate of localization of products. Additional charges and fees related to imported goods will gradually be omitted. The average import tariffs on agricultural products are 25%, while WTO requires that initiates must reduce their average import tariff down to 20% for agricultural products and 10% for processed goods.

Special exemption are available for import tariffs, especially for raw materials and intermediate inputs for production or goods to be resembled and exported. The regulations on setting up export processing zones have been in place since 1991. These regulations have brought Vietnam closer to the world market, preventing distortions and import controls.

In the past, the Government used non-tariff measures to keep control and regulate imports. But since 1992 when the list of taxable imported and exported goods applied, the issuance of import licenses and quotas has become looser. The number of goods under quota control has considerably decreased. All goods are freely imported and exported except for those that are not allowed and those still under quota control. At present, Vietnam is trying to get quotas removed in accordance with the Vietnam – US trade agreement, limit import charges, issue new regulations on the base value for import tariff, and open import-export business to non-State-owned enterprises.

Limitations on the rights to conduct traditional trade transactions were also important non-tax barriers used by the Government. The rights to trade (previously called rights to State trade or rights to conduct import export business) have been relaxed. Prior to 1986, the rights to conduct import-export businesses were mainly given to exclusive State
owned import-export incorporations. With the Law on Import Export Duties, control over 
establishing foreign trade organizations was relaxed and the State monopoly in foreign 
trade was put to an end. Organizations, companies of different economic sectors of 
Vietnam were then allowed to participate in international trade. After that, the rights of 
enterprises to conduct import business were expanded. By 1998, all regulations on 
requirements to conduct import-export business were removed with an aim at 
encouraging enterprises of all economic sectors to take part in international trade.

Vietnam has removed all regulations on quotas for almost all exported goods, except for 
a few essential items, such as rice. In the Memorandum on Foreign Trade Regime 
submitted to WTO, rice is the only agricultural product where export quotas apply for 
national food security reason. A reform on export tariffs on rice was reduced rates from 
2% (1997) to 0% (1998).